



Continental Cablevision - Southeastern Region

DONALD L. CROSBY

Regulatory Counsel

ORIGINAL
FILE COPY

July 17, 1996

VIA OVERNIGHT DELIVERY

960842-TX

Ms. Blanca S. Bayo
Director, Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

RE: TRANSFER OF CONTROL APPLICATION--
CONTINENTAL FLORIDA TELECOMMUNICATIONS, INC.

Dear Ms. Bayo:

Enclosed for filing is the original and 6 copies of the
Application for Authority to Transfer Control of Florida Public Service
Commission No. 4404 held by Continental Florida Telecommunications, Inc.

Also enclosed is our check in the amount of \$250 in payment of the
application fee.

A duplicate of this letter is enclosed. Please mark it to
indicate that the original was filed and return the duplicate to me.
Thank you for your assistance.

Sincerely,

Donald L. Crosby

Check received with filing and
forwarded to Fiscal for deposit.
Please to forward a copy of check
to IAR with proof of deposit.

Initials of person who forwarded check:

Enclosures

RECEIVED & FILED

EPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE

07576 JUL 18 96

FPSC-RECORDS/REPORTING



CONTINENTAL CABLEVISION
SOUTHEASTERN REGION
7800 BELFORT PARKWAY - SUITE 190
JACKSONVILLE, FLORIDA 32256

Check No.
000178913

VOUCH. NO.	INVOICE NO.	DATE	DESCRIPTION	GROSS	DISCOUNT	BALANCE
000189682	JXCKR009704	07/16/96	APP FEE (PSC)	250.00		250.00
VENDOR CODE FLORIDA47				VENDOR NAME FLORIDA PUBLIC SERVICE	\$250.00	\$250.00



CONTINENTAL CABLEVISION
SOUTHEASTERN REGION
7800 BELFORT PARKWAY - SUITE 190
JACKSONVILLE, FLORIDA 32256

\$1.60
111

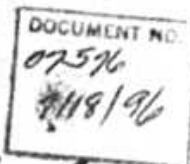
BANK OF BOSTON
CONNECTICUT

VENDOR ID.	CHECK NO.	DATE	PAY THIS AMOUNT
FLORIDA47	000178913	07/16/96	*****\$250.00

PAY Two hundred fifty and 00/100 Dollars

To the
order
of

FLORIDA PUBLIC SERVICE
COMMISSION
GUNTER BUILDING
2540 SHUMARD OAK BLVD
TALLAHASSEE FL 32399-0870



[Signature]

®00178913® 10111008051 574 07405®

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

APPLICATION
FOR APPROVAL OF
THE TRANSFER OF CONTROL OF

**CONTINENTAL FLORIDA
TELECOMMUNICATIONS, INC.**

FROM
CONTINENTAL CABLEVISION, INC.

TO
U S WEST, INC.

DOCUMENT NUMBER-DATE

07576 JUL 18 88

FPSC-RECORDS/REPORTING

**FLORIDA PUBLIC SERVICE COMMISSION
CAPITAL CIRCLE OFFICE CENTER - 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850**

**APPLICATION FORM
for**

**AUTHORITY TO PROVIDE ALTERNATIVE LOCAL EXCHANGE SERVICE
WITHIN THE STATE OF FLORIDA**

INSTRUCTIONS

1. This form is used for an original application for a certificate and for approval of sale, assignment or transfer of an existing alternative local exchange certificate. In case of a sale, assignment or transfer, the information provided shall be for the purchaser, assignee or transferee.
2. Respond to each item requested in the application and appendices. If an item is not applicable, please explain why.
3. Use a separate sheet for each answer which will not fit the allotted space.
4. If you have questions about completing the form, contact:

**Florida Public Service Commission
Division of Communications, Certification Compliance Section
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0866
(904) 413-6600**

5. Once completed, submit the original and six (6) copies of this form along with a non-refundable application fee of \$250 made payable to the Florida Public Service Commission at the above address.

1. This is an application for (check one):

☐ **Original authority** (new company)

☐ **Approval of transfer** (to another certificated company)

Example: a certificated company purchases an existing company and desires to retain the original certificate authority.

☐ **Approval of assignment** of existing certificate (to a non-certificated company)

Example: a non-certificated company purchases an existing company and desires to retain the certificate of authority rather than apply for a new certificate.

☐ **Approval for transfer of control** (to another certificated company)

Example: a company purchases 51% of a certificated company. The Commission must approve the new controlling entity.

☒ **Approval for transfer of control** (to a non-certificated company)

Please see Attachment A for an explanation of the transfer of control which is the subject of this application.

2. Name of joint applicants:

A. Continental Cablevision, Inc.

B. U S WEST, Inc.

3. A. National mailing address including street name, number, post office box, city, state, zip code, and phone number.

Continental Cablevision, Inc.
Pilot House, Lewis Wharf
Boston, MA 02110
(617) 742-9500

U S WEST, Inc.
7800 East Orchard Road
Englewood, CO 80111
(303) 793-6500

- B. Florida mailing address including street name, number, post office box, city, state, zip code, and phone number.

Continental Cablevision, Inc.
Southeastern Region
7800 Belfort Parkway, Suite 270
Jacksonville, Florida 32256-6925
(904) 419-4920

- C. Physical address of alternative local exchange service in Florida including street name, number, post office box, city, zip code and phone number.

Continental Florida Telecommunications, Inc.
5934 Richard Street
P. O. Box 17613F
Jacksonville, Florida 32216
(904) 731-8810
(904) 636-0521 (FAX)

4. Structure of organization:

<input type="checkbox"/> Individual	<input checked="" type="checkbox"/> Corporation
<input type="checkbox"/> Foreign corporation	<input type="checkbox"/> Foreign Partnership
<input type="checkbox"/> General Partnership	<input type="checkbox"/> Limited Partnership
<input type="checkbox"/> Joint Venture	<input type="checkbox"/> Other, please explain

5. If incorporated, please provide proof from the Florida Secretary of State that the applicant has authority to operate in Florida.

Corporate Charter Number: P95000047602
for Continental Florida Telecommunications, Inc.

6. Name under which the applicant will do business (d/b/a):

Not Applicable

7. If applicable, please provide proof of fictitious name (d/b/a) registration.

Fictitious name registration number: Not Applicable

8. If applicant is an individual, partnership, or joint venture, please give name, title and address of each legal entity.

Not Applicable

9. State whether any of the officers, directors, or any of the 10 largest stockholders have previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime, or whether such actions may result from pending proceedings. If so, please explain.

No

10. Please provide the name, title, address, telephone number, internet address, and facsimile number for the person serving as ongoing liaison with the Commission, and if different, the liaison responsible for this application.

Donald L. Crosby
Regulatory Counsel
Southeastern Region
Continental Cablevision, Inc.
7800 Belfort Parkway, Suite 270
Jacksonville, Florida 32256-6925
(904) 419-4920
(904) 281-0342 (FAX)

Steven Miller
Senior Attorney
U S WEST, Inc.
7800 East Orchard Road, Suite 490
P. O. Box 6508
Englewood, Colorado 80155-6508
(303) 796-6008
(303) 793-6244 (FAX)

11. Please list other states in which the applicant is currently providing or has applied to provide local exchange or alternative local exchange service.

A. Continental Cablevision, Inc., through subsidiaries, is authorized or has applied for authorization to provide alternative local exchange service in the following states: Florida, Virginia, California, Massachusetts, Michigan, Ohio, Illinois and New Hampshire.

B. U S WEST, Inc., through subsidiaries, currently provides local exchange service in the following states: Arizona, New Mexico, Utah, Colorado, Wyoming, Washington, Oregon, Idaho, Montana, North Dakota, South Dakota, Nebraska, Minnesota and Iowa. A subsidiary of U S WEST, Inc. is also authorized to provide alternative local exchange service in Georgia.

12. Has the applicant been denied certification in any other state? If so, please list the state and reason for denial.

No

13. Have penalties been imposed against the applicant in any other state? If so, please list the state and reason for penalty.

No

14. Please indicate how a customer can file a service complaint with your company.

A customer can file a service complaint with Continental Florida Telecommunications, Inc. by contacting the business office or by writing to the following person:

A. R. (Dick) Schleiden
Telecommunications Manager
Southeastern Region
Continental Cablevision, Inc.
7800 Belfort Parkway, Suite 270
Jacksonville, Florida 32256
(904) 448-3391
(904) 281-0342 (FAX)

15. Please provide all available documentation demonstrating that the applicant has the following capabilities to provide alternative local exchange service in Florida.

A. Financial capability.

CONTINENTAL: A copy of Continental Cablevision, Inc.'s most recent Annual Report for the period ending December 31, 1995, filed pursuant to the Securities and Exchange Act of 1934 (Form 10-K) is attached as Attachment

B. It contains the following statements:

1. the balance sheet;
2. income statement; and
3. statement of retained earnings for the most recent 3 years.

U.S. WEST: A copy of U.S. WEST, Inc.'s most recent Annual Report for the period ending December 31, 1995, filed pursuant to the Securities and Exchange Act of 1934 (Form 10-K) is attached as Attachment C. It contains the following statements:

1. the balance sheet;
2. income statement; and
3. statement of retained earnings for the most recent 3 years.

B. Managerial capability

Continental Florida Telecommunications, Inc. has the managerial capability of providing high quality telecommunications services to Florida customers and of offering such services at competitive prices. The company's current management group has demonstrated such capability during the period it has operated the company's affiliate, Continental Fiber Technologies, Inc. d/b/a AlterNet ("AlterNet"), which was certificated by the Commission in 1992. No change in management is anticipated by the Applicants following the transaction described in Attachment A, and thus experienced management will remain in place.

H.W. Goodall, III, is Senior Vice President of the Southeastern Region of Continental Cablevision, Inc. He will continue to have overall managerial responsibility for Continental Florida Telecommunications, Inc. after the transaction. A.R. (Dick) Schleiden is Telecommunications Manager for the Southeastern Region, and he will continue after the transaction to have day-to-day responsibility for the company's management. Both Mr. Goodall and Mr. Schleiden have served in management positions with AlterNet since the inauguration of its service or shortly thereafter.

C. Technical capability

Continental Florida Telecommunications, Inc. has the technical capability of providing high quality telecommunications services to Florida customers. The company's technical manager has demonstrated such capability during the period he has served in a similar position with AlterNet for over three years. No change in technical personnel is anticipated by the Applicants following the transaction described in Attachment A; therefore, experienced technical personnel will remain in place.

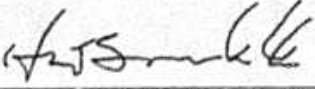
Scott T. Granger is Telecommunications Operations Manager of the Southeastern Region of Continental Cablevision, Inc. He will continue to manage the technical facilities of Continental Florida Telecommunications, Inc. after the transaction. Mr. Granger has managed the technical facilities of AlterNet since 1993.

AFFIDAVIT

By my signature below, I, the undersigned officer, attest to the accuracy of the information contained in this application and attached documents and that the applicant has the technical expertise, managerial ability, and financial capability to provide alternative local exchange service in the State of Florida. I have read the foregoing and declare that to the best of my knowledge and belief, the information is true and correct. I attest that I have the authority to sign on behalf of my company and agree to comply, now and in the future, with all applicable Commission rules and orders.

Further, I am aware that pursuant to Chapter 837.06, Florida Statutes, "Whoever knowingly makes a false statement in writing with the intent to mislead a public servant in the performance of his official duty shall be guilty of a misdemeanor of the second degree, punishable as provided in s. 775.082 and s. 775.083."

Official:


Signature: H.W. Goodall, III

7/15/96
Date

Title:

Senior Vice President
Southeastern Region
Continental Cablevision, Inc.

Telephone Number:
(904) 448-3777

Address:

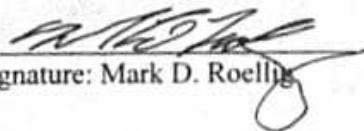
7800 Belfort Parkway, Suite 270
Jacksonville, FL 32256-6925

AFFIDAVIT

By my signature below, I, the undersigned officer, attest to the accuracy of the information contained in this application and attached documents and that the applicant has the technical expertise, managerial ability, and financial capability to provide alternative local exchange service in the State of Florida. I have read the foregoing and declare that to the best of my knowledge and belief, the information is true and correct. I attest that I have the authority to sign on behalf of my company and agree to comply, now and in the future, with all applicable Commission rules and orders.

Further, I am aware that pursuant to Chapter 837.06, Florida Statutes, "Whoever knowingly makes a false statement in writing with the intent to mislead a public servant in the performance of his official duty shall be guilty of a misdemeanor of the second degree, punishable as provided in s. 775.082 and s. 775.083."

Official:


Signature: Mark D. Roellig

7/12/96
Date

Title: Vice President, Law and Human Resources
Associate General Counsel
U S WEST, Inc

Telephone Number:
(303) 793-6500

Address: 7800 East Orchard Road
Englewood, CO 80111

ATTACHMENT A

Explanation of the Proposed Transaction

Continental Florida Telecommunications, Inc., a Florida corporation ("Continental-FL"), holds Florida Public Service Commission Certificate No. 4404 to provide alternative local exchange telecommunications service. See Order No. PSC-96-0293-FOF-TX, issued February 27, 1996.

Continental-FL is a wholly-owned subsidiary of Continental Telecommunications Corp. (Continental-TC"), which is in turn a wholly-owned subsidiary of Continental Cablevision, Inc. ("Continental"). Continental is the third-largest cable television system operator in the United States. Continental is a joint applicant in this application for approval of the transfer of control of Continental-FL through the contemplated transaction described below.

On February 27, 1996, Continental and U S WEST, Inc. ("U S WEST"), entered into an Agreement and Plan of Merger ("Merger Agreement") under which Continental is to merge with and into a subsidiary of U S WEST, with the U S WEST subsidiary continuing after the merger as the surviving corporation. U S WEST is a joint applicant in this application; a copy of the Merger Agreement is attached hereto as Attachment B.

U S WEST is a diversified global communications company, conducting its operations through U S WEST Media Group ("U S WEST-MG") and U S WEST Communications Group ("U S WEST-CG"). U S WEST-CG is a Regional Bell Operating Company, providing telecommunications services to more than 25 million residential and business customers in the 14 states listed in response to Question No. 11 of the application. U S WEST-MG is comprised of: (i) cable and telecommunications network operations outside of U S WEST-CG's 14-state region and internationally; (ii) domestic and international wireless communications network operations; and (iii) domestic and international directory and information services operations, including telephone directories.

Continental and U S WEST contemplate that Continental will be operated as a unit of U S WEST-MG after the merger. The terms of the Merger Agreement call for U S WEST to acquire from Continental shareholders all of the stock and assets of Continental in exchange for cash or stock in U S WEST and U S WEST-MG or both cash and stock. The Merger Agreement calls for closing of the planned transaction when the requisite regulatory and other approvals are obtained, providing for such closing to occur as early as November 15, 1996.

As a result of this exchange, U S WEST will hold all of the stock of Continental and, necessarily, all of the stock of Continental-TC and Continental-FL. Upon completion of the transaction as planned, control of Continental-FL will be transferred to U S WEST. The merger will have no effect on the legal status of Continental-FL, nor on its books and records. Continental and U S WEST intend for day-to-day operations of Continental to continue to be handled by the same experienced management group now in control of Continental.

ATTACHMENT B

Agreement and Plan of Merger

Between

U S WEST, Inc.

and

Continental Cablevision, Inc.

Dated as of February 27, 1996

AGREEMENT AND PLAN OF MERGER

between

U S WEST, INC.

and

CONTINENTAL CABLEVISION, INC.

Dated as of February 27, 1996

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EXHIBITS

- Exhibit A Form of Charter Amendment
- Exhibit B Form of Registration Rights Agreement for
Media Stock and Series D Preferred Stock
- Exhibit C Form of Certificate of Designation for
Series D Convertible Preferred Stock
- Exhibit D Form of Affiliate Letter
- Exhibit E Form of Certificate of Designation for Put
Shares
- Exhibit F Form of Registration Rights Agreement for
Put Shares

AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER, dated as of February 27, 1996, between U S WEST, INC., a Delaware corporation ("Acquiror"), and CONTINENTAL CABLEVISION, INC., a Delaware corporation (the "Company").

W I T N E S S E T H:

WHEREAS, upon the terms and subject to the conditions set forth in this Agreement, the Company and Acquiror will enter into a business combination transaction pursuant to which the Company will merge with and into Acquiror (the "Merger"), with Acquiror continuing as the surviving corporation (the "Surviving Corporation");

WHEREAS, the board of directors of the Company has determined that the Merger would be fair to and in the best interests of its stockholders, and such board of directors has approved this Agreement and the transactions contemplated hereby and has recommended the adoption by the stockholders of the Company of this Agreement and the amendment, substantially in the form of Exhibit A hereto (the "Charter Amendment"), to the Company's Restated Certificate of Incorporation to be effected immediately prior to the consummation of the Merger;

WHEREAS, the board of directors of Acquiror has determined that the Merger would be fair to and in the best interests of its stockholders, and such board of directors has approved this Agreement and the transactions contemplated hereby;

WHEREAS, concurrently with the execution of this Agreement and in order to induce Acquiror to enter into this Agreement, certain stockholders of the Company have executed and delivered an agreement (the "Stockholders' Agreement") pursuant to which, among other things, such Stockholders have granted to Acquiror their proxy to vote all of the votes entitled to be cast by such stockholders in favor of the adoption of this Agreement and the Charter Amendment;

WHEREAS, for Federal income tax purposes, it is intended that the Merger shall qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder (the "Code"); and

WHEREAS, Acquiror and the Company desire to make certain representations, warranties, covenants and agreements in connection with the Merger and also to prescribe various conditions to the Merger.

NOW, THEREFORE, in consideration of the foregoing and the representations, warranties, covenants and agreements herein contained, the parties hereto agree as follows:

ARTICLE I

DEFINITIONS

1.1 Definitions. For purposes of this Agreement, the following terms shall have the meanings set forth below:

"Acquiror Region" shall mean Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming.

"Affiliate" shall mean, with respect to any Person, any other Person directly or indirectly controlling, controlled by or under common control with such other Person.

"Appraiser" shall mean a nationally recognized investment banking firm that is independent of the Company, Acquiror and their respective Subsidiaries and has significant experience and expertise in the valuation of entities with businesses comparable to those being appraised.

"Basic Cable Service" shall mean as to each System the tier of video programming service defined in 47 C.F.R. § 76.901(a).

"Board of Directors" shall mean the board of directors of the Company.

"Business Day" shall mean a day other than a Saturday, Sunday or other day on which commercial banks in New York City are authorized or required by law to close.

"Cable Act" shall mean the Cable Communications Policy Act of 1984, as amended by the Cable Television

Consumer Protection and Competition Act of 1992 and the Telecommunications Act of 1996.

"Cable Programming Service" shall mean as to each System those video programming services defined in 47 C.F.R. § 76.901(b).

"Calculation Price" shall mean the Determination Price, Cap Price or Floor Price, as applicable, based upon which the Class A Common Conversion Number or Class B Common Conversion Number is determined in accordance with Section 3.1(d).

"Cap Price" shall mean \$28.175.

"Cash Consideration Amount" shall equal \$1 billion; provided, however, that the board of directors of Acquiror shall have the right, in its sole discretion, to increase the Cash Consideration Amount to a maximum of \$1.5 billion so long as notice of such change is given to the Company no later than one Business Day prior to the Effective Time; provided, further, that the board of directors of Acquiror shall have the right to increase the Cash Consideration Amount above \$1.5 billion in an amount equal to (x) the number of shares of Company Common Stock issued or to be issued in connection with any acquisition by the Company approved by Acquiror pursuant to Section 6.1 hereof multiplied by (y) the Share Price; and provided, further, that the Cash Consideration Amount may be reduced pursuant to Section 7.7(c).

"CATV" shall mean any method, presently existing, for the transmission and/or exhibition (whether by microwave, fiber optics or coaxial cable) of broadband video signals other than by means of DBS, MMDS, broadcast television and in-home video players (and which is based on the expectation of payment by the recipient), and shall include without limitation cable television (basic and premium) and pay-per-view television.

"Charter Amendment" shall have the meaning set forth in the second recital to this Agreement.

"Class A Common Percentage" shall mean the quotient (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) of (x) the Common Consideration Amount divided by (y) the Transaction Value.

"Class A Preferred Consideration Amount" shall mean the product of (x) the Class A Preferred Percentage multiplied by (y) the Share Price multiplied by (z) the number of shares of Class A Common Stock outstanding immediately prior to the Effective Time on a fully diluted basis.

"Class A Preferred Conversion Number" shall mean the quotient of (x) the product of (A) the Class A Preferred Percentage multiplied by (B) the Share Price divided by (y) the Liquidation Value (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth).

"Class A Preferred Percentage" shall mean the difference between (x) one and (y) the Class A Common Percentage.

"Class B Common Consideration Amount" shall mean the product of (x) the Class B Percentage multiplied by (y) the Common Consideration Amount.

"Class B Common Percentage" shall mean the quotient (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) of (x) the Class B Common Consideration Amount divided by (y) the sum of the Class B Common Consideration Amount and the Class B Preferred Consideration Amount.

"Class B Preferred Percentage" shall mean the quotient (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next highest hundredth) of (x) the Class B Preferred Consideration Amount divided by (y) the sum of the Class B Common Consideration Amount and the Class B Preferred Consideration Amount.

"Class B Percentage" shall mean the quotient (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) of (i) the number of shares of Class B Common Stock outstanding immediately prior to the Effective Time on a fully diluted basis, including giving effect to the conversion of all outstanding shares of Company Preferred Stock divided by (ii) the number of shares of Company Common Stock outstanding immediately prior to the Effective Time on a fully diluted basis, including giving effect to the conversion of all outstanding shares of Company Preferred Stock.

"Class B Preferred Consideration Amount" shall mean the difference between (x) the Preferred Consideration Amount and (y) the Class A Preferred Consideration Amount.

"Class B Preferred Conversion Number" shall mean the quotient of (x) the product of (A) the Class B Preferred Percentage multiplied by (B) the Share Price divided by (y) the Liquidation Value (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth).

"Code" shall have the meaning set forth in the fifth recital of this Agreement.

"Common Consideration Amount" shall equal the excess of (x) the Transaction Value over (y) the sum of the Preferred Consideration Amount and the Cash Consideration Amount.

"Communications Act" shall mean the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, et seq., as amended by the Telecommunications Act of 1996.

"Copyright Office" shall mean the United States Copyright Office of the Library of Congress or any successor agency that shall hold principal responsibility for administering the cable television compulsory license for retransmission of broadcast signals established pursuant to Section 111 of the Copyright Act, 17 U.S.C. § 111.

"DBS" shall mean a system providing direct-to-home in the broadcast satellite services authorized by the FCC.

"Determination Price" shall mean the average of the Intra-Day Closing Prices for the Random Trading Days.

"DGCL" shall mean the Delaware General Corporation Law.

"DOJ" shall mean the Department of Justice.

"Encumbrances" shall mean any and all mortgages, security interests, liens, claims, pledges, restrictions, leases, title exceptions, charges or other encumbrances.

"Environmental Claim" means any notice of violation, action, claim, Environmental Lien, demand, abatement or other Order or direction (conditional or

otherwise) by any Governmental Authority or any other Person for personal injury (including sickness, disease or death), tangible or intangible property damage, damage to the environment, pollution, contamination or other adverse effects on the environment, or for fines, penalties or restrictions resulting from or based upon (i) the existence of an Environmental Release (including, without limitation, sudden or non-sudden accidental or non-accidental Environmental Releases) of, or exposure to, any Hazardous Material, noxious odor or illegal audible noise in, into or onto the environment (including, without limitation, the air, soil, surface water or groundwater) at, in, by, from or related to any property owned, operated or leased by the Company or its Subsidiaries or any activities or operations thereof; (ii) the transportation, storage, treatment or disposal of Hazardous Materials in connection with any property owned, operated or leased by the Company or its Subsidiaries or their operations or facilities; or (iii) the violation, or alleged violation, of any Environmental Law or Environmental Permit of or from any Governmental Authority relating to environmental matters connected with any property owned, leased or operated by the Company or any of its Subsidiaries.

"Environmental Costs and Liabilities" means any and all losses, liabilities, obligations, damages, fines, penalties, judgments, actions, claims, costs and expenses (including, without limitation, fees, disbursements and expenses of legal counsel, experts, engineers and consultants and the costs of investigation and feasibility studies and Remedial Action) arising from or under any Environmental Law or contract, agreement or similar arrangement with any Governmental Authority or other Person required under any Environmental Law.

"Environmental Law" means any Federal, state, local, or foreign law (including common law), statute, code, ordinance, rule, regulation or other legally enforceable requirement relating to the environment, natural resources, or public or employee health and safety as it relates to exposure to Hazardous Materials and includes, but is not limited to, the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. § 9601 et seq., the Hazardous Materials Transportation Act, 49 U.S.C. § 1801 et seq., the Resource Conservation and Recovery Act, 42 U.S.C. § 6901 et seq., the Clean Water Act, 33 U.S.C. § 1251 et seq., the Clean Air Act, 33 U.S.C. § 2601 et seq., the Toxic Substances Control Act, 15 U.S.C. § 2601 et seq., the

Federal Insecticide, Fungicide, and Rodenticide Act, 7 U.S.C. § 136 et seq., the Oil Pollution Act of 1990, 33 U.S.C. § 2701 et seq. and the relevant portions of the Occupational Safety and Health Act, 29 U.S.C. § 651 et seq., as such laws have been amended or supplemented as of the date hereof, and the regulations promulgated pursuant thereto, and all analogous state or local statutes as of the date hereof.

"Environmental Lien" means any lien arising under Environmental Laws.

"Environmental Permit" means any permit, approval, authorization, license, variance, registration or permission required under any applicable Environmental Law.

"Environmental Release" means any release, spill, emission, leaking, pumping, pouring, dumping, emptying, injection, deposit, disposal, discharge, dispersal, leaching, or migration on or into the indoor or outdoor environment or into or out of any property not authorized under any Environmental Permit and requiring notification under any applicable Environmental Law.

"ERISA" shall mean the Employee Retirement Income Security Act of 1974, as amended, and the applicable regulations promulgated thereunder.

"ERISA Affiliate" shall mean any corporation or trade or business (whether or not incorporated) which are or have ever been treated as a single employer with or which are or have been under common control with the Company within the meaning of Section 414(b), (c), (m) or (o) of the Code.

"Exchange Act" shall mean the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

"FCC" shall mean the Federal Communications Commission.

"Final Order" shall mean an action or actions by any Governmental Authority or the FCC which has not been reversed, stayed, enjoined, set aside, annulled or suspended, and as to the FCC with respect to which the time for filing any request, petition or appeal of such action has expired and the time for the FCC to set aside its action

on its own motion has passed, and as to any Franchise Consent, when the Franchise Consent has been or is deemed to be approved as provided in Section 617 of the Cable Act.

"Floor Price" shall mean \$20.825.

"FTC" shall mean the Federal Trade Commission.

"GAAP" shall mean generally accepted accounting principles in effect in the United States of America as of the date of the applicable determination.

"Governmental Authority" shall mean any foreign, Federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality.

"Hazardous Material" means any substance, material or waste which is regulated by any Governmental Authority in jurisdictions in which the Company operates, including, without limitation, any material, substance or waste which is defined as a "hazardous waste," "hazardous material," "hazardous substance," "extremely hazardous waste," "restricted hazardous waste," "contaminant," "toxic waste" or "toxic substance" under any provision of Environmental Law, which includes, but is not limited to, petroleum, petroleum products, asbestos, and polychlorinated biphenyls.

"Homes Passed" shall mean the number of homes to which CATV service is currently available from the Company or the Subsidiaries, whether or not a given household subscribes to such service.

"HSR Act" shall mean the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

"Indebtedness" shall mean, with respect to any Person, any indebtedness, secured or unsecured, (i) in respect of borrowed money (whether or not the recourse of the lender is to the whole of the assets of such Person or only to a portion thereof), and evidenced by bonds, notes, debentures or similar instruments or letters of credit, to the extent of the face value thereof (or, in the case of evidence of indebtedness issued at a discount, the current accredit value thereof) or (ii) representing the balance deferred and unpaid of the purchase price of property or services (other than accounts payable in the ordinary course of business) and shall also include, to the extent not otherwise included, (A) any capitalized lease obligations

and (B) the face value of guaranties of items of other Persons which would be included within this definition for such other Persons (whether or not such items would appear upon the balance sheet of the guarantor). No item constituting Indebtedness under any of the definitions set forth above shall be counted twice by virtue of the fact that it constitutes "Indebtedness" under more than one of such definitions.

"Intra-Day Closing Prices" shall mean the volume weighted average sale price of the Media Stock (regular way) as shown on the Composite Tape of the NYSE.

"IRS" means the United States Internal Revenue Service.

"Knowledge of the Company" and "to the Company's Knowledge" shall mean the actual knowledge of the executive officers (as identified in the Company SEC Documents), the Senior Vice President-Corporate & Legal Affairs and the regional Senior Vice Presidents, in each case of the Company after reasonable investigation and due inquiry.

"Legal Proceedings" means any judicial, administrative or arbitral actions, suits, proceedings (public or private) or governmental proceedings.

"Material Adverse Effect" shall mean, (i) with respect to the Company, any change or effect that is or is reasonably likely to be materially adverse to the business, results of operations, properties, assets, liabilities or condition (financial or otherwise) of the Company and its Subsidiaries taken as whole and (ii) with respect to Acquiror, any change or effect that is or is reasonably likely to be materially adverse to the business, results of operations, properties, assets, liabilities or condition (financial or otherwise) of either (x) the Media Group or (y) Acquiror and its Subsidiaries taken as a whole; provided, however, that Material Adverse Effect shall in each instance exclude any change or effect due to general economic or industry wide conditions.

"Media Group" shall have the meaning set forth in Section 2.6.15 of Article V of the Restated Certificate of Incorporation of Acquiror as in effect as of the date hereof.

"Merger" shall have the meaning set forth in the first recital to this Agreement.

"MMDS" shall mean a system operating in the Multichannel Multipoint Distribution Services authorized by the FCC.

"NYSE" shall mean the New York Stock Exchange, Inc.

"Person" shall mean an individual, corporation, partnership, trust or unincorporated organization or a government or any agency or political subdivision thereof.

"Preferred Consideration Amount" shall equal \$1 billion.

"Random Trading Days" shall mean the 20 Trading Days selected by Acquiror by lot (through a method reasonably satisfactory to the Company) from the 30 Trading Days ending on the fourth Trading Day prior to the Closing Date.

"Recently Acquired Systems" shall mean the Systems acquired by the Company or its Subsidiaries from Providence Journal Company, Cablevision of Chicago, Columbia of Michigan, Consolidated Cablevision of California and N-COM Limited Partnership II since August 1, 1995.

"Registration Rights Agreement" shall mean the registration rights agreement, substantially in the form of Exhibit B hereto, to be entered into by Acquiror, Amos B. Hostetter, Jr. and the Amos B. Hostetter, Jr. 1989 Trust.

"Remedial Action" means all actions required under any applicable Environmental Law or otherwise undertaken by any Governmental Authority, including, without limitation, any capital expenditures, required or undertaken to (i) clean up, remove, treat, or in any other way address any Hazardous Material; (ii) prevent the Release or threat of Release, or minimize the further Release of any Hazardous Material so it does not migrate or endanger or threaten to endanger public health or welfare or the indoor or outdoor environment; (iii) perform pre-remedial studies and investigations or post-remedial monitoring and care; or (iv) bring facilities on any property owned, operated or leased by the Company or its Subsidiaries and the facilities located and operations conducted thereon into compliance

with all applicable Environmental Laws and Environmental Permits.

"SEC" shall mean the Securities and Exchange Commission.

"Securities Act" shall mean the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

"Share Price" shall mean \$30, decreased by the Per Share Adjustment Amount, if any, plus the Additional Amount, if any, in accordance with the terms of Section 3.7.

"Stockholders' Agreement" shall have the meaning set forth in the first recital of this Agreement.

"Subpart N of the FCC Rules" shall refer to the Subpart N of Part 76 of the FCC's rules (47 C.F.R. §§ 76.900 through 76.985), entitled "Cable Rate Regulation," added by order in Docket 92-266, adopted by the FCC on April 1, 1993, as such Subpart may be amended from time to time thereafter, as such rules were in effect on any particular date, and shall include successor provisions if recodified or otherwise modified.

"Subscriber" shall mean a member of the general public who receives video programming services distributed by a System and does not further distribute it; provided, however, that the number of Subscribers in a multi-unit dwelling or commercial structure that obtains service on a "bulk rate" basis shall be determined by dividing the bulk rate charge by the rate for individual households subscribing to the same level of service as the multi-unit structure (e.g., if the basic subscription rate for individual households is \$10 and the multi-unit dwelling or commercial structure paid a bulk fee of \$100 for the same level of service, then that multi-unit dwelling or structure shall be counted as having 10 Subscribers).

"Subsidiary" shall mean, with respect to any Person, (i) each corporation, partnership, joint venture or other legal entity of which such Person owns, either directly or indirectly, more than 50% of the stock or other equity interests the holders of which are generally entitled to vote for the election of the board of directors or similar governing body of such corporation, partnership, joint venture or other legal entity, (ii) each partnership

in which such Person or another Subsidiary of such Person is the sole general partner or sole managing partner and (iii) each limited liability company in which such Person or another Subsidiary of such Persons is the managing member or otherwise controls.

"Surviving Corporation" shall have the meaning set forth in the first recital of this Agreement.

"Systems" shall mean the cable television systems listed in Section 4.12(a) of the Company Disclosure Letter.

"Tax" or "Taxes" shall mean all taxes, charges, fees, imposts, levies or other assessments, including, without limitation, all net income, gross receipts, capital, sales, use, ad valorem, value added, transfer, franchise, profits, inventory, capital stock, license, withholding, payroll, employment, social security, unemployment, excise, severance, stamp, occupation, property and estimated taxes, customs duties, fees, assessments and charges of any kind whatsoever, together with any interest and any penalties, fines, additions to tax or additional amounts imposed by any taxing authority (domestic or foreign) and shall include any transferee liability in respect of Taxes.

"Third Party" shall mean a party or parties unaffiliated with either the Company or Acquiror.

"Trading Day" shall mean a day on which (i) the NYSE is open for the transaction of business and (ii) there is no suspension of trading of the Media Stock.

"Transaction Documents" shall mean the Stockholders' Agreement and the Registration Rights Agreement.

"Transaction Value" shall equal the product of (x) the Share Price multiplied by (y) the number of shares of Company Common Stock outstanding immediately prior to the Effective Time on a fully diluted basis, including giving effect to the conversion of all outstanding shares of Company Preferred Stock.

"WARN" shall mean the Worker Adjustment and Retraining Notification Act and any similar state or local "plant closing" law.

1.2 Terms Defined Elsewhere in the Agreement.
For purposes of this Agreement, the following terms have the meanings set forth in the sections indicated:

<u>Term</u>	<u>Section</u>
Acceleration Event	7.14(c)
Acquiror Certificates	3.2(b)
Acquiror Consents	5.5
Acquiror Disclosure Letter	5.2(b)
Acquiror SEC Documents	5.7(a)
Acquiror Termination Notice	3.1(d)(ii)
Acquisition Proposal	7.10(d)
Additional Amount	3.7
Additional Payment	7.14(c)
Additional Stockholders' Meeting	7.1(d)
Allocation Determination	3.2(d)
Applicable Laws	4.7(a)
Articles	10.7
Benefit Plans	4.11(a)
Cap Top-Up Intent Notice	3.1(d)(ii)
Cash Cap	3.3(a)
Cash Election	3.1(c)(ii)
Certificate of Merger	2.3
Certificates	3.2(b)
Class A Common Conversion Number	3.1(d)
Class A Common Stock	3.1(c)(i)
Class A Merger Consideration	3.1(c)(i)
Class B Common Conversion Number	3.1(d)
Class B Common Stock	3.1(c)(ii)
Class B Cash Consideration	3.1(c)(ii)
Class B Merger Consideration	3.1(c)(ii)
Class B Stock Consideration	3.1(c)(ii)
Class B Stock Election	3.2(a)
Closing	2.2
Closing Date	2.2
Communications Stock	5.2(a)
Company Capital Stock	4.2(a)
Company Certificate	3.1(c)(iii)
Company Common Stock	3.1
Company Consents	4.6
Company Letter of Transmittal	3.2(c)
Company Disclosure Letter	4.1(c)
Company Preferred Stock	4.2(a)
Company Representatives	7.10(a)
Company SEC Documents	4.8(a)
Company Termination Notice	3.1(d)(ii)
Confidentiality Agreements	6.3(c)

Copyright Act	4.12(e)
Designated Assets	7.7(b)
Designated Asset Fair Market Value	7.7(c)
Dissenting Shares	3.6
Effective Time	2.3
Election Deadline	3.2(d)
Election Form	3.2(c)
Equity Appreciation Rights Plans	4.11(i)
Excess Cash Amount	3.3(c)
Excise Tax	7.14(c)
Exchange Agent	3.2(b)
Exchange Fund	3.2(b)
Exhibits	10.7
Floor Top-Up Intent Notice	3.1(d)(ii)
Foreign Benefit Plans	4.11(b)
Form S-4	5.5
Fractional Shares	3.4(c)(i)
Franchise Consents	4.6
Franchises	4.12(a)
Gains Taxes	4.6
Incremental Excise Tax	7.14(c)
Indemnified Liabilities	7.11(b)
Indemnified Parties	7.11(b)
Initial Stockholders' Meeting	7.1(d)
Liquidation Value	3.1(c)(i)
License Consents	4.6
✓ Material Franchises	4.12(c)
Media Stock	3.1(c)(i)
Merger Consideration	3.2(b)
Non-Required Franchises	7.5(b)
Non-Required Systems	7.5(b)
Permits	4.7(a)
Per Share Adjustment Amount	7.7(c)
Prorated Cash Amount	3.3(b)
Proxy Statement	4.6
Put Closing Date	9.4(c)
Put Exercise Notice	9.4(b)
Put Right	9.4(a)
Put Shares	9.4(a)
Requested Cash Amount	3.3(a)
Required Franchise Consents	8.2(j)
Restricted Company Common Stock	3.5
Rights Agreement	5.2(a)
RSPA	3.5
Sections	10.7
Series D Preferred Stock	3.1(c)(i)
Social Contract Amendment	4.6
Social Contract Consents	4.6

Social Contract Order	4.6
Stock Election	3.2(a)
Stockholder Approvals	4.1(b)
Stockholders' Meeting	7.1(d)
Tax Returns	4.10(a)
Termination Date	9.1(d)

1.3 Other Definitional Provisions. (a) The words "hereof", "herein", and "hereunder" and words of similar import, when used in this Agreement, shall refer to this Agreement as a whole and not to any particular provision of this Agreement.

(b) The terms defined in the singular shall have a comparable meaning when used in the plural, and vice versa.

(c) The terms "dollars" and "\$" shall mean United States dollars.

ARTICLE II

THE MERGER

2.1 The Merger. Upon the terms and subject to the conditions set forth in this Agreement, and in accordance with the DGCL, the Company shall be merged with and into Acquiror at the Effective Time (as defined in Section 2.3). At the Effective Time, the separate corporate existence of the Company shall cease, and Acquiror shall continue as the Surviving Corporation and shall succeed to and assume all of the rights, properties, liabilities and obligations of the Company in accordance with the DGCL.

2.2 Closing. Unless this Agreement shall have been terminated and the transactions herein contemplated shall have been abandoned pursuant to Section 9.1, the closing of the Merger (the "Closing") shall take place at 10:00 a.m., New York City time, the later of (i) the fifth Business Day after the date on which the last of the conditions set forth in Article VIII is fulfilled or waived, other than conditions requiring deliveries at the Closing and (ii) November 15, 1996 (the "Closing Date"), at the offices of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, New York 10153, unless another date, time or place is agreed to in writing by the parties hereto.

2.3 Effective Time. Subject to the provisions of this Agreement, the parties hereto shall cause the Merger to be consummated by filing a certificate of merger (the "Certificate of Merger") with the Secretary of State of the State of Delaware, as provided in the DGCL, as soon as practicable on or after the Closing Date. The Merger shall become effective upon such filing or at such time thereafter as is provided in the Certificate of Merger (the "Effective Time").

2.4 Effects of the Merger. From and after the Effective Time, the Surviving Corporation shall possess all the rights, privileges, powers and franchises of a public as well as of a private nature, and be subject to all the restrictions, disabilities and duties of each of Acquiror and the Company; and all and singular rights, privileges, powers and franchises of each of Acquiror and the Company, and all property, real, personal and mixed, and all debts due to either of Acquiror or the Company on whatever account, as well as for stock subscriptions and all other things in action or belonging to each of Acquiror and the Company, shall be vested in the Surviving Corporation; and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the Surviving Corporation as they were of Acquiror and the Company; and the title to any real estate vested by deed or otherwise, in either of Acquiror or the Company, shall not revert or be in any way impaired; but all rights of creditors and all liens upon any property of either of Acquiror or the Company shall be preserved unimpaired; and all debts, liabilities and duties of Acquiror and the Company shall thenceforth attach to the Surviving Corporation, and may be enforced against it to the same extent as if said debts and liabilities had been incurred by it.

2.5 Directors; Certificate of Incorporation; Bylaws. (a) The directors of Acquiror and the officers of Acquiror immediately prior to the Effective Time shall be the directors and officers of the Surviving Corporation until their successors have been duly elected or appointed and qualified, or until their earlier death, resignation or removal in accordance with the Surviving Corporation's certificate of incorporation and bylaws.

(b) The Restated Certificate of Incorporation of Acquiror as in effect immediately prior to the Effective Time shall be the Restated Certificate of Incorporation of

the Surviving Corporation, until duly amended in accordance with the terms thereof and the DGCL.

(c) The Bylaws of Acquiror as in effect immediately prior to the Effective Time shall be the bylaws of the Surviving Corporation until thereafter amended as provided by Applicable Law, the Restated Certificate of Incorporation of the Surviving Corporation or such Bylaws.

ARTICLE III

EFFECT OF THE MERGER ON THE CAPITAL STOCK OF THE CONSTITUENT CORPORATIONS; EXCHANGE OF CERTIFICATES

3.1 Effect on Capital Stock. At the Effective Time, by virtue of the Merger and without any action on the part of the holder of any shares of Company Capital Stock (as defined in Section 4.2) or the holder of any shares of capital stock of Acquiror:

(a) Capital Stock of Acquiror. Each share of each class of capital stock of Acquiror issued and outstanding immediately prior to the Effective Time shall remain an issued and outstanding share of the same class of capital stock of the Surviving Corporation.

(b) Cancellation of Treasury Stock and Acquiror-Owned Stock. Each share of Company Capital Stock that is owned by the Company or any wholly owned Subsidiary of the Company and each share of Company Capital Stock that is owned by Acquiror or any wholly owned subsidiary of Acquiror shall be canceled and retired and shall cease to exist and no consideration shall be delivered or deliverable in exchange therefor.

(c) Conversion of Company Common Stock.

(i) Subject to Sections 3.5 and 3.6, at the Effective Time, each issued and outstanding share (excluding shares cancelled pursuant to Section 3.1(b)) of Class A Common Stock, par value \$.01 per share, of the Company ("Class A Common Stock") shall be converted into the right to receive (x) a number of shares of U S WEST Media Group Common Stock, par value \$.01 per share, of Acquiror (the "Media Stock") equal to the Class A Common Conversion Number (as determined in accordance with Section 3.1(d)) and (y) a number of shares of Series D Convertible Preferred Stock,

par value \$1.00 per share, of Acquiror (the "Series D Preferred Stock"), having the rights, preferences and terms set forth in the Certificate of Designation attached as Exhibit C hereto, with a liquidation value of \$50 per share (the "Liquidation Value"), equal to the Class A Preferred Conversion Number (collectively, the "Class A Merger Consideration").

(ii) Except as otherwise provided in Section 3.3 and subject to Sections 3.5 and 3.6, at the Effective Time each issued and outstanding share (excluding shares cancelled pursuant to Section 3.1(b)) of Class B Common Stock, par value \$.01 per share, of the Company ("Class B Common Stock"), shall be converted into, at the election of the holder thereof, one of the following (as adjusted pursuant to Section 3.3, the "Class B Merger Consideration"):

(x) for each such share of Class B Common Stock with respect to which an election to receive cash has been effectively made and not revoked, pursuant to Sections 3.2(c), (d) and (e) (a "Cash Election"), the right to receive an amount in cash from Acquiror, without interest, equal to the Share Price (the "Class B Cash Consideration"); or

(y) for each such share of Class B Common Stock (other than shares as to which a Cash Election was effectively made and not revoked), the right to receive (1) a number of shares of Media Stock equal to the Class B Common Conversion Number (as determined in accordance with Section 3.1(d)) and (2) a number of shares of Series D Preferred Stock equal to the Class B Preferred Conversion Number (collectively, the "Class B Stock Consideration").

(iii) As a result of the Merger and without any action on the part of the holder thereof, at the Effective Time all shares of Company Common Stock shall cease to be outstanding and shall be cancelled and retired and shall cease to exist, and each holder of shares of Company Common Stock shall thereafter cease to have any rights with respect to such shares of Company Common Stock, except the right to receive, without interest, the Class A Merger Consideration or Class B Merger Consideration, as applicable, and cash for fractional shares of Media Stock or Series D Preferred Stock in accordance with Section 3.6(c) upon the surrender of a certificate representing such shares of Company Common Stock

(a "Company Certificate"). The Media Stock and Series D Preferred Stock comprising part of the Merger Consideration, when issued to the holders of Company Common Stock, will be duly authorized, validly issued, fully paid, non-assessable and not subject to preemptive rights created by statute, Acquiror's Restated Certificate of Incorporation or Bylaws or any agreement to which Acquiror is a party or by which Acquiror is bound.

(d) Certain Adjustments and Determinations.

(i) If, between the date of this Agreement and the Effective Time, the outstanding shares of Media Stock, Series D Preferred Stock or Company Common Stock shall have been changed into a different number of shares or a different class, by reason of any stock dividend, subdivision, reclassification, recapitalization, split, combination or exchange of shares, the Common Conversion Number and the Preferred Conversion Number correspondingly shall be adjusted to reflect such stock dividend, subdivision, reclassification, recapitalization, split, combination or exchange of shares.

(ii) The Class A Common Conversion Number and Class B Common Conversion Number shall be determined in the following manner:

(A) If the Determination Price is greater than or equal to the Floor Price and less than or equal to the Cap Price, (x) the Class A Common Conversion Number shall be equal to the quotient of (1) the product of (I) the Class A Common Percentage multiplied by (II) the Share Price divided by (2) the Determination Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) and (y) the Class B Common Conversion Number shall be equal to the quotient of (1) the product of (I) the Class B Common Percentage multiplied by (II) the Share Price divided by (2) the Determination Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth).

(B) If the Determination Price is less than the Floor Price, (x) the Class A Common Conversion Number shall be equal to the quotient of (1) the product of (I) the Class A Common Percentage multiplied by (II) the Share Price divided by (2) the Floor Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) and (y) the Class B Common Conversion Number shall be equal to the quotient of (1) the

product of (I) the Class B Common Percentage multiplied by (II) the Share Price divided by (2) the Floor Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth); provided, however, that in such event Acquiror shall have the right to give written notice to the Company (the "Floor Top-Up Intent Notice") that the board of directors of Acquiror elects to increase both (x) the Class A Common Conversion Number to the quotient of (1) the product of (I) the Class A Common Percentage multiplied by (II) the Share Price divided by (2) the Determination Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) and (y) the Class B Common Conversion Number to the quotient of (1) the product of (I) the Class B Common Percentage multiplied by (II) the Share Price divided by (2) the Determination Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth). The Floor Top-Up Intent Notice shall be delivered to the Company no later than 2:00 p.m. on the second Business Day prior to the Closing Date. If, in such case, Acquiror does not deliver a Floor Top-Up Intent Notice, the Company shall have the right to give written notice to Acquiror (the "Company Termination Notice") that the Company elects to terminate this Agreement. The Company Termination Notice shall be delivered to Acquiror no later than 2:00 p.m. on the Business Day prior to the Closing Date.

(C) If the Determination Price is greater than the Cap Price, (x) the Class A Common Conversion Number shall be equal to the quotient of (1) the product of (I) the Class A Common Percentage multiplied by (II) the Share Price divided by (2) the Cap Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) and (y) the Class B Common Conversion Number shall be equal to the quotient of (1) the product of (I) the Class B Common Percentage multiplied by (II) the Share Price divided by (2) the Cap Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth); provided, however, that in such event, the Company shall have the right to give written notice to Acquiror (the "Cap Top-Up Intent Notice") that the Board of Directors elects to decrease both (x) the Class A Common Conversion Number to the quotient of (1) the product of (I) the Class A Common Percentage multiplied by (II) the Share Price divided by (2) the Determination Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth) and

(y) the Class B Common Conversion Number to the quotient of (1) the product of (I) the Class B Common Percentage multiplied by (II) the Share Price divided by (2) the Determination Price (rounded to the nearest hundredth, or if there shall not be a nearest hundredth, to the next lowest hundredth). The Cap Top-Up Intent Notice shall be delivered to Acquiror no later than 2:00 p.m. on the second Business Day prior to the Closing Date. If, in such case, the Company does not deliver a Cap Top-Up Intent Notice, Acquiror shall have the right to give written notice to the Company (the "Acquiror Termination Notice") that Acquiror elects to terminate this Agreement. The Acquiror Termination Notice shall be delivered to the Company no later than 2:00 p.m. on the Business Day prior to the Closing Date.

3.2 Company Common Stock Elections; Exchange Fund. (a) Each Person who, at the Effective Time, is a record holder of shares of Class B Common Stock (other than holders of shares of Class B Common Stock to be cancelled as set forth in Section 3.1(b) or subject to Section 3.5 or 3.6) shall have the right to submit an Election Form (as defined in Section 3.2(c)) specifying the number of shares of Class B Common Stock that such Person desires to have converted into the right to receive the Class B Stock Consideration (the "Stock Election") and the number of shares of Class B Common Stock that such Person desires to have converted into the right to receive the Class B Cash Consideration pursuant to the Class B Cash Election.

(b) Promptly after the Allocation Determination (as defined in Section 3.2(d)), (i) Acquiror shall deposit (or cause to be deposited) with a bank or trust company to be designated by Acquiror and reasonably acceptable to the Company (the "Exchange Agent"), for the benefit of the holders of shares of Class B Common Stock, for exchange in accordance with this Article III, cash in the amount sufficient to pay the aggregate Class B Cash Consideration and (ii) Acquiror shall deposit (or cause to be deposited) with the Exchange Agent, for the benefit of holders of shares of Company Common Stock, certificates representing the shares of Media Stock and Series D Preferred Stock ("Acquiror Certificates") for exchange in accordance with this Article III (the cash and shares deposited pursuant to clauses (i) and (ii) being hereinafter referred to as the "Exchange Fund"). The Media Stock and Series D Preferred Stock into which Company Common Stock shall be converted

pursuant to the Merger shall be deemed to have been issued at the Effective Time.

(c) As soon as reasonably practicable after the Effective Time, the Exchange Agent shall mail to each holder of record of Company Common Stock immediately prior to the Effective Time (excluding any shares of Company Common Stock which will be cancelled pursuant to Section 3.1(b) or which are subject to Section 3.5 or 3.6) (A) a letter of transmittal (the "Company Letter of Transmittal") (which shall specify that delivery shall be effected, and risk of loss and title to the Company Certificates shall pass, only upon delivery of such Company Certificates to the Exchange Agent and shall be in such form and have such other provisions as Acquiror shall specify) and (B) instructions for use in effecting the surrender of the Company Certificates in exchange for the Class A Merger Consideration or Class B Merger Consideration, as applicable, with respect to the shares of Company Common Stock formerly represented thereby. The Exchange Agent shall also mail to holders of Class B Common Stock, together with the items specified in the preceding sentence, an election form (the "Election Form") providing for such holders to make the Cash Election or the Stock Election. The Election Form shall include information as to the Share Price, the Class B Common Conversion Number, the Class B Preferred Conversion Number and the Cash Consideration Amount and state the pricing terms of the Series D Preferred Stock. As of the Election Deadline (as hereinafter defined) all holders of Class B Common Stock immediately prior to the Effective Time that shall not have submitted to the Exchange Agent or shall have properly revoked an effective, properly completed Election Form shall be deemed to have made a Stock Election.

(d) Any Cash Election or Stock Election (other than a deemed Stock Election) shall have been validly made only if the Exchange Agent shall have received by 5:00 p.m. New York, New York time on a date (the "Election Deadline") to be mutually agreed upon by Acquiror and the Company (which date shall not be later than the twentieth Business Day after the Effective Time), an Election Form properly completed and executed (with the signature or signatures thereof guaranteed to the extent required by the Election Form) by such holder accompanied by such holder's Company Certificates, or by an appropriate guarantee of delivery of such Company Certificates from a member of any registered national securities exchange or of the National Association

of Securities Dealers, Inc. or a commercial bank or trust company in the United States as set forth in such Election Form. Any holder of Class B Common Stock (other than a holder who has submitted an irrevocable election) who has made an election by submitting an Election Form to the Exchange Agent may at any time prior to the Election Deadline change such holder's election by submitting a revised Election Form, properly completed and signed that is received by the Exchange Agent prior to the Election Deadline. Any holder of Class B Common Stock may at any time prior to the Election Deadline revoke such holder's election by written notice to the Exchange Agent received by the close of business on the day prior to the Election Deadline. As soon as practicable after the Election Deadline, the Exchange Agent shall determine the allocation of the cash portion of the Class B Merger Consideration and the stock portion of the Class B Merger Consideration and shall notify Acquiror of its determination (the "Allocation Determination").

(e) Upon surrender of a Company Certificate for cancellation to the Exchange Agent, together with the Company Letter of Transmittal, duly executed, and such other documents as Acquiror or the Exchange Agent shall reasonably request, the holder of such Company Certificate shall be entitled to receive promptly after the Election Deadline in exchange therefor (A) a certified or bank cashier's check in the amount equal to the cash, if any, which such holder has the right to receive pursuant to the provisions of this Article III (including any cash in lieu of fractional shares of Media Stock and Series D Preferred Stock pursuant to Section 3.4(c)), and (B) Acquiror Certificates representing that number of shares of Media Stock and Series D Preferred Stock, if any, which such holder has the right to receive pursuant to this Article III (in each case less the amount of any required withholding taxes, if any, determined in accordance with Section 3.4(g)), and the Company Certificate so surrendered shall forthwith be cancelled. Until surrendered as contemplated by this Section 3.3, each Company Certificate shall be deemed at any time after the Effective Time to represent only the right to receive the Class A Merger Consideration or Class B Merger Consideration, as applicable, with respect to the shares of Company Common Stock formerly represented thereby.

(f) Acquiror shall have the right to make reasonable rules, not inconsistent with the terms of this Agreement, governing the validity of the Election Forms, the

manner and extent to which Cash Elections or Stock Elections are to be taken into account in making the determinations prescribed by Section 3.3, the issuance and delivery of certificates for Media Stock and Series D Preferred Stock into which shares of Class B Common Stock are converted in the Merger, and the payment of cash for shares of Class B Common Stock converted into the right to receive cash in the Merger.

3.3 Proration. (a) The aggregate amount of cash to be paid to holders of Class B Common Stock (the "Cash Cap") shall not exceed the Cash Consideration Amount.

(b) In the event that the aggregate amount of cash represented by the Cash Elections received by the Exchange Agent (the "Requested Cash Amount") exceeds the Cash Cap, each holder making a Cash Election shall receive, for each share of Class B Common Stock for which a Cash Election has been made, (x) cash in an amount equal to the product of the Class B Cash Consideration and a fraction, the numerator of which is the Cash Cap and the denominator of which is the Requested Cash Amount (such product, the "Prorated Cash Amount"), (y) a number of shares of Media Stock equal to the product of the Class B Common Percentage and a fraction, the numerator of which is equal to the Share Price minus the Prorated Cash Amount and the denominator of which is the Calculation Price and (z) a number of shares of Series D Preferred Stock equal to the product of the Class B Preferred Percentage and a fraction, the numerator of which is equal to the Share Price minus the Prorated Cash Amount and the denominator of which is equal to the Liquidation Value.

(c) In the event the Requested Cash Amount is less than the Cash Cap, each holder making a Stock Election (other than as set forth in Section 3.5) shall receive for each share of Class B Common Stock for which a Stock Election has been made, (x) cash in an amount equal to the quotient of (1) the excess of the Cash Cap over the Requested Cash Amount divided by (2) the number of shares of Class B Common Stock for which such Stock Elections have been made or have been deemed to have been made (such quotient, the "Excess Cash Amount"), (y) a number of shares of Media Stock equal to the product of the Class B Common Percentage and a fraction, the numerator of which is equal to the difference between the Share Price and the Excess Cash Amount and the denominator of which is equal to the Calculation Price and (z) a number of shares of Series D

Preferred Stock equal to the product of the Class B Preferred Percentage and a fraction, the numerator of which is equal to the difference between the Share Price and the Excess Cash Amount and the denominator of which is equal to the Liquidation Value.

3.4 Dividends, Fractional Shares, Etc.

(a) Notwithstanding any other provisions of this Agreement, no dividends or other distributions declared after the Effective Time on Media Stock or Series D Preferred Stock shall be paid with respect to any whole shares of Media Stock or Series D Preferred Stock represented by a Company Certificate until such Company Certificate is surrendered for exchange as provided herein. Subject to the effect of Applicable Laws, following surrender of any such Company Certificate, there shall be paid to the holder of the Acquiror Certificates issued in exchange therefor, without interest, (i) at the time of such surrender, the amount of dividends or other distributions with a record date after the Effective Time theretofore payable with respect to such whole shares of Media Stock and Series D Preferred Stock and not paid, less the amount of any withholding taxes which may be required thereon, and (ii) at the appropriate payment date, the amount of dividends or other distributions with a record date after the Effective Time but prior to surrender and a payment date subsequent to surrender payable with respect to such whole shares of Media Stock and Series D Preferred Stock, less the amount of any withholding taxes which may be required thereon.

(b) At or after the Effective Time, there shall be no transfers on the stock transfer books of the Company of the shares of Company Common Stock which were outstanding immediately prior to the Effective Time. If, after the Effective Time, certificates representing any such shares are presented to the Surviving Corporation, they shall be cancelled and exchanged for certificates for the consideration, if any, deliverable in respect thereof pursuant to this Agreement in accordance with the procedures set forth in this Article III. Company Certificates surrendered for exchange by any Person constituting an "affiliate" of the Company for purposes of Rule 145(c) under the Securities Act shall not be exchanged until Acquiror has received a written agreement from such Person as provided in Section 7.13.

(c) (i) No certificates or scrip evidencing fractional shares of Media Stock or Series D Preferred Stock

shall be issued upon the surrender for exchange of Company Certificates, and such fractional share interests will not entitle the owner thereof to vote or to any rights of a stockholder of Acquiror. In lieu of any such fractional shares, the Exchange Agent shall, on behalf of all holders of fractional shares of Media Stock and Series D Preferred Stock, as soon as practicable after the Effective Time, aggregate all such fractional interests (collectively, the "Fractional Shares") and, at Acquiror's option, such Fractional Shares shall be purchased by Acquiror or otherwise sold by the Exchange Agent as agent for the holders of such Fractional Shares, in either case at the then prevailing price on the NYSE, all in the manner provided hereinafter. Until the net proceeds of such sale or sales have been distributed to the holders of Fractional Shares, the Exchange Agent shall retain such proceeds in trust for the benefit of such holders. Acquiror shall pay all commissions, transfer taxes and other out-of-pocket transaction costs, including expenses and compensation of the Exchange Agent, incurred in connection with such sale of the Fractional Shares.

(ii) To the extent not purchased by Acquiror, the sale of the Fractional Shares by the Exchange Agent shall be executed on the NYSE or through one or more member firms of the NYSE and will be executed in round lots to the extent practicable. In either case, the Exchange Agent will determine the portion, if any, of the net proceeds of such sale to which each holder of Fractional Shares is entitled, by multiplying the amount of the aggregate net proceeds of the sale of the Fractional Shares, by a fraction, the numerator of which is the amount of Fractional Shares to which such holder is entitled and the denominator of which is the aggregate amount of Fractional Shares to which all holders of Fractional Shares are entitled.

(iii) As soon as practicable after the determination of the amount of cash, if any, to be paid to holders of Fractional Shares in lieu of such Fractional Shares, the Exchange Agent shall mail such amounts, without interest, to such holders; provided, however, that no such amount will be paid to any holder of such Fractional Shares prior to the surrender by such holder of the Company Certificates formerly representing such holder's shares of Company Common Stock.

(d) Any portion of the Exchange Fund that remains undistributed to the holders of Company Common Stock for six

months after the Effective Time shall be delivered to Acquiror, upon demand, and any holders of Company Common Stock who have not theretofore complied with this Article III shall thereafter look only to Acquiror for the Class A Merger Consideration or Class B Merger Consideration, as applicable, net cash proceeds from the sale of Fractional Shares and unpaid dividends and distributions on the Media Stock and Series D Preferred Stock to which they are entitled. All interest accrued in respect of the Exchange Fund shall inure to the benefit of and be paid to Acquiror.

(e) None of Acquiror, the Company or the Exchange Agent shall be liable to any holder of shares of Company Common Stock for any cash, shares of Media Stock or Series D Preferred Stock, net cash proceeds from the sale of Fractional Shares or unpaid dividends or distributions with respect to Media Stock or Series D Preferred Stock from the Exchange Fund delivered to a public official pursuant to any applicable abandoned property, escheat or similar law. If any Company Certificates shall not have been surrendered prior to seven years after the Effective Time (or immediately prior to such earlier date on which any cash, shares of Media Stock or Series D Preferred Stock, net cash proceeds from the sale of Fractional Shares or unpaid dividends or distributions with respect to Media Stock or Series D Preferred Stock in respect of such Company Certificates would otherwise escheat to or become the property of any Governmental Authority), any such cash, shares or unpaid dividends or distributions in respect of such Company Certificates shall, to the extent permitted by Applicable Laws, become the property of the Surviving Corporation; provided, however, that any holder of Company Common Stock shall thereafter have the right to demand from Acquiror any such cash, shares or unpaid dividends or distributions.

(f) In the event that any Company Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Company Certificate to be lost, stolen or destroyed and, if required by Acquiror, the posting by such Person of a bond in such reasonable amount as Acquiror may direct as indemnity against any claim that may be made against it with respect to such Company Certificate, the Exchange Agent (or Acquiror, as the case may be) will issue in exchange for such lost, stolen or destroyed Company Certificate the Class A Merger Consideration or Class B Merger Consideration, as applicable, cash in lieu of fractional

shares, and unpaid dividends and distributions on shares of Media Stock and Series D Preferred Stock deliverable in respect thereof pursuant to this Agreement.

(g) Acquiror shall be entitled to, or shall be entitled to cause the Exchange Agent to, deduct and withhold from the consideration otherwise payable pursuant to this Agreement to any holder of shares of Company Common Stock such amounts as are required to be deducted and withheld with respect to the making of such payment under the Code, or any provision of state, local or foreign tax law. To the extent that amounts are so withheld by Acquiror or the Exchange Agent, as the case may be, such withheld amounts shall be treated for all purposes of this Agreement as having been paid to the holder of the shares of Company Common Stock in respect of which such deduction and withholding was made by Acquiror.

3.5 Restricted Stock. To the extent any Company Common Stock that is unvested and outstanding immediately prior to the Effective Time is subject to the terms and conditions of a Restricted Stock Purchase Agreement ("RSPA") between the Company and any current or former employee of the Company ("Restricted Company Common Stock"), (i) the holder of such Restricted Company Common Stock shall not be entitled to make a Cash Election in respect of such Restricted Company Common Stock nor shall it receive cash pursuant to Section 3.3 and (ii) any Media Stock or Series D Preferred Stock received with respect to such Restricted Company Common Stock shall be subject to the terms of such RSPA, as amended by an Amendment to Restricted Stock Purchase Agreement substantially in the form set forth in Section 3.5 of the Company Disclosure Letter.

3.6 Dissenting Shares. Notwithstanding any other provisions of this Agreement to the contrary, shares of Company Common Stock that are outstanding immediately prior to the Effective Time and that are held by stockholders who shall have not voted in favor of the Merger or consented thereto in writing and who shall have demanded properly in writing appraisal for such shares in accordance with Section 262 of the DGCL (collectively, the "Dissenting Shares") shall not be converted into or represent the right to receive the Class A Merger Consideration or Class B Merger Consideration, as applicable. Such stockholders shall be entitled to receive payment of the appraised value of such shares of Company Common Stock held by them in accordance with the provisions of such Section 262, except that all

Dissenting Shares held by stockholders who shall have failed to perfect or who effectively shall have withdrawn or lost their rights to appraisal of such shares of Company Common Stock under such Section 262 shall thereupon be deemed to have been converted into and to have become exchangeable, as of the Effective Time, for the right to receive, without any interest thereon, the Class A Merger Consideration or Class B Merger Consideration, as applicable, upon surrender in the manner provided in this Article III, of the Company Certificate or Company Certificates that formerly evidenced such shares of Class B Common Stock.

3.7 Share Price Adjustment. If the Closing shall not have occurred on or prior to January 3, 1997, the Share Price shall be increased at a rate equal to 8% per annum from and including January 1, 1997 to and excluding the Closing Date calculated on the basis of the actual number of days in the period (such amount being the "Additional Amount"); provided, however, that no such amount shall be added to the Share Price if (i) the Closing has not occurred on or prior to January 3, 1997 and the last of the conditions set forth in Article VIII to be fulfilled is the condition set forth in Section 8.2(h) or the condition set forth in Section 8.1(a), other than, in each case as a result of any action taken or not taken by Acquiror or (ii) the Company has taken any action that would result in any of the conditions to the consummation of the Merger set forth herein not being satisfied at such time; provided, further, that upon satisfaction of the conditions described in clause (i) above if either such condition is the last condition to be fulfilled, the Additional Amount shall be added to the Share Price and shall be calculated commencing five Business Days after the date of such satisfaction.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company hereby represents and warrants to Acquiror as follows:

4.1 Organization and Authority of the Company.

(a) Each of the Company and its Subsidiaries is a corporation or partnership duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation or organization with all requisite power to enable it to own, lease and operate its assets and

properties and to conduct its business as currently being conducted and is qualified and in good standing to do business in each jurisdiction in which the nature of the business conducted by it or the character or location of the properties owned or leased by it requires such qualification, except to the extent the failure so to qualify would not have a Material Adverse Effect with respect to the Company. Complete and correct copies of the Restated Certificate of Incorporation and Bylaws, each as amended to date, of the Company have been delivered to Acquiror. Such Restated Certificate of Incorporation and Bylaws are in full force and effect.

(b) The Company has all requisite corporate power and authority to execute and deliver this Agreement and the Transaction Documents to which it is a party and to perform its obligations hereunder and thereunder and, subject to (i) the adoption of this Agreement by the holders of a majority of the voting power of the outstanding shares of Company Capital Stock, voting as a single class and (ii) the adoption of the Charter Amendment by 66-2/3% of the voting power of the outstanding shares of Company Capital Stock voting as a single class and a majority of the voting power of each of the outstanding shares of the Class A Common Stock and the Class B Common Stock voting as separate classes (collectively, the "Stockholder Approvals"), to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and such Transaction Documents and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all requisite corporate action on the part of the Company, subject, in the case of this Agreement, the Merger and the Charter Amendment, to the Stockholder Approvals. This Agreement and each Transaction Document to which the Company is a party has been duly executed and delivered by the Company and constitutes the legal, valid and binding obligation of the Company, enforceable against it in accordance with its terms, except (i) as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally and (ii) as the remedy of specific performance and injunctive and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any proceeding therefor may be brought.

(c) Section 4.1 of the letter from the Company, dated the date hereof, addressed to Acquiror (the "Company

Disclosure Letter") sets forth, as of the date hereof, a true and complete list of all of the Company's Subsidiaries, including the jurisdiction of incorporation or organization of each Subsidiary and the percentage of each Subsidiary's outstanding capital stock or other ownership interest owned by the Company or another Subsidiary of the Company or by any other Person. All of the outstanding shares of capital stock of each Subsidiary have been validly issued and are fully paid and nonassessable and, except as set forth in Section 4.1 of the Company Disclosure Letter, are owned by the Company or a Subsidiary, free and clear of all Encumbrances. Except as set forth in Section 4.1 of the Company Disclosure Letter, the Company does not, directly or indirectly, own any capital stock of or other equity interests in any corporation, partnership or other Person and neither the Company nor any of its Subsidiaries is a member of or participant in a partnership, joint venture or similar Person.

4.2 Capitalization. (a) As of the date hereof, the authorized capital stock of the Company consists of:

- (i) 425,000,000 shares of Class A Common Stock, of which (A) 38,885,385 shares are issued and outstanding, all of which are duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights created by statute, the Company's Restated Certificate of Incorporation or Bylaws or any agreement to which the Company is a party or by which the Company is bound and (B) no shares are held in the treasury of the Company;
- (ii) 200,000,000 shares of Class B Common Stock, of which (A) 109,349,496 shares are issued and outstanding, all of which are duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights created by statute, the Company's Restated Certificate of Incorporation or Bylaws or any agreement to which the Company is a party or by which the Company is bound, (B) no shares are held in the treasury of the Company and (C) 28,571,450 shares are issuable upon conversion of Company Preferred Stock; and (iii) 200,000,000 shares of Preferred Stock, par value \$.01 per share, of the Company, of which 1,142,858 shares have been designated Series A Participating Convertible Preferred Stock (the "Company Preferred Stock" and, together with the Company Common Stock, the "Company Capital Stock") and are issued and outstanding, all of which are duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights created by statute, the Company's Certificate of Incorporation or Bylaws or any agreement to

which the Company is a party or by which the Company is bound.

(b) Other than as described in this Section 4.2, or as listed in Section 4.2(b) of the Company Disclosure Letter, no shares of the capital stock of the Company are authorized, issued or outstanding, or reserved for any other purpose, and there are no options, warrants or other rights (including tag-along, right of first refusal, buy-sell, registration or similar rights), agreements, arrangements or commitments of any character to which the Company, any of its Subsidiaries or any Person in which the Company or its Subsidiaries own any interest is a party relating to the issued or unissued capital stock of the Company, any of its Subsidiaries or any such Person or obligating or which could obligate the Company or any of its Subsidiaries to grant, issue or sell any shares of capital stock of the Company, any of its Subsidiaries or any Person in which the Company or its Subsidiaries own any interest, by sale, lease, license or otherwise. Except as described in Section 4.2(b) of the Company Disclosure Letter, the Company has no outstanding bonds, debentures, notes or other obligations the holders of which have the right to vote or that are convertible into or exercisable for securities having the right to vote with the stockholders of the Company on any matter. Except as set forth in Section 4.2(b) of the Company Disclosure Letter, there are, to the knowledge of the Company, no voting trusts or other agreements or understandings with respect to the voting of Company Capital Stock. Except as set forth on Section 4.2 of the Company Disclosure Letter, none of the Company, its Subsidiaries or any Person in which the Company or its Subsidiaries own any interest is a party to any non-competition agreement or other agreement or arrangement which restrains, limits or impedes the current or contemplated business or operations of the Company or any of its Subsidiaries or would apply to Acquiror or any of its Affiliates following the Effective Time.

4.3 No Conflicts. Except as set forth in Section 4.3 of the Company Disclosure Letter, subject to obtaining the Company Consents (as defined in Section 4.6), the execution and delivery of this Agreement and each of the Transaction Documents to which the Company is a party by the Company do not, and the consummation of the transactions contemplated hereby and thereby and compliance with the terms hereof and thereof will not, conflict with, or result in any violation of or default (with or without notice or

lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to loss of a material benefit under, or to increased, additional, accelerated or guaranteed rights or entitlements of any Person under, or result in the creation of any Encumbrances upon any of the properties or assets of the Company or its Subsidiaries under any provision of (i) the Certificate of Incorporation, Bylaws or other organizational document of the Company or any Subsidiary, (ii) any note, bond, mortgage, indenture or deed of trust, deed to secure debt or any license, lease, contract, commitment, permit, concession, franchise, agreement or other binding arrangement to which the Company or any of its Subsidiaries is a party or by which any of them or their respective properties or assets are bound, including any Franchise, (iii) any judgment, order, writ, injunction or decree of any court, governmental body, administrative agency or arbitrator applicable to the Company or any Subsidiary or their respective properties or assets as of the date hereof or (iv) any law, statute, rule, regulation or judicial or administrative decision applicable to the Company or any Subsidiary, except in the case of clauses (ii) and (iv), such conflicts, violations and defaults, termination, cancellation and acceleration rights and entitlements and Encumbrances that in the aggregate would not hinder or impair the consummation of the transactions contemplated hereby or have a Material Adverse Effect with respect to the Company.

4.4 Vote Required. The Stockholder Approvals are the only votes of the holders of any class or series of Company Capital Stock necessary or required (under Applicable Law or otherwise) to approve this Agreement and the transactions contemplated hereby.

4.5 Board Recommendation; Opinion of Financial Advisor. (a) The Board of Directors at a meeting duly called and held, has by unanimous vote of those directors present (who constituted 100% of the directors then in office) (i) determined that this Agreement and the transactions contemplated hereby, including the Merger, are fair to and in the best interests of the stockholders of the Company and has approved the same, and (ii) resolved to recommend that the holders of the shares of Company Capital Stock adopt this Agreement and the transactions contemplated hereby, including the Merger.

(b) The Company has received the opinions of (i) Lazard Freres & Co. LLC, dated February 27, 1996, to the effect that, as of the date hereof, the consideration to be received by the holders of shares of Company Capital Stock in the Merger is fair from a financial point of view to such holders and (ii) Allen & Company Incorporated, dated February 27, 1996, to the effect that, as of the date hereof, the consideration to be received by the holders of the Class A Common Stock in the Merger is fair from a financial point of view to such holders. A signed, true and complete copy of such opinions has been delivered to Acquiror.

4.6 Consents. Not later than 30 days after the date of this Agreement, the Company shall furnish to Acquiror a list of each Franchise as to which notice to, or the consent of, a Governmental Authority is required as a condition to the transfer of control or the right to control the Franchise in connection with the transactions contemplated hereby (all such notices and consents being "Franchise Consents"). Section 4.6 of the Company Disclosure Letter lists each FCC license held by the Company or any Subsidiary, other than private mobile radio service licenses, as to which FCC consent is required prior to the assignment or transfer of control of such license in connection with the transactions contemplated hereby (all such notices and consents being "License Consents"). Except for (i) the Franchise Consents and License Consents, (ii) as set forth in Section 4.6 of the Company Disclosure Letter, (iii) compliance with and filings under the HSR Act, (iv) the filing with the SEC of (A) a proxy statement under the Exchange Act relating to the meeting (or meetings) of the Company's stockholders to be held in connection with the Merger, the Charter Amendment and the other transactions contemplated by this Agreement (the "Proxy Statement"), (B) any registration statement required to be filed in connection with any action taken by the Company pursuant to Section 7.7 and (C) such reports under the Exchange Act as may be required in connection with this Agreement and the transactions contemplated hereby, (v) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware and appropriate documents with the relevant authorities of other states in which the Company is qualified to do business, (vi) such filings and approvals as may be required by any applicable state securities, "blue sky" or takeover laws, (vii) such filings in connection with any state or local tax which is attributable to the beneficial ownership of the Company's or its Subsidiaries'

real property, if any (collectively, "Gains Taxes"), and (viii) such filings as may be required with the FCC or any Governmental Authority to obtain their consent to the assumption by the Acquiror of the Social Contract (including all Systems and communities encompassed thereby) between the Company and the FCC, as approved by Memorandum Opinion and Order released August 3, 1995 (FCC 95-335) (the "Social Contract Order") and as may be modified thereafter by a proposed Social Contract Amendment that is substantially similar to that which the Company has provided to Acquiror (the "Social Contract Amendment") (such notice and consent being the "Social Contract Consents") (the items in clauses (i) through (vi) being collectively referred to herein as "Company Consents"), no consents, approvals, licenses, permits, orders or authorizations of, or registrations, declarations, notices or filings with, any Governmental Authority or any Third Party are required to be obtained or made by or with respect to the Company or any of its Subsidiaries on or prior to the Closing Date in connection with (A) the execution, delivery and performance of this Agreement or any of the Transaction Documents to which the Company is a party, the consummation of the transactions contemplated hereby and thereby or the taking by the Company of any other action contemplated hereby or thereby, (B) the continuing validity and effectiveness of (and prevention of any material default under or violation of the terms of) any Franchise or any other material, license, permit or authorization or any material contract, agreement or lease to which the Company or any Subsidiary is a party or (C) the conduct by the Company or any of its Subsidiaries of their respective businesses following the Closing as conducted on the date hereof, which, if not obtained or made in connection with clauses (A), (B) and (C), would have a Material Adverse Effect with respect to the Company.

4.7 Compliance; No Defaults. (a) Except as set forth in Section 4.7 of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries is in violation of, is, to the Knowledge of the Company, under investigation with respect to any violation of, has been given notice or been charged with violation of, or failed to comply with any statute, law, ordinance, rule, order or regulation of any Governmental Authority (including but not limited to the Social Contract Order, as amended) applicable to its business or operations ("Applicable Laws"), except for violations and failures to comply that would not have a Material Adverse Effect with respect to the Company. Except as set forth in Section 4.7 of the Company Disclosure

Letter, the Company and its Subsidiaries have all permits, licenses, variances, exemptions, orders and approvals of all Governmental Authorities ("Permits") which are material to the operation of the businesses of the Company and its Subsidiaries, taken as a whole.

(b) Neither the Company nor any of its Subsidiaries is in default or violation (and no event has occurred which, with notice or the lapse of time or both, would constitute a default or violation) of any term, condition or provision of (i) its Certificate of Incorporation, as amended, or Bylaws or other comparable organizational document or (ii) any note, bond, mortgage, indenture, license, agreement or other instrument or obligation to which the Company or any of its Subsidiaries is now a party or by which the Company or any of its Subsidiaries or any of their respective properties or assets may be bound, except in the case of clause (ii), for defaults or violations which in the aggregate would not have a Material Adverse Effect with respect to the Company.

4.8 SEC Documents; Undisclosed Liabilities.

(a) The Company has made available to Acquiror a true and complete copy of each report, schedule, registration statement and definitive proxy statement filed by the Company with the SEC since January 1, 1993 (as such documents have since the time of their filing been amended, the "Company SEC Documents"), which are all the documents (other than preliminary proxy materials) that the Company was required to file with the SEC since such date. As of their respective dates, the Company SEC Documents (including any financial statements filed, to be filed or required to have been filed as a part thereof) complied in all material respects with the requirements of the Securities Act or the Exchange Act, as applicable, and the rules and regulations of the SEC thereunder applicable to such Company SEC Documents, and none of the Company SEC Documents contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The financial statements of the Company included in the Company SEC Documents comply as to form in all material respects with applicable accounting requirements and with the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with GAAP applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present

(subject, in the case of the unaudited financial statements, to normal, recurring audit adjustments, which were not individually or in the aggregate material) the consolidated financial position of the Company and its consolidated Subsidiaries as at the dates thereof and the consolidated results of their operations and cash flows for the periods then ended.

(b) Except as disclosed in the Company SEC Documents or in Section 4.8 or 4.9 of the Company Disclosure Letter, as of the date hereof the Company and its Subsidiaries do not have any material indebtedness, obligations or liabilities of any kind (whether accrued, absolute, contingent or otherwise, and whether due or to become due or asserted or unasserted) required by GAAP to be reflected on a consolidated balance sheet of the Company and its consolidated Subsidiaries or in the notes, exhibits or schedules thereto.

4.9 Litigation. Except as set forth in the Company SEC Documents or in Section 4.9 of the Company Disclosure Letter, there are no Legal Proceedings against or affecting the Company or any of its Subsidiaries or their respective properties or assets pending or, to the Knowledge of the Company, threatened against the Company or any of its Subsidiaries, that individually or in the aggregate could (i) have a Material Adverse Effect with respect to the Company or (ii) as of the date hereof, prevent, materially hinder or delay the consummation of the transactions contemplated by this Agreement or the Transaction Documents or seek to limit the ownership or operation of the Company by Acquiror. Except as set forth in Section 4.9 of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries is a party or subject to or in default under any judgment, order, injunction or decree of any Governmental Authority applicable to it or to its respective properties or assets, which judgment, order, injunction, decree or default thereunder constitutes a Material Adverse Effect with respect to the Company.

4.10 Taxes. (a) Except as set forth in Section 4.10(a) of the Company Disclosure Letter, (i) all Federal, state, local and foreign Tax returns, declarations and reports ("Tax Returns") required to be filed by or on behalf of the Company or any of its Subsidiaries have been filed on a timely basis with the appropriate Governmental Authorities in all jurisdictions in which such Tax Returns are required to be filed (after giving effect to any valid extensions of

time in which to make such filings), except for Tax Returns as to which the failure to file would not individually or in the aggregate have a Material Adverse Effect with respect to the Company, and all such Tax Returns were true, correct and complete in all material respects; (ii) all amounts due and payable in respect of such Tax Returns (including interest and penalties) have been fully and timely paid or are or will be adequately provided for in the appropriate financial statements of the Company and its Subsidiaries, except for amounts the failure to pay would not have a Material Adverse Effect with respect to the Company; (iii) no waivers of statutes of limitations have been given or requested with respect to the Company or any of its Subsidiaries in connection with any Tax Returns covering the Company or any of its Subsidiaries with respect to any income or franchise Taxes or other material Taxes payable by any of them; and (iv) each of the Company and its Subsidiaries has duly and timely withheld from salaries, wages and other compensation of its employees and paid over to the appropriate taxing authorities all amounts required to be so withheld and paid over for all periods not barred by applicable statutes of limitations under all Applicable Laws, except for amounts as to which the failure to withhold or pay would not have a Material Adverse Effect with respect to the Company.

(b) Except as set forth in Section 4.10(b) of the Company Disclosure Letter, all deficiencies asserted or assessments made in an amount in excess of \$300,000 by the IRS or any other taxing authority of the Tax Returns of or covering the Company or any of its Subsidiaries have been fully paid or are or will be adequately provided for in the appropriate financial statements of the Company and its Subsidiaries.

(c) Except as set forth in Section 4.10(c) of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries nor any other Person on behalf of the Company or any of its Subsidiaries: (i) has filed a consent pursuant to Section 341(f) of the Code or agreed to have Section 341(f)(2) of the Code apply to any disposition of a subsection (f) asset (as such term is defined in Section 341(f)(4) of the Code) owned by the Company or any of its Subsidiaries; (ii) has executed or entered into a closing agreement pursuant to Section 7121 of the Code or any predecessor provision thereof or any similar provision of state, local or foreign law; or (iii) has agreed to or is required to make any adjustments pursuant to Section 481(a) of the Code or any similar provision of state, local or

foreign law by reason of a change in accounting method initiated by the Company or any of its Subsidiaries nor to the Knowledge of the Company (which for purposes of this Section 4.10 shall include the tax director) has the IRS proposed any such adjustment or change in accounting method, or has any application pending with any taxing authority requesting permission for any changes in accounting methods that relate to the business or operations of the Company or any of its Subsidiaries.

(d) Except as set forth in Section 4.10(d) of the Company Disclosure Letter, none of the assets of the Company and its Subsidiaries is property required to be treated as being owned by another Person pursuant to the provisions of Section 168(f)(8) of the Internal Revenue Code of 1954, as amended and in effect immediately prior to the enactment of the Tax Reform Act of 1986 or is "tax-exempt use property" within the meaning of Section 168(h)(1) of the Code.

(e) The Federal income Tax Returns of the Company and its Subsidiaries, any of their predecessors or any affiliated group of which the Company or any of its Subsidiaries is or was a member have been examined by the IRS, or the periods covered by such Tax Returns have been closed by applicable statute of limitations, for all periods through December 31, 1991, except to the extent such Tax Returns may be examined for the purpose of determining loss or credit carryforwards to a year not so closed. The state income or franchise Tax Returns of the Company and its Subsidiaries, any of their predecessors or any affiliated, combined or unitary group of which the Company or any of its Subsidiaries is or was a member have been examined by the relevant taxing authorities, or the periods covered by such Tax Returns have been closed by applicable statute of limitations, in each case through at least December 31, 1991, except to the extent such Tax Returns may be examined for the purpose of determining loss or credit carryforwards to a year not so closed.

(f) Except as set forth in Section 4.10(f) of the Company Disclosure Letter, (i) no Tax audits or other administrative proceedings are pending with regard to any Taxes for which the Company or any of its Subsidiaries may be liable and (ii) no written notice of any such audit has been received by the Company or any of its Subsidiaries.

(g) As of December 31, 1995, the Company had net operating loss carryforwards for Federal income tax purposes of no less than \$900 million.

(h) Except as set forth in Section 4.10(h) of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries is a party to or bound by any agreement providing for the allocation or sharing of Taxes.

(i) Except as set forth in Section 4.10(i) of the Company Disclosure Letter, since January 1, 1989 neither the Company nor any of its Subsidiaries has been a member of, or was acquired from, any "affiliated group" (as defined in Section 1504 of the Code) other than (i) in a transaction in which the common parent of such affiliated group was acquired or (ii) the affiliated group in which the Company is the common parent.

(j) Except as set forth in Section 4.10(j) of the Company Disclosure Letter, the performance of the transactions contemplated by this Agreement will not (either alone or upon the occurrence of any additional or subsequent event) result in any payment that would constitute an "excess parachute payment" within the meaning of Section 280G of the Code.

(k) The Company and each of its Subsidiaries is not currently, has not been within the last five years and does not anticipate becoming a "United States real property holding corporation" within the meaning of Section 897(c) of the Code.

4.11 Employee Benefits. (a) Section 4.11(a) of the Company Disclosure Letter lists all "employee benefit plans," as defined in Section 3(3) of ERISA, and all other deferred compensation, bonus or other incentive compensation, stock purchase or other Equity Appreciation Rights Plans, severance pay, salary continuation for disability or other leave of absence, supplemental unemployment benefits, lay-off or reduction in force, change in control or educational assistance arrangements or policies for which the Company or any of its Subsidiaries has any material obligation or liability (each a "Benefit Plan" and collectively, the "Benefit Plans"), including, but not limited to, any individual benefit arrangement, policy or practice with respect to any current or former officer, employee or director of the Company or any of its Subsidiaries.

(b) Section 4.11(b) of the Company Disclosure Letter lists, separately for each foreign country, all Benefit Plans covering employees of the Company and its Subsidiaries who are employed outside of the United States ("Foreign Benefit Plans").

(c) The Company and its Subsidiaries have delivered to Acquiror correct and complete copies of all Benefit Plans, and, where applicable, each of the following documents with respect to such plans: (i) any amendments, (ii) any related trust documents, (iii) the two most recently filed IRS Forms 5500 with all attachments thereto, (iv) the last IRS determination letter, (v) the most recent summary plan descriptions and summaries of material modifications, (vi) the last actuarial valuation report and (vii) written communications to employees to the extent the substance of the Benefit Plans described therein differs materially from the other documentation furnished under this Section.

(d) Except as disclosed in Section 4.11(d) of the Company Disclosure Letter, none of the Benefit Plans is subject to Title IV of ERISA or Section 412 of the Code, and the Company and its ERISA Affiliates from time to time have not within the preceding six years had any obligation to make any contribution to a retirement plan subject to Title IV of ERISA or incurred any liability (contingent or otherwise) under Title IV of ERISA and neither the Company, its Subsidiaries nor any of its ERISA Affiliates has any actual or potential obligation or liability to any multiemployer plan (as defined in Section 4001(a)(3) of ERISA).

(e) Each Benefit Plan, including any associated trust, intended to qualify under Section 401 of the Code does so qualify.

(f) Except as disclosed on Section 4.11(f) of the Company Disclosure Letter and except as would not have a Material Adverse Effect with respect to the Company, the Benefit Plans have been maintained and administered in accordance with their terms and with the provisions of ERISA, the Code and other Applicable Laws.

(g) There are no pending or, to the Company's Knowledge, overtly threatened actions, claims or lawsuits that have been asserted or instituted against any of the Benefit Plans, the assets of any of the trusts under such

plans or the plan sponsor, plan administrator or fiduciary of any of the Benefit Plans with respect to the operation of such plans (other than routine benefit claims) that individually or in the aggregate could have a Material Adverse Effect with respect to the Company.

(h) The Company and its Subsidiaries do not provide, and are not obligated to provide, retiree life insurance or retiree health benefits to any current or former employee after his or her termination of employment with the Company or any Subsidiary, except as may be required under Section 4980B of the Code and Part 6 of Subtitle B of Title I of ERISA or as disclosed in Section 4.11(h) of the Company Disclosure Letter.

(i) Except as disclosed in Section 4.11(i) of the Company Disclosure Letter and except with respect to payments under the Equity Appreciation Rights Plans that will be paid or satisfied by the Company on or prior to Closing of all estimated payments, neither the execution and delivery of this Agreement nor the consummation of the transactions contemplated hereby will (i) result in any payment becoming due to any employee (current or former) of the Company or any Subsidiary, (ii) increase any benefits otherwise payable under any Benefit Plan or (iii) result in the acceleration of the time of payment or the vesting of any benefits under any Benefit Plan. The Company has also delivered to Acquiror a schedule of all estimated payments to be made under each Equity Appreciation Rights Plan on or prior to the Closing. "Equity Appreciation Rights Plans" are all plans or arrangements maintained by the Company or any of its Subsidiaries that provide for a benefit based upon the issuance of stock, restricted stock, stock options, phantom stock or other equity appreciation rights or incentive awards, determined by the book, fair market or formula value of a share of stock of the Company.

(j) Except as disclosed in Section 4.11(j) of the Company Disclosure Letter, (i) no employee of the Company or any Subsidiary will be entitled to any severance payments upon the sale of the Company or any Subsidiary, or any divisions or business units thereof, absent an employee's actual loss of employment and (ii) none of the executives of the Company or any Subsidiary are eligible to receive any payment under any severance pay, stay bonus or other retention plan, program or arrangement of the Company or any of its Subsidiaries.

(k) Except as disclosed in Schedule 4.11(k) of the Company Disclosure Letter, the projected benefit obligation of the Company or any Subsidiary (as calculated using actuarial assumptions used to calculate liabilities under FAS 87 with respect to post-employment benefits accrued) under each Benefit Plan that is a defined benefit pension plan is fully funded by assets of such plan or by an adequate reserve on the applicable balance sheet of the Company or any Subsidiary.

4.12 Cable Television Franchises. (a) Section 4.12 of the Company Disclosure Letter sets forth a list of the Systems, and as to each such System, (i) the geographic area and FCC community unit(s) served, (ii) the name of the legal entity that owns such System and holds the applicable franchise, as well as the identity, ownership interest and relationship to the Company, if any, of each owner of any interest in such legal entity, (iii) as of December 31, 1995, the number of Homes Passed and Subscribers served by such System, and (iv) the names and addresses of the Governmental Authorities issuing the franchises and/or implementing such ordinances. By no later than 30 days after the date of this Agreement, the Company shall furnish to Acquiror a complete and accurate list and copy of all of the franchise agreements and similar governing agreements, instruments, resolutions, statutes and/or CATV-franchise-related ordinances that are used, necessary or required in order to operate, or to which the Company or its Subsidiaries are subject by reason of their operation of, the Systems (individually as to each System, its "Franchise" and collectively, the "Franchises"), and, as of December 31, 1995, the number of Homes Passed and Subscribers served by the Systems by Franchise. The Systems listed in Section 4.12 of the Company Disclosure Letter represent all of the "cable television systems", as defined in Section 602(7) of the Cable Act, owned and operated by the Company and its Subsidiaries in the United States. The Franchises and any related regulatory ordinances contain all material commitments, obligations and rights of the Company and its Subsidiaries with respect to each of the Governmental Authorities granting such Franchises, in connection with the construction, ownership and operation of the Systems. The Franchises enable the Company and its Subsidiaries to operate, and, subject to obtaining the Franchise Consents and License Consents, immediately following the Closing will enable the Surviving Corporation and its Subsidiaries to continue to operate all of the Systems as and where they are presently operated. To the Knowledge of the Company, each

Franchise is valid under all Federal, state and local laws and is validly held by the Company or its Subsidiaries, as the case may be. The Company and its Subsidiaries have complied with the material terms and conditions of the Franchises and the same will not be subject to revocation or nonrenewal as a result of the execution and delivery of this Agreement or the Transaction Documents, or the consummation of the transactions contemplated hereby and thereby, subject to obtaining the Franchise Consents and License Consents. Except as set forth in Section 4.12 of the Company Disclosure Letter, there are no lawsuits, revocation proceedings or disputes pending with respect to any of the Franchises or Systems that would material affect the right of the Company or any Subsidiary to operate a System, and no Governmental Authority or other Person has notified the Company or any of its Subsidiaries in writing of its intention to conduct or initiate the same. Neither the Company nor any of its Subsidiaries has received any written notice that any such Franchise is under consideration to be revoked nor, except for Franchises that are subject to renewal negotiations, to be modified in any material respect.

(b) Except as set forth in Section 4.12 of the Company Disclosure Letter, no Person other than certain municipalities (a list of which will be provided no later than 30 days after the date of this Agreement) has any right to acquire any interest in any of the Systems, or to designate any other person or entity to acquire any interest in any of the Systems (including, without limitation, any right of first refusal or similar right to purchase any interest in the Systems), which right has not been validly, properly and irrevocably (except for the right to revoke such waiver only if this Agreement is terminated pursuant to Article IX hereof) waived by the party entitled to assert such right.

(c) Section 4.12 of the Company Disclosure Letter lists the date on which each Franchise will expire or has expired. Except as set forth in Section 4.12 of the Company Disclosure Letter, there are not now pending any proceedings of any Governmental Authority with respect to any proposal for renewal of any Franchise. There exists no fact or circumstance that makes it likely that any Franchise will not be renewed or extended on commercially reasonable terms. Except where the Company or its Subsidiaries are proceeding under informal renewal procedures as provided for by the Cable Act, the Company and its Subsidiaries have timely

filed with the appropriate Governmental Authority all appropriate requests for renewal within 30 to 36 months under the Cable Act. Section 4.12 of the Company Disclosure Letter sets forth those Franchises serving 25,000 or more Subscribers ("Material Franchises") where the Company or a Subsidiary has not filed a written renewal notice pursuant to § 626(a)(1) of the Cable Act. Except as set forth in Section 4.12 of the Company Disclosure Letter, as to any Franchise that has expired prior to the date hereof, the Company is currently operating such Franchise under duly authorized extensions, and the Company has no reason to believe that such extensions will not be renewed until such time as the Franchise itself has been renewed for an additional term.

(d) To the Company's Knowledge, the Systems and all related businesses of the Company and its Subsidiaries are, and have been, operated in compliance with the Communications Act and all regulations of the FCC established pursuant thereto, and the Company and its Subsidiaries have submitted to the FCC all filings that are required under the rules, orders and regulations of the FCC or other Governmental Authorities with jurisdiction. Except as set forth in Section 4.12 of the Company Disclosure Letter, the operation of the Systems has been, and is, in compliance with the rules and regulations of the FCC or other Governmental Authorities with jurisdiction and the Company and its Subsidiaries have not received any written notice from the FCC or other Governmental Authorities with jurisdiction with respect to any material violation of its rules and regulations or from any other Governmental Authorities with jurisdiction with respect to any material violation of any Franchise.

(e) To the Company's Knowledge, for each relevant semi-annual reporting period, the Company has timely filed with the United States Copyright Office all required Statements of Account in true and correct form in all material respects, and has paid when due all required copyright royalty fee payments in the correct amount, relating to the Systems' carriage of television broadcast signals and appropriately classifying the applicable tiers on which the Systems carry television broadcast signals. To the Company's Knowledge, carriage of all broadcast signals is in compliance with the Copyright Act of 1976, as amended (the "Copyright Act") and the rules and regulations of the Copyright Office and is eligible for the compulsory license under Section 111 of the Copyright Act. Except as set forth

in Section 4.12 of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries has received any inquiry from the Copyright Office or any Third Party challenging or questioning the information submitted in any Statement of Account or the amount of any royalty payment, for which the Company has not provided adequate reserves in its reasonable business judgment, nor are the Company or its Subsidiaries aware of any basis for such inquiry. Except as set forth in Section 4.12 of the Company Disclosure Letter, to the Company's Knowledge, no claim or copyright infringement has been made against the Company or any of its Subsidiaries that has not been settled, nor is any such claim pending or threatened.

(f) Other than as set forth in Section 4.12 of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries is subject to any FCC proceeding challenging the rights of the Company or its Subsidiaries to carry or not carry any signal, nor has the Company or any of its Subsidiaries received any written notice or demand to carry or not carry any signal, the carriage or non-carriage of which could have a material adverse effect on any System.

(g) The Systems (other than the Recently Acquired Systems) are, and have been, operated in material compliance with the Social Contract Order and the Company and its Subsidiaries have submitted to the FCC and any relevant Governmental Authority all forms, notices and other written material required thereunder for implementation of the Social Contract. Each such filing has been prepared and filed in compliance with the Social Contract Order and is complete and accurate in all material respects. Neither the Company nor any Subsidiary has received written notice from the FCC as to any non-compliance with the Social Contract Order. The Company shall use its reasonable best efforts to seek amendment of the Social Contract Order to bring the Recently Acquired Systems under terms substantially the same as those contained in the proposed Social Contract Amendment.

(h) Section 4.12 of the Company Disclosure Letter lists each of the Governmental Authorities that (i) has been certified by the FCC pursuant to 47 C.F.R. § 76.910 to regulate Basic Cable Service and associated equipment of a System or (ii) has petitioned the FCC to regulate the rates for Basic Cable Service and associated equipment pursuant to 47 C.F.R. § 76.913; Section 4.12 of the Company Disclosure Letter also lists each complaint filed against Cable

Programming Service rates on FCC Form 329 that has not been settled by the Social Contract Order. Of those listed, the Form 329 complaints pertaining to the Recently Acquired Systems would be settled by the proposed Social Contract Amendment.

(i) To the extent that the Company's and/or its Subsidiaries' rates have not been settled pursuant to the Social Contract or would not be settled by the proposed Social Contract Amendment, the Company and/or its Subsidiaries are in compliance in all material respects with FCC rate requirements.

(j) Except as set forth in Section 4.12 of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries (x) is under any investigation by the FCC or any Governmental Authority with respect to any of its rates for Basic Cable Service or any Cable Programming Service (including but not limited to rates for associated equipment) or (y) is a party to any proceeding before the FCC or any other Governmental Authority the collective outcome of which could result in the Company or any of its Subsidiaries being ordered to make refunds to Subscribers in excess of \$2,000,000 (exclusive of potential Social Contract Amendment refunds) or reduce the rates currently charged to Subscribers when netted against any increases to which the Company is entitled.

(k) Section 4.12 of the Company Disclosure Letter lists each System, and the Franchise(s) by which it is authorized, that is subject to effective competition (as that term is defined in Section 623(1)(1) of the Cable Act) and the basis for the Company's determination that the System operating under that Franchise is subject to effective competition.

4.13 Environmental Matters. Except as set forth in Section 4.13 of the Company Disclosure Letter:

(i) the operations of the Company and its Subsidiaries are in material compliance with all applicable Environmental Laws;

(ii) to the Company's Knowledge, all real property owned, operated or leased by the Company and its Subsidiaries are free from contamination by any Hazardous Material that is reasonably likely to result in

Environmental Costs and Liabilities to the Company in excess of \$2,000,000;

(iii) to the Knowledge of the Company, the Company and its Subsidiaries have obtained and currently maintain all material Environmental Permits necessary for their operations and are in material compliance with such Environmental Permits;

(iv) except to the extent such matters are the subject matter of other representations and warranties of the Company contained herein, there are no Legal Proceedings or Environmental Claims pending, or to the Knowledge of the Company, threatened against the Company or its Subsidiaries alleging the violation of any Environmental Law or asserting claims regarding Environmental Costs and Liabilities under any Environmental Law;

(v) neither the Company nor its Subsidiaries nor to the Knowledge of the Company, any predecessor of the Company or its Subsidiaries or any owner of premises leased or operated by the Company or its Subsidiaries with respect to such property, has filed any formal notice under Federal, state, local or foreign law indicating past or present generation treatment, storage, or disposal of or reporting a Release of Hazardous Material into the environment; and

(vi) to the Knowledge of the Company, there is not now, nor has there been in the past, on, in or under any real property owned, leased or operated by the Company or its Subsidiaries (A) any underground storage tanks, above-ground storage tanks, dikes or impoundments, (B) any friable asbestos-containing materials or (C) any polychlorinated biphenyls which, in each case, is material to the operation of its business at such real property.

4.14 Labor. (a) Except as set forth in Section 4.14(a)(1) of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries is a party to any labor or collective bargaining agreement and there are no labor or collective bargaining agreements that govern the terms and conditions of employment with the Company or its Subsidiaries with respect to employees of the Company or its Subsidiaries. Section 4.14(a)(2) of the Company Disclosure Letter lists all employment, management, consulting, management retention or other personal service, or compensation agreements or arrangements covering one or more non-employees (including severance, termination or change-

of-control arrangements) and all material employment, management, consulting, management retention or other personal service, or compensation agreements or arrangements covering one or more employees (including severance, termination or change-of-control arrangements) in each case, entered into by the Company or any of its Subsidiaries and a copy of each such agreement has been delivered to Acquiror.

(b) Except as set forth in Section 4.14(b) of the Company Disclosure Letter, no employees of the Company or any of its Subsidiaries are represented by any labor organization; no labor organization or group of employees of the Company or any of its Subsidiaries has made a pending demand against the Company or any Subsidiary for recognition, and there are no representation proceedings or petitions seeking a representation proceeding presently pending against or, to the knowledge of the Company, threatened to be brought or filed against the Company or any Subsidiary, with the National Labor Relations Board or other labor relations tribunal; there is no organizing activity involving the Company or any of the Subsidiaries pending or, to the knowledge of the Company, threatened by any labor organization or group of employees of the Company or any its Subsidiaries.

(c) There are no (i) strikes, work stoppages, slowdowns, lockouts or arbitrations (in the case of arbitrations which if adversely decided would reasonably be expected to involve the payment of damages of more than \$500,000) or (ii) material grievances or other material labor disputes pending or, to the knowledge of the Company, threatened against or involving the Company or any of its Subsidiaries. There are no unfair labor practice charges, grievances or complaints pending or, to the knowledge of the Company, threatened by or on behalf of any employee or group of employees of the Company or any of its Subsidiaries that individually or in the aggregate involve more than \$500,000.

(d) Except as set forth in Section 4.14(d) of the Company Disclosure Letter, there are no material complaints, charges or claims against the Company and its Subsidiaries pending or, to the knowledge of the Company, threatened to be brought or filed with any Governmental Authority or in which an employee or former employee of the Company or any of its Subsidiaries is a party or a complainant based on, arising out of, in connection with, or otherwise relating to the employment or termination of employment by the Company or a Subsidiary of any individual, including any claim for

workers' compensation or under the Occupational Safety and Health Act of 1970, as amended. In the aggregate, the complaints and charges set forth in Section 4.14(d) of the Company Disclosure Letter would not have, singly or in the aggregate, a Material Adverse Effect with respect to the Company even if each were resolved adversely to the Company and its Subsidiaries.

(e) Hours worked by and payments made to employees of the Company and its Subsidiaries have not been in material violation of the Federal Fair Labor Standards Act or any other Applicable Law dealing with such matters.

(f) The Company and its Subsidiaries are in material compliance with all Applicable Laws relating to the FCC-Equal Employment Opportunity Commission standards and employment or termination of employment of labor (including, but not limited to, leased workers and independent contractors), including all such Applicable Laws and WARN relating to wages, hours, collective bargaining, employment discrimination, civil rights, safety and health, workers' compensation, pay equity and the collection and payment of withholding and/or social security taxes and similar Taxes.

4.15 Absence of Changes or Events. Except as set forth in Section 4.15 of the Company Disclosure Letter or disclosed in the Company SEC Documents, since the date of the most recent audited financial statements included in the Company SEC Documents, the Company and its Subsidiaries have operated their respective businesses only in the ordinary and usual course and in substantially the same manner as previously conducted and there has not been:

(i) any damage, destruction or loss with respect to the properties or assets of the Company or its Subsidiaries whether covered by insurance or not, which has had or would have, individually or in the aggregate, a Material Adverse Effect with respect to the Company;

(ii) any change, occurrence or circumstance that had a Material Adverse Effect with respect to the Company;

(iii) any change in the accounting principles, methods, practices or procedures followed by the Company in connection with the business of the Company or any change in the depreciation or amortization

policies or rates theretofore adopted by the Company in connection with the business of the Company and its Subsidiaries;

(iv) any declaration or payment of any dividends, or other distributions in respect of the outstanding shares of Capital Stock of the Company or any of its Subsidiaries (other than dividends declared or paid by wholly-owned Subsidiaries);

(v) any split, combination or reclassification of the Company's capital stock or any issuance of shares of capital stock of the Company or any Subsidiary or any other change in the authorized capitalization of the Company or any Subsidiary, except as contemplated by this Agreement;

(vi) any repurchase or redemption by the Company of shares of its capital stock or any issuance by the Company of any other securities in exchange or in substitution for shares of its capital stock except pursuant to employee benefit plans, programs or arrangements in existence on the date hereof, in the ordinary course of business consistent with past practice; or

(vii) any grant or award of any options, warrants, conversion rights or other rights to acquire any shares of capital stock of the Company or any Subsidiary, except as contemplated by this Agreement or except pursuant to employee benefit plans, programs or arrangements in existence on the date hereof, in the ordinary course of business consistent with past practice.

4.16 Unlawful Payments and Contributions.

Neither the Company nor, to the Knowledge of the Company, any of its directors, officers or any of its other employees or agents has (a) used any Company funds for any unlawful contribution, endorsement, gift, entertainment or other unlawful expense relating to political activity; (b) made any direct or indirect unlawful payment to any government official or employee from Company funds; (c) violated or is in violation of any provision of the Foreign Corrupt Practices Act of 1977, as amended, in connection with the Company's and its Subsidiaries' business; or (d) made any bribe, rebate, payoff, influence payment, kickback or other

unlawful payment to any Person or entity with respect to matters pertaining to the Company.

4.17 Brokers and Intermediaries. Neither the Company nor any of its officers, directors or employees has employed any broker or finder or incurred any liability for any brokerage fees, commissions or finder's fees in connection with the transactions contemplated by this Agreement and the Transaction Documents, except that the Company has retained Lazard Freres & Co. LLC and Allen & Company Incorporated as its financial advisors, whose respective fees and expenses shall be paid by the Company. The Company has delivered to Acquiror a copy of the retention agreement related thereto.

ARTICLE V

REPRESENTATIONS AND WARRANTIES OF ACQUIROR

Acquiror represents and warrants to the Company that:

5.1 Organization and Authority of Acquiror.

(a) Each of Acquiror and its Subsidiaries is a corporation or partnership duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation or organization with all requisite power to enable it to own, lease and operate its assets and properties and to conduct its business as currently being conducted and is qualified and in good standing to do business in each jurisdiction in which the nature of the business conducted by it or the character or location of the properties owned or leased by it requires such qualification, except to the extent the failure so to qualify would not have a Material Adverse Effect with respect to Acquiror. Complete and correct copies of the Certificate of Incorporation and Bylaws, each as amended to date, of Acquiror have been delivered to the Company. Such Restated Certificate of Incorporation and Bylaws are in full force and effect.

(b) Acquiror has all requisite corporate power and authority to execute and deliver this Agreement and the Transaction Documents to which it is a party and to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and such Transaction Documents and the consummation of the

transactions contemplated hereby and thereby have been duly authorized by all requisite corporate action on the part of Acquiror. This Agreement and each Transaction Document to which Acquiror is a party has been duly executed and delivered by Acquiror and constitutes the legal, valid and binding obligation of Acquiror, enforceable against it in accordance with its terms, except (i) as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally and (ii) as the remedy of specific performance and injunctive and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any proceeding therefor may be brought.

5.2 Capitalization. (a) As of the date hereof, the authorized capital stock of Acquiror consists of (i) 2,000,000,000 shares of U S WEST Communications Group Common Stock, par value \$:01 per share ("Communications Stock"), of which 475,604,443 shares were issued and outstanding as of February 23, 1996, all of which are duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights created by statute, Acquiror's Restated Certificate of Incorporation or any agreement to which Acquiror is a party or by which Acquiror is bound, (ii) 2,000,000,000 shares of Media Stock, of which 473,225,728 shares were issued and outstanding as of February 23, 1996, all of which are duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights created by statute, Acquiror's Restated Certificate of Incorporation or any agreement to which Acquiror is a party or by which Acquiror is bound, and (iii) 200,000,000 shares of Preferred Stock, par value \$1.00 per share, of which (A) 10,000,000 shares have been designated as Series A Junior Participating Cumulative Preferred Stock, none of which are issued and outstanding and all of which are reserved for issuance in connection with rights to purchase Communications Stock pursuant to the Amended and Restated Rights Agreement, dated as of October 31, 1995 (the "Rights Agreement"), by and between Acquiror and State Street Bank and Trust Company, as rights agent, (B) 10,000,000 shares have been designated as Series B Junior Participating Cumulative Preferred Stock, none of which are issued and outstanding and all of which are reserved for issuance in connection with rights to purchase Media Stock pursuant to the Rights Agreement, and (C) 50,000 shares have been designated as Series C Cumulative Redeemable Preferred Stock and are issued and outstanding, all of which are duly authorized, validly issued, fully paid

and nonassessable and not subject to preemptive rights created by statute, Acquiror's Restated Certificate of Incorporation or Bylaws or any agreement to which Acquiror is a party or by which Acquiror is bound. As of the date hereof, the Number of Shares Issuable with Respect to the InterGroup Interest (as defined in Section 2.6.19 of Article V of Acquiror's Restated Certificate of Incorporation) is zero.

(b) Other than as described in the Acquiror SEC Documents or in Section 5.2 of the Letter from Acquiror, dated the date hereof, addressed to the Company (the "Acquiror Disclosure Letter"), no shares of the capital stock of Acquiror are authorized, issued or outstanding, or reserved for any other purpose, and there are no options, warrants or other rights (including registration rights), agreements, arrangements or commitments of any character to which Acquiror is a party relating to the issued or unissued capital stock of Acquiror or any obligation of Acquiror to grant, issue or sell any shares of capital stock of Acquiror by sale, lease, license or otherwise. Except as disclosed in the Acquiror SEC Documents or in Section 5.2 of the Acquiror Disclosure Letter, Acquiror has no outstanding bonds, debentures, notes or other obligations the holders of which have the right to vote or which are convertible into or exercisable for securities having the right to vote with the stockholders of Acquiror on any matter. Except as set forth in Section 5.2 of the Acquiror Disclosure Letter there are no voting trusts or other agreements or understandings with respect to the voting of the capital stock of Acquiror.

5.3 No Conflicts. Subject to obtaining the Acquiror Consents (as defined in Section 5.5), the execution and delivery of this Agreement and each of the Transaction Documents to which Acquiror is a party do not, and the consummation of the transactions contemplated hereby and thereby and compliance with the terms hereof and thereof will not, conflict with, or result in any violation of or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to loss of a material benefit under, or to the increased, additional, accelerated or guaranteed rights or entitlements of any Person under, or result in the creation of any Encumbrances upon any of the properties or assets of Acquiror under, any provision of (i) the Restated Certificate of Incorporation and Bylaws of Acquiror, (ii) any note, bond, mortgage, indenture or deed of trust, deed to secure debt or any license, lease,

contract, commitment, permit, concession, franchise, agreement or other binding arrangement to which Acquiror is a party or by which any of its properties or assets may be bound or subject, (iii) any judgment, order, writ, injunction or decree of any court, governmental body, administrative agency or arbitrator applicable to Acquiror or its properties or assets, or (iv) any law, statute, rule, regulation or judicial or administrative decision applicable to Acquiror; except in the case of clauses (ii) and (iv), such conflicts, violations and defaults, termination, cancellation and acceleration rights and entitlements and Encumbrances that in the aggregate would not hinder or impair the consummation of the transactions contemplated hereby or have a Material Adverse Effect with respect to Acquiror.

5.4 Stockholder Vote. At such time as all conditions to the Merger have otherwise been satisfied, no vote of the holders of any class or series of Acquiror's capital stock not theretofore obtained will be necessary or required (under Applicable Law or otherwise) to approve this Agreement and the transactions contemplated hereby.

5.5 Consents. Except for (i) as set forth in Section 5.5 of the Acquiror Disclosure Letter, (ii) compliance with and filings under the HSR Act, (iii) the filing with the SEC by Acquiror of a registration statement on Form S-4 registering under the Securities Act the shares of Media Stock and Series D Preferred Stock to be issued in the Merger (the "Form S-4") and such reports under the Exchange Act as may be required in connection with this Agreement and the transactions contemplated hereby, (iv) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware and appropriate documents with the relevant authorities of other states in which the Company is qualified to do business, (v) such filings and approvals as may be required by any applicable state securities, "blue sky" or takeover laws, and (vi) such filings in connection with Gains Taxes (the items in clauses (i) through (vi) being collectively referred to herein as "Acquiror Consents"), no consents, approvals, licenses, permits, orders or authorizations of, or registrations, declarations, notices or filings with, any Governmental Authority or any Third Party are required to be obtained or made by or with respect to Acquiror in connection with the execution, delivery and performance of this Agreement or any of the other agreements contemplated hereby to which it is a party or the consummation of the transactions contemplated

hereby and thereby or the taking by Acquiror of any other action contemplated hereby or thereby, which, if not obtained or made, would have a Material Adverse Effect with respect to Acquiror.

5.6 Compliance; No Defaults. (a) Except as set forth in Section 5.6 of the Acquiror Disclosure Letter, neither Acquiror nor any of its Subsidiaries is in violation of, is, to the knowledge of Acquiror, under investigation with respect to any violation of, has been given notice or been charged with violation of, or failed to comply with any Applicable Laws, except for violations and failures to comply that would not have a Material Adverse Effect with respect to Acquiror. Except as set forth in Section 5.6 of the Acquiror Disclosure Letter, Acquiror and its Subsidiaries have all Permits which are material to the operation of the businesses of Acquiror and its Subsidiaries.

(b) Neither Acquiror nor any of its Subsidiaries is in default or violation (and no event has occurred which, with notice or the lapse of time or both, would constitute a default or violation) of any term, condition or provision of (i) its Restated Certificate of Incorporation or Bylaws or other comparable organizational document or (ii) any note, bond, mortgage, indenture, license, agreement or other instrument or obligation to which Acquiror or any of its Subsidiaries is now a party or by which Acquiror or any of its Subsidiaries or any of their respective properties or assets may be bound, except in the case of clause (ii), for defaults or violations which in the aggregate would not have a Material Adverse Effect with respect to Acquiror.

5.7 Acquiror SEC Documents; Undisclosed Liabilities. (a) Acquiror has filed all required reports, schedules, registration statements and definitive proxy statements with the SEC since January 1, 1993 (as such documents have since the time of their filing been amended, the "Acquiror SEC Documents"). As of their respective dates, the Acquiror SEC Documents (including any financial statements filed, to be filed or required to have been filed as a part thereof) complied in all material respects with the requirements of the Securities Act or the Exchange Act, as applicable, and the rules and regulations of the SEC thereunder applicable to such Acquiror SEC Documents, and none of the Acquiror SEC Documents contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the

statements therein, in light of the circumstances under which they were made, not misleading. The financial statements of Acquiror included in the Acquiror SEC Documents comply as to form in all material respects with applicable accounting requirements and with the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with GAAP applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present (subject, in the case of the unaudited financial statements, to normal, recurring audit adjustments, which were not individually or in the aggregate material) the consolidated financial position of Acquiror and its consolidated Subsidiaries as at the dates thereof and the consolidated results of their operations and cash flows for the periods then ended.

(b) Except as disclosed in the Acquiror SEC Documents or in Section 5.7 of the Acquiror Disclosure Letter, as of the date hereof, Acquiror and its Subsidiaries do not have any material indebtedness, obligations or liabilities of any kind (whether accrued, absolute, contingent or otherwise, and whether due or to become due or asserted or unasserted) required by GAAP to be reflected on a consolidated balance sheet of the Acquiror and its consolidated Subsidiaries or in the notes, exhibits or schedules thereto.

5.8 Litigation. Except as set forth in the Acquiror SEC Documents or in Section 5.8 of the Acquiror Disclosure Letter, there are no Legal Proceedings against or affecting Acquiror or any of its Subsidiaries or their respective properties or assets pending or, to the knowledge of Acquiror, threatened, that individually or in the aggregate could (i) have a Material Adverse Effect with respect to Acquiror or (ii) prevent, hinder or materially delay the consummation of the transactions contemplated by this Agreement or the Transaction Documents. Except as set forth in Section 5.8 of the Acquiror Disclosure Letter, neither Acquiror nor any of its Subsidiaries is a party or subject to or in default under any judgment, order, injunction or decree of any Governmental Authority applicable to it or to its respective properties or assets, which judgment, order, injunction, decree or default thereunder constitutes a Material Adverse Effect with respect to Acquiror.

5.9 Absence of Changes or Events. Except as disclosed in the Acquiror SEC Documents, since the date of the most recent audited financial statements included in the Acquiror SEC Documents, Acquiror and its Subsidiaries have conducted their business operations only in the ordinary course and there has not occurred (i) any change, occurrence or circumstance that had any Material Adverse Effect with respect to Acquiror or (ii) other events or conditions of any character that, individually or in the aggregate, have or would reasonably be expected to have, a Material Adverse Effect with respect to Acquiror or on the ability of Acquiror to perform its material obligations under this Agreement and the Transaction Documents to which it is a party.

5.10 Brokers and Intermediaries. Neither Acquiror nor any of its officers, directors or employees has employed any broker or finder or incurred any liability for any brokerage fees, commissions or finders' fees in connection with the transactions contemplated by this Agreement and the Transaction Documents, except that Acquiror has retained Lehman Brothers Inc., as its financial advisor, whose fees and expenses shall be paid by Acquiror.

5.11 Ownership of Company Capital Stock. Neither Acquiror nor any of its Subsidiaries owns, directly or indirectly, any shares of Company Capital Stock.

ARTICLE VI

COVENANTS RELATING TO CONDUCT OF BUSINESS

6.1 Conduct of Business of the Company. Except as otherwise expressly permitted by the terms of this Agreement, from the date hereof to the Effective Time, the Company shall, and shall cause its Subsidiaries to, carry on their respective businesses in the ordinary course in substantially the same manner as presently conducted (including with respect to advertising, promotions and capital expenditures) and in compliance in all material respects with Applicable Laws, use their reasonable best efforts consistent with past practices to keep available the services of the present employees of the Company and its Subsidiaries and to preserve their relationships with customers, suppliers and others with whom the Company and its Subsidiaries deal to the end that their goodwill and ongoing businesses shall not be materially impaired in any

material respect at the Closing Date. The Company shall not, and shall cause its Subsidiaries not to, take any action that would, or that is reasonably likely to, result in any of the representations and warranties of the Company set forth in Article IV being untrue in any material respect as of the date made or in any of the conditions to the consummation of the Merger set forth herein not being satisfied. In addition, and without limiting the generality of the foregoing, except as otherwise expressly permitted by the terms of this Agreement or as set forth in Section 6.1 of the Company Disclosure Letter, during the period from the date hereof to the Effective Time, the Company shall not (and shall cause its Subsidiaries not to), without the written consent of Acquiror, which decision regarding consents shall be made promptly (in light of its circumstances) after receipt of notice seeking such consent:

(i) except for the Charter Amendment, amend its Certificate of Incorporation, Bylaws or other comparable organizational documents;

(ii) subject to Sections 7.7 and 7.14(b), redeem or otherwise acquire any shares of its capital stock, or issue any capital stock or any option, warrant or right relating thereto or any securities convertible into or exchangeable for any shares of its capital stock, or split, combine or reclassify any of its capital stock or issue any securities in exchange or in substitution for shares of its capital stock;

(iii) subject to Section 7.14(b), (A) grant or agree to grant to any employee any increase in wages or bonus, severance, profit sharing, retirement, deferred compensation, insurance or other compensation or benefits, or establish any new compensation or benefit plans or arrangements, or amend or agree to amend any existing Benefit Plans or Equity Appreciation Rights Plans, except as may be required under existing agreements or in the ordinary course of business consistent with past practices or (B) enter into any new RSPA or amend the terms of any existing RSPA or accelerate the vesting of any shares of Class B Common Stock issued thereunder;

(iv) merge, amalgamate or consolidate with any other entity in any transaction in which the Company is not the surviving corporation (other than mergers between Subsidiaries of the Company), sell all or

substantially all of its business or assets, or acquire all or substantially all of the business or assets of any other Person;

(v) enter into or amend any employment, consulting, severance or similar agreement with any individual, except with respect to severance gifts or payments of a nominal nature to persons holding non-officer/executive level positions in the ordinary course of business consistent with past practice;

(vi) subject to Section 7.7, declare, set aside or make any dividends, payments or distributions in cash, securities or property to the stockholders of the Company, whether or not upon or in respect of any share of Company Capital Stock;

(vii) incur or assume any Indebtedness other than as specifically set forth in Section 6.1(vii) of the Company Disclosure Letter;

(viii) voluntarily grant any material Encumbrance on any of its material assets, other than Encumbrances that are incurred in the ordinary course of business;

(ix) make any change in any method of accounting or accounting practice or policy, except as required by Applicable Laws or by GAAP;

(x) make or incur any capital expenditures that are not set forth in Section 6.1(x) of the Company Disclosure Letter or that, individually, are in excess of \$25 million or, in the aggregate, in excess of \$50 million;

(xi) subject to Section 7.7, sell, lease, swap or otherwise dispose of any assets, other than (A) sales, leases, swaps or other dispositions of such assets not having a fair market value in excess of \$15 million individually or \$30 million in the aggregate (so long as the Company provides notice to Acquiror of any sale, lease, swap or other disposition of any asset having a fair market value of greater than \$5 million) or (B) swaps of Systems or assets of Systems in order to facilitate the clustering of Systems or dispose of Systems located in the Acquiror Region; provided, however, that (1) such swaps shall not in the aggregate involve more than 500,000 Subscribers of the Company or

its Subsidiaries, (2) any cable television systems acquired by the Company or any of its Subsidiaries in any such swap shall not be located in the Acquiror Region, (3) any cable television systems acquired by the Company in any such swap shall not be in a franchise area where there is a substantial overbuild with any other CATV system owned by the Company, Acquiror or any of their respective Affiliates, (4) the aggregate amount of cash paid by the Company or any of its Subsidiaries in any such swap shall not exceed \$50 million in the aggregate, (5) any such swap shall require the approval of Acquiror, which approval shall not be unreasonably withheld and Acquiror shall be reasonably satisfied that the Company has received substantially equivalent value including cash or other assets and (6) to the extent that the Company or any Subsidiary must apply for the consent of the Governmental Authority as a condition to the transfer of control or assignment of any Franchise associated with any such swap, such application shall include an application to the Governmental Authority, and relevant information relating to the proposed transaction, requesting contemporaneous approval for the anticipated acquisition of the Company or its Subsidiary by Acquiror as contemplated herein and the transfer of control of said Franchise to the Surviving Corporation in accordance with the terms hereof; and provided, further, that any consent required from a Governmental Authority as a condition to consummating such swap shall be deemed a Required Franchise Consent;

(xii) acquire or agree to acquire by merging or consolidating with, or by purchasing all or a substantial portion of the assets of or equity in, or by any other manner, any business of any Person or acquire or agree to acquire any assets (other than supplies, raw materials and inventory in the ordinary course, capital expenditures permitted by clause (x) above and asset swaps permitted by clause (xi) above);

(xiii) abandon, avoid, dispose, surrender, fail to file for timely renewal, terminate or amend in any materially adverse manner the terms of any material Franchises, any FCC license that would have a material adverse effect on the operation of a System or the Social Contract Order, except as amended by virtue of the proposed Social Contract Amendment, or, with

respect to any Material Franchise, fail to file for renewal pursuant to Section 626(a) of the Cable Act;

(xiv) delete any programming service on the Systems or make material change in the programming services offered on the Systems other than in the ordinary course of business or as required by the Cable Act, the Social Contract Order or any amendments thereto;

(xv) except as otherwise permitted by clauses (xi) and (xii), modify, amend, terminate, renew or fail to use reasonable efforts to renew any material contract or agreement necessary to continue the Company's business in the ordinary course or waive, release or assign any material rights or claims, other than in the ordinary course of business;

(xvi) offer free or reduced-price service as an inducement to any Person, except in the ordinary course of business consistent with past practice;

(xvii) except as permitted by Applicable Law, including the Social Contract Order and any amendments thereto, and (A) as disclosed to Acquiror in writing at least 30 days prior to any rate change, implement any rate change, retiering or repackaging of CATV programming offered by any of its Subsidiaries, (B) and as disclosed in writing to Acquiror at least 30 days prior to any cost-of-service rate change make any cost-of-service election under the rules and regulations adopted under the Cable Act, (C) determine a method of refund pursuant to 47 C.F.R. Section 76.942(d) or 76.961(c) or (D) amend any Franchise or agree to make any payments or commitments, including commitments to make future capital improvements or provide future services, in connection with any renewal of any Franchise other than that which the Company would make in the ordinary course of business;

(xviii) enter into any agreement, understanding or commitment that restrains, limits or impedes the Company's or Acquiror's ability to compete with or conduct any business or line of business;

(xix) invest or enter into any agreement, understanding or commitment, whether written or oral, by or on behalf of the Company or its Subsidiaries, to

invest or provide additional capital in respect of assets, businesses or entities; provided, however, that the restrictions contained in this clause shall not apply to existing commitments as set forth in Section 6.1(xix) of the Company Disclosure Letter or to any investments in excess of \$10 million individually or \$20 million in the aggregate;

(xx) except as otherwise provided in clause (xix) above or Section 7.14, enter into any material contract or agreement with, or make any loan or advance to, any Affiliate (other than a wholly owned Subsidiary) of the Company or any stockholder or Affiliate thereof;

(xxi) enter into, or amend the terms of, any agreement relating to interest rate swaps, caps or other hedging or derivative instruments relating to Indebtedness of the Company and its Subsidiaries, except as required under agreements relating to existing Indebtedness and Indebtedness permitted by clause (vii) above;

(xxii) conduct its business in a manner or take, or cause to be taken, any other action (including, without limitation, effecting or agreeing to effect or announcing an intention or proposal to effect, any acquisition, business combination, merger, consolidation, restructuring or similar transaction) that would or might reasonably be expected to prevent Acquiror or the Company from consummating the transactions contemplated hereby in accordance with the terms of this Agreement (regardless of whether such action would otherwise be permitted or not prohibited hereunder), including, without limitation, any action which may limit the ability of Acquiror or the Company to consummate the transactions contemplated hereby as a result of antitrust or other regulatory concerns;

(xxiii) purchase, sell or trade (or announce any intention or proposal to purchase, sell or trade) any shares of Media Stock, or take any other action a principal purpose of which is to affect the calculation of the Determination Price; or

(xxiv) agree, whether in writing or otherwise, to do any of the foregoing.

Prior to the date hereof, Acquiror has delivered to the Company a list (which the Acquiror may update from time to time) designating certain individuals of the Acquiror to whom the Company may direct requests for consents under this Section 6.1.

6.2 Conduct of Business of Acquiror. Except as set forth in Section 6.2 of the Acquiror Disclosure Letter, from the date hereof to the Effective Time, Acquiror shall not (and shall cause its Subsidiaries not to):

(i) issue shares of Media Stock or any option, warrant or right relating thereto or any securities convertible into or exchangeable for any shares of Media Stock at less than fair market value as determined by the Board of Directors of Acquiror (other than pursuant to the terms of existing options or benefit plans), or split, combine, redeem, convert or reclassify the Media Stock or issue any securities in exchange or in substitution for shares of Media Stock;

(ii) amend its Certificate of Incorporation or Bylaws (other than the filing of a Certificate of Designations for the issuance of any series of Preferred Stock of Acquiror) in any manner adverse to the holders of Media Stock;

(iii) declare, set aside or make any dividends or distributions in cash, securities or property to holders of Media Stock;

(iv) conduct its business in a manner or take, or cause to be taken, any other action (including, without limitation, effecting or agreeing to effect or announcing an intention or proposal to effect, any acquisition, business combination, merger, consolidation, restructuring or similar transaction) that would or might reasonably be expected to prevent Acquiror or the Company from consummating the transactions contemplated hereby in accordance with the terms of this Agreement (regardless of whether such action would otherwise be permitted or not prohibited hereunder), including, without limitation, any action which may limit the ability of Acquiror or the Company to consummate the transactions contemplated hereby as a result of antitrust or other regulatory concerns;

(v) take any action that would, or that is reasonably likely to, result in any of the representations and warranties of Acquiror set forth in Article V being untrue in any material respect as of the date made or any of the conditions to the Merger set forth herein not being satisfied;

(vi) purchase, sell (other than through primary issuances) or trade (or announce any intention or proposal to purchase, sell or trade) any shares of Media Stock, or take any other action a principal purpose of which is to affect the calculation of the Determination Price, other than pursuant to benefit plans in the ordinary course of business;

(vii) sell all or substantially all of the properties and assets of the Media Group (within the meaning of Section 2.4.1(B) of Article V of the Restated Certificate of Incorporation of Acquiror); or

(viii) acquire, or agree to acquire, any shares of Company Capital Stock so long as, after giving effect to the purchase of the Put Shares pursuant to Section 9.4, Acquiror would beneficially own less than 10% of the Company Capital Stock.

6.3 Access to Information. (a) From the date hereof until the Closing Date, the Company shall permit Acquiror and its representatives to have full access to the management, facilities, suppliers, accounts, books, records (including, without limitation, budgets, forecasts and personnel files and records), contracts and other materials of the Company and its Subsidiaries reasonably requested by Acquiror or such representatives and to make available to Acquiror and its representatives the directors, officers, employees and independent accountants of the Company for interviews for the purpose, among other things, of verifying the information furnished to Acquiror, developing transition plans and integrating the operations of the Company and its Subsidiaries with the operations of Acquiror and its Subsidiaries and Affiliates. Such access shall be subject to existing confidentiality agreements and shall be conducted by Acquiror and its representatives during normal business hours, upon reasonable advance notice and in such a manner as not to interfere unreasonably with the business or operations of the Company and its Subsidiaries.

(b) From the date hereof until the Closing Date, Acquiror shall permit the Company and its representatives to have full access to the management, facilities, suppliers, accounts, books, records (including, without limitation, budgets and forecasts), contracts and other materials of the Media Group reasonably requested by the Company or such representatives and to make available to the Company and its representatives the directors, officers, employees and independent accountants of the Media Group for interviews for the purpose, among other things, of verifying the information furnished to the Company. Such access shall be subject to existing confidentiality agreements and shall be conducted by the Company and its representatives during normal business hours, upon reasonable advance notice and in such a manner as not to interfere unreasonably with the business or operations of the Media Group.

(c) Each of the Company and Acquiror agrees that it will not, and will cause each of their respective Affiliates and representatives not to, use any information obtained pursuant to this Section 6.3 for any purpose unrelated to the consummation of the transactions contemplated by this Agreement. The Confidentiality Agreement, dated as of September 26, 1994, as amended on January 11, 1996, between Acquiror and the Company and the Confidentiality Agreement, dated as of April 19, 1995, between Acquiror and the Company (the "Confidentiality Agreements") shall apply with respect to information furnished thereunder or hereunder and any other activities contemplated thereby.

ARTICLE VII

ADDITIONAL AGREEMENTS

7.1 Preparation of Form S-4 and the Proxy Statement; Stockholders' Meeting; Charter Amendment.

(a) Promptly following the date of this Agreement, the Company shall prepare and file with the SEC the Proxy Statement and Acquiror shall prepare and file with the SEC the Form S-4, in which the Proxy Statement will be included as a prospectus. Each of the Company and Acquiror shall use its reasonable best efforts to have the Form S-4 declared effective under the Securities Act as promptly as practicable after such filing. The Company shall use its reasonable best efforts to cause the Proxy Statement to be mailed to the Company's stockholders, as promptly as

practicable after the Form S-4 is declared effective under the Securities Act. Acquiror shall also take any action (other than qualifying to do business in any jurisdiction in which it is not now so qualified or consenting to service of process in any jurisdiction in which it has not previously so consented in any action other than one arising out of the offering of the Media Stock and the Series D Preferred Stock in such jurisdiction) required to be taken to qualify the Media Stock and Series D Preferred Stock to be issued in the Merger under any applicable state securities or "blue sky" laws prior to the Effective Time, and the Company shall furnish all information concerning the Company and the holders of the Company Capital Stock as may be reasonably requested in connection with any such action.

(b) None of the information supplied or to be supplied by the Company, on the one hand, or Acquiror, on the other hand, for inclusion or incorporation by reference in (i) the Form S-4 will, at the time the Form S-4 is filed with the SEC, at any time it is amended or supplemented or at the time it becomes effective under the Securities Act, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) the Proxy Statement will, at the date it is first mailed to the stockholders of the Company or at the time of each Stockholders' Meeting (as defined in Section 7.1(d)), contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. The Proxy Statement and the Form S-4 will comply as to form in all material respects with the requirements of the Exchange Act or the Securities Act, as the case may be. Notwithstanding the foregoing, (i) no representation is made by the Company with respect to statements made or incorporated by reference therein based on information supplied in writing by Acquiror specifically for inclusion or incorporation by reference in the Proxy Statement and (ii) no representation is made by Acquiror with respect to statements made or incorporated by reference therein based on information supplied in writing by the Company specifically for inclusion or incorporation by reference in the Form S-4.

(c) The Company and Acquiror shall cooperate with each other and provide to each other all information necessary in order to prepare the Proxy Statement and the

Form S-4. The Company and Acquiror shall notify each other promptly of the receipt of any comments from the SEC or its staff and of any requests by the SEC or its staff for amendments or supplements to the Form S-4 or the Proxy Statement or for additional information and shall supply the other parties with copies of all correspondence between the Company or any of its representatives, or Acquiror or any of its representatives, as the case may be, on the one hand, and the SEC or its staff, on the other hand, with respect thereto. The Company and Acquiror shall use their respective reasonable best efforts to respond to any comments of the SEC with respect to the Form S-4 and the Proxy Statement as promptly as practicable. If at any time prior to the Effective Time there shall occur (i) any event with respect to the Company or any of its Subsidiaries, or with respect to other information supplied by the Company for inclusion in the Proxy Statement or (ii) any event with respect to Acquiror, or with respect to information supplied by Acquiror for inclusion in the Form S-4, in either case which event is required to be described in an amendment of, or a supplement to, the Proxy Statement or Form S-4, such event shall be so described, and such amendment or supplement shall be promptly filed with the SEC and, as required by law, disseminated to the stockholders of the Company. Acquiror shall notify the Company promptly upon (i) the declaration by the SEC of the effectiveness of the Form S-4, (ii) the issuance or threatened issuance of any stop order or other order preventing or suspending the use of any prospectus relating to the Form S-4, (iii) any suspension or threatened suspension of the use of any prospectus relating to the Form S-4 in any state, (iv) any proceedings commenced or threatened to be commenced by the SEC or any state securities commission that might result in the issuance of a stop order or other order or suspension of use or (v) any request by the SEC to supplement or amend any prospectus relating to the Form S-4 after the effectiveness thereof. Acquiror and, to the extent applicable, the Company, shall use its reasonable best efforts to prevent or promptly remove any stop order or other order preventing or suspending the use of any prospectus relating to the Form S-4 and to comply with any such request by the SEC or any state securities commission to amend or supplement the Form S-4 or the prospectus relating thereto.

(d) The Company shall, as promptly as practicable, duly call, give notice of, convene and hold a meeting of its stockholders (the "Initial Stockholders' Meeting") for the purpose of obtaining the Stockholder Approvals. The

Company shall use its reasonable best efforts to hold such meeting as soon as practicable. In the event the Charter Amendment is not approved at the Initial Stockholders' Meeting, the Company shall, as promptly as practicable following the date of the Initial Stockholders' Meeting, duly call, give notice of, convene and hold another meeting of its stockholders (the "Additional Stockholders' Meeting" and, together with the Initial Stockholders' Meeting, collectively, the "Stockholders' Meetings" and individually, a "Stockholders' Meeting") for the purpose of obtaining the Stockholder Approvals. The Company shall, as promptly as practicable after the date of the Initial Stockholders' Meeting, hold the Additional Stockholders' Meeting. Subject to the fiduciary duties of the Board of Directors of the Company under Applicable Laws and to Section 9.1(g), the Company shall, through the Board of Directors, recommend to its stockholders adoption of this Agreement, the Charter Amendment and the other transactions contemplated hereby and shall use its best efforts to solicit from stockholders proxies in favor of adoption of this Agreement and the Charter Amendment and to take all other action necessary to secure the Stockholder Approvals at the Initial Stockholders' Meeting or the Additional Stockholders' Meeting, as the case may be. Without limiting the generality of the foregoing, the Company agrees that its obligations pursuant to the first and third sentences of this Section 7.1(d) shall not be altered by the commencement, public proposal or communication to the Company of any Acquisition Proposal (as defined in Section 7.10).

(e) Subject to receipt of the Stockholder Approvals, the Company shall take all actions necessary to cause the Charter Amendment to be executed, acknowledged and filed and to become effective no later than immediately prior to the Effective Time in accordance with the DGCL as soon as practicable after the approval thereof at a Stockholders' Meeting.

(f) The Company shall make stock transfer records relating to the Company available to Acquiror to the extent reasonably necessary to effectuate the intent of this Agreement.

7.2 Letter of the Company's Accountants. The Company shall use its reasonable best efforts to cause to be delivered to Acquiror letters of (i) Deloitte & Touche LLP, the Company's independent public accountants and (ii) any other independent public accountants whose reports are

included or incorporated by reference in the Form S-4, each dated a date within two business days before the date on which the Form S-4 shall become effective and addressed to Acquiror, in form and substance reasonably satisfactory to Acquiror and customary in scope and substance for letters delivered by independent public accountants in connection with registration statements similar to the Form S-4.

7.3 Letter of Acquiror's Accountants. Acquiror shall use its reasonable best efforts to cause to be delivered to the Company a letter of Coopers & Lybrand L.L.P., Acquiror's independent public accountants, dated a date within two business days before the date on which the Form S-4 shall become effective and addressed to the Company, in form and substance reasonably satisfactory to the Company and customary in scope and substance for letters delivered by independent public accountants in connection with registration statements similar to the Form S-4.

7.4 Reasonable Best Efforts. Subject to the terms and conditions of this Agreement, including, without limitation, Section 7.6, each of the parties hereto agrees to use its reasonable best efforts to take, or cause to be taken, all action and to do, or cause to be done, all things necessary, proper or advisable under Applicable Laws and regulations to consummate and make effective the transactions contemplated by this Agreement (including the execution of the Transaction Documents to which they or any of their Affiliates are a party), subject to the Stockholder Approval, including (a) the obtaining of all necessary actions or nonactions, waivers, consents and approvals from Governmental Authorities and the making of it all necessary registrations and filings (including filings with Governmental Authorities, if any), and the taking of all reasonable steps as may be necessary to obtain an approval or waiver from, or to avoid an action or proceeding by, any Governmental Authorities, (b) the obtaining of all necessary consents, approvals or waivers from Third Parties and (c) the execution and delivery of any additional instruments necessary to consummate the transactions contemplated by this Agreement and the Transaction Documents. In furtherance of the foregoing, Acquiror and the Company each shall furnish to the other such necessary information and reasonable assistance as the other may request in connection with obtaining any consents required to be obtained by it hereunder.

7.5 Franchise and License Consents. (a) Without limiting the generality of Section 7.4, the Company and Acquiror shall each use their respective reasonable best efforts to obtain all Franchise Consents and License Consents, including taking the actions specified herein. In order to secure the Franchise Consents and License Consents from Governmental Authorities and the FCC, the Company shall proceed immediately in good faith and using its reasonable best efforts, to prepare, file and prosecute each Franchise Consent and License Consent from the relevant Governmental Authority and the FCC, with the full right of participation by Acquiror including, without limitation, the right of prior review and approval of correspondence or forms of transfer resolutions, applications, ordinances or agreements to be submitted to Governmental Authorities and the FCC (which approval shall not be unreasonably withheld or delayed) and to be represented at all meetings or hearings as may be scheduled to consider such submissions. The Company shall send notice of the transactions contemplated in this Agreement to all Governmental Authorities. The Company shall submit to each Governmental Authority whose consent is required a form of ordinance or resolution, as appropriate, relating to the transfer of the Franchise, which ordinance or resolution shall be in a form reasonably acceptable to Acquiror and the Company. The Company shall consult with Acquiror and promptly and regularly notify Acquiror with regard to all material developments of the Franchise Consent and License Consent process, and shall give Acquiror reasonable prior notice of all meetings scheduled with the Governmental Authorities and the FCC. Acquiror shall use its reasonable best efforts to promptly assist the Company and shall take such prompt and affirmative actions as may reasonably be necessary in obtaining such approvals and shall cooperate with the Company in the preparation, filing and prosecution of such applications as may reasonably be necessary, including the preparation, filing and prosecution of any joint applications required to be filed with the Governmental Authorities or the FCC, and agrees to use its reasonable best efforts to furnish all information as is reasonably or as is customarily required by the approving entity, and, if required by a Governmental Authority or the FCC upon reasonable notice, Acquiror shall have the obligation to be represented at such meetings or hearings as may be scheduled to consider such applications. Any administrative filing fees imposed or expenses for which reimbursement is required by the Governmental Authority in connection with obtaining the Franchise Consents or the License Consents shall be

borne by the Company and each of the parties shall bear its own legal fees or other costs of professional advisors incurred in the filing and prosecution of such applications. If, in connection with obtaining Franchise Consents or the License Consents from a Governmental Authority or the FCC, a Governmental Authority or the FCC impose new, material Franchise or license conditions as a condition to granting its consent, Acquiror and the Company shall negotiate jointly with such Governmental Authority or the FCC with respect to such conditions, with such conditions to be accepted only if consented to by Acquiror and the Company, which consent shall not be unreasonably withheld. Acquiror agrees that prior to the Closing Date, it will not, without the prior written consent of the Company, seek amendments, modifications or other changes to Franchises and shall not institute any discussions with Governmental Authorities or the FCC without the prior written consent of the Company and without offering a representative of the Company an opportunity to participate or observe such discussions. To the extent such request would not, in the reasonable judgment of the Company, delay or impair the ability to obtain any Franchise Consents, any application to any Governmental Authority for any Franchise Consent necessary for the transfer of control of any Franchise shall request that the relevant Governmental Authority also agree that no further Franchise Consent shall be required for the subsequent transfer of control of, or assignment of, such Franchise to a specified Person identified in such application who is an Affiliate of Acquiror to which Acquiror intends to transfer or assign the Franchise immediately prior to Closing. In addition, the Company will use reasonable best efforts to obtain necessary transfers of all private mobile radio service licenses.

(b) To the extent that any Franchise Consents listed in Section 4.6 of the Company Disclosure Letter have not been obtained by Final Order prior to Closing (such Franchises hereinafter referred to as the "Non-Required Franchises"), Acquiror and Company shall enter into negotiations to determine the disposition of the Non-Required Franchises after Closing. In the event that the parties agree to transfer any part of a System which includes, in part, areas covered by a Non-Required Franchise (hereinafter the "Non-Required Systems"), the parties shall continue to be subject to Section 7.5(a) until such time as all Franchise Consents are obtained and the Non-Required Franchises are transferred to Acquiror.

7.6 Antitrust Notification. (a) The Company and Acquiror shall as promptly as practicable, but in no event later than 30 Business Days following the execution and delivery of this Agreement, file with the FTC and the DOJ the notification and report form required for the transactions contemplated hereby and any supplemental information requested in connection therewith pursuant to the HSR Act. Each of Acquiror and the Company shall furnish to each other's counsel such necessary information and reasonable assistance as the other may request in connection with its preparation of any filing or submission that is necessary under the HSR Act. The Company and Acquiror acknowledge that more than one filing may be required under the HSR Act in order to consummate the transactions contemplated by this Agreement, and agree to cooperate and furnish to each other's counsel such necessary information and reasonable assistance as the other may request in connection with its preparation of any subsequent filing.

(b) The Company and Acquiror shall keep each other apprised of the status of any communications with, and any inquiries or requests for additional information from, the FTC and the DOJ and shall comply promptly with any such inquiry or request.

(c) Each of the Company and Acquiror shall use its reasonable best efforts to obtain any clearance required under the HSR Act for the consummation of the Merger, which efforts, for purposes of this Agreement shall not, except as provided in Section 7.6(d), require Acquiror in order to obtain any consent or clearance from the DOJ or any other Governmental Authority to (i) hold separate, sell or otherwise dispose of any assets, including assets of the Company, the effect of any of which, in the reasonable judgment of Acquiror, would be to materially impair the value of the Merger to Acquiror or (ii) contest any suit brought or threatened by the FTC or DOJ or attempt to lift or rescind any injunction or restraining order obtained by the FTC or DOJ adversely affecting the ability of the parties hereto to consummate the transactions contemplated hereby.

(d) For purposes of Section 7.6(c), "reasonable best efforts" shall include entry into a consent decree in any action brought by the DOJ or into a consent order with the FTC where such decree or order requires the divestiture of the Designated Assets and of the assets set forth in Section 7.6(d) of the Company Disclosure Letter, if and only

if, such decree or order does not require, either absolutely or conditionally, the divestiture of any other assets or of the stock of any other corporation, or (except for reasonable and customary compliance and other requirements ancillary to the required divestiture) impose any additional requirement or limitation on Acquiror, on its ability to operate its current and contemplated businesses, or on its ability to acquire assets or stock in any corporation; and only if such decree or order provides that Acquiror shall have a period of at least 12 months to effect such divestiture itself and an additional 12 months to divest pursuant to a reasonable and customary trusteeship provision.

7.7 Certain Actions. (a) Except as otherwise specifically limited by this Agreement, each of the Company and Acquiror agrees to use its reasonable best efforts and to take, or cause to be taken, all actions and to do, or cause to be done, all things necessary, proper or advisable to ensure that there shall be no regulatory impediments, pursuant to the Communications Act, the rules and regulations of the FCC, or otherwise, to the closing of the transactions contemplated hereby and the Company agrees not to acquire any assets or engage in any activities prior to the Closing of a type which Acquiror would be precluded from acquiring or engaging in pursuant to the Communications Act, the rules and regulations of the FCC or otherwise.

(b) On or prior to the Closing Date, the Company shall sell, distribute to stockholders or otherwise dispose of the properties of the Company and its Subsidiaries listed in Section 7.7 of the Company Disclosure Letter (the "Designated Assets") in a manner acceptable to Acquiror, in its sole discretion.

(c) Not later than one hundred and twenty (120) days following the date hereof, the Company and Acquiror shall agree to the fair market value of the Designated Assets (the "Designated Asset Fair Market Value"). In the event of a sale or other disposition of the Designated Assets for an amount less than the Designated Asset Fair Market Value, the Share Price shall be reduced by the quotient of (i) the excess of (x) the Designated Asset Fair Market Value over (y) the amount of consideration received by the Company in respect of such sale or disposition divided by (ii) the number of shares of Company Common Stock outstanding immediately prior to the Effective Time on a fully diluted basis, including giving effect to the

conversion of all outstanding shares of Company Preferred Stock. In the event of a distribution of the Designated Assets to the stockholders of the Company, the Share Price shall be reduced by an amount equal to the quotient of (i) the Designated Asset Fair Market Value divided by (ii) the number of shares of Company Common Stock outstanding immediately prior to the Effective Time on a fully diluted basis, including giving effect to the conversion of all outstanding shares of Company Preferred Stock. The amount of any adjustment to the Share Price pursuant to this Section 7.7(c) shall be referred to as the "Per Share Adjustment Amount" and the Cash Consideration Amount shall be reduced by the Per Share Adjustment Amount multiplied by the number of shares of Company Common Stock outstanding immediately prior to the Effective Time on a fully diluted basis, including giving effect to the conversion of all outstanding shares of Company Preferred Stock.

7.8 Supplemental Disclosure. The Company shall confer on a regular and frequent basis with Acquiror, report on operational matters and promptly notify Acquiror of, and furnish Acquiror with, any information it may reasonably request with respect to, any event or condition or the existence of any fact that would cause any of the conditions to Acquiror's obligation to consummate the Merger not to be completed, and Acquiror shall promptly notify the Company of, and furnish the Company any information it may reasonably request with respect to, any event or condition or the existence of any fact that would cause any of the conditions to the Company's obligation to consummate the Merger not to be completed.

7.9 Announcements. Prior to the Closing, neither the Company nor Acquiror will issue any press release or otherwise make any public statement with respect to this Agreement and the transactions contemplated hereby without the prior consent of the other (which consent shall not be unreasonably withheld), except as may be required by Applicable Law or stock exchange regulations (including, without limitation, pursuant to the United States Federal securities laws in connection with any registration statement or report filed thereunder), in which event the party required to make the release or announcement shall, if possible, allow the other party reasonable time to comment on such release or announcement in advance of such issuance.

7.10 No Solicitation. (a) From the date hereof until the Effective Time, the Company shall not, nor shall it permit any of its Subsidiaries to, nor shall it authorize or permit any of its officers, directors, employees, agents, investment bankers, attorneys, financial advisors or other representatives or those of any of its Subsidiaries (collectively, "Company Representatives") to, directly or indirectly, solicit, initiate or encourage (including by way of furnishing information or assistance) or take other action to facilitate any inquiries or the making of any proposal that constitutes or may reasonably be expected to lead to, an Acquisition Proposal from any Third Party, or engage in any discussions or negotiations relating thereto or in furtherance thereof or accept or enter any agreement with respect to any Acquisition Proposal; provided, however, that, notwithstanding anything to the contrary in this Agreement, (i) prior to the approval of this Agreement by the Stockholders of the Company, the Company may engage in discussions or negotiations with, and may furnish information concerning the Company and its business, properties and assets to, a Third Party who, without any solicitation, initiation, encouragement, discussion or negotiation, directly or indirectly, by or with the Company or any Company Representatives, or in furtherance thereof makes a written, bona fide Acquisition Proposal that is not subject to any material contingencies relating to financing and that is reasonably capable of being financed and is financially superior to the consideration to be received by the Company's stockholders pursuant to the Merger (as determined in good faith by the Board of Directors after consultation with the Company's financial advisors) if (1) the Board of Directors determines in its good faith, after receipt of written advice of the Company's outside legal counsel, that such action is advisable for the Board of Directors to act in a manner consistent with its fiduciary duties under Applicable Law and (2) prior to furnishing information with respect to the Company and its Subsidiaries to, such Third Party, the Company shall receive from such Third Party an executed confidentiality agreement in reasonably customary form on terms not more favorable to such Person or entity than the terms contained in the Confidentiality Agreements, or (ii) the Board of Directors may take and disclose to the Company's stockholders a position with regard to a tender offer or exchange offer to the extent required by Rule 14e-2(a) under the Exchange Act. Without limiting the foregoing, it is understood that any violation of the restrictions set forth in the preceding sentence by any investment banker or financial advisor

retained by the Company, whether or not such Person is purporting to act of behalf of the Company or any of its Subsidiaries or otherwise, shall constitute a breach of this Section 7.10 by the Company.

(b) The Company shall promptly notify Acquiror orally and in writing of any Acquisition Proposal or any inquiry with respect to or which could lead to any Acquisition Proposal, within 24 hours of the receipt thereof, including the identity of the Third Party making any such Acquisition Proposal or inquiry and the material terms and conditions of any Acquisition Proposal, and if such Acquisition Proposal or inquiry is in writing, shall deliver to Acquiror a copy of such Acquisition Proposal or inquiry. The Company shall keep Acquiror informed of the status and details of any such Acquisition Proposal or inquiry.

(c) The Company shall immediately cease and cause to be terminated any existing solicitation, initiation, encouragement, activity, discussion or negotiation with any parties conducted heretofore by the Company or any Company Representatives with respect to any of the foregoing.

(d) As used in this Agreement, "Acquisition Proposal" shall mean any proposal or offer, other than a proposal or offer by Acquiror or any of its Affiliates, for a tender or exchange offer, merger, consolidation or other business combination involving the Company or any of its material Subsidiaries or any proposal to acquire in any manner a substantial equity interest in or a substantial portion of the assets of the Company or any of its material Subsidiaries; provided, however, that, the term "Acquisition Proposal" shall not include any acquisition by the Company or any of its Subsidiaries of any assets, businesses or entities in any transaction or series of related transactions in exchange for other assets, businesses or entities of any Third Party.

7.11 Indemnification: Directors' and Officers Insurance. (a) The Restated Certificate of Incorporation and Bylaws of the Surviving Corporation at the Effective Time shall not be amended, repealed or otherwise modified for a period of six years after the Effective Time in any manner that would adversely affect the rights thereunder of individuals who at any time prior to the Effective Time were directors or officers of the Company or its Subsidiaries in respect of actions or omissions occurring at or prior to the

Effective Time (including, without limitation, the transactions contemplated by this Agreement), unless such modification is required by law.

(b) From and after the Effective Time, the Surviving Corporation shall, indemnify, defend and hold harmless each Person who is now, or has been at any time prior to the date hereof or who becomes prior to the Effective Time, an officer or director of the Company or any of its Subsidiaries (the "Indemnified Parties") against all losses, claims, damages, costs, expenses (including attorneys' fees and expenses), liabilities or judgments or amounts that are paid in settlement with the approval of the indemnifying party (which approval shall not be unreasonably withheld) of or in connection with any threatened or actual claim, action, suit, proceeding or investigation based in whole or in part on or arising in whole or in part out of the fact that such Person is or was a director or officer of the Company or any of its Subsidiaries or served as a director of any Third Party on behalf of the Company or any of its Subsidiaries whether pertaining to any matter existing or occurring at or prior to the Effective Time and whether asserted or claimed prior to, or at or after, the Effective Time ("Indemnified Liabilities"), including, without limitation, all Indemnified Liabilities based in whole or in part on, or arising in whole or in part out of, or pertaining to this Agreement or the transactions contemplated hereby, in each case to the fullest extent a corporation is permitted under the DGCL to indemnify its own directors or officers as the case may be (and the Company or the Surviving Corporation, as the case may be, will pay expenses in advance of the final disposition of any such action or proceeding to each Indemnified Party to the full extent permitted by law).

(c) The provisions of this Section 7.11 are intended to be for the benefit of, and shall be enforceable by, each Indemnified Party, his or her heirs and his or her personal representatives and shall be binding on all successors and assigns of Acquiror and the Company.

7.12 NYSE Listing. Acquiror shall use its best efforts to cause the shares of Media Stock and Series D Preferred Stock to be issued in the Merger to be approved for listing on the NYSE, subject only to notice of official issuance, prior to the Effective Time. If, for any reason, Acquiror shall not be able to list the shares of the Series D Preferred Stock to be issued in the Merger on the NYSE,

Acquiror shall use its best efforts to, prior to the Effective Date, list such shares on such other stock exchange, or cause such shares to be eligible for trading on such other trading facility, as the Company may request.

7.13 Affiliates. Prior to the Closing Date, the Company shall deliver to Acquiror a letter identifying all Persons who are, at the time this Agreement is submitted to the stockholders of the Company, "affiliates" of the Company for purposes of Rule 145 under the Securities Act. The Company shall use its best efforts to cause each such Person to deliver to Acquiror on or prior to the Closing Date a written agreement substantially in the form attached as Exhibit D.

7.14 Employee Benefits. (a) For a period of one year following the Effective Time, Acquiror shall maintain in effect for employees of the Company and its Subsidiaries benefits (other than RSPAs or similar benefits) no less favorable in the aggregate than the benefits offered by the Company immediately prior to the Effective Time. Acquiror agrees to honor and perform all severance, employment and similar agreements of the Company disclosed in Section 4.11 of the Company Disclosure Letter and each RSPA and related Tax Liability Financing Agreement.

(b) Following the date hereof, the Company shall, after consultation with Acquiror, be permitted to

(i) forgive up to \$35.7 million principal amount of outstanding loans made by the Company to employees to enable such employees to pay income Taxes incurred by such employees as a result of the purchase of shares of Company Common Stock by such employees pursuant to the RSPAs in accordance with the terms of an amendment to the Tax Liability Financing Agreement substantially in the form set forth in Section 7.14 of the Company Disclosure Letter; provided, however, that any loan to an employee of the Company who is, or reasonably can be expected to become, a "covered employee" (within the meaning of Section 162(m) of the Code) shall in no event be forgiven, in whole or in part, prior to the day following the Closing Date,

(ii) issue up to 350,000 shares of Company Common Stock pursuant to RSPAs substantially in the form heretofore provided to Acquiror to employees of the Company or any of its Subsidiaries; and provided, further, that, in each case, such forgiveness or issuance acts as incentive for the purpose of retaining and motivating such employee to continue in the employment of the Company following the

Effective Time and is implemented in a manner consistent with such purpose.

(c) If, following the Effective Time, the termination of the employee's employment with the Company or any of its Subsidiaries results in the acceleration of the vesting of an award under any RSPA or the forgiveness of a loan related to an RSPA pursuant to a Tax Liability Financing Agreement (other than as a result of termination of employment by reason of the employee's death or disability) (an "Acceleration Event") and as a result of such Acceleration Event, the employee either (i) becomes subject to an excise tax (the "Excise Tax") under Section 4999 of the Code that such employee would not have been subject to without the occurrence of such Acceleration Event or (ii) the amount of the Excise Tax imposed on such employee is greater than the amount of the Excise Tax that would have been imposed without the occurrence of such Acceleration Event (the "Incremental Excise Tax"), Acquiror shall pay or shall cause to be paid to the employee, at the time specified below, an additional amount (the "Additional Payment") sufficient to (a) in the case of clause (i) above, reimburse the employee for the Excise Tax and in the case of clause (ii) above, reimburse the employee for the Incremental Excise Tax and (b) in either case, reimburse the employee for any federal, state or local income tax or any additional excise tax under Section 4999 of the Code payable with respect to any Additional Payment made pursuant to this Section 7.14(c). The Additional Payment provided for in this Section 7.14(c) shall be made no later than the due date for the Excise Tax or Incremental Excise Tax (as the case may be) imposed. In the event of any dispute in the calculations made pursuant to this Section 7.14(c), an independent big six accounting firm shall be selected to resolve any such dispute and the decision of such accounting firm shall be final and binding on the Company and the employee. The fees and costs of such accounting firm shall be shared equally among the Company and the employee.

7.15 Registration Rights Agreement. Acquiror shall execute and deliver to the other parties thereto the Registration Rights Agreement at or prior to the Closing.

7.16 Tax Treatment. (a) Each of Acquiror and the Company shall use its reasonable best efforts to cause the Merger to qualify as a reorganization under the provisions of Sections 368(a) of the Code and to obtain the opinions of counsel referred to in Sections 8.2(c) and 8.3(c).

(b) The Company and Acquiror agree that if a ruling satisfactory to the Company, Acquiror and The Providence Journal Company is obtained from the IRS, this Agreement shall be amended to permit the creation of a newly-formed holding company to acquire the capital stock of the Company and Acquiror.

7.17 Series D Preferred Stock. Prior to the Effective Time, Acquiror shall file with the Secretary of State of the State of Delaware a Certificate of Designation, in the form of Exhibit C hereto, with respect to the shares of Series D Preferred Stock issuable pursuant to Section 3.1.

7.18 Company Indebtedness. The Company shall assist Acquiror, and shall take such actions as Acquiror may reasonably request at Acquiror's sole expense in order to facilitate with respect to the amendment, repayment, redemption, refinancing or other restructuring of outstanding Indebtedness of the Company on or after the Effective Time in connection with the Merger.

7.19 Authorization of Issuance of Merger Consideration. Acquiror shall obtain any authorizations and consents necessary, and shall take such further actions as may be required, for the issuance of the Media Stock and the Series D Preferred Stock to holders of Company Common Stock pursuant to the terms of this Agreement.

7.20 Attribution. Following the Effective Time, the board of directors of Acquiror shall attribute all of the assets and liabilities of the Company and its Subsidiaries to the Media Group pursuant to Sections 2.5.1 and 2.6.15 of Article V of the Restated Certificate of Incorporation of Acquiror as in effect as of the date hereof.

7.21 Further Assurances. Each of the parties hereto shall execute such documents and other instruments and take such further actions as may be reasonably required or desirable to carry out the provisions hereof and consummate and evidence the transactions contemplated hereby or, at and after the Closing Date, to evidence the consummation of the transactions contemplated by this Agreement. Upon the terms and subject to the conditions hereof, each of the parties hereto shall take or cause to be taken all actions and to do or cause to be done all other things necessary, proper or advisable to consummate and make effective as promptly as practicable the transactions contemplated by

this Agreement and to obtain in a timely manner all necessary waivers, consents and approvals and to effect all necessary registrations and filings.

ARTICLE VIII

CONDITIONS PRECEDENT

8.1 Conditions to Each Party's Obligation to Effect the Merger. The respective obligation of each party to effect the Merger shall be subject to the satisfaction prior to the Closing Date of the following conditions:

(a) **Stockholder Approvals; Charter Amendment.** The Company shall have obtained the Stockholder Approvals and the Charter Amendment shall have been executed, acknowledged and filed and shall have become effective in accordance with the DGCL.

(b) **HSR Act.** (i) The waiting periods (and any extension thereof) applicable to the Merger under the HSR Act shall have expired or been terminated; (ii) neither the FTC nor DOJ shall have authorized the institution of enforcement proceedings (that have not been dismissed or otherwise disposed of) to delay, prohibit, or otherwise restrain the transactions contemplated by the Agreement; (iii) no such proceeding will be pending as of the Closing Date and (iv) other than as contemplated by Section 7.6(d), no injunction or order shall have been issued by a court of competent jurisdiction and remain in effect as of the Closing Date.

(c) **No Injunctions or Restraints.** No statute, rule, regulation, injunction, restraining order or decree of any court or Governmental Authority of competent jurisdiction shall be in effect that restrains or prevents the transactions contemplated hereby.

(d) **Form S-4.** The Form S-4 shall have been declared effective under the Securities Act and shall not be the subject of any stop order or proceedings seeking a stop order, and any material "blue sky" and other state securities laws applicable to the issuance of the Media Stock and Series D Preferred Stock shall have been complied with.

(e) NYSE Listing. The shares of Media Stock issuable to the Company's stockholders pursuant to this Agreement shall have been approved for listing on the NYSE, subject only to official notice of issuance.

(f) Conversion of Company Preferred Stock; Certain Elections. The holders of shares of Company Preferred Stock shall have converted such shares into shares of Company Common Stock, effective no later than immediately prior to the Effective Time.

8.2 Conditions of Obligations of Acquiror. The obligations of Acquiror to effect the Merger are subject to the satisfaction of the following conditions, any or all of which may be waived in whole or in part by Acquiror:

(a) Representations and Warranties. There shall be no breach of any representation or warranty of the Company made hereunder that, individually or together with all other such breaches, results in a Material Adverse Effect with respect to the Company. Acquiror shall have received a certificate from the Company dated the Closing Date signed by an authorized officer of the Company certifying to the fulfillment of this condition.

(b) Agreements. The Company shall have performed and complied in all material respects with all of its respective undertakings, covenants, conditions and agreements required by this Agreement to be performed or complied with by it prior to or at the Closing. Acquiror shall have received a certificate from the Company dated the Closing Date signed by an authorized officer of the Company and certifying to the fulfillment of this condition.

(c) Tax Opinion. Acquiror shall have received an opinion of Weil, Gotshal & Manges LLP, dated the Closing Date, to the effect that (i) the Merger should be treated for Federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code; (ii) each of Acquiror and the Company should be a party to the reorganization within the meaning of Section 368(b) of the Code; and (iii) no gain or loss should be recognized by the Company or Acquiror as a result of the Merger. In rendering such opinion, Weil, Gotshal & Manges LLP may receive and rely upon representations contained in certificates of the

Company, Acquiror, and certain stockholders of the Company.

(d) Letters from Affiliates. Acquiror shall have received from each Person in the letter referred to in Section 7.13 an executed copy of an agreement substantially in the form of Exhibit D.

(e) Consents. All Company Consents (other than Franchise Consents) and Acquiror Consents shall have been obtained, except where the failure to obtain any such consent would not have a Material Adverse Effect with respect to the Company or Acquiror, as the case may be.

(f) Transaction Documents. Each of the Transaction Documents which were not executed on the date hereof shall have been duly authorized and executed by the parties thereto other than Acquiror.

(g) Dissenting Shares. Acquiror shall have received evidence, in form and substance reasonably satisfactory to it, that the number of Dissenting Shares shall constitute no greater than 10% of the total number of shares of Company Common Stock (assuming conversion of the Company Preferred Stock) outstanding immediately prior to the Effective Time.

(h) Other Actions. The Company shall have disposed of the Designated Assets as provided in Section 7.7.

(i) Litigation. Except as described in Section 7.6(c), there shall not be pending or threatened by any Governmental Authority any suit, action or proceeding, (i) seeking to restrain or prohibit the Merger or seeking to obtain from Acquiror or the Company or any of their respective Subsidiaries in connection with the Merger any material damages, (ii) seeking to prohibit or limit the ownership or operation by Acquiror, the Company or any of their respective Subsidiaries of any material portion of the business or assets of Acquiror and its Subsidiaries taken as a whole or the Company and its Subsidiaries taken as a whole, or to compel Acquiror, the Company or any of their respective Subsidiaries to dispose of or hold separate any material portion of the business or assets of Acquiror and its Subsidiaries taken as a whole or the Company

and its Subsidiaries taken as a whole, in each case as a result of the Merger or any of the other transactions contemplated by this Agreement or the Transaction Documents, (iii) seeking to impose limitations on the ability of Acquiror to acquire or hold, or exercise full rights of ownership of, the shares of Company Capital Stock, including the right to vote such shares of Company Capital Stock on all matters properly presented to the stockholders of the Company or (iv) seeking to prohibit Acquiror from effectively controlling in any material respect any portion of the business or operations of the Company or any of its Subsidiaries taken as a whole, which, in each case, has a reasonable likelihood of success and if determined in a manner adverse to the Company or Acquiror, could reasonably be expected to result in a Material Adverse Effect with respect to Acquiror or the Company.

(j) Franchise and License Consents. The Company shall have obtained, in accordance with the terms of Section 7.5, (i) all Franchise Consents required pursuant to this Section 8.2(j) (the "Required Franchise Consents"); (ii) all License Consents for each FCC license set forth in Section 4.6 of the Company Disclosure Letter and (iii) to the extent required by the FCC or any Governmental Authority with jurisdiction, the Social Contract Consent; provided, however, that each Franchise Consent and License Consent and the Social Contract Consent required to be obtained hereunder shall be a Final Order. The aggregate number of Subscribers covered by the Required Franchise Consents (i) as to which Franchise Consents are obtained in accordance with the terms of Section 7.5 and (ii) that do not require Franchise Consents, shall equal at least ninety percent (90%) of the total number of Subscribers covered by all Franchises and shall equal at least ninety-five percent (95%) of the total number of Subscribers covered by Franchises located within the thirty largest Metropolitan Statistical Areas (as ranked on the basis of the 1994 U.S. Census by Rand McNally) in which the Company or its Subsidiaries operates a Franchise, in each case as of March 31, 1996 based on the Company's month-end billing report as of such date, as adjusted to reflect any acquisitions or dispositions of Systems. The aggregate number of Required Franchise Consents (i) as to which Franchise Consents are obtained in accordance with the terms of Section 7.5 and (ii) that do not

require Franchise Consents, shall equal at least eighty-five percent (85%) of the total number of Franchises as of the date hereof.

(k) Corporate Proceedings and Documents. All corporate proceedings taken by the Company in connection with the transactions contemplated hereby and all documents incident thereto shall be reasonably satisfactory in all material respects to Acquiror and Acquiror's counsel, and Acquiror and Acquiror's Counsel shall have received all such counterpart originals or certified or other copies of such documents as they may reasonably request.

8.3 Conditions of Obligations of the Company.
The obligation of the Company to effect the Merger is subject to the satisfaction of the following conditions, any or all of which may be waived in whole or in part by the Company:

(a) Representations and Warranties. There shall be no breach of any representation or warranty of Acquiror made hereunder that, individually or together with all other such breaches, results in a Material Adverse Effect with respect to Acquiror. The Company shall have received a certificate dated the Closing Date signed by an authorized officer of Acquiror certifying to the fulfillment of this condition.

(b) Agreements. Acquiror shall have performed and complied in all material respects with all of their respective undertakings, covenants, conditions and agreements required by this Agreement to be performed or complied with by Acquiror prior to or at the Closing. The Company shall have received a certificate dated the Closing Date signed by an authorized officer of Acquiror certifying to the fulfillment of this condition.

(c) Tax Opinion. The Company shall have received an opinion of Sullivan & Worcester LLP, dated the Closing Date, to the effect that (i) the Merger will be treated for Federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code; (ii) each of the Acquiror and the Company will be a party to the reorganization within the meaning of Section 368(b) of the Code; and (iii) gain, if any, realized will be recognized by a stockholder of

the Company as a result of the Merger, but not in excess of the amount of cash received by such stockholder. In rendering such opinion, Sullivan & Worcester LLP, may receive and rely upon representations contained in certificates of Acquiror, the Company, and certain stockholders of the Company.

(d) Consents. All Company Consents and Acquiror Consents shall have been obtained, except where the failure to obtain any such consent would not have a Material Adverse Effect with respect to the Company or Acquiror, as the case may be.

(e) Transaction Documents. Each of the Transaction Documents shall have been duly authorized and executed by the parties thereto other than the Company.

(f) Preferred Stock Listing. The shares of Series D Preferred Stock issuable to the Company's stockholders pursuant to this Agreement shall have been approved for listing on the NYSE or otherwise approved for listing or eligible for trading as provided in Section 7.12 hereof, subject only to official notice of issuance.

(g) Corporate Proceedings and Documents. All corporate proceedings taken by Acquiror in connection with the transactions contemplated hereby and all documents incident thereto shall be reasonably satisfactory in all material respects to the Company and the Company's counsel, and the Company and the Company's counsel shall have received all such counterpart originals or certified or other copies of such documents as they may reasonably request.

ARTICLE IX

TERMINATION AND AMENDMENT

9.1 Termination. This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, whether before or after approval of the matters presented in connection with the Merger by the stockholders of the Company:

(a) by mutual written consent of the Company, on the one hand, and Acquiror, on the other hand, or by mutual action of their respective boards of directors;

(b) by Acquiror, if any of the conditions set forth in Section 8.1 or 8.2 shall have become incapable of fulfillment, and shall not have been waived by Acquiror, or if the Company shall breach in any material respect any of its representations, warranties or obligations hereunder and such breach shall not have been cured in all material respects or waived and the Company shall not have provided reasonable assurance that such breach will be cured in all material respects on or before the Closing Date, but only if such breach, singly or together with all other such breaches, would have a Material Adverse Effect with respect to the Company;

(c) by the Company, if any of the conditions set forth in Section 8.1 or 8.3 shall have become incapable of fulfillment, and shall not have been waived by the Company, or if Acquiror shall breach in any material respect any of its representations, warranties or obligations hereunder and such breach shall not have been cured in all material respects or waived and Acquiror shall not have provided reasonable assurance that such breach will be cured in all material respects on or before the Closing Date, but only if such breach, singly or together with all other such breaches, would have a Material Adverse Effect with respect to Acquiror;

(d) by either the Company or Acquiror, if the Merger shall not have been consummated on or before August 31, 1997 (the "Termination Date"); provided, however, that if all the conditions set forth in Article VIII (other than the conditions set forth in Sections 8.1(a), 8.1(b), 8.1(c), 8.2(e), 8.2(h), 8.2(i) and 8.2(j)) have been satisfied at the Termination Date, either Acquiror or the Company may, by notice to the other prior to such date, extend the Termination Date to the latest date so extended by either party but in no event later than December 31, 1997;

(e) by either the Company or Acquiror if the Stockholder Approvals shall not have been obtained by reason of the failure to obtain the required vote upon a vote held at the Stockholders' Meetings (including

any postponements or adjournments thereof); provided, however, that if the Stockholder Approvals are not obtained at the Initial Stockholders' Meeting solely by reason of a failure to obtain approval of the Charter Amendment, then this Agreement shall not be terminable unless the Stockholder Approvals shall not have been obtained by reason of a failure to obtain the required vote upon a vote held at the Additional Stockholders' Meeting;

(f) by Acquiror, if the Company shall have
(i) withdrawn or modified, in a manner adverse to Acquiror, its approval or recommendation of this Agreement or any of the transactions contemplated hereby,
(ii) failed to include such recommendation in the Proxy Statement, (iii) approved or recommended any Acquisition Proposal from a Third Party or
(iv) resolved to do any of the foregoing;

(g) by the Company, prior to the approval of this Agreement by the stockholders of the Company, if the Board of Directors shall approve, and the Company shall enter into, a definitive agreement providing for the implementation of an Acquisition Proposal; provided, however, that (i) the Company is not then in breach of Section 7.10, (ii) prior to such termination, the Company has negotiated with Acquiror in good faith to make such adjustments in the terms and conditions of this Agreement as would enable the Company to proceed with the transactions contemplated hereby and (iii) the Board of Directors, has determined in good faith (on the basis of the terms of such Acquisition Proposal and the terms of this Agreement, after giving effect to any concessions offered by Acquiror pursuant to clause (ii) above), after receipt of written advice from the Company's outside legal counsel, that such termination is advisable for the Board of Directors to act in a manner consistent with its fiduciary duties to stockholders under Applicable Law and (iv) the Company shall provide to Acquiror prior written notice of such termination, which notice shall advise Acquiror of the matters described in clauses (ii) and (iii) above;

(h) by the Company pursuant to Section 3.1(d)(ii)(B); or

(i) by Acquiror pursuant to Section 3.1(d)(ii)(C).

Notwithstanding the foregoing, a party shall not be permitted to terminate this Agreement pursuant to clause (b), (c) or (d) hereof if such party is in breach of any of its material representations, warranties, covenants or agreements contained in this Agreement.

9.2 Effect of Termination. In the event of termination by the Company or Acquiror pursuant to Section 9.1, written notice thereof shall promptly be given to the other parties and, except as otherwise provided herein, the transactions contemplated by this Agreement shall be terminated, without further action by any party. Notwithstanding the foregoing, nothing in this Section 9.2 shall be deemed to release any party from any liability for any breach by such party of the terms and provisions of this Agreement or to impair the right of the Company, on the one hand, and Acquiror, on the other hand, to compel specific performance of the other party of its or their obligations under this Agreement.

9.3 Fees and Expenses. In order to induce Acquiror to, among other things, enter into this Agreement, the Company agrees that if this Agreement is terminated (A) by Acquiror pursuant to Section 9.1(f) hereof, (B) by the Company pursuant to Section 9.1(g) hereof, or (C) by the Company or Acquiror pursuant to Section 9.1(e) hereof and the Board of Directors shall have materially modified or withdrawn its approval, determination or recommendation of this Agreement or any of the transactions contemplated hereby prior to the Initial Stockholders' Meeting or there shall have been an Acquisition Proposal and such proposal shall not have been withdrawn prior to the Initial Stockholders' Meeting and within one year thereafter the Company enters into a definitive agreement with respect to such Acquisition Proposal (including any definitive agreement relating to an Acquisition Proposal offered by the same proponent or its Affiliate as such Acquisition Proposal), then the Company shall promptly pay Acquiror a fee of \$125 million, plus an amount equal to the actual reasonable fees and expenses paid or payable by or on behalf of Acquiror to its attorneys, accountants, environmental consultants, management consultants, and other consultants and advisors in connection with the negotiation, execution and delivery of this Agreement and the transactions contemplated hereby; provided, however, that payment for fees and expenses shall in no event exceed \$15 million. Any payment required by this Section 9.3 shall be made in same day funds to Acquiror by the Company no later than five

Business Days following termination of this Agreement by Acquiror or the Company, as the case may be.

9.4 Certain Purchase Obligations. (a) In order to induce the Company to, among other things, enter into this Agreement, Acquiror agrees that if this Agreement is terminated by the Company pursuant to Section 9.1(h), then the Company shall have the right, for a period of 30 days thereafter, to require Acquiror to purchase from the Company (the "Put Right") 5,650,000 shares of Series B Convertible Preferred Stock, par value \$.01 per share, of the Company, having the rights, preferences and terms set forth in the Certificate of Designations attached as Exhibit E hereto (the "Put Shares") for an aggregate purchase price of \$282.5 million.

(b) Following termination by the Company of this Agreement pursuant to Section 9.1(h), the Company may exercise the Put Right by delivering to Acquiror a written notice of such exercise (the "Put Exercise Notice"), which shall specify a date not less than 90 days from the date of such notice for the closing of the purchase of the Put Shares by Acquiror.

(c) The closing with respect to the purchase of the Put Shares shall take place on the earlier of (i) the date specified in the Put Exercise Notice and (ii) the second Business Day following the date on which the last of the conditions set forth in Section 9.4(d) is fulfilled or waived, unless another date, time or place is agreed to in writing by the parties hereto (the "Put Closing Date"). At such closing, the Company shall deliver to Acquiror certificates representing the Put Shares and Acquiror shall deliver to the Company \$282.5 million by wire transfer of immediately available funds to an account designated by the Company.

(d) The obligations of Acquiror to purchase the Put Shares shall be subject to the satisfaction prior to the Put Closing Date of the following conditions:

(i) HSR Act. The waiting periods (and any extension thereof) applicable to the purchase of the Put Shares under the HSR Act shall have expired or been terminated and there shall be no authorized or pending action by a Governmental Authority seeking to restrain or prevent the purchase of the Put Shares.

(ii) No Injunctions or Restraints. No statute, rule, regulation, injunction, restraining order or decree of any nature of any court or Governmental Authority shall be in effect that restrains or prevents the purchase of the Put Shares.

(iii) Representations and Warranties. There shall be no breach of any representation or warranty of the Company made hereunder that, individually or together with all other such breaches, results in a Material Adverse Effect with respect to the Company. Acquiror shall have received a certificate from the Company dated the Put Closing Date signed by an authorized officer of the Company certifying to the fulfillment of this condition.

(iv) Agreements. The Company shall have performed and complied in all material respects with all of its respective undertakings, covenants, conditions and agreements required by this Agreement to be performed or complied with by it prior to or at the Put Closing Date. Acquiror shall have received a certificate from the Company dated the Put Closing Date signed by an authorized officer of the Company and certifying to the fulfillment of this condition.

(v) Franchise Consents. To the extent any Franchise(s) individually or collectively representing more than 5% of total Subscribers of the Company and its Subsidiaries require notice to, or the consent of, a Governmental Authority in connection with the purchase by Acquiror of the Put Shares, the consent of each such Governmental Authority shall have been obtained by the Company.

(vi) Registration Rights Agreement. The Company and Acquiror shall have entered into a Registration Rights Agreement substantially in the form of Exhibit F hereto.

(e) From and after the Put Closing Date, for so long as Acquiror owns any of the Put Shares, Acquiror shall not acquire, or agree to acquire, directly or indirectly, any shares of Company Capital Stock, or any rights or options to acquire shares of Company Capital Stock, if as a result of any such acquisition, Acquiror would beneficially own 10 percent or more of the Company Capital Stock.

9.5 Amendment. Subject to Applicable Law, this Agreement may be amended, modified or supplemented only by written agreement of Acquiror and the Company at any time prior to the Effective Time with respect to any of the terms contained herein; provided, however, that, after this Agreement is approved by the Company's stockholders, no such amendment or modification shall (i) alter or change the amount or kind of consideration to be delivered to the stockholders of the Company or (ii) alter or change any of the terms and conditions of this Agreement, if such alteration or change would adversely affect the holders of any class of capital stock of the Company.

9.6 Extension; Waiver. At any time prior to the Effective Time, the parties hereto, by action taken or authorized by their respective boards of directors, may, to the extent legally allowed: (i) extend the time for the performance of any of the obligations or other acts of the other parties hereto; (ii) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto; and (iii) waive compliance with any of the agreements or conditions contained herein. Any agreement on the part of a party hereto to any such extension or waiver shall be valid only if set forth in a written instrument signed on behalf of such party. The failure of any party hereto to assert any of its rights hereunder shall not constitute a waiver of such rights nor in any way effect the validity of this Agreement or any part hereof or the right of such party thereafter to enforce each and every provision of this Agreement. No waiver of any breach of or non-compliance with this Agreement shall be held to be a waiver of any other or subsequent breach or non-compliance.

ARTICLE X

GENERAL PROVISIONS

10.1 Frustration of the Closing Conditions. Neither the Company nor Acquiror may rely on the failure of any condition precedent set forth in Article VIII to be satisfied if such failure was caused by such party's (or parties') failure to act in good faith or to use its reasonable best efforts to consummate the transactions contemplated by this Agreement in accordance with Section 7.4.

10.2 Effectiveness of Representations, Warranties and Agreements. The representations, warranties and agreements in this Agreement shall terminate at the Effective Time or upon the termination of this Agreement pursuant to Article IX, except that the agreements set forth in Articles I, II and III and Section 7.11, 7.14 and 7.20 shall survive the Effective Time and those set forth in Sections 9.2, 9.3, 9.4 and Article X hereof shall survive termination.

10.3 Expenses. Except as otherwise provided herein, including in Sections 7.5 and 9.3, each of the parties hereto shall pay the fees and expenses of its respective counsel, accountants and other experts and shall pay all other costs and expenses incurred by it in connection with the negotiation, preparation and execution of this Agreement and the Transaction Documents and the consummation of the transactions contemplated hereby and thereby; provided, however, that the Company shall pay, with funds of the Company and not with funds provided by Acquiror, any and all property or transfer Taxes imposed on the Company or any Gains Taxes.

10.4 Applicable Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Delaware without reference to choice of law principles, including all matters of construction, validity and performance.

10.5 Notices. Notices, requests, permissions, waivers, and other communications hereunder shall be in writing and shall be deemed to have been duly given if signed by the respective Persons giving them (in the case of any corporation the signature shall be by an officer thereof) and delivered by hand, deposited in the United States mail (registered or certified, return receipt requested), properly addressed and postage prepaid, or delivered by telecopy:

If to the Company, to:

Continental Cablevision, Inc.
The Pilot House
Lewis Wharf
Boston, Massachusetts 02110
Telephone: (617) 742-9500
Telecopy: (617) 742-0530
Attention: Amos B. Hostetter, Jr.

with a copy to:

Chadbourn & Parke LLP
30 Rockefeller Plaza
New York, New York 10112
Telephone: (212) 408-5100
Telecopy: (212) 541-5369
Attention: Dennis J. Friedman, Esq.

and:

Sullivan & Worcester LLP
One Post Office Square
Boston, Massachusetts 02109
Telephone: (617) 338-2800
Telecopy: (617) 338-2880
Attention: Patrick K. Miehle, Esq.

If to Acquiror, to:

U S WEST, Inc
7800 East Orchard Road
Englewood, Colorado 80111
Telephone: (303) 793-6310
Telecopy: (303) 793-6707
Attention: General Counsel

with a copy to:

Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, New York 10153
Telephone: (212) 310-8000
Telecopy: (212) 310-8007
Attention: Dennis J. Block, Esq.

Such names and addresses may be changed by notice given in accordance with this Section 10.5.

10.6 Entire Agreement. This Agreement and the Transaction Documents (including the Exhibits attached hereto, all of which are a part hereof) contain the entire understanding of the parties hereto and thereto with respect to the subject matter contained herein and therein, supersede and cancel all prior agreements, negotiations, correspondence, undertakings and communications of the parties, oral or written, respecting such subject matter. There are no restrictions, promises, representations,

warranties, agreements or undertakings of any party hereto or to any of the Transaction Documents with respect to the transactions contemplated by this Agreement and the Transaction Documents other than those set forth herein or therein or made hereunder or thereunder. Notwithstanding the foregoing, the Confidentiality Agreements shall remain in full force and effect and shall survive any termination of this Agreement.

10.7 Headings; References. The article, section and paragraph headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. All references herein to "Articles", "Sections" or "Exhibits" shall be deemed to be references to Articles or Sections hereof or Exhibits hereto unless otherwise indicated.

10.8 Counterparts. This Agreement may be executed in one or more counterparts and each counterpart shall be deemed to be an original, but all of which shall constitute one and the same original.

10.9 Parties in Interest; Assignment. Neither this Agreement nor any of the rights, interest or obligations hereunder shall be assigned by any of the parties hereto without the prior written consent of the other parties. This Agreement shall inure to the benefit of and be binding upon the Company and Acquiror and shall inure to the sole benefit of the Company and Acquiror and their respective successors and permitted assigns. Except as set forth in Section 7.11 and Section 7.14(c), nothing in this Agreement, express or implied, is intended to confer upon any other Person any rights or remedies under or by reason of this Agreement.

10.10 Severability; Enforcement. The invalidity of any portion hereof shall not affect the validity, force or effect of the remaining portions hereof. If it is ever held that any restriction hereunder is too broad to permit enforcement of such restriction to its fullest extent, each party agrees that a court of competent jurisdiction may enforce such restriction to the maximum extent permitted by law, and each party hereby consents and agrees that such scope may be judicially modified accordingly in any proceeding brought to enforce such restriction.

10.11 Specific Performance. The parties hereto agree that the remedy at law for any breach of this

Agreement will be inadequate and that any party by whom this Agreement is enforceable shall be entitled to specific performance in addition to any other appropriate relief or remedy. Such party may, in its sole discretion, apply to a court of competent jurisdiction for specific performance or injunctive or such other relief as such court may deem just and proper in order to enforce this Agreement or prevent any violation hereof and, to the extent permitted by Applicable Law, each party waives any objection to the imposition of such relief.

10.12 Jurisdiction. Each party to this Agreement hereby irrevocably agrees that any legal action, suit or proceeding arising out of or relating to this Agreement, the Transaction Documents or any other agreements or transactions contemplated hereby shall be brought in the Chancery Court of the State of Delaware and each party hereto agrees not to assert, by way of motion, as a defense or otherwise, in any such action, suit or proceeding any claim that it is not subject personally to the jurisdiction of such court, that the action, suit or proceeding is brought in an inconvenient forum, that the venue of the action, suit or proceeding is improper or that this Agreement, any Transaction Document, any other agreement or transaction or the subject matter hereof or thereof may not be enforced in or by such court. Each party hereto further and irrevocably submits to the jurisdiction of such court in any action, suit or proceeding.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the date first above written.

U S WEST, INC.

By: Charles M. Lillis
Name: Charles M. Lillis
Title: Executive Vice President;
President and Chief
Executive Officer of the
U S WEST Media Group

CONTINENTAL CABLEVISION, INC.

By: Amos B. Hostetter, Jr.
Name: Amos B. Hostetter, Jr.
Title: Chairman of the Board and
Chief Executive Officer

ATTACHMENT C

Form 10-K of

Continental Cablevision, Inc.

For the Period Ending December 31, 1995

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

(Mark One)

- ☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (FEE REQUIRED)

For the Fiscal Year Ended December 31, 1995

OR

- ☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

For the transition period from _____ to _____

Commission File Number 33-57471

CONTINENTAL CABLEVISION, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation)

04-2370836
(I.R.S. Employer
Identification No.)

**The Pilot House
Lewis Wharf
Boston, MA**
(Address of principal
executive offices)

02110
(Zip Code)

617-742-9500

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X

The aggregate market value of the voting stock of the registrant held by non-affiliates is not applicable as no public market for the voting stock of the registrant exists.

Number of shares of the registrant's Class A
Common Stock at March 15, 1996: 38,885,385

Number of shares of the registrant's Class B
Common Stock at March 15, 1996: 109,664,521

CONTINENTAL CABLEVISION, INC.

1995 FORM 10-K ANNUAL REPORT

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PART I

Item 1. Business.

(a) Development of Business.

Continental Cablevision, Inc. ("Continental" or the "Company," which terms include its consolidated subsidiaries unless the context indicates otherwise) is a leading provider of broadband communications services. As of December 31, 1995, the Company's systems and those of its U.S. affiliates passed approximately 7.2 million homes and provided service to approximately 4.2 million basic cable subscribers, making the Company the third-largest cable television system operator in the United States. In addition, Continental has pursued investments in sectors that are complementary to its core business, including (i) international broadband communications; (ii) interests in telecommunications and technology, including competitive-access telephony and direct broadcast satellite ("DBS") service; and (iii) interests in programming services.

Effective October 5, 1995, Continental acquired the cable television businesses and assets of Providence Journal Company ("Providence Journal"), serving approximately 779,000 basic subscribers, through the merger of Providence Journal into Continental and related transactions (the "Providence Journal Merger"). The Company also completed during the year ended December 31, 1995: (i) acquisitions of systems serving approximately 88,000 basic subscribers in Chicago, Illinois ("Cablevision of Chicago"), 74,000 basic subscribers in Michigan ("Columbia Cable of Michigan") and 12,000 basic subscribers in Northern California ("Consolidated Cablevision of California") and (ii) the acquisition of the remaining 66.2% interest in N-COM Limited Partnership II ("N-COM"), which owned systems serving approximately 56,000 basic subscribers in Michigan (the "N-COM Buyout" and, collectively, the "Recent Acquisitions"). See "Description of Business—U.S. Acquisitions and Investments."

On February 27, 1996, the Company entered into a definitive Agreement and Plan of Merger (the "Merger Agreement") with U S WEST, Inc. ("U S WEST") providing for the merger of the Company with and into U S WEST (the "Merger"). As a result of the Merger, Continental's operations will become part of U S WEST Media Group ("UMG"), a leading global media and telecommunications company. UMG is one of two major groups that comprise U S WEST. U S WEST's other major group, U S WEST Communications, provides telecommunications services to more than 25 million customers in 14 western and mid-western states.

If the Merger is consummated, UMG will acquire all of Continental's outstanding capital stock for aggregate consideration of approximately \$5.3 billion, consisting of the following: shares of a new class of U S WEST Series D Convertible Preferred Stock (the "Series D Preferred Stock") valued at \$1 billion, shares of U S WEST Media Group Common Stock ("UMG Common Stock") valued at \$3.3 billion and \$1 billion in cash. The Common Stock, \$.01 par value per share, of the Company (the "Common Stock") has been valued at \$30 per share for purposes of the Merger. At U S WEST's election, the cash consideration may be increased, and the consideration to be paid in UMG Common Stock may be reduced, by up to \$500 million. As part of the Merger, U S WEST will also assume Continental's outstanding indebtedness and other liabilities, which are currently approximately \$5.5 billion.

The Merger has been structured to be a tax-free reorganization; the gain, if any, recognized by a Continental stockholder will be taxable only to the extent of any cash received. In the Merger, each holder of Class A Common Stock of the Company (the "Class A Common Stock") is entitled to receive shares of UMG Common Stock and shares of Series D Preferred Stock, and each holder of Class B Common Stock of the Company (the "Class B Common Stock") (including those issued upon conversion of the Series A Participating Convertible Preferred Stock of Continental (the "Series A Preferred Stock")) is entitled to receive, at the holder's election, either cash or shares of UMG Common Stock and shares of Series D Preferred Stock, or a combination thereof. In order to maintain the tax-free status of the Providence Journal Merger, holders of Class A Common Stock, comprised mainly of former Providence Journal stockholders, will be asked to approve an amendment to the Company's Amended and Restated Certificate of Incorporation that will allow cash consideration to be received only by holders of Class B Common Stock.

For purposes of determining the number of shares of UMG Common Stock to be delivered in the Merger, such stock will be valued on the basis of the average last reported intra-day sale price of UMG Common Stock during the 20 trading days selected by lot from the 30 trading days ending on the fourth trading day before the effective date of the Merger (the "UMG Share Price"). Continental and U S WEST will be required to consummate the Merger if the UMG Share Price as so determined is no less than \$20.825 and no greater than \$28.175. If the UMG Share Price is below \$20.825, Continental will have the right to terminate the Merger Agreement unless U S WEST elects to issue shares of UMG Common Stock based on the actual UMG Share Price. If U S WEST does not so elect and Continental terminates the Merger Agreement, Continental will have the right to require U S WEST to purchase 5,650,000 shares of a new Series B Convertible Preferred Stock of Continental for a purchase price of \$282.5 million. Conversely, if the UMG Share Price is above \$28.175, U S WEST will have the right to terminate the Merger Agreement unless Continental elects to accept shares of UMG Common Stock in the Merger based on the actual UMG Share Price.

The Merger is expected to close in the fourth quarter of 1996. The consummation of the Merger is subject to various conditions to closing, including, but not limited to, regulatory approvals and Continental stockholder votes. Certain major stockholders have agreed to vote in favor of the Merger and other related matters. However, no assurances can be given that the Merger will occur, or occur in the foregoing manner.

Unless otherwise indicated, all industry data set forth herein are based upon information compiled by the National Cable Television Association ("NCTA"), Paul Kagan Associates and/or Warren Publishing Co., and median household income data are derived from demographic information provided by Equifax Marketing Decision Systems, Inc. The demographic information was provided by zip code area and was averaged by Continental (weighted by the number of basic subscribers in each zip code area) (i) for all of the zip code areas Continental serves and (ii) for the zip code areas in each of Continental's five U.S. cable television management regions. Equifax Marketing Decision Systems, Inc. developed the 1995 demographic information by adjusting 1990 census data to take into account estimated growth rates which were developed by the WEFA Group (formerly Wharton Econometric Forecasting Associates and Chase Econometrics).

The share information contained herein, except as otherwise provided, gives effect to a stock dividend of 24 shares, which was effective September 29, 1995, on each share of Class A Common Stock and Class B Common Stock of the Company outstanding on the record date for such stock dividend.

The Company logo is a trademark of the Company. All other brand names and trademarks appearing herein are the property of their respective holders.

The Company was incorporated in the State of Delaware in 1963 and has been providing basic and pay cable television services since its inception.

(b) Description of Business.

U.S. Cable Television Business

The Company's five management regions operate systems that are organized into 22 operating clusters in 20 states. As of December 31, 1995, approximately 55.0% of Continental's total basic subscribers were located in the Company's seven largest operating clusters. The Providence Journal Merger and the Recent Acquisitions increased the total number of subscribers in these clusters by approximately 33.0%, to more than 2.3 million. Continental believes that its operating scale in key markets generates significant benefits, including operating efficiencies, and enhances its ability to develop and deploy new technologies and services.

Continental's systems have channel capacity and addressability that are among the highest in the cable industry. The Company's systems are located principally in suburban communities adjacent to major

metropolitan markets, as well as in mid-sized cities, that generally have attractive demographics and are geographically diverse. These systems serve communities with a median household income of approximately \$42,300 versus the national median of approximately \$37,900. Continental believes that its technologically advanced broadband networks and the demographic profile of its subscriber base, coupled with its effective marketing, are essential to its ability to sustain pay-to-basic penetration rates and total monthly revenue per average basic subscriber that are among the highest in the cable television industry. Continental believes that the geographic diversity of its system clusters reduces its exposure to economic, competitive or regulatory factors in any particular region.

Cable television is a service that delivers a wide variety of channels of television programming, consisting primarily of video entertainment, sports and news, as well as informational services, locally originated programming and digital audio programming, to the homes of subscribers who pay a monthly fee for the service. Television and radio signals are received by off-air antennas, microwave relay systems, satellite earth stations and fiber-optic cables and then distributed to subscribers' homes over networks of coaxial and fiber-optic cables.

The Company's systems offer subscribers various levels (or "tiers") of cable services consisting of broadcast television signals available off-air in any locality, television signals from so-called "superstations" originating in distant cities (such as WTBS, WGN and WWOR), various satellite-delivered, non-broadcast channels (such as Entertainment and Sports Programming Network ("ESPN"), Cable News Network ("CNN"), the USA Network ("USA") and Music Television ("MTV")), displays of information featuring news, weather and stock market reports and programming originated locally by the systems (such as public, educational and governmental access channels). The Company's systems also provide premium services to basic subscribers for an extra monthly charge. These premium services include Home Box Office ("HBO"), Cinemax, Showtime, The Movie Channel, Encore, The Disney Channel and certain regional sports networks, which are satellite-delivered channels that consist principally of feature films, live sporting events and other special entertainment features, usually presented without commercial interruption. Certain of the Company's systems also carry "multiplexed" premium services, which are available from certain premium-service providers such as HBO. Multiplexing allows a premium-service supplier to offer its programming on two or more channels simultaneously, but scheduled differently, so as to provide the subscriber with an expanded choice of programs at any given time.

Although services vary from system to system because of differences in channel capacity and viewer interest, most of Continental's systems offer a Basic Broadcast Tier ("BBT") as the lowest-priced tier (consisting generally of broadcast television signals available locally off-air, local origination and public, educational and governmental access channels), one or more Cable Programming Service ("CPS") tiers (which include satellite-delivered cable programming services) and several premium and pay-per-view channels. Subscribers may choose various combinations of such services. Certain Continental systems offer satellite-delivered, non-broadcast services as a New Product Tier ("NPT"), which the FCC has indicated it will forebear from regulating. See "Legislation and Regulation" for a description of recent legislation and regulation, which limits Continental's ability to price and tier certain programming services. Continental may offer such NPTs to subscribers in additional systems as it expands channel capacity in such systems. As a result of a social contract (the "Social Contract") adopted by the Federal Communications Commission (the "FCC"), Continental is permitted on each existing system (currently excluding the systems acquired in the Providence Journal Merger and the Recent Acquisitions) to move up to four existing services on CPS tier(s) to a single tier called a Migrated Product Tier, provided such tier is offered without requiring customers to purchase any tier other than the BBT. The rates of the Migrated Product Tier will be regulated under the Social Contract until January 1997 and then may be converted into NPTs. Under a proposed amendment to the Social Contract that has been released for public comment by the FCC (the "Social Contract Amendment"), former Providence Journal systems and systems acquired in the Recent Acquisitions will also be permitted to implement Migrated Product Tiers. See "U.S. Operating Strategy—U.S. Regulatory Strategy; Social Contract."

A customer generally pays an initial installation charge and fixed monthly fees for the BBT, CPS tier, NPT, Migrated Product Tier and premium programming services. Such monthly service fees constitute Continental's primary source of revenues. In addition to these monthly revenues, Continental's systems currently generate

revenues from additional fees paid by customers for pay-per-view programming of movies and special events and from the sale of available advertising spots on advertiser-supported programming. Continental's systems also offer home shopping services, from which Continental receives a share of revenues from sales of merchandise in its service areas.

U.S. Operating Strategy

Continental's strategy in the United States is to acquire and retain customers that will subscribe to a broad range of enhanced video, high-speed data, telephony and other telecommunications services. Execution of this strategy involves the following key operating principles:

Operating Scale. Continental is committed to preserving and further expanding its operating scale in key markets (as measured by the number of homes passed) through internal growth and strategic acquisitions and exchanges of systems. Continental believes that operating scale is critical to its ability to meet the growing capital and technical requirements that are vital to its long-term competitiveness and will enable it to realize operating efficiencies, enhance its ability to develop and deploy new technologies and provide new services.

Large Regional System Clusters. Since its inception, Continental has concentrated its operations in large regional system clusters located primarily in suburban communities adjacent to major metropolitan markets, as well as in mid-sized cities, that generally have attractive demographics and are geographically diverse. Continental believes that clustering creates operating efficiencies through reduced marketing and personnel costs and lower capital expenditures, particularly in systems where cable service can be delivered to several communities within a single region through a central headend reception facility. Regional system clusters are attractive to advertisers in that they maximize the scope and effectiveness of advertising expenditures. Large system clusters also enable Continental to attract and retain high-quality management at the system level and to more effectively deploy new products and services. In addition to selectively acquiring systems, Continental is exploring opportunities to enlarge and enhance key system clusters by exchanging certain of its systems for those of other cable television operators. See "U.S. Acquisitions and Investments."

As of December 31, 1995, approximately 55.0% of Continental's total basic subscribers were located in the Company's seven largest operating clusters, which include the greater metropolitan areas of Boston, Chicago, Los Angeles and Detroit. The Providence Journal Merger and the Recent Acquisitions increased the total number of basic subscribers in these operating clusters by approximately 33.0%, to more than 2.3 million.

Communities that are served by Continental's systems have a median household income of approximately \$42,300, versus the national median of approximately \$37,900. Continental's five management regions operate systems that are organized into 22 operating clusters in 20 states. No single region accounts for more than 24.9% of total basic subscribers. Continental believes that this geographic diversity reduces its exposure to economic, competitive or regulatory factors in any particular region.

Technologically Advanced Systems. Continental strives to maintain the highest technological standards in the industry and is continually upgrading its systems. By deploying high-capacity fiber-optic cable and addressable technology in its broadband network, Continental continues to develop the foundation from which to provide a broad range of enhanced video, high-speed data, telephony and other telecommunications services. Fiber-optic cable provides the capacity necessary to offer such services. Addressable technology, which enables Continental to control electronically the cable television services to be delivered to each customer, is essential to realize the full growth potential of pay-per-view, tiered programming offerings such as NPTs and Migrated Product Tiers and other interactive video services. Continental's continuing investment in its systems enhances picture quality and signal reliability, reduces operating costs and improves overall customer satisfaction.

Continental continues to upgrade its systems with addressable technology and fiber-optic cable. As of December 31, 1995, Continental provided at least 54-channel capacity in systems serving over 80.0% of its basic

subscribers. In addition, Continental had addressable technology in systems serving approximately 88.0% of its basic subscribers. Continental will also begin to deploy digital converter boxes, as they become commercially available, to certain basic subscribers. Digital compression significantly increases the number of video channels that can be carried on a system and greatly increases Continental's ability to provide enhanced video, high-speed data, telephony and other telecommunications services. In addition to upgrading its systems, Continental is deploying an information technology system in order to increase operating efficiencies (including billing and customer service).

Continental has recently installed digital advertising insertion equipment in several markets including Boston, Richmond, Jacksonville, Pompano, Dayton, Fresno and Detroit. This equipment allows Continental to download advertisements electronically to certain headends, thereby significantly enhancing the flexibility and reliability of Continental's advertising sales. Continental's Northeast region employs high-speed Asynchronous Transfer Mode switches, which, in addition to facilitating advertising insertion, have other potential uses, including improving Continental's ability to provide enhanced video, voice and high-speed data offerings. Asynchronous Transfer Mode is a new high-speed data transport and packaging protocol that allows data, video and voice to be sent simultaneously over the same communication line.

Decentralized and Locally Responsible Management. Continental has developed a decentralized and locally responsive management structure that brings significant management expertise and stability to every region and allows Continental to respond effectively to the specific needs of the communities it serves. Broad operating authority has been delegated to the Senior Vice President managing each region, who has, on average, 13 years of experience with Continental and 20 years within the cable industry. Certain employees, including the regional Senior Vice Presidents, are awarded equity compensation in the form of restricted stock grants, which vest over time, as an additional incentive to maximize stockholder value. Continental believes that the expertise, stability and commitment of its regional management is integral to its ability to provide superior customer service, maintain strong community and local regulatory relations and maximize growth potential.

Effective Marketing. Continental seeks to maximize revenues by increasing subscriptions to its BBT, CPS, NPT, Migrated Product Tier, premium and pay-per-view programming services through effective marketing, combined with a local focus on customer service and community relations. Continental markets cable television services through telemarketing, direct mail and door-to-door solicitation, reinforced by radio, cable television, off-air television and newspaper advertising. Continental seeks to attract and retain long-term subscribers and increase the percentage of homes in its service areas that subscribe to expanded service offerings. Continental believes that its technologically advanced systems and the demographic profile of its subscriber base, coupled with its effective marketing, are essential to its ability to sustain pay-to-basic penetration rates and total monthly revenue per average basic subscriber that are among the highest in the cable industry. As of December 31, 1995, Continental's ratio of premium service subscriptions to basic subscribers was 90.0%, and its total monthly cable revenue per average basic subscriber was \$35.99.

Customer Service and Community Relations. Continental believes that it is an industry leader in addressing the needs of its local customers. Through the use of surveys, focus groups, and other research tools, and by continually investing in information technology and employee training, Continental believes it has created one of the most extensive customer service programs in the cable television industry, supported by training centers in each of its regions. To improve its customer service efforts, Continental is in the process of incorporating information technology into its customer service functions, which will enable customer service representatives to more effectively interact with the customer. Continental's emphasis on customer service has helped to foster and sustain good relationships with the communities it serves.

Continental believes that its focus on customer service and community relations and reputation for quality will provide a competitive advantage as it plans to market a broad range of enhanced video, high-speed data, telephony and other telecommunications services to homes in its operating regions, frequently in competition with other providers of these services. See "Competition."

Leadership in Regulatory and Other Industry Matters. Continental has fostered strong regulatory relations at the federal and local levels. In order to resolve a variety of significant regulatory issues and obtain more certainty in the regulatory environment, Continental negotiated the Social Contract, the first comprehensive rate agreement involving cable television ever approved by the FCC. The Social Contract was adopted by the FCC on August 3, 1995, and extends through the year 2000. It settled all rate cases pending before the FCC at the time and all cost-of-service cases pending before local franchise authorities. The Social Contract Amendment, which would incorporate into the Social Contract the systems acquired in the Providence Journal Merger and the Recent Acquisitions and would settle all outstanding rate cases and appeals involving these systems pending before the FCC, was released for public comment on March 6, 1996. See "U.S. Regulatory Strategy; Social Contract." Continental was also the first major cable television company to reach a retransmission consent agreement with a broadcaster not requiring cash compensation for the right to carry the broadcaster's local television signals.

Expanded Service Offerings. Continental believes that its operating strategy has generated and will continue to generate additional revenues from numerous sources, as customer demand expands and regulations permit. Increased channel capacity and addressability enable Continental to offer enhanced video services such as "tiered" and "multiplexed" services. Continental believes that the "tiering" of programming services, which includes providing Migrated Product Tiers and NPTs, leads to increased customer satisfaction by offering subscribers a wider variety of programming and pricing packages from which to choose. In addition, Continental currently uses "multiplexing" in many systems to enhance the perceived value of certain of its premium service offerings such as HBO.

Continental derives revenues from the sale of advertising time on advertising-supported, satellite-delivered networks such as ESPN, MTV and CNN, as well as on locally originated programming. Continental's advertising revenues increased from \$27.0 million for the year ended December 31, 1990 to \$73.4 million for the year ended December 31, 1995 (representing a 22.1% compound annual growth rate in advertising revenues) and accounted for 5.1% of Continental's total revenues for the year ended December 31, 1995. Continental has increased its advertising sales through its participation in several regional cable advertising interconnects (associations of cable companies organized to effectively deliver a large market to advertisers), as well as through the deployment of advanced technologies, including digital advertising insertion equipment and Asynchronous Transfer Mode switches. Continental also participates in the national development of cable advertising through its ownership interest in National Cable Communications L.P. ("NCC"), the largest cable advertising representation firm in the country.

Pay-per-view programming is offered to subscribers on an individual event basis and consists of recently released movies and special events (including boxing matches, other sporting events and concerts). Continental realized 14.9% compound annual growth in pay-per-view revenues from December 31, 1990 to December 31, 1995; for the year ended December 31, 1995, pay-per-view revenues accounted for approximately 2.3% of Continental's total revenues.

Continental believes that increased channel capacity and the further deployment of addressable technology in its systems will enable it to expand the number of channels dedicated to pay-per-view services and increase the number of subscribers with access to pay-per-view programming. Continental will be conducting marketing and engineering trials in its Natick, Massachusetts system to evaluate the viability of enhanced pay-per-view or near video-on-demand ("NVOD") services. The Natick trials are scheduled to begin in late 1996 and will cover approximately 1,500 homes. Based on the results of these tests, Continental may offer enhanced pay-per-view or NVOD services in certain of its other systems in 1997.

Continental also receives a percentage of the proceeds from subscribers' purchases of merchandise offered on home shopping programming services such as QVC, Inc. ("QVC"), Home Shopping Network, Inc. ("HSN") and Valuevision. Combined, advertising, pay-per-view and home shopping revenues have increased at a compound annual rate of 20.2% from December 31, 1990 to December 31, 1995. Continental believes that these and other services could become more substantial sources of revenue over time; however, there can be no assurance in this regard.

In addition, Continental has created an advanced broadband telecommunications network for Boston College in Newton, Massachusetts, which is a fully interactive, 750 MHz network providing service to 150 classrooms, 250 administrative locations and over 8,000 outlets in dormitory locations on campus. The network provides video and high-speed data services, including full access to library resources and the Internet from each outlet, and will provide "cable-commuting" services to faculty, administrators and students. The project represents an opportunity for Continental to capitalize on its existing network infrastructure to provide comprehensive broadband network services. Based on its experience providing these services to Boston College, Continental may make these services available on its systems in other markets.

Continental currently provides competitive-access telephony service to business customers in Jacksonville, Florida and Richmond, Virginia. Continental is currently certificated to provide residential telephony service in Florida and California and has already installed telephone switching equipment in Jacksonville, Florida. The Company plans to provide residential telephone service initially to multiple-dwelling units in selected Florida communities in 1996 and introduce residential telephone service to single-family homes by the end of 1997. Continental has applied for certification to provide telephony services in New Hampshire and will likely apply for certification in Massachusetts, Illinois, Ohio, Virginia and Michigan during 1996.

Finally, the Company currently acts as a local distributor of the PrimeStar Partners, L.P. ("PrimeStar") DBS service. In this role, it sells to, services, and collects monthly fees from consumers. PrimeStar, of which Continental owns a 10.4% interest, currently offers a wide range of programming, including 73 channels of cable and network television, sports and movies as well as several audio channels. As of December 31, 1995, Continental served approximately 80,000 of PrimeStar's approximately 961,000 customers. In addition, Continental's DBS-service business generated revenue of \$37.0 million and operating income before depreciation and amortization of \$4.3 million for the year ended December 31, 1995. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Telecommunications and Technology."

U.S. Regulatory Strategy; Social Contract. In October 1992, Congress enacted the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Cable Act"), which, among other things, authorized the FCC to set standards for governmental authorities to regulate the rates for certain cable television services and equipment and gave local broadcast stations the option to elect mandatory carriage or require retransmission consent.

After extensive evaluation of cost-of-service principles and economic and legal analyses by experts in the rate regulation area, Continental decided to defend certain of its service rates using the FCC's benchmark methodology and certain of its service rates using the cost-of-service methodology.

On August 3, 1995, the FCC adopted a Social Contract with Continental, which covered all of Continental's franchises, regulated or unregulated (excluding the franchises acquired in the Providence Journal Merger and the Recent Acquisitions). It was the first comprehensive rate agreement involving cable television ever approved by the FCC. Continental's Social Contract resolved 377 cable rate cases; provided \$9.5 million of in-kind refunds to affected subscribers; created low-priced life-line BBTs in all Continental systems in a manner that was revenue-neutral to the Company; committed Continental to invest \$1.35 billion in system rebuilds and upgrades from 1995 through 2000 to expand channel capacity and improve technical reliability and picture quality; and established a plan to stabilize rates for the BBT and for CPS tiers in all Continental franchises, including franchises that are not subject to rate regulation.

In establishing low-priced life-line BBTs, Continental was permitted to adjust its CPS-tier rates to offset the 15% to 20% reductions in its BBT rates and to allow for external cost increases, inflation and channel additions permitted by the FCC's "going forward" rules (the "Going Forward Rules"). Under the Going Forward Rules, Continental, along with other cable operators, during the two-year period beginning January 1, 1995, is permitted to add new services to the CPS tier and to reflect the cost of those new services by an amount not to exceed \$.20 per added channel up to an aggregate of \$1.20, plus the actual license fees for the added channels not to exceed a total of \$.30. In 1997, a seventh channel may be added at a rate of \$.20 plus the license fee.

Pursuant to the Social Contract, Continental is permitted to conduct a second round of channel additions during the three-year period commencing January 1, 1998 on the same terms as the first round under the Going Forward Rules.

Continental is also permitted to average broad categories of equipment and various installation costs for all its systems on a state or region-wide basis, rather than on a franchise-by-franchise basis. This averaging is now also permitted by the Telecommunications Act of 1996 (the "1996 Telecommunications Act"), discussed herein. Such rates will be reviewed and approved by the FCC, subject to enforcement by local franchise authorities.

Finally, Continental is permitted on each system to move up to four existing services on CPS tier(s) to a single Migrated Product Tier, provided the Migrated Product Tier is offered without requiring customers to purchase any tier other than the BBT. The rates of the Migrated Product Tier will be regulated in accordance with price limits contained in the Social Contract until January 1, 1997, at which point Continental systems may elect to convert their Migrated Product Tiers into NPTs, as defined by the Going Forward Rules, provided the tiers continue to be offered without requiring customers to purchase any tier other than the BBT. The rates for the NPTs are regulated by market forces. See "Legislation and Regulation—Federal Regulation—Rate Regulation." In addition, Continental has the right to add an unlimited number of new channels to its Migrated Product Tier at \$.20 per channel, plus the actual license fees for the added channels.

Continental has the right to petition the FCC to incorporate acquisitions of cable television systems under the Social Contract. The Social Contract Amendment was released by the FCC for public comment on March 6, 1996.

The Social Contract Amendment, if adopted, would incorporate into the Social Contract all franchises acquired in the Providence Journal Merger and the Recent Acquisitions; resolve all CPS-tier rate cases involving the systems acquired in the Providence Journal Merger and the Recent Acquisitions; provide for cash refunds in the form of bill credits to affected customers totaling approximately \$1.6 million; and find that current rates being charged for CPS-tier services in all such franchises, except for Naples, Florida, are not unreasonable. Subscribers in the Naples, Florida system, which was acquired in the Providence Journal Merger, would receive their proportionate share of CPS-tier rate reductions not to exceed \$250,000 in the aggregate. For the systems acquired in the Providence Journal Merger and the Recent Acquisitions, Continental would establish a life-line BBT priced 15% to 20% below current rates and would recoup the reduced amount by a revenue-neutral increase on CPS-tier services, as in the original Social Contract.

The Company would be able to continue to offer all packages of a la carte channels that are currently offered in former Providence Journal systems; such packages would be treated as Migrated Product Tiers. The only exception would be Naples, Florida, where four of eight channels in the a la carte package would have to be moved to the CPS tier. New channels would be added to the Migrated Product Tier at a price of \$.20 per channel plus actual license fees. Where only one a la carte package was created, it may later be converted into an NPT. If two a la carte packages were created, they would remain Migrated Product Tiers through the term of the Social Contract. For systems acquired in the Providence Journal Merger and the Recent Acquisitions that did not create a la carte packages, the Company would be able to create Migrated Product Tiers consisting of up to four services migrated from regulated CPS tiers.

Local franchising authorities may elect to opt out of the \$1.6 million of cash refunds under the Social Contract Amendment, but would be bound by the other terms of the Social Contract Amendment. Further, if a local franchising authority in the Naples, Florida system elects to opt out of the cash refunds, subscribers in that franchise area would not receive their share of the \$250,000 prospective rate reduction.

The resolution of pending rate cases is without any finding by the FCC of any wrongdoing by the Company, Providence Journal or any of the entities from which the Company purchased systems in the Recent Acquisitions.

In addition, the proposed Social Contract Amendment would effect certain changes to the original Social Contract, such as an increase in the capital investment commitment from \$1.35 billion to \$1.7 billion for the upgrade of Continental's systems, including the systems acquired in the Providence Journal Merger and the Recent Acquisitions. In addition, instead of using the Going Forward Rules and the second round of Going Forward Rules permitted by the Social Contract, Continental would agree to add, on average, 10 additional regulated services to the CPS tier during the life of the Social Contract and would be able to increase monthly rates for the CPS tier by \$1.00 each year in the systems acquired in the Providence Journal Merger and the Recent Acquisitions from 1996 through 1999 (net of any Going Forward increases taken in 1996) and by \$1.00 each year in all other Continental systems from 1997 through 1999. During the life of the Social Contract, the only other permitted CPS-tier increases would be for inflation and increases in external costs. The Company would provide a free cable connection to public schools (K-12) and a cable connection at cost to secondary private schools whose students receive funding under Title I of the Elementary and Secondary Education Act and would provide free cable service to all connected schools. Within one year of the commercial availability of a Continental on-line service for personal computers, the Company would, upon request, provide the cable-connected schools with one free modem and free on-line service during the school year. Additional modems would be made available at cost. The Company would also provide teacher training and support.

The rate restructuring, Migrated Product Tier and "Going Forward" adjustments that Continental has implemented under the Social Contract and the Social Contract Amendment, if adopted, will continue to apply to systems divested by Continental through a system sale or exchange. Other rights and obligations will apply only if the new owner notifies the FCC that it agrees to be bound by the same or similar terms and conditions as those contained in the Social Contract and the Social Contract Amendment, if adopted. Continental will not be relieved of its total capital investment requirement under the Social Contract and the Social Contract Amendment, if adopted, by reason of these divestitures. The Social Contract also provides for its termination in the future if the laws and regulations applicable to services offered in any Continental franchise change in a manner that would have a material favorable financial impact on Continental. In that instance, the Company may petition the FCC to terminate the Social Contract.

In February 1996, the 1996 Telecommunications Act was enacted into law. The 1996 Telecommunications Act modifies various provisions of the Communications Act of 1934, the Cable Communications Policy Act of 1984 (the "1984 Cable Act") and the 1992 Cable Act, with the intent of establishing a pro-competitive, deregulatory policy framework for telecommunications. Among other provisions, discussed below, the 1996 Telecommunications Act sets a date for removal of CPS-tier rate regulations, allows telephone companies to build and operate cable systems in their local markets, and sets forth the conditions for voice and data competition in the local telephone market. The Company at this time cannot predict the full effect that the 1996 Telecommunications Act or the FCC's implementing regulations may have on Continental's operations. See "Legislation and Regulation."

U.S. Systems

The following table summarizes the growth of the Company and its affiliates within the United States since December 31, 1993.

	As of December 31,		
	1993	1994	1995
Homes passed by cable (1)	5,192,000	5,372,000	7,191,000
Number of basic subscribers (2)	2,895,000	3,081,000	4,190,000
Basic penetration (3)	55.8%	57.4%	58.3%
Number of premium subscriptions (4)	2,454,000	2,635,000	3,770,000
Premium penetration (5)	84.8%	85.5%	90.0%
Monthly cable revenue per average basic subscriber (6)	\$35.69	\$35.06	\$35.99

- (1) Represents estimated dwelling units located sufficiently close to the Company's cable plant to be practicably connected without any further extension of principal transmission lines.
- (2) A "basic subscriber" means a person who, at a minimum, subscribes to the Company's BBT which consists of broadcast television signals available off-air locally, local origination and public, educational and governmental access channels. Bulk subscribers are accounted for on an "equivalent billing unit" basis, dividing aggregate BBT revenues by the stated BBT rate.
- (3) Basic subscribers as a percentage of homes passed by cable.
- (4) Equals the number of premium services subscribed to by basic subscribers. Premium services include only single channel services offered for a monthly fee per channel and do not include packages of channels offered for a single monthly fee.
- (5) Premium subscriptions as a percentage of basic subscribers. A basic subscriber may purchase more than one premium service, each of which is counted as a separate premium subscription. This ratio may be greater than 100% if the average customer subscribes to more than one premium service.
- (6) Cable revenues (excluding DBS-service revenues) divided by the weighted average number of basic subscribers for the Company's consolidated subsidiaries during the twelve-month period ended December 31 for each year presented.

The following table sets forth operating information pertaining to Continental's U.S. systems and the systems of certain U.S. affiliates as of December 31, 1995.

Management Region	Homes Passed By Cable	Number of Basic Subscribers	Basic Penetration	Number of Premium Subscriptions	Premium Penetration
Northeast Region					
Eastern New England (MA)	473,638	327,757	69.2%	306,567	93.5%
Southern New England (RI, MA)	386,406	266,399	68.9%	250,831	94.2%
Northern New England (NH, ME)	232,762	17,265	76.2%	114,963	64.9%
Western New England (MA, CT)	221,888	152,976	68.9%	132,412	86.6%
New York (Haverstraw/Ossining)	149,645	119,604	79.9%	98,329	82.2%
Total	1,464,339	1,044,001	71.3%	903,102	86.5%
Western Region					
Southern California	1,419,184	559,761	39.4%	645,954	115.4%
Greater Metropolitan Fresno	334,197	158,084	47.3%	167,242	105.8%
Greater Metropolitan Stockton	194,625	112,415	57.8%	62,215	55.3%
Yuba City, California	44,215	32,664	73.9%	44,108	135.0%
Reno, Nevada	13,748	9,915	72.1%	6,453	65.1%
Northern California/Washington/Idaho	52,897	35,185	66.5%	15,822	45.0%
Total	2,058,866	908,024	44.1%	941,794	103.7%
Southeast Region					
Jacksonville, Florida	416,997	242,636	58.2%	254,134	104.7%
Pompano/Hialeah, Florida	386,633	231,611	59.9%	171,741	74.2%
Naples, Florida	178,446	121,246	68.0%	61,085	50.4%
Richmond, Virginia	246,425	166,932	67.7%	140,421	84.1%
Total	1,228,501	762,425	62.1%	627,381	82.3%
Midwest Region					
Greater Dayton	250,331	172,115	68.8%	123,885	72.0%
Greater Metropolitan Detroit	394,231	259,784	65.9%	223,868	86.2%
Lansing and Greater Metropolitan Lansing	125,412	85,986	68.6%	54,437	63.3%
Greater Metropolitan Cleveland	122,706	86,697	70.7%	62,335	71.9%
North Central Ohio	121,156	83,874	69.2%	56,673	67.6%
Total	1,013,836	688,456	67.9%	521,198	75.7%
Central Region					
Greater Metropolitan Chicago (West)	630,425	348,085	55.2%	408,202	117.3%
Southern Illinois	85,477	61,657	72.1%	35,731	58.0%
St. Louis, Missouri (1)	174,297	100,393	57.6%	119,879	119.4%
Minneapolis/St. Paul, Minnesota	311,785	153,721	49.3%	135,883	88.4%
Total	1,201,984	663,856	55.2%	699,695	105.4%
Affiliated Companies (2)	223,411	123,397	55.2%	77,322	62.7%
Total	7,190,937	4,190,159	58.3%	3,770,492	90.0%
Systems Designation:					
Consolidated Systems	6,967,526	4,066,762	58.4%	3,693,170	90.8%
Affiliated Companies (2)	223,411	123,397	55.2%	77,322	62.7%
Total	7,190,937	4,190,159	58.3%	3,770,492	90.0%

- (1) The Company has entered into an agreement to exchange these systems for other systems in New England. See "U.S. Acquisitions and Investments—Other Acquisitions."
- (2) Affiliated Companies are those companies not majority-owned or controlled by the Company. The systems held by Affiliated Companies consist of systems held by four limited partnerships. See "U.S. Acquisitions and Investments—U.S. Minority Cable Investments." The Company owns less than 50% of the outstanding limited partnership interests of each such partnership. None of the systems owned by Affiliated Companies are managed by the Company. In reporting subscriber and other data for systems not controlled or managed by the Company, only that portion of data corresponding to the Company's percentage ownership is included.

Management Regions. A description of Continental's five U.S. cable television management regions and their significant operating clusters is set forth below.

Northeast. The Northeast region is Continental's largest management region based on the number of basic cable subscribers, representing approximately 20.4% of Continental's total homes passed and 24.9% of its total basic subscribers as of December 31, 1995. This region includes systems in the New England states of Maine, New Hampshire, Massachusetts, Connecticut and Rhode Island, as well as in and around Westchester County, New York. Significant operating clusters in Massachusetts, which include greater metropolitan Boston and the city of Springfield and the surrounding communities in the western part of the state, represent approximately 68.4% of the region's total basic subscribers. The Northeast region commenced a five-year rebuild program in 1994, which upon completion will result in a combination of 550 MHz and 750 MHz capacity for most of the region. The median household income for the communities served by Continental in the Northeast region is approximately \$47,700, versus the national median household income of \$37,900.

Western. The Western region represented approximately 28.6% of Continental's total homes passed and 21.7% of its total basic subscribers as of December 31, 1995. This region includes systems in the city and county of Los Angeles, where Continental is the largest cable operator, with approximately 560,000 of its basic subscribers clustered in geographically contiguous franchises served by two headends. This region also includes Continental's Northern California systems, which include the cities of Fresno, Visalia, Stockton, and Yuba City, as well as Reno, Nevada. An upgrade of the Los Angeles systems, that will bring capacity to 750 MHz, is currently under way. The median household income for the communities served by Continental in the Western region is approximately \$41,300.

Southeast. The Southeast region represented approximately 17.1% of Continental's total homes passed and 18.2% of its total basic subscribers as of December 31, 1995. This region includes significant operating clusters serving the communities surrounding Jacksonville, Naples and Pompano, Florida and Richmond, Virginia. The Jacksonville cluster is one of Continental's largest, serving over 240,000 basic subscribers. In 1994, the Jacksonville and Pompano systems commenced rebuild projects which will provide 750 MHz capacity to fiber nodes serving approximately 1,000 or fewer homes by 1997. The median household income for the communities served by Continental in the Southeast region is approximately \$35,600.

Midwest. The Midwest region represented approximately 14.1% of Continental's total homes passed and 16.4% of its total basic subscribers as of December 31, 1995. This region includes systems in greater metropolitan Detroit and Lansing, which includes the communities of Southfield, Dearborn Heights, Westland, and Jackson. In Ohio, Continental's systems serve the greater Dayton and Cleveland communities, as well as several communities throughout North Central Ohio. The Dayton systems have recently been rebuilt to provide 550 MHz capacity to fiber nodes serving approximately 2,000 or fewer homes. The median household income for the communities served by Continental in the Midwest region is approximately \$40,000.

Central. The Central region represented approximately 16.7% of Continental's total homes passed and 15.8% of its total basic subscribers as of December 31, 1995. This region includes systems in metropolitan Chicago and Southern Illinois, Minneapolis/St. Paul, Minnesota, and St. Louis, Missouri. Continental's metropolitan Chicago cluster, which includes the suburban Chicago communities of Elmhurst, Forest Park, Oak Brook, Rosemont, Northfield, Westchester, and Wilmette, is one of Continental's largest, with approximately 348,000 basic subscribers served by four headends. All of the Central region's systems are scheduled to be rebuilt or upgraded by 1997, at which time all major markets will have between 600 MHz and 750 MHz capacity. The Company has entered into an agreement to exchange its systems in St. Louis for other systems in New England. See "U.S. Acquisitions and Investments—Other Acquisitions." The median household income for the communities served by Continental in the Central region is approximately \$44,800.

Franchises. Continental believes it has maintained good relations with its local franchise authorities. Continental has never had a franchise revoked, and to date all of its franchises have been renewed or extended at their expirations, frequently on modified but satisfactory terms. Continental's franchises establish the terms and conditions under which the systems are operated. Typically, they establish certain performance and safety standards related to the Company's construction and maintenance of facilities in, under and over public streets and rights-of-way in the franchise areas. Some, but not all, of these franchises specify the services to be offered. Nearly all of the Company's franchises provide for the payment of fees to the local franchising authorities, which currently average approximately 3.2% of gross revenues. The 1984 Cable Act prohibits local franchising authorities from imposing annual franchise fees in excess of 5.0% of gross revenues and also permits the cable system operator to seek renegotiation and modification of franchise requirements if warranted by changed circumstances. The Company's franchises are usually issued for fixed terms ranging from 10 to 15 years and must periodically be renewed. Most of such franchises can be terminated prior to their stated expirations for breach of material provisions.

Franchises representing approximately 1.7 million basic subscribers are scheduled to expire through 2000. The 1984 Cable Act provides, among other things, for an orderly franchise renewal process in which a franchise renewal will not be unreasonably withheld or, if renewal is withheld and the system is acquired by the franchise authority or a third party, the franchise authority must pay the operator the "fair market value" of the system covered by such franchise. In addition, the 1984 Cable Act establishes comprehensive renewal procedures which require that an incumbent franchisee's renewal application be assessed on its own merit and not as part of a comparative process with competing applications. See "Legislation and Regulation—Cable Communications Policy Act of 1984."

Programming. The Company provides programming to its subscribers pursuant to contracts with programming suppliers. The Company generally pays a flat monthly fee per subscriber for programming on its basic and premium services. Some programming suppliers provide volume discount pricing structures and/or offer marketing support to the Company. The Company's programming contracts are generally for fixed periods of time ranging from 3 to 10 years and are subject to negotiated renewal. The costs to the Company to provide cable programming have increased in recent years and are expected to continue to increase due to additional programming being provided to basic subscribers, increased costs to produce or purchase cable programming, inflationary increases and other factors. Increases in the cost of programming services have been offset in part by additional volume discounts as a result of the growth of Continental and its success in selling such services to its customers. Effective in May 1994, the FCC's rate regulations under the 1992 Cable Act permit operators to pass through to customers increases in programming costs in excess of the inflation rate. Management believes that Continental will continue to have access to programming services at reasonable price levels. See "Legislation and Regulation."

The "program-access" provisions of the 1992 Cable Act require that much of the cable network programming in which Continental has an ownership interest be sold, under certain circumstances, to multichannel video programming providers that compete with Continental's local cable systems. The 1996 Telecommunications Act extends the program-access requirements of the 1992 Cable Act to a telephone company that provides video programming by any means directly to subscribers, and to programming in which such a company holds an attributable ownership interest, thus allowing Continental's cable systems similar access to programming developed by their telephone company competitors.

Must Carry/Retransmission Consent. The 1992 Cable Act contains broadcast signal carriage requirements, and the FCC has adopted regulations which are currently in force implementing such statutory carriage requirements. These new rules allow local commercial television broadcast stations, commencing on June 17, 1993 and every three years thereafter, either to elect required carriage ("must-carry" status), or to require a cable television system to negotiate for "retransmission consent" rights. A cable television system generally is required to devote up to one-third of its activated channel capacity for the mandatory carriage of

local commercial television stations. Local non-commercial television stations are also given mandatory carriage rights on cable television systems under the 1992 Cable Act and the FCC's rules; however, such stations are not given the option to negotiate for retransmission consent rights. Additionally, as of October 6, 1993, cable television systems were required to obtain retransmission consent for all "distant" commercial television stations (except for commercial satellite-delivered independent "superstations" such as WTBS), commercial radio stations and certain low-power television stations carried by cable television systems. Continental has been successful at reaching retransmission consent agreements for terms generally ranging from three to seven years with virtually all of the local broadcast stations that elected retransmission consent (all without payment of cash compensation), and only in a very few instances has Continental been forced to drop a local broadcast signal from its programming. Some of Continental's systems have been required to carry television broadcast stations that they otherwise would not have elected to carry due to must-carry elections. At this time, Continental cannot predict the outcome of any future must-carry elections by and retransmission consent negotiations with local broadcasters. A second election period for must-carry or retransmission consent will occur for many stations this year, ending on October 6, 1996. See "Legislation and Regulation."

U.S. Acquisitions and Investments

Continental has recently acquired or agreed to acquire cable television systems that are contiguous, or in close proximity, to its existing systems. The Company also continues to review opportunities to exchange additional systems for those of other cable television system operators in order to enlarge and enhance its system clusters. See "Other U.S. Acquisitions." Continental generates incremental operating income from such acquisitions and exchanges through the expansion of service offerings and efficiencies resulting from system consolidation.

The Providence Journal Merger. The Company recently completed a series of acquisitions in the United States, the most significant of which was the acquisition of the cable television businesses and assets of Providence Journal. On October 5, 1995, pursuant to the terms of an Agreement and Plan of Merger, dated as of November 18, 1994, as amended and restated as of August 1, 1995, by and among Continental, Providence Journal, The Providence Journal Company, King Holding Corp. and King Broadcasting Company, Continental acquired all of the cable television businesses and assets of Providence Journal ("Providence Journal Cable") in a series of related transactions, the result of which was that Providence Journal, following an internal corporate restructuring in which the non-cable businesses and assets of Providence Journal were transferred to The Providence Journal Company (a newly formed company), merged with and into Continental. Continental issued approximately 30.1 million shares of Class A Common Stock to Providence Journal stockholders in the Providence Journal Merger. The shares of Class A Common Stock received in the Providence Journal Merger are not transferable by the former Providence Journal stockholders except for transfers not for value to certain specified permitted transferees until October 5, 1996.

As part of the Providence Journal Merger, Continental also purchased certain cable television systems owned by a subsidiary of Providence Journal for a purchase price of \$405.0 million and discharged approximately \$410.0 million of Providence Journal liabilities. The systems acquired in the Providence Journal Merger passed approximately 1.3 million homes and served approximately 779,000 basic subscribers in nine states. Such systems are, for the most part, located in communities contiguous, or in close proximity to other Continental systems.

Other U.S. Acquisitions. The following is a summary of other recent acquisitions of U.S. cable systems consummated during the year ended December 31, 1995 and other pending transactions:

In August 1995, Continental acquired Cablevision of Chicago's systems serving approximately 88,000 basic subscribers in the Chicago, Illinois area for a purchase price of approximately \$168.5 million. These systems are in close proximity to Continental's existing systems in its Central region.

In September 1995, Continental acquired Consolidated Cablevision of California's systems serving approximately 12,000 basic subscribers in northern California for approximately \$17.0 million. These systems are in close proximity to Continental's existing systems in its Western region.

In October 1995, Continental purchased Columbia Cable of Michigan's systems serving approximately 74,000 basic subscribers in Michigan for approximately \$155.0 million. In December 1995, Continental acquired the remaining partnership interests and discharged certain liabilities of N-COM, a limited partnership that operates cable television systems serving approximately 56,000 basic subscribers in greater metropolitan Detroit for approximately \$88.0 million. The Columbia Cable of Michigan and N-COM systems are in close proximity to other Continental systems in its Midwest region.

In March 1996, Continental entered into a purchase agreement to acquire the remaining partnership interests (the "Pending M/NH Buyout") in Meredith/New Heritage Strategic Partners L.P. ("M/NH"). The purchase agreement remains subject to the completion of certain schedules and exhibits thereto. Continental currently owns a 37.9% interest in M/NH. Under the current terms of the transaction, Continental would acquire the remaining interests in M/NH for a cash purchase price of approximately \$129.2 million, plus the assumption or repayment of approximately \$90.0 million of indebtedness. As of December 31, 1995, M/NH owned and operated cable television systems serving approximately 126,000 basic subscribers in the Minneapolis/St. Paul, Minnesota area. These systems are in close proximity to Continental's other systems in the Minneapolis/St. Paul area. The closing of the Pending M/NH Buyout is expected to occur in the third quarter of 1996.

In December 1995, Continental and TCI Cable Partners of St. Louis L.P. ("TCI Cable Partners") agreed to a tax-free exchange of the Company's systems in and around St. Louis County, Missouri for TCI Cable Partners' systems in and around Andover, Barnstable, Nantucket and Waltham, Massachusetts. The systems of each party cover approximately 100,000 basic subscribers. The Company expects to consummate this transaction in the second quarter of 1996.

U.S. Minority Cable Investments. The acquisitions of minority ownership interests in various U.S. cable television companies has contributed to Continental's nationwide operating scale. As of December 31, 1995, Continental held minority ownership positions in the following U.S. cable companies:

Investment	As of December 31, 1995			
	Homes Passed	Total Basic Subscribers	Total Debt	Percentage Ownership
		(dollars in thousands)		
Insight Communications Company, L.P.	304,261	163,923	\$172,975	34.4%
Meredith/New Heritage Strategic Partners, L.P.(1)	240,786	126,047	88,732	37.9%
Prime Cable of Hickory, L.P.	53,047	36,535	38,342	33.3%
Inland Bay Cable TV Associates	19,922	14,361	4,639	49.0%

- (1) Continental has entered into a purchase agreement to acquire the remaining ownership interests in M/NH from the other partners and discharge or assume certain liabilities for total consideration of approximately \$219.2 million. No assurances can be made at this time that such transaction will be consummated. See "U.S. Acquisitions and Investments—Other U.S. Acquisitions."

International Operations

Continental has made investments in international broadband communications networks, principally in Latin America and the Pacific Rim. These investments represent opportunities for Continental to capitalize on its managerial, technical and marketing expertise in international markets.

Argentina. Continental owns an approximate 50% interest in Fintelco, S.A. ("Fintelco") an Argentine cable television operator. Fintelco is the largest cable television operator in Argentina, with approximately 616,000 subscribers in regional system clusters in the Argentine provinces of Buenos Aires, Cordoba and Santa Fe. These systems are currently managed by Continental's Argentine partner, with technical assistance provided by Continental.

Fintelco's operating strategy focuses on creating large regional system clusters in key markets. As of December 31, 1995, Fintelco had approximately 315,000 subscribers in the province of Buenos Aires, 179,000 subscribers in the province of Cordoba and 122,000 subscribers in the province of Santa Fe. Average monthly subscriber rates for Fintelco's cable television services are the equivalent of approximately US\$30. Most systems in Argentina provide a single package of services, which typically includes premium movie channels such as HBO Olé. For the fiscal year ended November 30, 1995, Fintelco recorded revenues of approximately US\$244.0 million and operating income before depreciation and amortization of approximately US\$47.0 million.

There is currently no regulation of cable subscription rates in Argentina. Cable operators in Argentina are issued non-exclusive broadcast licenses for the carriage of their programming services, and may compete with other cable operators for the same subscribers. The multi-channel television industry in Argentina is extremely competitive. Fintelco competes in certain areas of Buenos Aires, Cordoba and Santa Fe. Fintelco believes that competition is primarily based on price, program offerings, customer satisfaction and quality of the system network. Other cable operators in Buenos Aires include: Cablevision, S.A. (which is currently 51% owned by an affiliate of U.S. cable operator Tele-Communications, Inc. ("TCI")), Grupo Clarin (d/b/a Multicanal) and Fin Cable S.A. (d/b/a Telefe).

In November 1990, the Argentine telephone system was privatized and two companies, Telefónica de Argentina S.A. ("Telefónica") and Telecom Argentina STET- France Telecom S.A. ("Telecom"), were granted exclusive licenses to provide local and long-distance telephony service. The exclusivity of these licenses is scheduled to expire in 1997, but may be extended for an additional three-year period if the licensees have met certain mandatory standards for the expansion of their telephone networks and improvements in quality of service. No assurance can be given, however, that cable operators in Argentina will be permitted to offer telephony services in 1997, in 2000 or at any other time in the future. During the period their telephony licenses are exclusive, Telefónica and Telecom are not permitted to provide cable television on a commercial basis over their networks.

Australia. Continental has entered into an agreement with Optus Communications Pty Limited ("Optus"), the second licensed carrier in Australia, providing long-distance and cellular telephone services, Publishing and Broadcasting Limited ("Nine"), the parent company of Kerry Packer's Nine Network, and Seven Network Limited ("Seven") to create a broadband communications network in Australia. The venture ("Optus Vision") is owned 46.5% by Continental, 46.5% by Optus, 5% by Nine and 2% by Seven. Nine and Seven represent two of Australia's three major commercial television networks. Each of Nine and Seven has an option to increase at fair market value its shareholding to 20% and 15%, respectively, at any time prior to July 1, 1997. Optus Vision is providing cable television, and will provide local telephone and a variety of advanced broadband interactive services to business and residential customers in Australia's major markets. Optus Vision anticipates that it will begin to offer local telephone service in the second half of 1996.

Australia has a population of approximately 17.8 million, with over 5.6 million television households and VCR penetration of approximately 71%. Construction of the Optus Vision network began in March 1995. Optus Vision's plan anticipates passing approximately 2.9 million households throughout Australia by mid-1998, beginning with the major metropolitan centers of Sydney, Melbourne and Brisbane.

Although the network will have capacity for 64 channels, Optus Vision began providing a programming package in September 1995, which now has 17 channels including three movie channels, three sports channels and a variety of local and international programming.

The subscription television industry in Australia has been and is expected to continue to be competitive. Optus Vision expects to compete in Australia with, among others, (i) FOXTEL, the joint venture between Telstra Corporation Limited, the government-owned Australian national telecommunications carrier, and The News Corporation Limited, a major international media and entertainment company, which provides subscription

television services under the name FOXTEL over a cable television network, and (ii) Australis Media Ltd. ("Australis"), which currently provides subscription television services by way of Multi-channel, Multi-point Distribution Services ("MMDS"), commonly called wireless cable systems, under the name Galaxy and will provide services by way of both MMDS and DBS technology in the future.

FOXTEL has entered into a long-term programming agreement for the exclusive distribution of Australis' programming. FOXTEL and Australis announced a proposed merger of their operations in October 1995. In February 1996, the Australian Competition and Consumer Commission announced that the proposed merger would breach certain provisions of the Trade Practices Act. As a result, the merger of FOXTEL and Australis has not proceeded as proposed.

Optus Vision currently employs approximately 1,600 people, including several former Continental employees. H. Franklin Anthony III, the former Senior Vice President and General Manager of Continental's Northeast region, serves as the Chief Operating Officer of Optus Vision.

Singapore. Continental has a 25% equity interest in Singapore Cablevision Pte Ltd ("SCV"), a joint venture that is constructing a high-capacity network to provide cable television and a variety of interactive services to substantially all of Singapore's approximate 820,000 households. SCV has the exclusive right, through June 2002, to provide traditional cable television service in Singapore. Cable television service has not previously been available in Singapore. Continental's partners in this venture are Singapore Technologies Venture Pte. Ltd., Singapore International Media Pte. Ltd. and Singapore Press Holdings Limited, each of which is affiliated with the government of Singapore. The system activated its first subscribers in June 1995, and by 1999, when construction is expected to be completed, it is anticipated that there will be nearly one million households in Singapore. SCV's service offerings include both Mandarin and English language programming. Continental is managing the system's construction and ongoing operations under a five-year agreement, for which it receives management fees based upon the gross revenues generated by the system.

Telecommunications and Technology

Continental is currently rebuilding and upgrading its U.S. systems to create advanced hybrid fiber-optic and coaxial cable networks that will serve as the infrastructure for the provision of enhanced video, high-speed data, telephony and other telecommunications services. Although Continental believes that demand exists to support the entry of cable television companies into the telephony business, the offering of these services will require the removal of existing regulatory and legislative barriers to local telephone competition. See "Competition" and "Legislation and Regulation."

TCG. Continental currently has a 20% equity interest in Teleport Communications Group, Inc. ("TCG"), a leading "competitive-access provider" in the United States. TCG is a local telecommunications services provider and a leading fiber-optic-based competitor to local telephone companies nationwide. TCG provides local telecommunications services primarily over high-capacity fiber-optic networks (which it owns or leases from cable operators such as Continental) to meet the voice, data and video transmission needs of high-volume business customers in major metropolitan areas throughout the United States. TCG's customers include long-distance carriers and resellers, international telephone carriers, financial services firms, banking and brokerage institutions, media companies and other telecommunications-intensive businesses. In competition with the Regional Bell Operating Companies ("RBOCs") and other Local Exchange Carriers ("LECs"), TCG offers its customers vendor diversity for local service, superior quality, competitive pricing and state-of-the-art technology.

Since 1985, TCG has owned and operated the nation's largest non-LEC local telecommunications network in the New York City metropolitan area, the country's leading telecommunications market. Beginning in 1988 with the construction of a Boston network, TCG has expanded its network operations to 26 telecommunications markets in the United States, including Los Angeles, Chicago, San Francisco, Dallas, Detroit, Miami, Houston, Seattle, San Diego and Milwaukee. In several of these markets, Continental is a partner and a primary network provider for TCG.

In addition to Continental, the other partners in TCG include Cox Cable Communications, Inc. ("Cox"), TCI and Comcast Corporation ("Comcast"), which currently have interests of approximately 30%, 30% and 20%, respectively.

Other Telecommunications Activities. Continental also owns an 80.0% interest in Continental Fiber Technologies, Inc. and a 63.0% interest in Alternet of Virginia, Inc., which both have fiber-optic networks that they own or lease from Continental. Such networks provide local telephony service to business customers in Jacksonville, Florida and Richmond, Virginia, respectively.

Continental is currently certificated to provide residential telephony service in Florida and California and has already installed telephony switching equipment in Jacksonville, Florida. The Company plans to provide residential telephone service initially to multiple-dwelling units in selected Florida communities in 1996 and introduce residential telephone service to single-family homes by 1997. Continental has applied for certification to provide telephony services in New Hampshire and will likely apply for certification in Massachusetts, Illinois, Ohio, Virginia and Michigan during 1996.

PrimeStar. Continental currently owns a 10.4% interest in PrimeStar, a nationwide provider of DBS service. The remaining interests in PrimeStar are held by GE Americom Services, Inc. (an affiliate of General Electric) with 16.6% and five other cable television operators (TCI and Time Warner Cable own 20.9% each; Comcast, Cox and Newhouse Broadcasting Corp. own 10.4% each).

PrimeStar provided medium-powered DBS service to approximately 961,000 customers nationwide as of December 31, 1995. PrimeStar acts as a wholesaler of DBS services, securing programming services for eventual resale to consumers and arranging for the transmission of the programming via satellite. PrimeStar does not sell directly to end users, but rather sells the rights to resell programming to local distributors, including Continental and its other cable partners, who in turn sell to, service, and collect monthly fees from consumers. Continental served approximately 80,000 of PrimeStar's customers as of December 31, 1995. During the year ended December 31, 1995, Continental recorded DBS-service revenue of \$37.0 million and operating income before depreciation and amortization of \$4.3 million. PrimeStar currently offers a wide range of programming, including 73 channels of cable and network television, sports and movies, as well as several music channels. In order to expand its service, PrimeStar's partners have agreed in principal on a long-term path for medium-powered DBS service with the option for a fifteen-year transponder lease from GE Americom Communications, Inc. This would give PrimeStar the potential to deliver approximately 150 channels of programming. PrimeStar is still considering its options for the delivery of high-powered DBS service following the conclusion of an FCC auction, which left PrimeStar without the assured use of certain desirable spectrum frequencies for high-powered service.

The following is a summary of financial and operating statistics for PrimeStar, which commenced operations in 1991.

	Year Ended December 31,		
	1993	1994	1995
	(dollars in thousands)		
Revenues	\$10,900	\$27,800	\$180,595
Growth rate	110%	155%	550%
Customers	66,800	230,800	961,200
Growth rate	51%	246%	316%

Programming and Other Investments

Continental has made minority investments in programming services based upon Continental's belief that programming is a means of generating additional interest in cable television. The following summarizes certain of Continental's programming investments:

Turner Broadcasting System, Inc. and Home Shopping Network, Inc. Continental holds marketable equity securities of Turner Broadcasting System, Inc. ("Turner") and HSN. As of December 31, 1995, the approximate market values of Continental's investments in Turner and HSN were \$147.0 million and \$4.4 million, respectively. On September 22, 1995, Turner and Time Warner, Inc. ("Time Warner") entered into a merger agreement providing for the merger of Turner into a wholly owned subsidiary of Time Warner. The merger agreement provides that all outstanding shares of Turner capital stock will be converted into shares of Time Warner common stock. If the merger is consummated under its current terms, the Company will receive approximately 4.4 million shares of Time Warner common stock in exchange for its shares of Turner capital stock. The merger is subject to a number of conditions, including regulatory approvals. There can be no assurances that all of the conditions to the consummation of the merger will be satisfied or that, as a condition to the grant of regulatory approvals, changes will not be required to the terms of the merger. The approximate market value of the Time Warner shares that Continental would have received had the merger taken place as of March 11, 1996 would have been approximately \$189.8 million. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources." Timothy P. Neher, Director and Vice Chairman of the Board of Continental, serves on the Board of Directors of Turner.

E! Entertainment Television, Inc. Continental owns a 10.4% interest in E! Entertainment Television, Inc. ("E!"), whose programming includes entertainment related news, information and features. E! has agreements with every major U.S. cable television operator and, as of December 31, 1995, was distributed to approximately 37.3 million customers, representing more than 50% of U.S. multi-channel television households. Other shareholders in E! include Comcast, Cox and TCI, each with an approximate 10.4% interest, and Time Warner Cable, with a 48% interest. Robert A. Stengel, a Senior Vice President of Continental, serves on the Board of Directors of E!.

The following is a summary of financial and operating statistics for E!:

	Year Ended December 31,		
	1993	1994	1995
	(in thousands, except percentages)		
Revenues	\$31,700	\$49,100	\$74,300
Growth rate	43.4%	54.9%	51.3%
Subscribers	25,800	27,800	37,300
Growth rate	30.1%	7.8%	34.2%

National Cable Communications, L.P. Continental has a 12.5% limited partnership interest in NCC, the largest representation firm in spot cable advertising sales. The other limited partners in NCC are Cox, Time Warner Cable and Comcast, each with a 12.5% interest. NCC's managing partner is Katz Cable Corporation, with a 50.0% interest. Robert A. Stengel, a Senior Vice President of Continental, serves on the management committee of NCC. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

New England Cable News. Continental and The Hearst Corporation each own 50% of New England Cable News, a regional cable news network featuring news, sports and weather programming on an exclusive basis to cable television systems in the New England area. New England Cable News had revenues of \$5.5 million for the year ended December 31, 1995. Russell Stephens, a Senior Vice President of Continental's Northeast region, serves on the Board of Directors of New England Cable News.

Viewer's Choice. PPVN Holding Co. ("PPVN"), which operates under the brand-name Viewer's Choice, is a cable operator-controlled buying cooperative and distributor for pay-per-view programming. Continental holds a 10.0% interest in PPVN. William T. Schleyer, the President and Chief Operating Officer of Continental, serves on the Board of Directors of PPVN.

The Golf Channel. Continental owns an approximate 20.2% interest in The Golf Channel, a cable programming service which provides golf-related programming 24 hours a day. Timothy P. Neher, Director and Vice Chairman of the Board of Continental, serves on the Board of Directors of The Golf Channel.

TV Food Network. Continental owns an approximate 15.0% interest in the TV Food Network, a cable operator-owned programming service which offers programs on cooking, food preparation and other related topics. Robert A. Stengel, a Senior Vice President of Continental, serves on the Management Committee of the TV Food Network.

The Sunshine Network. Continental owns an approximate 7.5% interest in The Sunshine Network, a joint venture that provides programming consisting of Florida sporting events, sports news and related programs, as well as local public affairs programs. Jeffrey T. DeLorme, an Executive Vice President of Continental, serves on the Board of Directors of The Sunshine Network.

Music Choice. Digital Cable Radio Associates ("Music Choice") distributes audio programming in digital format over coaxial cable. The service allows cable television customers to receive compact disc-quality sound in several music formats. Continental owns an approximate 10.1% interest in Music Choice. Robert A. Stengel, a Senior Vice President of Continental, serves on the Board of Directors of Music Choice.

Outdoor Life Network and Speedvision. Continental owns an approximate 23.0% and 22.1% interest in the Outdoor Life Network and Speedvision, respectively, both newly created programming services. The Outdoor Life Network is the first 24-hour network dedicated entirely to outdoor activities. Speedvision is the first network for automotive, marine and aviation enthusiasts. Both of these programming ventures are scheduled to debut in 1996. Robert A. Stengel, a Senior Vice President of Continental serves on the Board of Directors of both Outdoor Life and Speedvision.

Competition

Cable Television Competition. Continental's systems compete with other communications and entertainment media, including conventional off-air television broadcasting services, newspapers, movie theaters, live sporting events and home video products. Cable television service was first offered as a means of improving television reception in markets where terrain factors or remoteness from major cities limited the availability of off-air television. In some of the areas served by Continental's systems, a substantial variety of television programming can be received off-air, including low-power (UHF) television stations, which have increased the number of television signals in the country and provided off-air television programs to limited local areas. The extent to which cable television service is competitive depends upon a cable television system's ability to provide, on a cost-effective basis, an even greater variety of programming than that available off-air or through other alternative delivery sources.

Since Continental's U.S. cable television systems operate under non-exclusive franchises, other companies may obtain permission to build cable television systems in areas where Continental presently operates. Telephone company affiliates have recently applied for and been granted franchises in certain markets in which Continental operates. While Continental believes that the current level of overbuilding is not material, it is currently unable to predict the extent to which overbuilds may occur in its franchise areas and the impact, if any, such overbuilds may have on Continental in the future.

Additional competition may come from satellite master antenna television ("SMATV") systems serving condominiums, apartment complexes and other private residential developments. The operators of these private systems often enter into exclusive agreements with apartment building owners or homeowners' associations that preclude operators of franchised cable television systems from serving residents of such private complexes. The widespread availability of reasonably priced earth stations enables private cable television systems to offer both improved reception of local television stations and many of the same satellite-delivered program services that are offered by franchised cable television systems. FCC regulations permit SMATV operators to use point-to-

point microwave service to distribute video entertainment programming to their SMATV systems. A private cable television system normally is free of the regulatory burdens imposed on franchised cable television systems. Although a number of states have enacted laws to afford operators of franchised cable television systems access to private complexes, the U.S. Supreme Court has held that cable companies cannot have such access without compensating the property owner. The access statutes of several states have been challenged successfully in the courts, including those of states in which Continental operates.

In recent years, the FCC has initiated new policies and authorized new technologies to provide a more favorable operating environment for certain existing technologies and to create substantial additional competition to cable television systems. These technologies include, among others, DBS services, which transmit signals by satellite to receiving facilities located on customers' premises. Although satellite-delivered programming has been available to backyard earth stations for some time, new, high-powered direct-to-home satellites make possible the wide-scale delivery of programming to individuals throughout the United States using roof-top or wall-mounted antennas. Companies offering DBS services use video compression technology to increase channel capacity and to provide a package of movies, broadcast and other program services highly competitive with those of cable television systems. Two companies began offering high-powered DBS service in 1994 and a third company began service in 1996 in competition with cable television operators and PrimeStar. Continental has invested in PrimeStar, a medium-powered DBS-service provider, which currently offers 73 channels of video and audio service. In order to expand its service, PrimeStar's partners have agreed in principle on a long-term path for medium-powered DBS service with the option for a fifteen-year transponder lease from GE Americom Communications Inc., which would give PrimeStar the potential to deliver approximately 150 channels of programming. Other companies intend to offer expanded service over high-powered satellites using video compression technology. DBS service providers may be able to offer new and highly specialized services using a national base of subscribers. The ability of DBS-service providers to compete with the cable television industry depends on, among other factors, the availability of reception equipment at reasonable prices. Initial sales of DBS services indicate that it may offer substantial competition to cable television operators. PrimeStar is still considering its options for the delivery of high-powered DBS service following the conclusion of an FCC auction, which left PrimeStar without the assured use of certain desirable spectrum frequencies for high-powered service. See "Telecommunications and Technology."

Cable television systems also may compete with wireless program distribution services such as MMDS, which are licensed to serve specific areas. MMDS uses low-power microwave frequencies to transmit television programming over-the-air to subscribers. MMDS systems' ability to compete with cable television systems has previously been limited by a lack of channel capacity, the inability to obtain programming and regulatory delays. However, NYNEX Corp. and Bell Atlantic Corporation have agreed to invest up to \$100.0 million in CAI Wireless Systems Inc., an MMDS operator. In addition, Pacific Telesis Group has acquired Cross Country Wireless Inc., another MMDS operator. A series of actions taken by the FCC, including reallocating certain frequencies to the wireless services, are intended to facilitate the development of wireless cable television systems as an alternative means of distributing video programming. The FCC also initiated a rule-making proceeding to allocate frequencies in the 28 GHz band for a new multi-channel wireless video service. Continental is unable to predict the extent to which additional competition from these services will materialize in the future or the impact such competition would have on Continental's operations.

The Company believes that as a result of its investment in technologically advanced systems, it is well-positioned to offer new services such as on-line services, data communications and telephony. Continental believes that the ability to offer interactive services over a high-capacity, two-way network provides a distinct competitive advantage over DBS and MMDS, which are currently one-way services.

Other new technologies may become competitive with non-entertainment services that cable television systems can offer. The FCC has authorized television broadcast stations to transmit textual and graphic

information useful both to consumers and to businesses. The FCC also permits commercial and non-commercial FM stations to use their subcarrier frequencies to provide non-broadcast services, including data transmissions. The FCC established an over-the-air Interactive Video and Data Service that will permit two-way interaction with commercial and educational programming along with informational and data services. Telephone companies and other common carriers also provide facilities for the transmission and distribution of data and other non-video services.

In the past, federal cross-ownership restrictions have limited entry into the cable television business by potentially strong competitors such as telephone companies. Removal of these entry barriers makes it possible for companies with considerable resources, and, consequently, a potentially greater willingness or ability to overbuild, to enter the cable television and telecommunications business. The 1996 Telecommunications Act repeals the 1984 Cable Act's prohibition against telco-cable cross-ownership and provides that a local exchange telephone company, also known as a LEC, may provide video programming directly to subscribers through a variety of means, including: (1) as a radio-based (MMDS or DBS) multichannel video programming distributor; (2) as a cable operator, fully subject to the franchising, rate regulation and other provisions of the 1984 Cable Act and the 1992 Cable Act; and (3) through an "open video system" that is certified by the FCC to offer non-discriminatory access to a portion of its channel capacity for unaffiliated program distributors, subject only to selected portions of the regulations applicable to cable operators. A local telephone company also may provide the "transmission of video programming" on a common carrier basis. Telephone companies in several of the Company's franchise areas have applied for franchises to offer cable service. Ameritech Corporation, for example, has obtained a franchise to build a cable system in several of the communities formerly served by N-COM, which Continental acquired in December 1995. The total number of subscribers is not material in relation to Continental's total subscriber base, but there can be no assurances with respect to the number of communities for which Ameritech Corporation may obtain franchises in the future. See "Legislation and Regulation—Federal Regulation."

The 1996 Telecommunications Act also prohibits a telephone company or a cable system operator in the same market from acquiring each other, except in limited circumstances, such as areas of smaller population.

Telephony Competition. LECs currently dominate the two-way switched voice and data market. The LECs provide a full range of local telecommunications services and equipment to customers as well as origination and termination access to their local networks to inter-exchange carriers ("IXCs") and mobile radio service providers. Prior to the 1996 Telecommunications Act, in many states the LECs have had an exclusive franchise by law to provide telephone service. As a consequence of this monopoly position, the LECs have established relationships with their customers and provide those customers with various transmission and switching services that other potential telecommunications service providers were not permitted by law to offer.

In addition to the LECs and existing competitive-access providers, competitors which are potentially capable of offering private line, special access and switched services include other cable television companies, electric utilities, long-distance carriers, microwave carriers, wireless service providers and private networks built by large end-users.

While several states have engaged in legislative or regulatory efforts to remove local telecommunications market entry restrictions, new market entrants have maintained a high degree of dependence upon the incumbent LEC for interconnection to LEC customers and for allocation of telephone numbers.

Telecommunications Regulation. The 1996 Telecommunications Act removes barriers to entry in the local telephone market that is now monopolized by the RBOCs and other LECs by preempting state and local laws that restrict competition and by requiring incumbent LECs to provide nondiscriminatory access and interconnection to potential competitors, such as cable operators and long-distance companies. At the same time, the new law eliminates the Modified Final Judgment and permits the RBOCs to enter the market for long-distance service (through a separate subsidiary) after they satisfy a "competitive checklist." The 1996 Telecommunications Act also permits interstate utility companies to enter the telecommunications market for the first time.

The 1996 Telecommunications Act also eliminates or streamlines many of the requirements applicable to LECs, and requires the FCC and states to review universal service programs and encourage access to advanced telecommunications services provided by all entities, including cable companies, by schools, libraries and other public institutions. The FCC and, in some cases, states are required to conduct numerous rulemaking proceedings to implement these provisions.

Legislation and Regulation

The cable television industry is regulated by the FCC, some state governments and substantially all local governments. In addition, various legislative and regulatory proposals under consideration from time to time by Congress and various federal agencies may materially affect the cable television industry. The following is a summary of federal laws and regulations affecting the growth and operation of the cable television industry and a description of certain state and local laws.

Cable Communications Policy Act of 1984. The 1984 Cable Act became effective in December 1984. This federal statute, which amended the Communications Act of 1934, created uniform national standards and guidelines for the regulation of cable television systems. Violations by a cable television system operator of provisions of the 1984 Cable Act, as well as of FCC regulations, can subject the operator to substantial monetary penalties and other sanctions. Among other things, the 1984 Cable Act affirmed the right of franchising authorities (state or local, depending on the practice in individual states) to award one or more franchises within their jurisdictions. It also prohibited non-grandfathered cable television systems from operating without a franchise in such jurisdictions. In connection with new franchises, the 1984 Cable Act provides that in granting or renewing franchises, franchising authorities may establish requirements for cable-related facilities and equipment, but may not establish or enforce requirements for video programming or information services other than in broad categories. The 1996 Telecommunications Act preempted the ability of franchising authorities to impose any oversight of cable operators' technical standards.

Cable Television Consumer Protection and Competition Act of 1992. In October 1992, Congress enacted the 1992 Cable Act. This legislation made significant changes to the legislative and regulatory environment in which the cable industry operates. It amended the 1984 Cable Act in many respects. The 1992 Cable Act became effective in December 1992, although certain provisions, most notably those dealing with rate regulation and retransmission consent, became effective at later dates. The legislation required the FCC to initiate a number of rule-making proceedings to implement various provisions of the statute, the majority of which, including certain of those related to rate regulation, have been completed. The 1992 Cable Act allows for a greater degree of regulation of the cable industry with respect to, among other things: (i) cable system rates for both the BBT and certain CP§ tiers; (ii) programming access and exclusivity arrangements; (iii) access to cable channels by unaffiliated programming services; (iv) leased-access terms and conditions; (v) horizontal and vertical ownership of cable systems; (vi) customer service requirements; (vii) franchise renewals; (viii) television broadcast signal carriage and retransmission consent; (ix) technical standards; (x) customer privacy; (xi) consumer protection issues; (xii) cable equipment compatibility; (xiii) obscene or indecent programming; and (xiv) subscription to tiers of service other than the BBT as a condition of purchasing premium services. Additionally, the 1992 Cable Act encourages competition with existing cable television systems by: allowing municipalities to own and operate their own cable television systems without a franchise; preventing franchising authorities from granting exclusive franchises or unreasonably refusing to award additional franchises covering an existing cable system's service area; and prohibiting the common ownership of cable systems and co-located MMDS or SMATV systems. The 1992 Cable Act also precludes video programmers affiliated with cable television companies from favoring cable operators over competitors and requires such programmers to sell their programming to other multi-channel video distributors.

Various cable operators have filed actions in the United States District Court in the District of Columbia challenging the constitutionality of several sections of the 1992 Cable Act. Pursuant to special jurisdictional provisions in the 1992 Cable Act, a challenge to the must-carry provisions of the 1992 Cable Act was heard by a three-judge panel of the district court. In April 1993, the three-judge court granted summary judgment for the

government, upholding the constitutional validity of the must-carry provisions of the 1992 Cable Act. That decision was appealed directly to the United States Supreme Court, which in June 1994, remanded the case to the district court. The lower court again upheld the must-carry rules, but this decision is again on appeal to the United States Supreme Court, which has agreed to hear this appeal in 1996. Pending the outcome of further proceedings, the must-carry statutes and the FCC regulations remain in place.

The cable operators' constitutional challenge to the balance of the 1992 Cable Act provisions was heard by a single judge of the district court. In September 1993, the court rendered its decision upholding the constitutionality of all but three provisions of the statute (multiple ownership limits for cable operators, advance notice of free previews for certain programming services, and channel set-asides for DBS operators). This decision was appealed to the United States Court of Appeals for the District of Columbia Circuit and was heard by that court in November 1995. Appeals were also filed in that court from the FCC's rate regulation rule-making decisions. The FCC's rate regulations were substantially upheld in June 1995, and the United States Supreme Court has refused to hear an appeal of that decision.

Telecommunications Act of 1996. As noted above, the 1996 Telecommunications Act was enacted into law in February 1996. The 1996 Telecommunications Act modifies various provisions of the Communications Act of 1934, the 1984 Cable Act and the 1992 Cable Act, with the intent of establishing a pro-competitive, deregulatory policy framework for both video and telecommunications services. Continental at this time cannot predict the full effect that the 1996 Telecommunications Act or the FCC's implementing regulations may have on Continental's operations.

Federal Regulation. The FCC, the principal federal agency with jurisdiction over cable television, has promulgated regulations covering such areas as the registration of cable television systems, cross-ownership between cable television systems and other communications businesses, carriage of television broadcast programming, consumer education and lockbox enforcement, origination, cablecasting and sponsorship identification, children's programming, the regulation of basic cable service rates in areas where cable television systems are not subject to effective competition, signal leakage and frequency use, technical performance, maintenance of various records, equal employment opportunity, and antenna structure notification, marking and lighting. The FCC has the authority to enforce these regulations through the imposition of substantial fines, the issuance of cease and desist orders and/or the imposition of other administrative sanctions, such as the revocation of FCC licenses needed to operate certain transmission facilities often used in connection with cable operations. The 1992 Cable Act required the FCC to adopt additional regulations covering, among other things, cable rates, signal carriage, consumer protection and customer service, leased access, indecent programming, programmer access to cable television systems, programming agreements, technical standards, consumer electronics equipment compatibility, ownership of home wiring, program exclusivity, equal employment opportunity, and various aspects of DBS system ownership and operation. The 1996 Telecommunications Act mandates changes in certain of these regulations. A brief summary of certain of these federal regulations as adopted to date follows.

Rate Regulation. The 1984 Cable Act codified existing FCC preemption of rate regulation for premium channels and optional CPS tiers. The 1984 Cable Act also deregulated basic cable rates for cable television systems determined by the FCC to be subject to effective competition. The 1992 Cable Act substantially changed the 1984 Cable Act and FCC rate regulation standards then in existence. The 1992 Cable Act replaced the FCC's old standard for determining effective competition, under which most cable systems were not subject to local rate regulation, with a statutory provision that results in nearly all cable television systems becoming subject to local rate regulation of the BBT. Additionally, the legislation eliminates the 5% annual rate increase for basic service previously allowed by the 1984 Cable Act without local approval; requires the FCC to adopt a formula for franchising authorities to enforce, to assure that BBT rates are reasonable; allows the FCC to review rates for CPS tiers (other than per-channel or per-event services) in response to complaints filed by franchising authorities and/or cable customers; prohibits cable television systems from requiring subscribers to purchase service tiers above the BBT in order to purchase premium services if the system is technically capable of doing so; requires the FCC to adopt regulations to establish, on the basis of actual costs, the price for installation of cable service,

remote controls, converter boxes and additional outlets; and allows the FCC to impose restrictions on the re-tiering and rearrangement of cable services under certain limited circumstances.

The 1992 Cable Act authorizes the FCC to, among other things, set standards for governmental authorities to regulate the rates for certain cable television services and equipment and gives local broadcast stations the option to elect mandatory carriage or require retransmission consent.

Pursuant to authority granted under the 1992 Cable Act, the FCC in April 1993 promulgated rate regulations that established maximum allowable rates for cable television services; except for services offered on a per-channel or per-program basis. In February 1994, the FCC adopted a revised regulatory scheme which included, among other things, interim cost-of-service standards and a new benchmark formula to determine certain service rates. In creating the new benchmark formula, the FCC mandated a further reduction in rates for certain regulated services. Final cost-of-service rules were adopted in January 1996.

The FCC has issued a series of new rules covering such issues as increases for inflation and external costs, and the addition of new channels to regulated CPS tiers (the "Going Forward Rules" and Form 1210); rules permitting a single annual rate increase, and allowing operators to anticipate 12 months of inflation and known increases in external costs, while providing for a true-up of costs after 12 months (Form 1240); abbreviated cost-of-service rules for network upgrades (Form 1235); and rules that limit the FCC's review of CPS tier rates to the amount of the increase only, thereby grandfathering all rates that were unregulated prior to November 1995.

The FCC also publicly announced that it would consider "social contracts" as an alternative form of rate regulation for cable operators. Continental's Social Contract with the FCC was adopted by the FCC on August 3, 1995. The Social Contract settles all of Continental's pending cost-of-service rate cases and all of its benchmark CPS-tier rate cases. Benchmark BBT cases will be resolved by Continental and local franchise authorities. Under the Social Contract Amendment, which was released for public comment on March 6, 1996 and incorporates into the Social Contract the systems acquired in the Providence Journal Merger and the Recent Acquisitions, CPS-tier rates may be increased by \$1.00 per year per subscriber plus inflation and allowable external costs. BBT rates may increase by inflation and external costs. The Social Contract and, if adopted by the FCC, the Social Contract Amendment, will govern Continental's future rates. The Social Contract also provides for its termination in the future if the laws and regulations applicable to services offered in any Continental franchise change in a manner that would have a material favorable financial impact on Continental. In that instance, the Company may petition the FCC to terminate the Social Contract. For a description of the Social Contract and the Social Contract Amendment see "Business—Description of Business—U.S. Operating Strategy—U.S. Regulatory Strategy; Social Contract."

Furthermore, the 1996 Telecommunications Act, which provides for the deregulation of CPS-tier rates after March 31, 1996, permits regulated equipment rates to be computed by aggregating costs of broad categories of equipment at the franchise, system, regional or Company level. The 1996 Telecommunications Act also eliminates the right of individual subscribers to file rate complaints with the FCC concerning CPS tiers, and instead requires that such complaints be filed by a franchising authority.

The 1992 Cable Act provided that all rate regulation, for both the CPS tiers and for the BBT, is eliminated when a cable system is subject to "effective competition" from another multichannel video programming provider such as MMDS, DBS, a telephone company, or a combination of any (or all) of these. The 1996 Telecommunications Act expanded the definition of "effective competition" to include instances in which a local telephone company or its affiliate (or a multichannel video programming distributor using the facilities of a telephone company or its affiliate) offers comparable video programming directly to subscribers by any means (other than DBS) in the cable operator's franchise area. Since telephone companies are providing or planning to provide video services in several of Continental's franchise areas, this provision will allow the Company greater flexibility in packaging and pricing its product in those markets.

The 1996 Telecommunications Act also eliminates the uniform rate structure requirements of the 1992 Cable Act for cable operators in areas subject to effective competition or as applied to video programming offered on a per-channel or per-program basis and allows non-uniform bulk discount rates to be offered to multiple dwelling units.

Other Regulations under the 1992 Cable Act. In addition to the foregoing rate regulations, the FCC has adopted regulations pursuant to the 1992 Cable Act which require cable systems to permit customers to purchase video programming on a per-channel or a per-event basis without the necessity of subscribing to any tier of service, other than the basic service tier, unless the cable system is technically incapable of doing so. Generally, this exemption from compliance with the statute for cable systems that do not have such technical capability is available until a cable system obtains the capability, but not later than December 2002. The FCC also has adopted a number of measures for improving compatibility between existing cable systems and consumer equipment. In conjunction therewith, the FCC rules prohibit cable operators from scrambling program signals carried on the basic tier, absent a waiver.

The FCC also has adopted regulations in connection with its cost-of-service proceedings which govern programming charges for affiliated entities. These rules apply to systems subject to regulation under both the benchmark and cost-of-service regulations. The cost of programming to affiliated entities must be the prevailing company price, based on the sale of programming to third parties, or a price equal to the lower of the programming service's net book cost and its estimated fair market value.

Carriage of Broadcast Television Signals. The 1992 Cable Act contains signal carriage requirements allowing commercial television broadcast stations which are "local" to a cable system (i.e., the system is located in the station's Area of Dominant Influence) to elect every three years whether to require the cable system to carry the station ("must-carry" status) or to negotiate for "retransmission consent" to carry it. The first such election was made in June 1993. A recent amendment to the Copyright Act in some cases increased the number of stations that may elect must-carry status on cable systems located within such stations' Areas of Dominant Influence. Local non-commercial television stations are given mandatory carriage rights, subject to certain exceptions, within the larger of: (i) a 50 mile radius from the station's city of license or (ii) the station's grade B contour (a measure of signal strength). Unlike commercial stations, non-commercial stations are not given the option to negotiate retransmission consent for the carriage of their signal. In addition, cable systems have to obtain retransmission consent for the carriage of all "distant" commercial broadcast stations, except for certain "superstations" (i.e., commercial satellite-delivered independent stations such as WTBS).

Nonduplication of Network Programming. Cable television systems that have 1,000 or more customers must, upon the appropriate request of a local television station, delete the simultaneous or non-simultaneous network programming of a distant station when such programming has also been contracted for by the local station on an exclusive basis.

Deletion of Syndicated Programming. FCC regulations enable television broadcast stations that have obtained exclusive distribution rights for syndicated programming in their market to require a cable system to delete or "black out" such programming from other television stations which are carried by the cable system. The extent of such deletions will vary from market to market and cannot be predicted with certainty. However, it is possible that such deletions could be substantial and could lead the cable operator to drop a distant signal in its entirety. The FCC also has commenced a proceeding to determine whether to relax or abolish the geographic limitations on program exclusivity contained in its rules, which would allow parties to set the geographic scope of exclusive distribution rights entirely by contract, and to determine whether such exclusivity rights should be extended to non-commercial educational stations. It is possible that the outcome of these proceedings will increase the amount of programming that cable operators are required to black out. Finally, the FCC has declined to impose equivalent syndicated exclusivity rules on satellite carriers who provide services to the owners of home satellite dishes similar to those provided by cable systems.

Franchise Fees. Although franchising authorities may impose franchise fees under the 1984 Cable Act, such payments cannot exceed 5% of a cable system's annual gross revenues. Franchising authorities are also

empowered in awarding new franchises or renewing existing franchises to require cable operators to provide cable-related facilities and equipment and to enforce compliance with voluntary commitments. In the case of franchises in effect prior to the effective date of the 1984 Cable Act, franchising authorities may enforce requirements contained in the franchise relating to facilities, equipment and services, whether or not cable-related. The 1984 Cable Act, under certain limited circumstances, permits a cable operator to obtain modifications of franchise obligations.

Renewal of Franchises. The 1984 Cable Act established renewal procedures and criteria designed to protect incumbent franchises against arbitrary denials of renewal. While these formal procedures are not mandatory unless timely invoked by either the cable operator or the franchising authority, they can provide substantial protection to incumbent franchisees. Even after the formal renewal procedures are invoked, franchising authorities and cable operators remain free to negotiate a renewal outside the formal process.

Nevertheless, renewal is by no means assured, as the franchisee must meet certain statutory standards. Even if a franchise is renewed, a franchising authority may impose new and more onerous requirements such as upgrading facilities and equipment, although the municipality must take into account the cost of meeting such requirements.

The 1992 Cable Act made several changes to the process under which a cable operator seeks to enforce its renewal rights that could make it easier in some cases for a franchising authority to deny renewal. While a cable operator must still submit its request to commence renewal proceedings within 30 to 36 months prior to franchise expiration to invoke the formal renewal process, the request must be in writing and the franchising authority must commence renewal proceedings not later than six months after receipt of such notice. The four-month period for the franchising authority to grant or deny the renewal now runs from the submission of the renewal proposal, not the completion of the public proceeding. Franchising authorities may consider the "level" of programming service provided by a cable operator in deciding whether to renew. Franchising authorities are no longer precluded from denying renewal based on failure to substantially comply with the material terms of the franchise where the franchising authority has "effectively acquiesced" to such past violations. However, the franchising authority is estopped from denying renewal if, after giving the cable operator notice and opportunity to cure, it fails to respond to a written notice from the cable operator of its failure or inability to cure. Courts may not reverse a denial of a renewal based on procedural violations found to be "harmless error."

Channel Set-Asides. The 1984 Cable Act permits local franchising authorities to require cable operators to set aside certain channels for public, educational and governmental access programming. The 1984 Cable Act further requires cable television systems with 36 or more activated channels to designate a portion of their channel capacity for commercial leased access by unaffiliated third parties. While the 1984 Cable Act allowed cable operators substantial latitude in setting leased-access rates, the 1992 Cable Act required leased-access rates to be set according to an FCC-prescribed formula. The FCC adopted such a formula and implemented regulations in April 1993. The FCC is expected to act shortly on petitions requesting the FCC to reconsider its decision and adopt lower leased-access rates.

Competing Franchises. Questions concerning the right of a municipality to award de facto exclusive cable television franchises and to impose certain franchise restrictions upon cable television companies are under consideration in *Preferred Communications, Inc. v. City of Los Angeles*, involving a proposed applicant for a franchise in one of the Company's service areas, in which the United States Supreme Court declared that cable television operators have First Amendment rights which cannot be abridged in the absence of overriding governmental interests. However, the 1992 Cable Act, among other things, prohibits franchising authorities from unreasonably refusing to grant franchises to competing cable television systems and permits franchising authorities to operate their own cable television systems without franchises.

Ownership and Cross-Ownership Limitations. The 1984 Cable Act codified then-existing FCC cross-ownership regulations, which, in part, prohibited LECs from providing video programming directly to customers within their local exchange telephone service areas, except in rural areas or by specific waiver of FCC rules. As noted above, this restriction was removed by the 1996 Telecommunications Act.

The 1984 Cable Act and the FCC's rules also prohibited the common ownership, operation, control or interest in a cable system and a local television broadcast station whose predicted grade B contour (a measure of a television station's significant signal strength as defined by the FCC's rules) covers any portion of the community served by the cable system. Common ownership or control has historically also been prohibited by the FCC (but not by the 1984 Cable Act) between a cable system and a national television network, although the FCC adopted an order that substantially relaxed the network/cable cross ownership prohibitions subject to certain national and local ownership limits. Finally, in order to encourage competition in the provision of video programming, the FCC adopted a rule prohibiting the common ownership, affiliation, control or interest in cable television systems and MMDS facilities having overlapping service areas, except in very limited circumstances. The 1992 Cable Act codified this restriction and extended it to co-located SMATV systems. Permitted arrangements in effect as of October 5, 1992 were grandfathered. In January 1995, the FCC loosened its previously stringent interpretation of the lack of ability of a cable operator to purchase a SMATV system in the same franchise area. The 1992 Cable Act permits states or local franchising authorities to adopt certain additional restrictions on the ownership of cable television systems.

The 1996 Telecommunications Act repeals the statutory ban on cable-broadcast station cross-ownership to permit common ownership or control of a television station and a cable system with overlapping service areas. The 1996 Telecommunications Act leaves in place, however, the cable system-television station cross-ownership restriction contained in the FCC's rules and does not mandate an outcome for the FCC's review of the regulation, which will occur this year. The 1996 Telecommunications Act also directs the FCC to revise its existing regulations concerning broadcast network-cable cross-ownership to permit common control of both a television network and a cable system. The 1996 Telecommunications Act removes the statutory ban on cable-MMDS cross-ownership by any cable operator in a franchise area where one cable operator is subject to effective competition.

Pursuant to the 1992 Cable Act, the FCC has imposed limits on the number of cable systems which a single cable operator can own. In general, no cable operator can have an attributable interest in cable systems which pass more than 30% of all homes nationwide. Attributable interests for these purposes include voting interests of 5% or more (unless there is another single holder of more than 50% of the voting stock), officerships, directorships and general partnership interests. The FCC has stayed the effectiveness of these rules pending the outcome of the appeal from the United States District Court decision holding the multiple-ownership limit provision of the 1992 Cable Act unconstitutional.

The FCC has also adopted rules which limit the number of channels on a cable system which may be occupied by programming in which the entity which owns the cable system has an attributable interest to 40% of all activated channels.

Equal Employment Opportunity. The 1984 Cable Act includes provisions to ensure that minorities and women are provided equal employment opportunities within the cable television industry. The statute requires the FCC to adopt reporting and certification rules that apply to all cable system operators with more than five full-time employees. Pursuant to the requirements of the 1992 Cable Act, the FCC has imposed more detailed annual Equal Employment Opportunity ("EEO") reporting requirements on cable operators and has expanded those requirements to all multi-channel video-service distributors. Failure to comply with the EEO requirements can result in the imposition of fines and/or other administrative sanctions, or may, in certain circumstances, be cited by a franchising authority as a reason for denying a franchisee's renewal request.

Privacy. The 1984 Cable Act imposes a number of restrictions on the manner in which cable system operators can collect and disclose data about individual system customers. The statute also requires that the system operator must periodically provide all customers with written information about its policies regarding the collection and handling of data about customers, their privacy rights under federal law and their enforcement rights. In the event that a cable operator is found to have violated the customer privacy provisions of the 1984 Cable Act, it could be required to pay damages, attorneys' fees and other costs. Under the 1992 Cable Act, the privacy requirements are strengthened to require that cable operators take such actions as are necessary to prevent unauthorized access to personally identifiable information.

Anti-Trafficking/Franchise Transfer Approval. The 1992 Cable Act precluded cable operators from selling or otherwise transferring ownership of a cable television system within 36 months after acquisition or initial construction, with various exceptions. This provision was eliminated by the 1996 Telecommunications Act. The 1992 Cable Act also requires franchising authorities to act on any franchise transfer request submitted after December 4, 1992 within 120 days after receipt of all information required by FCC regulations and by the franchising authority. Approval is deemed to be granted if the franchising authority fails to act within such period.

Registration Procedure and Reporting Requirements. Prior to commencing operation in a particular community, all cable television systems must file a registration statement with the FCC listing the broadcast signals they will carry and certain other information. Additionally, cable operators periodically are required to file various informational reports with the FCC. Cable operators who operate in certain frequency bands are required on an annual basis to file the results of their periodic cumulative leakage testing measurements. Operators who fail to make this filing or who exceed the FCC's allowable cumulative leakage index risk being prohibited from operating in those frequency bands in addition to other sanctions.

Technical Requirements. Historically, the FCC has imposed technical standards applicable to the cable channels on which broadcast stations are carried, and has prohibited franchising authorities from adopting standards which were in conflict with or more restrictive than those established by the FCC. The FCC has recently revised such standards and made them applicable to all classes of channels which carry downstream National Television System Committee video programming. Local franchising authorities are permitted to enforce the FCC's new technical standards. The FCC also has adopted additional standards applicable to cable television systems using frequencies in the 108-137 MHz and 225-400 MHz bands in order to prevent harmful interference with aeronautical navigation and safety radio services and has also established limits on cable system signal leakage. The 1992 Cable Act requires the FCC to periodically update its technical standards to take into account changes in technology and to entertain waiver requests from franchising authorities who would seek to impose more stringent technical standards upon their franchised cable television systems. Although the 1992 Cable Act requires the FCC to establish "minimum technical standards relating to cable television systems technical operation and signal quality," the FCC announced that its recently completed cable television technical standards rule-making satisfied the new statutory mandate. The 1996 Telecommunications Act preempted the ability of franchising authorities to impose any oversight of cable operators' technical standards.

Pole Attachments. The FCC currently regulates the rates and conditions imposed by certain public utilities for use of their poles, unless under the Federal Pole Attachments Act, state public utility commissions are able to demonstrate that they regulate rates, terms and conditions of the cable television pole attachments. A number of states and the District of Columbia have certified to the FCC that they regulate the rates, terms and conditions for pole attachments. In the absence of state regulation, the FCC administers such pole attachment rates through use of a formula which it has devised and from time to time revises.

The 1996 Telecommunications Act modifies the current pole attachment provisions of the Communications Act of 1934 by requiring that utilities provide cable systems and telecommunications carriers with non-discriminatory access to any pole, conduit or right-of-way controlled by the utility. The FCC is required to adopt new regulations to govern the charges for pole attachments used by companies providing telecommunications services, including cable operators. These regulations are likely to increase the rates charged to cable companies providing voice and data, in addition to video services. These new pole attachment regulations will not become effective, however, until five years after enactment of the 1996 Telecommunications Act, and any increase in attachment rates resulting from the FCC's new regulations will be phased in in equal annual increments over a period of five years.

Other Matters. FCC regulation also includes matters regarding a cable system's carriage of local sports programming; restrictions on origination and cablecasting by cable system operators; application of the rules governing political broadcasts; customer service; home wiring and limitations on advertising contained in non-broadcast children's programming.

Implementing provisions of the 1993 Budget Act, the FCC adopted requirements for payment of 1994 annual "regulatory fees." Cable television systems were required to pay regulatory fees of \$0.37 per subscriber, which, may be passed on to subscribers as "external cost" adjustments to rates for basic cable service. This amount was increased to \$.49 per subscriber in 1995 and may be further increased in 1996. Fees are also assessed for other licenses, including licenses for business radio and cable television-relay systems and earth stations, which, however, may not be collected directly from subscribers. Beginning in 1995, no fee is assessed for receive-only, cable-earth stations.

Copyright Regulation. Cable television systems are subject to federal copyright licensing covering carriage of broadcast signals. In exchange for making semi-annual payments to a federal copyright royalty pool and meeting certain other obligations, cable operators obtain a statutory license to retransmit broadcast signals. The amount of this royalty payment varies, depending on the amount of system revenues from certain sources, the number of distant signals carried and the location of the cable system with respect to over-the-air television stations. Cable operators are liable for interest on underpaid and unpaid royalty fees, but are not entitled to collect interest on refunds received for the overpayment of copyright fees. Originally, the Federal Copyright Royalty Tribunal was empowered to make and, in fact, did make several adjustments in copyright royalty rates. This tribunal was eliminated by Congress in 1993. Any future adjustment to the copyright royalty rates will be done through an arbitration process to be supervised by the U.S. Copyright Office.

Various bills have been introduced into Congress over the past several years that would eliminate or modify the cable television compulsory copyright license. The FCC has recommended to Congress that it repeal the cable industry's compulsory copyright license. The FCC determined that the statutory compulsory copyright license for local and distant broadcast signals no longer serves the public interest and that private negotiations between the applicable parties would better serve the public. Without the compulsory license, cable operators might need to negotiate rights from the copyright owners for each program carried on each broadcast station in the channel lineup. Such negotiated agreements could increase the cost to cable operators of carrying broadcast signals. The 1992 Cable Act's retransmission consent provisions expressly provide that retransmission consent agreements between television broadcast stations and cable operators do not obviate the need for cable operators to obtain a copyright license for the programming carried on each broadcaster's signal.

Copyright music performed in programming supplied to cable television systems by pay cable networks (such as HBO) and cable programming networks (such as USA) has generally been licensed by the networks through private agreements with the American Society of Composers and Publishers ("ASCAP") and BMI, Inc. ("BMI"), the two major performing rights organizations in the United States. ASCAP and BMI offer "through to the viewer" licenses to the cable networks, which cover the retransmission of the cable networks' programming by cable television systems to their customers. The cable industry has not yet concluded negotiations on licensing fees with music performing rights societies for the use of music performed in programs locally originated by cable television systems. See "Legal Proceedings."

State and Local Regulations. Because cable television systems use local streets and rights-of-way, cable television systems are subject to state and local regulation, typically imposed through the franchising process. State and/or local officials are usually involved in franchise selection, system design and construction, safety, service rates, consumer relations, billing practices and community-related programming and services.

Cable television systems generally are operated pursuant to non-exclusive franchises, permits or licenses granted by a municipality or other state or local government entity. Franchises generally are granted for fixed terms and in many cases are terminable if the franchise operator fails to comply with material provisions. Although the 1984 Cable Act provides for certain procedural protection, there can be no assurance that renewals will be granted or that renewals will be made on similar terms and conditions. Franchises usually call for the payment of fees, often based on a percentage of the system's gross customer revenues, to the granting authority. Upon receipt of a franchise, the cable system owner usually is subject to a broad range of obligations to the issuing authority directly affecting the business of the system. The terms and conditions of franchises vary

materially from jurisdiction to jurisdiction, and even from city to city within the same state, historically ranging from reasonable to highly restrictive or burdensome. The 1984 Cable Act places certain limitations on a franchising authority's ability to control the operation of a cable system, and the courts have from time to time reviewed the constitutionality of several general franchise requirements, including franchise fees and leased-access channel requirements, often with inconsistent results. On the other hand, the 1992 Cable Act prohibits exclusive franchises, and allows franchising authorities to exercise greater control over the operation of franchised cable television systems, especially in the areas of customer service and rate regulation. The 1992 Cable Act also allows franchising authorities to operate their own multi-channel video distribution system without having to obtain a franchise and permits states or local franchising authorities to adopt certain restrictions on the ownership of cable television systems. Moreover, franchising authorities are immunized from monetary damage awards arising from regulation of cable television systems or decisions made on franchise grants, renewals, transfers and amendments.

The specific terms and conditions of a franchise and the laws and regulations under which it was granted directly affect the profitability of the cable television system. Cable franchises generally contain provisions governing charges for basic cable television services, fees to be paid to the franchising authority, length of the franchise term, renewal, sale or transfer of the franchise, territory of the franchise, design and technical performance of the system, use and occupancy of public streets and number and types of cable services provided.

Various proposals have been introduced at the state and local levels with regard to the regulation of cable television systems, and a number of states have adopted legislation subjecting cable television systems to the jurisdiction of centralized state governmental agencies, some of which impose regulations of a character similar to that of a public utility.

Regulation of Telecommunications Activities. As noted above under "Telecommunications and Technology," Continental provides in certain of its systems alternate-access local telecommunications services over a portion of its fiber-optic cable facilities, and Continental currently owns a 20% interest in TCG. Local telecommunications activities are regulated by either the FCC or state public utility commissions, or both. In some instances, Continental or TCG may be required to obtain regulatory permission to offer such services, and may be required to file tariffs for its service offerings, depending on whether particular alternate-access activities of Continental or TCG are classified as common carriage or private carriage. See "Federal Regulation—Ownership and Cross-Ownership Limitations." As noted above, the 1996 Telecommunications Act preempts state and locally-imposed barriers to the provision of intrastate and interstate telecommunications services by cable system operators in competition with local telephone companies.

The foregoing does not purport to be a summary of all present and proposed federal, state and local regulations and legislation relating to the cable television industry. Other existing federal regulations, copyright licensing, and, in many jurisdictions, state and local franchise requirements, currently are the subject of a variety of judicial proceedings, legislative hearings, and administrative and legislative proposals which could change, in varying degrees, the manner in which cable television systems operate. Neither the outcome of these proceedings nor their impact upon the cable industry or the Company can be predicted at this time.

Employees

Continental currently has approximately 9,200 full-time employees, including approximately 100 employees located at Continental's Boston headquarters, who provide staff support in the areas of corporate planning, finance, marketing, program acquisition, employee training and benefits administration, government relations, internal auditing, financial and tax reporting and regulatory compliance. Continental believes that its relations with its employees are good.

Item 2. Properties.

The Company's principal physical assets consist of cable television systems, including signal receiving, encoding and decoding apparatus, headends, distribution systems, and subscriber house-drop equipment for each of its systems. The signal receiving apparatus typically includes a tower, antenna, ancillary electronic equipment, and earth stations for reception of satellite signals. Headends, consisting of associated electronic equipment necessary for the reception, amplification and modulation of signals, are located near the receiving devices. The Company's distribution systems consist of coaxial and fiber-optic cables and related electronic equipment. Subscriber equipment consists of taps, house drops, converters and analog addressable converters. The Company owns its distribution system, various office and studio fixtures, test equipment and service vehicles. The physical components of Continental's systems require maintenance and periodic upgrading to keep pace with technological advances.

The Company's coaxial and fiber-optic cables are generally attached to utility poles under pole-rental agreements with local public utilities, although in some areas the distribution cable is buried in underground ducts or trenches. The FCC regulates pole-attachment rates under the Federal Pole Attachments Act. See "Business—Description of Business—Legislation and Regulation—Federal Regulation—Pole Attachments."

The Company owns or leases parcels of real property for signal reception sites (antenna towers and headends), microwave facilities and business offices. The Company owns the building which houses its headquarters in Boston, Massachusetts.

The Company believes its properties, both owned and leased, are in good operating condition and are suitable and adequate for its business operations.

Item 3. Legal Proceedings.

On October 24, 1995, a class of ASCAP members filed a class action copyright infringement action in federal district court against a class comprised of cable television operators that had transmitted satellite-generated pay-per-view programming to their subscribers during the three-year period from October 25, 1992 through the date of the suit. Continental was named as one of the defendant class representatives. Plaintiffs alleged that the defendant class members had infringed their copyrights by exhibiting pay-per-view programs, which contain music owned by plaintiffs, without a license to "perform" plaintiffs' copyrighted musical compositions. Plaintiffs sought a permanent injunction restraining such public performances without authorization, actual or statutory damages, and an award of costs and attorneys' fees. The parties entered into a settlement agreement dated as of February 12, 1996, which settled all copyright infringement claims relating to the Company, and the case was dismissed on February 27, 1996 pursuant to the terms of the settlement agreement. License fees will be negotiated or, failing agreement, established by the ASCAP Rate Court.

Item 4. Submission of Matters to a Vote of Security Holders.

There were no matters submitted to a vote of security holders of the Company during the fourth quarter of the fiscal year ended December 31, 1995.

PART II

Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters.

No established public trading market exists for the Company's Class A Common Stock or Class B Common Stock, and accordingly no high and low bid information or quotations are available with respect to the Company's Common Stock. The shares of Class A Common Stock held by the former Providence Journal stockholders are subject to contractual restrictions on transfer until October 5, 1996.

As of March 15, 1996, there were 560 holders of record of Class A Common Stock and 348 holders of record of Class B Common Stock. The Company has not paid dividends on its Common Stock and has no present intention of so doing. Certain agreements, pursuant to which the Company has borrowed funds, contain provisions that limit the amount of dividends and stock repurchases that the Company may make. See Note 7 to the Company's Consolidated Financial Statements.

Item 6. Selected Consolidated Financial Information.

The following tables present selected consolidated financial information relating to the financial condition and results of operations of the Company over the past five years, and should be read in conjunction with the Consolidated Financial Statements of the Company for the year ended December 31, 1995 set forth in Part IV hereof.

	Year Ended December 31,				
	1991	1992	1993	1994	1995
	(dollars in thousands, except per share amounts)				
Statement of Operations Data:					
Revenues	\$ 1,039,163	\$ 1,113,475	\$ 1,177,163	\$ 1,197,977	\$ 1,442,392
Costs and expenses:					
Operating	347,469	365,513	382,195	405,535	498,239
Selling, general and administrative	246,986	259,632	267,376	267,349	339,002
Depreciation and amortization	267,510	272,851	279,009	283,183	341,171
Restricted stock purchase program(1)	10,067	9,683	11,004	11,316	12,005
Total	872,032	907,679	939,584	967,383	1,190,417
Operating income	167,131	205,796	237,579	230,594	251,975
Interest expense (net)	324,976	296,031	282,252	315,541	363,826
Other (income) expense(2)	1,936	11,071	(10,978)	24,048	48,085
Total	326,912	307,102	271,274	339,589	411,911
Loss before income taxes, extraordinary item and cumulative effect of accounting change	(159,781)	(101,306)	(33,695)	(108,995)	(159,936)
Benefit (provision) for income taxes	(1,861)	(1,654)	7,921	40,419	47,909
Loss before extraordinary item and cumulative effect of accounting change ..	(161,642)	(102,960)	(25,774)	(68,576)	(112,027)
Extraordinary item	—	—	—	(18,265)	—
Loss before cumulative effect of accounting change	(161,642)	(102,960)	(25,774)	(86,841)	(112,027)
Cumulative effect of accounting change	—	—	(184,996)	—	—
Net loss	(161,642)	(102,960)	(210,770)	(86,841)	(112,027)
Preferred stock preferences	(5,771)	(16,861)	(34,115)	(36,800)	(39,802)
Loss applicable to common stockholders ...	\$ (167,413)	\$ (119,821)	\$ (244,885)	\$ (123,641)	\$ (151,829)
Per common share:					
Loss before extraordinary item and cumulative effect of accounting change	\$ (1.42)	\$ (1.00)	\$ (.53)	\$ (.92)	\$ (1.22)
Extraordinary item	—	—	—	(.16)	—
Cumulative effect of accounting change	—	—	(1.62)	—	—
Net loss	\$ (1.42)	\$ (1.00)	\$ (2.15)	\$ (1.08)	\$ (1.22)
Weighted average common shares outstanding (in thousands)	117,534	119,544	114,055	114,334	124,882
Other Data:					
EBITDA(3)	\$ 444,708	\$ 488,330	\$ 527,592	\$ 525,093	\$ 605,151
EBITDA as % of revenues	42.8%	43.9%	44.8%	43.8%	42.0%
Net cash provided from operating activities	\$ 123,543	\$ 215,045	\$ 250,504	\$ 236,304	\$ 221,264
Capital expenditures	\$ 145,846	\$ 145,189	\$ 185,691	\$ 300,511	\$ 518,161

As of December 31,

1991	1992	1993	1994	1995
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(dollars in thousands)

Balance Sheet Data:

Cash	\$ 14,265	\$ 27,352	\$ 122,640	\$ 11,564	\$ 18,551
Total assets	2,082,182	2,003,196	2,091,853	2,483,639	5,080,593
Total debt	3,338,281	3,011,669	3,177,178	3,449,907	5,285,159
Redeemable common stock	445,463	223,716	213,548	232,399	256,135
Stockholder's equity (deficiency)	(1,919,525)	(1,486,231)	(1,667,088)	(1,688,334)	(1,215,951)

- (1) Represents the difference between the consideration paid by employees for purchases of shares of Common Stock of the Company under the Company's Restricted Stock Purchase Program and the fair market value of such shares (as determined by the Company's Board of Directors) at the date of issuance, amortized over the vesting schedule of such shares. See Note 11 to the Company's Consolidated Financial Statements.
- (2) Includes equity in net income (loss) of affiliates, minority interest in net loss of subsidiaries, other non-operating income and expenses, gains on sale of marketable equity securities of \$10.3 million, \$17.1 million and \$24.1 million from the Company's sales of its investment in affiliates in 1992 and 1993 and sale of marketable equity securities and a portion of an investment in 1995, respectively. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."
- (3) Operating income before depreciation and amortization and non-cash stock compensation (Restricted Stock Purchase Program expense). Based on its experience in the cable television industry, the Company believes that EBITDA and related measures of cash flow serve as important financial analysis tools for measuring and comparing cable television companies in several areas, such as liquidity, operating performance and leverage. EBITDA should not be considered by the reader as an alternative to operating or net income (as determined in accordance with GAAP) as an indicator of the Company's performance or as an alternative to cash flows from operating activities (as determined in accordance with GAAP) as a measure of liquidity. Substantially all of the Company's financing agreements contain certain covenants in which EBITDA is used as a measure of financial performance. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

Continental is a leading provider of broadband communications services. Continental's operations consist primarily of U.S. cable television systems with complementary operations and investments in three other areas: (i) international broadband communications ventures; (ii) interests in the telecommunications and technology industries, including companies offering competitive-access telephony and DBS service; and (iii) interests in programming services.

Substantially all of Continental's revenues are earned from customer fees for basic cable programming and premium television services, the rental of converters and remote control devices, and cable installation fees. During the period from December 31, 1992 through December 31, 1995, Continental's revenues increased at a compound annual growth rate of 9.0% primarily through basic subscriber growth and increases in monthly revenue per average basic subscriber. Revenues for the year ended December 31, 1995 increased 20.4% compared to 1994 (10.3% excluding acquisitions). Revenues for the year ended December 31, 1994 increased only 1.8% compared to 1993 due to basic rate reductions and non-cash revenue reserves recorded in connection with the FCC rate regulations.

Additional revenues are generated by the sale of advertising, pay-per-view programming fees, DBS service and payments received as a result of revenue-sharing agreements for products sold through home shopping networks. Continental expects that advertising and home shopping revenues (which currently represent approximately 6.3% of Continental's total revenues) may become a larger percentage of total revenues. These sources of revenues tend to be cyclical and seasonal in nature and could increase the cyclical and seasonality in Continental's total revenues.

Continental's business is subject to significant regulatory developments, including recent federal laws and regulations, which regulate rates charged by Continental for certain cable services. Such laws and regulations will limit Continental's ability to increase or restructure its rates for certain services. On August 3, 1995, the Social Contract between Continental and the FCC was adopted, which covers all of Continental's existing franchises (excluding the systems acquired in the Providence Journal Merger and the Recent Acquisitions), including those that are currently unregulated, and is the first comprehensive rate agreement involving cable television ever approved by the FCC. The Social Contract settled Continental's pending cost-of-service rate cases and its benchmark CPS-tier rate cases. The Social Contract Amendment was released by the FCC for public comment on March 6, 1996. This amendment incorporates into the Social Contract the cable television systems acquired in the Providence Journal Merger and the Recent Acquisitions and makes certain other changes to the Social Contract. See "Business—Description of Business—U.S. Operating Strategy—U.S. Regulatory Strategy; Social Contract." In addition, the 1996 Telecommunications Act has been enacted into law. The 1996 Telecommunications Act modifies various provisions of the Communications Act of 1934, the 1984 Cable Act and the 1992 Cable Act with the intent of establishing a pro-competitive, deregulatory policy framework for the telecommunications industry.

The high level of depreciation and amortization associated with Continental's capital expenditures and acquisitions and the interest costs related to financing activities, have caused Continental to report net losses. Continental believes that such net losses are common for cable television companies.

The Company has recently completed a series of acquisitions in the United States, the most significant of which was the acquisition of the cable television businesses and assets of Providence Journal. See "Business Description of Business—U.S. Acquisitions and Investments—The Providence Journal Merger." Results of operations of the companies and businesses acquired have been included in the accompanying results of operations from their respective dates of acquisition.

Proposed Merger with U S WEST

On February 27, 1996, the Company entered into the Merger Agreement with U S WEST, providing for the Merger of the Company with and into U S WEST. As a result of the Merger, Continental's operations will become part of UMG, a leading global media and telecommunications company.

The Merger is expected to close in the fourth quarter of 1996. The consummation of the Merger is subject to various conditions to closing, including, but not limited to, regulatory approvals and Continental stockholder votes. Certain major stockholders have agreed to vote in favor of the Merger and other related matters. However, no assurances can be given that the Merger will occur, or occur in the foregoing manner. See "Business—Development of Business."

Results of Operations

The following table sets forth, for the years indicated, certain items in the Company's Selected Consolidated Financial Information. See the footnotes to "Selected Consolidated Financial Information."

	Year Ended December 31,		
	1993	1994	1995
	(dollars in thousands)		
Statement of Operations Data:			
Revenues:			
Basic cable service	\$ 845,213	\$ 849,889	\$1,013,405
Premium cable service	242,956	245,605	269,069
Advertising	52,618	57,896	73,389
Pay-per-view	25,746	24,523	32,467
Other	8,875	14,035	17,014
DBS	1,755	6,029	37,048
Total	1,177,163	1,197,977	1,442,392
Operating, selling, general and administrative expenses	649,571	672,884	837,241
Depreciation and amortization	279,009	283,183	341,171
Restricted stock purchase program	11,004	11,316	12,005
Operating income	237,579	230,594	251,975
Interest expense, net	282,252	315,541	363,826
Other (income) expenses	(10,978)	24,048	48,085
Loss before income taxes, extraordinary item and cumulative effect of accounting change	(33,695)	(108,995)	(159,936)
Benefit for income taxes	(7,921)	(40,419)	(47,909)
Loss before extraordinary item and cumulative effect of accounting change	(25,774)	(68,576)	(112,027)
Extraordinary item	—	(18,265)	—
Loss before cumulative effect of accounting change	(25,774)	(86,841)	(112,027)
Cumulative effect of accounting change	(184,996)	—	—
Net loss	\$ (210,770)	\$ (86,841)	\$ (112,027)
Other Data:			
EBITDA	\$ 527,592	\$ 525,093	\$ 605,151
EBITDA as a % of revenues	44.8%	43.8%	42.0%

Subscriber Data For U.S. Cable Systems

	As of December 31,		
	1993	1994	1995
Homes passed by cable	5,192,000	5,372,000	7,191,000
Number of basic subscribers	2,895,000	3,081,000	4,190,000
Basic penetration	55.8%	57.4%	58.3%
Number of premium subscriptions	2,454,000	2,635,000	3,770,000
Premium penetration	84.8%	85.5%	90.0%

Year Ended December 31, 1995 Compared to Year Ended December 31, 1994. Revenues increased 20.4% (or \$244.4 million) to approximately \$1.4 billion. The acquisition of cable television systems in New Hampshire and Florida during 1994, the Providence Journal Merger and the Recent Acquisitions, serving a total of approximately 1,087,000 basic subscribers as of their respective acquisition dates, accounted for \$122.1 million of such revenue increase. Excluding the effects of the foregoing acquisitions, revenues increased 10.3% (or \$122.3 million) as a result of a 3.1% increase in ending basic cable subscribers, an increase in cable revenue per average basic subscriber and an increase in DBS-service revenues. Excluding the foregoing acquisitions and DBS-service revenues, monthly cable revenue per average basic subscriber increased from \$35.23 to \$36.56. The \$1.33 increase in monthly cable revenue per average basic subscriber, reflects: (i) increases in basic rates and a reversal during 1995 of certain non-cash revenue reserves (see below) as a result of the Social Contract and (ii) an increase in premium and other revenue categories. Revenues from premium cable services increased by \$3.8 million to \$248.1 million (excluding the foregoing acquisitions and DBS service) due to an increase in premium subscriptions. The increase in revenues (excluding the foregoing acquisitions and DBS service) was also due to a \$9.2 million increase in advertising revenues to \$66.9 million, a \$2.4 million increase in home shopping revenues to \$16.4 million and a \$5.6 million increase in pay-per-view revenues to \$30.1 million. Revenues from DBS service increased by \$31.0 million to \$37.0 million principally as a result of an increase of 58,000 in the number of DBS-service customers to approximately 80,000 as of December 31, 1995.

Operating, selling, general and administrative expenses increased 24.4% to \$837.2 million due primarily to the foregoing acquisitions, the provision of DBS service, and increases in programming costs and wages. Many of the increases in expenses were not passed through to subscribers in the form of rate increases in accordance with the FCC's rate regulations due to the negotiation and implementation of the Social Contract. See "Business—Development of Business—U.S. Operating Strategy—U.S. Regulatory Strategy; Social Contract." Depreciation and amortization expenses increased 20.5% to \$341.2 million due to the foregoing acquisitions and increased levels of capital expenditures. Non-cash stock compensation (Restricted Stock Purchase Program expense) increased 6.1% to \$12.0 million due to a vesting of a greater percentage of shares issued under Continental's Restricted Stock Purchase Program as compared to 1994. Operating income increased 9.3% to \$252.0 million. Interest expense increased 15.3% to \$363.8 million as a result of a 25.0% increase in average debt outstanding. The effective interest rate decreased from 9.7% to 9.0%. Other (income) expenses included a gain of \$23.0 million from the sale of the Company's shares of QVC common stock and a gain of \$1.0 million on the sale of a portion of its investment in NCC. Other (income) expense also includes equity in net loss of affiliates, which increased from \$25.0 million to \$70.4 million primarily due to the Company recording its proportionate share of losses from its international investments in Australia, Argentina and Singapore and its investments in TCG and The Golf Channel. The effective tax rate was lower in 1995 since a tax benefit was not recorded for the equity in net loss of foreign affiliates. As a result of the above factors, the net loss before extraordinary item for 1995 compared to 1994 increased by \$43.5 million to \$112.0 million.

Year Ended December 31, 1994 Compared to Year Ended December 31, 1993. Revenues increased by 1.8% (or \$20.8 million) to approximately \$1.2 billion. The cable television systems acquired in New Hampshire and Florida during 1994 served a total of approximately 78,000 basic subscribers as of their respective acquisition dates and accounted for \$8.0 million of such revenue increase. Excluding the effects of the foregoing acquisitions, revenues increased 1.1% (or \$12.8 million) as a result of a 3.7% increase in ending basic subscribers and an increase in premium and certain other revenue. Monthly cable revenue per average basic subscriber decreased from \$35.71 to \$35.23. The \$.48 decrease was primarily due to rate reductions and non-cash revenue reserves recorded during 1994 in connection with the FCC's rate regulations, net of an \$.11 increase in premium, advertising and other revenue. See "Liquidity and Capital Resources—Recent Legislation." Revenues from premium cable increased by \$1.3 million (excluding the foregoing acquisitions and DBS-service revenues) due to an increase in premium subscriptions. The increase in revenues (excluding the foregoing acquisitions and DBS-service revenues) was also due to a \$5.0 million increase in advertising revenue and a \$5.1 million increase in other revenue due to continued growth in home shopping revenue, less a \$1.3 million decrease in pay-per-view revenue. Pay-per-view revenue decreased due to the lack of availability of special events offered as compared to 1993, reflecting industry-wide trends. Revenues from DBS service increased \$4.3 million or 244.0% as a result of an increase in DBS-service customers from 4,300 to 22,000.

Operating, selling, general and administrative expenses increased 3.6% to \$672.9 million, primarily due to the foregoing acquisitions and increases in programming costs and wages. Depreciation and amortization expenses increased 1.5% to \$283.2 million due to an increase in capital expenditures. Non-cash stock compensation (Restricted Stock Purchase Program expense) increased 2.8% to \$11.3 million due to the vesting of a greater percentage of shares issued under Continental's Restricted Stock Purchase Program as compared to 1993. Operating income decreased 2.9% to \$230.6 million. Interest expense increased approximately 11.8% to \$315.5 million due to a 5.0% increase in average debt outstanding and an increase in the effective interest rate from 9.1% to 9.7%. Other (income) expenses decreased as a result of equity in net loss of affiliates which increased from \$12.8 million to \$25.0 million, primarily due to Continental recording its proportionate share of losses from PrimeStar and TCG and its affiliates. Continental also recorded an extraordinary loss of \$18.3 million due to the extinguishment of debt.

As a result of such factors, loss before the cumulative effect of the accounting change for the year ended December 31, 1994, compared to December 31, 1993, increased by \$61.1 million to \$86.8 million, and net loss for the year ended December 31, 1994, compared to December 31, 1993, decreased from \$210.8 million to \$86.8 million.

Continental implemented Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109") as of January 1, 1993. SFAS 109 required a change from the deferred to the liability method for computing deferred income taxes. The cumulative effect of this change was a non-recurring increase in net loss of \$185.0 million. The cumulative change resulted from net deferred tax liabilities recognized for the difference between the financial reporting and tax bases of assets and liabilities. The income tax benefit recognized in 1993 was \$7.9 million due to deferred tax benefits recognized under SFAS 109. The income tax benefit for 1993 was decreased by \$4.2 million as a result of applying the newly enacted federal tax rates to deferred tax balances as of January 1, 1993.

EBITDA. Based on its experience in the cable television industry, Continental believes that EBITDA and related measures of cash flow serve as important financial analysis tools for measuring and comparing cable television companies in several areas, such as liquidity, operating performance and leverage. EBITDA should not be considered as an alternative to operating or net income (measured in accordance with GAAP) as an indicator of Continental's performance or as an alternative to cash flows from operating activities (measured in accordance with GAAP) as a measure of Continental's liquidity. For the year ended December 31, 1995, EBITDA increased 15.2% to \$605.2 million, as compared to the same period in 1994. Excluding the effect of the acquisition of cable television systems in New Hampshire and Florida in 1994, the Providence Journal Merger and the Recent Acquisitions, EBITDA increased 6.3%. DBS service accounted for \$4.3 million of EBITDA for the year ended December 31, 1995, compared to \$(1.9) million as of December 31, 1994. The remaining increase in EBITDA for the year ended December 31, 1995 (excluding the effects of acquisitions) was the result of increases in revenue. EBITDA decreased 0.5% to \$525.1 million for the year ended December 31, 1994, primarily due to rate reductions and non-cash revenue reserves recorded in connection with the FCC's rate regulations.

Inflation. Certain of the Company's expenses, such as those for wages and benefits, for equipment repair and replacement, and for billing and marketing, increase with general inflation. However, the Company does not believe that its financial results have been, or will be, adversely affected by inflation, provided that it is able to increase its service rates periodically. For a description of recent legislation and regulations that may limit the Company's ability to raise its rates for certain services, see "Business—Description of Business—U.S. Operating Strategy—U.S. Regulatory Strategy; Social Contract" and "Legislation and Regulation."

Recent Accounting Pronouncements. In March 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS 121"), which is effective for fiscal years beginning after December 15, 1995. SFAS 121 addresses the accounting for potential impairment of long-lived assets. The effect of implementing SFAS 121 is expected to be immaterial to Continental's financial position and results of operations.

In October 1995, the FASB issued Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). SFAS 123, which is effective for fiscal years beginning after December 15, 1995, establishes financial accounting and reporting requirements for stock-based employee compensation plans. The effect of implementing SFAS 123 is expected to be immaterial to Continental's financial position and results of operations.

Liquidity and Capital Resources

The following table sets forth for the period indicated certain items from the Company's Statement of Consolidated Cash Flows:

	Year Ended December 31, 1995
Net cash provided from operating activities	\$ 221,264
Net cash provided from (used for) financing activities:	
Net borrowings	\$ 1,828,979
Other	(4,445)
Total	\$ 1,824,534
Net cash provided from (used for) investing activities:	
Acquisitions (net)	\$ (1,243,879)
Property, plant and equipment	(518,161)
Investments	(280,142)
Other assets	(25,167)
Proceeds from sale of marketable equity securities	27,357
Proceeds from sale of investment-net	1,181
Total	\$ (2,038,811)

1995 Financing Activities. On December 13, 1995, Continental issued \$600.0 million in aggregate principal amount of 8.30% Senior Notes Due 2006 (the "8.30% Senior Notes") in an offering pursuant to Rule 144A of the Securities Act of 1933. The net proceeds from the sale of the 8.30% Senior Notes were used initially to repay \$587.1 million of the indebtedness outstanding under an unsecured, reducing revolving credit facility of the Company and certain of its subsidiaries (the "1994 Credit Facility"). The maximum credit availability under the 1994 Credit Facility is \$2.2 billion, which will decrease annually commencing in December 1997, with a final maturity in October 2003.

On July 18, 1995, certain of Continental's subsidiaries entered into an unsecured, reducing revolving credit facility (the "1995 Credit Facility"). The maximum credit availability under the 1995 Credit Facility is \$1.2 billion, which will decrease annually commencing in December 1998, with a final maturity in September 2004. Such facility has other terms and conditions that are similar in certain respects to those contained in the 1994 Credit Facility.

In October 1995, Continental borrowed under the 1995 Credit Facility to fund approximately \$815.0 million in connection with the Providence Journal Merger and approximately \$155.0 million for the acquisition of Columbia Cable of Michigan. In December 1995, Continental borrowed under the 1995 Credit Facility to fund approximately \$88.0 million in connection with the N-COM Buyout. Subsequent borrowings under the 1995 Credit Facility will be used for general corporate purposes, including capital expenditures for the Providence Journal Cable, Columbia Cable of Michigan and N-COM systems.

Credit Arrangements of Continental. On December 31, 1995, Continental had cash on hand of \$18.6 million and the following credit arrangements: (i) approximately \$1.6 billion outstanding under the 1994 Credit Facility; (ii) approximately \$1.0 billion outstanding under the 1995 Credit Facility; (iii) \$125.8 million of 10.12% Senior Notes Due 1999 to the Prudential Life Insurance Company; (iv) \$200.0 million of 8½% Senior Notes

Due 2001; (v) \$100.0 million of 8¼% Senior Notes Due 2003; (vi) \$275.0 million of 8¼% Senior Debentures Due 2005; (vii) \$600.0 million of the 8.30% Senior Notes; (viii) \$300.0 million of 9% Senior Debentures Due 2008; (ix) \$525.0 million of 9¼% Senior Debentures Due 2013; (x) \$100.0 million of 10¼% Senior Subordinated Notes Due 2002; (xi) \$100.0 million of Senior Subordinated Floating Rate Debentures Due 2004 (the "Floating Rate Debentures"); and (xii) \$300.0 million of 11% Senior Subordinated Debentures Due 2007. Other miscellaneous debt was approximately \$34.2 million as of December 31, 1995. As of December 31, 1995, there was credit availability of \$613.8 million and \$161.0 million under the 1994 Credit Facility and 1995 Credit Facility, respectively. In February 1996, the Company borrowed funds under the 1994 Credit Facility in order to redeem \$100.0 million in aggregate principal amount of the Floating Rate Debentures, plus accrued interest thereon.

As of December 31, 1995, a subsidiary of Continental had issued a standby letter of credit of approximately \$56.3 million on behalf of PrimeStar, which guaranteed a portion of the financing incurred by PrimeStar to construct a successor-satellite system. On March 11, 1996, the obligations under such letter of credit increased to approximately \$70.6 million. The letter of credit is secured by certain marketable equity securities with a fair market value of approximately \$163.7 million as of March 11, 1996.

The annual maturities of Continental's indebtedness for the years ending December 31, 1996, 1997, 1998, 1999 and 2000 will be approximately \$29.6 million, \$32.1 million, \$33.6 million, \$112.3 million and \$559.0 million, respectively.

Capital Expenditures and U.S. Acquisitions. Continental's expenditures for property, plant and equipment totaled approximately \$518.2 million for the year ended December 31, 1995. The increase in Continental's capital expenditures for 1995 as compared to 1994 was due to: (i) the rebuild and upgrade of its systems; (ii) the provision of DBS service; and (iii) the acquisition of cable systems in New Hampshire and Florida in 1994, the Providence Journal Merger and the Recent Acquisitions. Continental anticipates that it will spend during 1996: (i) approximately \$529.0 million on capital expenditures for its systems (excluding the systems to be acquired in the Pending M/NH Buyout), (ii) approximately \$85.0 million on capital expenditures for the provision of DBS service and (iii) approximately \$120.0 million on capital expenditures for new businesses such as telephony and high-speed data services. However, Continental is continually reevaluating its capital budget based on economic, technological and other factors. In accordance with the recently adopted Social Contract with the FCC, Continental has agreed to invest a minimum of \$1.35 billion in system rebuilds and upgrades in the United States from 1995 to 2000 to expand channel capacity and improve system reliability and picture quality, \$419.2 million of which has already been invested. Under the Social Contract Amendment, which was recently released by the FCC for public comment, Continental would agree to increase the minimum investment from \$1.35 billion to \$1.7 billion, in order to incorporate into the Social Contract the systems acquired in the Providence Journal Merger and the Recent Acquisitions. See "Business—Description of Business—U.S. Operating Strategy—U.S. Regulatory Strategy; Social Contract."

In 1995, Continental acquired (i) the cable television systems of Providence Journal for total consideration of approximately \$1.4 billion pursuant to the Providence Journal Merger, and (ii) other cable television systems, or interests therein, in the Recent Acquisitions for an aggregate of approximately \$428.5 million. See "Business—Description of Business—U.S. Acquisitions and Investments." Continental has entered into a purchase agreement to acquire the remaining ownership interests and discharge or assume certain liabilities of M/NH for total consideration of approximately \$219.2 million. The Cablevision of Chicago and the Consolidated Cablevision of California acquisitions closed in August 1995 and September 1995, respectively, and both the Providence Journal Merger and Columbia Cable of Michigan acquisition closed in October 1995. The N-COM Buyout closed in December 1995. The Pending M/NH Buyout is expected to close in the third quarter of 1996. All of these cable television systems primarily serve communities that are contiguous, or in close proximity, to Continental's other systems. Continental funded the acquisition of Columbia Cable of Michigan and the N-COM Buyout with borrowings under the 1995 Credit Facility. Continental funded the Cablevision of Chicago and the

Consolidated Cablevision of California acquisitions with borrowings under the 1994 Credit Facility. Continental funded the Providence Journal Merger with borrowings under the 1995 Credit Facility as well as through the issuance of approximately 30.1 million shares of Class A Common Stock. See "Business—Description of Business—U.S. Acquisitions and Investments—The Providence Journal Merger" and "Other U.S. Acquisitions."

Investments. For purposes of the Statement of Consolidated Cash Flows, the Company's investments include, among other things, telecommunications and technology and international.

International Investments. As of December 31, 1995, Continental had advanced US\$150.5 million to Fintelco. In addition, Continental has recorded commitments to contribute an additional US\$24.2 million to Fintelco in order to finance a portion of certain acquisitions of Argentine cable television systems. Fintelco recently entered into a US\$140.0 million credit facility, and is in the process of arranging an aggregate of approximately US\$65.0 million in additional credit facilities. Proceeds from such facilities will be used to refinance existing short-term indebtedness and for general corporate purposes, including capital expenditures. Such facilities may reduce the amount of future advances from Fintelco's shareholders, including Continental. No assurance can be given at this time that such additional facilities will be successfully arranged. See "Business—Description of Business—International Operations."

As of December 31, 1995, Continental had invested approximately US\$169.1 million in Optus Vision. Optus Vision anticipates at this time that the remaining funding needs of the project will be approximately US\$1.2 billion (based upon exchange rates at December 31, 1995) through 1999, which will be provided by a combination of equity from the joint venture partners and third-party debt. Optus Vision recently arranged A\$230.0 million of short-term credit facilities. Proceeds from such facilities will be used for general corporate purposes, including capital expenditures. Such facilities may reduce the amount of future advances from Optus Vision shareholders, including Continental. Continental's funding requirements would be reduced if either or both of Nine and Seven exercise their options to increase their equity interests in Optus Vision to 20% and 15%, respectively, but there can be no assurances that Nine and/or Seven will exercise their options. See "Business—Description of Business—International Operations."

As of December 31, 1995, Continental had made capital contributions to SCV of US\$17.6 million and committed to contribute up to approximately US\$27.0 million (based on exchange rates as of December 31, 1995) in additional capital. In addition, Continental has committed to lend up to approximately US\$45.0 million (based on exchange rates as of December 31, 1995) to SCV if third-party debt financing is unavailable. SCV has arranged an aggregate of S\$106.0 million in senior credit facilities and is in the process of arranging additional senior credit facilities. Such facilities may reduce the amount of future advances from SCV's shareholders, including Continental. No assurance can be given at this time that all such additional facilities will be successfully arranged. See "Business—Description of Business—International Operations."

Investments in Telecommunications and Technology. Continental has made numerous investments which are related to its ownership interests in TCG and PrimeStar.

In 1993, Continental purchased 20% of TCG for a purchase price of \$66.0 million. In addition, Continental has committed to lend up to \$69.9 million to TCG through 2003, of which \$53.8 million was advanced as of December 31, 1995. Continental has also invested \$56.7 million in joint ventures involving TCG and other cable television operators. On May 22, 1995, TCG entered into a \$250.0 million revolving credit facility with a group of financial institutions. Borrowings under the facility may be used for general corporate purposes of TCG, including capital expenditures. Such facility may reduce the amount of future advance from TCG's shareholders, including Continental.

Continental also owns an approximate 10.4% partnership interest in PrimeStar. Continental has made cash investments totaling \$25.8 million as of December 31, 1995 to fund PrimeStar's ongoing operations and may in the future make additional investments in PrimeStar. See "Business—Description of Business—Telecommunications and Technology."

Other Financing and Investment Activities. In January 1995, Continental sold its shares of QVC common stock in a tender offer for approximately \$27.4 million and sold a portion of its investment in NCC for approximately \$1.2 million. The proceeds from these sales were used to repay amounts outstanding under the 1994 Credit Facility.

Intangible and other assets increased by a total of \$1.5 billion during the year ended December 31, 1995 due primarily to assets recorded in connection with the Providence Journal Merger and the Recent Acquisitions and an increase of approximately \$14.2 million in loans to certain employees to cover tax obligations in connection with Continental's Restricted Stock Purchase Program. See Note 11 to Continental's Consolidated Financial Statements.

1998-1999 Share Repurchase Program. Continental is a party to a liquidity agreement (the "Stock Liquidation Agreement") with certain shareholders, including H. Irving Grousbeck (a co-founder of the Company), and the partners of certain general investment limited partnerships managed by Burr, Egan, Deleage & Co. (collectively, the "Subject Stockholders"), pursuant to which Continental has obligations to purchase, and the Subject Stockholders and other stockholders who have elected to have their shares of Common Stock covered thereby ("Redeemable Common Stock") have obligations to sell, such Redeemable Common Stock in 1998 or 1999, as described below (the "1998-1999 Share Repurchase Program").

Continental's obligation under the Stock Liquidation Agreement is to repurchase approximately 16.7 million shares of Redeemable Common Stock (representing approximately 9.42% of its outstanding shares of Common Stock on a fully diluted basis, assuming conversion of the outstanding shares of Series A Preferred Stock) on December 15, 1998 (or January 15, 1999), at each such stockholder's election. The purchase price for such redemption is equal to the greater of (i) the dollar amount that a holder of Common Stock would receive per share of Common Stock upon a sale of the Company as a whole pursuant to a merger or a sale of stock or, if greater, the dollar amount a holder of Common Stock would then receive per share of Common Stock derived from the sale of the Company's assets and subsequent distribution of the proceeds therefrom (net of corporate taxes, including sales and capital gains taxes in connection with such sale of assets), in either case less a discount of 22.5%, or (ii) the dollar amount equal to the net proceeds which would be expected to be received by a stockholder of the Company from the sale of a share of Common Stock in an underwritten public offering at the time the shares are to be repurchased after, under certain circumstances, being reduced by pro forma expenses and underwriting discounts. In the event the Company is unable to perform its obligation to complete the 1998-1999 Share Repurchase Program within six months of the payment date therefor, the Company is obligated, at the request made within such six-month period of any one or more Subject Stockholders or transferees holding an aggregate of at least 2.5 million shares of such transferred shares of Redeemable Common Stock, to use its best efforts (subject to compliance with applicable laws and regulations) to cause the sale of all or substantially all of the assets of the Company and, following the consummation of such sale, to liquidate the Company.

Capital Resources. Historically, cash generated from the Company's operating activities in conjunction with borrowings and, to a lesser extent, proceeds from private equity issuances have been sufficient to fund the Company's capital expenditures, investments and acquisitions, debt service requirements and stock repurchase obligations. Prior to the consummation of the Merger with U S WEST, Continental anticipates funding its capital expenditures, acquisitions, investments and debt service requirements with cash provided from operating activities and borrowings under existing and new credit facilities. If the Merger is not consummated, Continental anticipates funding its capital needs with cash provided from operating activities, borrowings under existing and new credit facilities and future equity issuances. However, there can be no assurance in this regard. Furthermore, there can be no assurance that the terms available for any future debt or equity financing would be favorable to the Company.

Recent Legislation. In October 1992, Congress passed the 1992 Cable Act, which, among other things, authorizes the FCC to set standards for governmental authorities to regulate the rates for certain cable television

services and equipment and gives local broadcast stations the option to elect mandatory carriage or require retransmission consent. Pursuant to authority granted under the 1992 Cable Act, the FCC adopted a series of rate regulations.

The FCC also publicly announced that it would consider "social contracts" as an alternative form of rate regulation for cable operators. Continental's Social Contract with the FCC was adopted by the FCC on August 3, 1995. In addition, the Social Contract Amendment was released for public comment on March 6, 1996 and incorporates into the Social Contract the systems acquired in the Providence Journal Merger and the Recent Acquisitions. The Social Contract and the Social Contract Amendment, if adopted by the FCC, will govern Continental's future rates. The Social Contract also provides for its termination in the future if the laws and regulations applicable to services offered in any Continental franchise change in a manner that would have a material favorable financial impact on Continental. In that instance, the Company may petition the FCC to terminate the Social Contract. For a description of the Social Contract and the Social Contract Amendment, see "Business—Description of Business—U.S. Operating Strategy—U.S. Regulatory Strategy; Social Contract."

Furthermore, the 1996 Telecommunications Act has been enacted into law. The 1996 Telecommunications Act modifies various provisions of the Communications Act of 1934, the 1984 Cable Act and the 1992 Cable Act, with the intent of establishing a pro-competitive, deregulatory policy framework for the telecommunications industry. See "Business—Description of Business—U.S. Operating Strategy—Legislation and Regulation."

Item 8. Financial Statements and Supplementary Data.

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INDEPENDENT AUDITORS' REPORT

Continental Cablevision, Inc.:

We have audited the accompanying consolidated balance sheets of Continental Cablevision, Inc. and its subsidiaries as of December 31, 1994 and 1995 and the related statements of consolidated operations, consolidated stockholders' equity (deficiency) and consolidated cash flows for each of the three years in the period ended December 31, 1995. Our audits also included the financial statement schedules listed in the index as Item 14. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements of Continental Cablevision, Inc. and its subsidiaries present fairly, in all material respects, the financial position of the companies at December 31, 1994 and 1995 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1995 in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Notes 12 and 4 to the consolidated financial statements, the Company changed its method of accounting for income taxes and investments in 1993 and 1994, respectively.

DELOITTE & TOUCHE LLP

Boston, Massachusetts
February 14, 1996

CONTINENTAL CABLEVISION, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
	1994	1995
	(In Thousands)	
<u>ASSETS</u>		
Cash	\$ 11,564	\$ 18,551
Accounts Receivable—net	58,212	110,132
Prepaid Expenses and Other	14,321	9,967
Supplies	62,517	88,687
Marketable Equity Securities	122,510	151,378
Investments	335,479	538,352
Property, Plant and Equipment—net	1,353,789	2,107,473
Intangible Assets—net	421,420	1,902,796
Other Assets—net	103,827	153,257
TOTAL	\$ 2,483,639	\$ 5,080,593
<u>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)</u>		
Accounts Payable	\$ 82,083	\$ 96,833
Accrued Interest	82,040	86,977
Accrued and Other Liabilities	206,271	238,343
Debt	3,449,907	5,285,159
Deferred Income Taxes	116,482	307,041
Minority Interest in Subsidiaries	2,791	26,056
Commitments and Contingencies		
Redeemable Common Stock, \$.01 par value; 16,684,150 shares outstanding ..	232,399	256,135
Stockholders' Equity (Deficiency):		
Preferred Stock, \$.01 par value; 198,857,142 shares authorized; none outstanding	—	—
Series A Convertible Preferred Stock, \$.01 par value; 1,142,858 shares authorized and outstanding; liquidation preference—\$487,776,000 and \$527,578,000	11	11
Class A Common Stock, \$.01 par value; 425,000,000 shares authorized; 8,585,500 and 38,780,694 shares outstanding	86	388
Class B Common Stock, \$.01 par value; 200,000,000 shares authorized; 90,291,375 and 92,572,000 shares outstanding	903	926
Additional Paid-In Capital	583,181	1,181,193
Unearned Compensation	(12,097)	(45,851)
Net Unrealized Holding Gain on Marketable Equity Securities	47,996	67,823
Deficit	(2,308,414)	(2,420,441)
Stockholders' Equity (Deficiency)	(1,688,334)	(1,215,951)
TOTAL	\$ 2,483,639	\$ 5,080,593

See Notes to Consolidated Financial Statements.

CONTINENTAL CABLEVISION, INC. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED OPERATIONS

	Year Ended December 31,		
	1993	1994	1995
	(In Thousands, except per share amounts)		
Revenues	\$1,177,163	\$1,197,977	\$1,442,392
Costs and Expenses:			
Operating	382,195	405,535	498,239
Selling, General and Administrative	267,376	267,349	339,002
Depreciation and Amortization	279,009	283,183	341,171
Restricted Stock Purchase Program	11,004	11,316	12,005
Total	939,584	967,383	1,190,417
Operating Income	237,579	230,594	251,975
Other (Income) Expense:			
Interest	282,252	315,541	363,826
Equity in Net Loss of Affiliates	12,827	25,002	70,364
Gain on Sale of Marketable Equity Securities	(4,322)	(1,204)	(23,032)
Gain on Sale of Investments	(17,067)	—	(1,035)
Minority Interest in Net Income (Loss) of Subsidiaries	184	(205)	(39)
Dividend Income	(650)	(824)	(715)
Other	(1,950)	1,279	2,542
Total	271,274	339,589	411,911
Loss From Operations Before Income Taxes, Extraordinary Item and Cumulative Effect of Change in Accounting for Income Taxes	(33,695)	(108,995)	(159,936)
Income Tax Benefit	(7,921)	(40,419)	(47,909)
Loss Before Extraordinary Item and Cumulative Effect of Change in Accounting for Income Taxes	(25,774)	(68,576)	(112,027)
Extraordinary Item, Net of Income Taxes	—	(18,265)	—
Loss Before Cumulative Effect of Change in Accounting for Income Taxes	(25,774)	(86,841)	(112,027)
Cumulative Effect of Change in Accounting for Income Taxes	(184,996)	—	—
Net Loss	(210,770)	(86,841)	(112,027)
Preferred Stock Preferences	(34,115)	(36,800)	(39,802)
Loss Applicable to Common Stockholders	\$ (244,885)	\$ (123,641)	\$ (151,829)
Loss Per Common Share:			
Loss Before Extraordinary Item and Cumulative Effect of Change in Accounting for Income Taxes	\$ (.53)	\$ (.92)	\$ (1.22)
Extraordinary Item	—	(.16)	—
Loss Before Cumulative Effect of Change in Accounting for Income Taxes	(.53)	(1.08)	(1.22)
Cumulative Effect of Change in Accounting for Income Taxes	(1.62)	—	—
Net Loss	\$ (2.15)	\$ (1.08)	\$ (1.22)

See Notes to Consolidated Financial Statements.

CONTINENTAL CABLEVISION, INC. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED STOCKHOLDERS' EQUITY (DEFICIENCY)

	Series A Convertible Preferred Stock	Common Stock		Addition Paid-In Capital	Unearned Compensation	Net Unrealized Holding Gain on Marketable Equity Securities	Deficit
		Class A	Class B		(In Thousands)		
Balance, January 1, 1993	\$ 11	\$ 38	\$913	\$ 558,529	\$ (34,919)	\$ —	\$ (2,010,803)
Net Loss	—	—	—	—	—	—	(210,770)
Accretion of Redeemable Common Stock	—	—	—	(14,766)	—	—	—
Issuance of Class A Common Stock	—	24	—	46,476	—	—	—
Reclassification of Redeemable Common Stock to Class A Common Stock	—	—	—	5,085	—	—	—
Restricted Stock Purchase Program:							
Stock Issued (Class B)	—	—	—	544	(544)	—	—
Stock Vested	—	—	—	—	11,004	—	—
Stock Forfeited	—	—	—	(882)	882	—	—
Stock Exchanged for Loans	—	—	—	(6,526)	—	—	—
Stock Repurchased	—	—	—	(11,384)	—	—	—
Balance, December 31, 1993	11	62	913	577,076	(23,577)	—	(2,221,573)
Adjustment due to change in accounting principle for marketable equity securities, net of income taxes of \$56,434	—	—	—	—	—	84,650	—
Net Loss	—	—	—	—	—	—	(86,841)
Accretion of Redeemable Common Stock	—	—	—	(19,932)	—	—	—
Restricted Stock Purchase Program:							
Stock Vested	—	—	—	—	11,316	—	—
Stock Forfeited	—	—	—	(164)	164	—	—
Stock Exchanged for Loans	—	—	—	(611)	—	—	—
Conversion of Class B to Class A Common Stock	—	8	(8)	—	—	—	—
Stock Repurchased	—	—	(2)	(3,672)	—	—	—
Issuance of Class A Common Stock	—	16	—	30,484	—	—	—
Change in Unrealized Gain, net of income taxes of \$24,081	—	—	—	—	—	(36,654)	—
Balance, December 31, 1994	11	86	903	583,181	(12,097)	47,996	(2,308,414)
Net Loss	—	—	—	—	—	—	(112,027)
Accretion of Redeemable Common Stock	—	—	—	(23,736)	—	—	—
Restricted Stock Purchase Program:							
Stock Issued	—	—	23	46,205	(46,228)	—	—
Stock Vested	—	—	—	—	12,005	—	—
Stock Forfeited	—	—	—	(469)	469	—	—
Stock Exchanged for Loans	—	—	—	(337)	—	—	—
Issuance of Class A Common Stock in connection with acquisition, net of issuance costs of \$8,111	—	302	—	576,349	—	—	—
Change in Unrealized Gain, net of income taxes of \$13,364	—	—	—	—	—	19,827	—
Balance, December 31, 1995	\$ 11	\$388	\$926	\$1,181,193	\$ (45,851)	\$ 67,823	\$ (2,420,441)

See Notes to Consolidated Financial Statements.

CONTINENTAL CABLEVISION, INC. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED CASH FLOWS

	Year Ended December 31,		
	1993	1994	1995
	(In Thousands)		
OPERATING ACTIVITIES:			
Net Loss	\$ (210,770)	\$ (86,841)	\$ (112,027)
Adjustments to Reconcile Net Loss to Net Cash Provided from Operating Activities, Net of Acquisitions:			
Extraordinary Item	—	18,265	—
Cumulative Effect of Change in Accounting for Income Taxes	184,996	—	—
Depreciation and Amortization	279,009	283,183	341,171
Restricted Stock Purchase Program	11,004	11,316	12,005
Amortization of Deferred Financing Costs	5,554	5,759	9,184
Equity in Net Loss of Affiliates	12,827	25,002	70,364
Gain on Sale of Marketable Equity Securities	(4,322)	(1,204)	(23,032)
Gain on Sale of Investments	(17,067)	—	(1,035)
Minority Interest in Net Income (Loss) of Subsidiaries	184	(205)	(39)
Deferred Income Taxes	(9,788)	(42,272)	(48,783)
Accrued Interest	15,787	9,632	4,937
Accounts Payable, Accrued and Other Liabilities	(3,633)	66,142	5,515
Other Working Capital Changes	(13,277)	(52,473)	(36,996)
NET CASH PROVIDED FROM OPERATING ACTIVITIES	250,504	236,304	221,264
FINANCING ACTIVITIES:			
Proceeds from Borrowings	1,502,304	1,709,980	2,635,240
Repayment of Borrowings	(1,369,341)	(1,456,061)	(806,261)
Premium Paid on Extinguishment of Debt	—	(20,924)	—
Increase (Decrease) in Minority Interests	(2,580)	779	3,666
Issuance of Common Stock	46,500	30,500	(8,111)
Repurchase of Common Stock and Redeemable Common Stock ..	(31,232)	(4,755)	—
NET CASH PROVIDED FROM FINANCING ACTIVITIES	145,651	259,519	1,824,534
INVESTING ACTIVITIES:			
Acquisitions, Net of Liabilities Assumed and Cash Acquired	—	(114,990)	(1,243,879)
Property, Plant and Equipment	(185,691)	(300,511)	(518,161)
Investments	(106,819)	(192,119)	(280,142)
Other Assets	(7,182)	(16,832)	(25,167)
Purchase of Marketable Equity Securities	(8,042)	—	—
Proceeds from Sale of Marketable Equity Securities	5,719	17,553	27,357
Proceeds from Sale of Investment—net	1,148	—	1,181
NET CASH USED FOR INVESTING ACTIVITIES	(300,867)	(606,899)	(2,038,811)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	95,288	(111,076)	6,987
BALANCE AT BEGINNING OF YEAR	27,352	122,640	11,564
BALANCE AT END OF YEAR	\$ 122,640	\$ 11,564	\$ 18,551

See Notes to Consolidated Financial Statements.

CONTINENTAL CABLEVISION, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Basis of Presentation

The Company is a provider of broadband communications services with operations and investments encompassing cable television systems, international broadband communication ventures, telecommunications and technology ventures and programming services.

The accompanying consolidated financial statements include the accounts of Continental Cablevision, Inc. (the Company) and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The preparation of the Company's consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at each balance sheet date and during each reporting period. Significant estimates included in the consolidated financial statements include the assigned useful lives of property, plant and equipment and intangible assets, the carrying value of cost method investments, certain accruals, and valuation allowances for deferred tax assets. Actual results could differ from these estimates.

Stock Dividend

On September 28, 1995, the stockholders approved an increase in the number of authorized shares of common stock to 625,000,000 (425,000,000 Class A and 200,000,000 Class B, respectively) and preferred stock to 200,000,000. In addition, the Company's Board of Directors approved a stock dividend of 24 shares of Class A or B common stock for each share of Class A or B common stock held as of the record date. Due to the significance of this stock dividend to the Company's capital structure, all share and per share information have been restated to present this stock dividend as though it had occurred at the beginning of the earliest period presented.

Supplies and Property, Plant and Equipment

Supplies are stated at the lower of cost (first-in, first-out method) or market. Property, plant and equipment are stated at cost and include capitalized interest of \$908,000, \$2,377,000 and \$7,233,000 in 1993, 1994 and 1995, respectively. Depreciation is provided using the straight-line group method over estimated useful lives as follows: buildings, 25 to 40 years; reception and distribution facilities, 3 to 15 years; and equipment and fixtures, 4 to 12½ years. (See Note 6)

Intangible and Other Assets

Intangible assets consist primarily of franchise costs and goodwill recorded in various acquisitions. Such amounts are generally amortized over 10 to 40 years. Franchise costs, net of accumulated amortization, at December 31, 1994 and 1995 are \$355,488,000 and \$1,491,269,000, respectively. Other assets represent deferred financing costs and loans to employees (see Note 11). Accumulated amortization for intangible and other assets aggregated \$714,492,000 and \$807,644,000 at December 31, 1994 and 1995, respectively.

On an ongoing basis management evaluates the amortization periods and the recoverability of the net carrying value of intangible assets by reviewing the performance of the underlying operations, in particular, of the future undiscounted operating cash flows of the acquired entities.

Allowance for Doubtful Accounts

The allowance for doubtful accounts at December 31, 1994 and 1995 is \$9,771,000 and \$12,476,000, respectively.

Investments

Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115) requires that certain debt and equity securities be categorized as either securities available for sale, securities held to maturity or trading account securities. The Company has classified all investments subject to SFAS 115 as available for sale and as such reports these securities at fair value, with the unrealized gains or losses, net of tax, reported as a separate component of stockholders' equity (deficiency). Realized gains and losses are included in results of operations. Prior to January 1, 1994, marketable equity securities were carried at either the lower of cost or market. In accordance with SFAS 115, prior period financial statements have not been restated to reflect the change in accounting principle. (See Note 4)

Investments in 20-50% owned affiliates and other investments where the Company owns less than 20% but has the ability to exert significant influence are generally accounted for using the equity method. The excess of the cost of equity investments over the underlying value of the net assets is amortized over a period of approximately 10 years. Investments in less than 20% owned companies whose equity securities do not have a readily determinable market value are generally accounted for using the cost method. Investments in debt securities not subject to SFAS 115 are reported at amortized cost. (See Note 5)

Derivative Financial Instruments

The Company uses derivative financial instruments (primarily Interest Rate Exchange Agreements (Swaps) and Interest Rate Cap Agreements (Caps)) as a means of managing interest-rate risk associated with current debt or anticipated debt transactions that have a high probability of being executed. These instruments are matched with either fixed or variable rate debt and periodic cash payments are accrued on a settlement basis as an adjustment to interest expense. Derivative financial instruments are not held for trading purposes. Any premiums associated with the instruments are amortized over their term and realized gains or losses as a result of the termination of the instruments are deferred and amortized over the shorter of the remaining term of the instrument or the underlying debt. (See Note 7)

Income Taxes

The Company implemented Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109) as of January 1, 1993. Deferred tax liabilities and assets are recognized for the future tax consequences of temporary differences between the financial reporting and tax bases of existing assets and liabilities. In addition, future tax benefits, such as net operating loss and investment tax credit carryforwards, are recognized to the extent realization of such benefits is more likely than not. (See Note 12)

Fair Value of Financial Instruments

The estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of December 31, 1994 and 1995. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and current estimates of fair value may differ significantly from the amounts presented herein.

The following is a summary of the estimated fair value and carrying value of the Company's financial instruments:

	December 31,			
	1994		1995	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(In Thousands)			
Assets				
Marketable Equity Securities (See Note 4)	\$ 122,510	\$ 122,510	\$ 151,378	\$ 151,378
Cost Method Investments (See Note 5)	33,175	47,322	35,663	54,221
Liabilities				
Total Debt, Swaps and Caps (See Note 7)	3,449,907	3,516,588	5,285,159	5,418,137
Redeemable Common Stock (See Note 9)	232,399	329,011	256,135	353,704

The Company believes carrying value approximates fair value for all other financial instruments.

Loss per Common Share

Loss per common share is calculated by dividing the loss available to common stockholders by the weighted average number of common shares outstanding of 114,055,000, 114,334,000 and 124,882,000 for the years ended December 31, 1993, 1994 and 1995, respectively. Shares of the Series A Convertible Preferred Stock were not assumed to be converted into shares of common stock since the result would be anti-dilutive.

Reclassifications

Certain amounts have been reclassified from previous presentation in the accompanying consolidated financial statements.

Recent Accounting Standards and Pronouncements

The Accounting Standards Executive Committee of the AICPA adopted Statement of Position 94-6 (SOP) on December 30, 1994. This SOP, *Disclosure of Certain Significant Risks and Uncertainties*, is effective for fiscal years ending after December 15, 1995. The disclosures required by the SOP focus primarily on the nature of an entity's operations, the use of estimates in preparation of financial statements and on risks and uncertainties that could significantly affect the amounts reported in the financial statements. The company's consolidated financial statements are in compliance with this statement.

In March 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 121 (SFAS 121), *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*, which is effective for fiscal years beginning after December 15, 1995. SFAS 121 addresses the accounting for potential impairment of long-lived assets. The effect of implementing SFAS 121 is expected to be immaterial to the Company's financial position and results of operations.

In October 1995, the Financial Accounting Standards Board issued Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). SFAS 123, which is effective for fiscal years beginning after December 15, 1995, establishes financial accounting and reporting requirements for stock-based employee compensation plans. The effect of implementing SFAS 123 is expected to be immaterial to the Company's financial position and results of operations.

2. SUPPLEMENTAL DISCLOSURE OF CASH FLOWS

The following represents non-cash investing and financing activities and cash paid for interest and income taxes during the years ended December 31, 1993, 1994 and 1995.

	Year Ended December 31,		
	1993	1994	1995
	(In Thousands)		
Acquisitions:			
Fair Value of Assets Acquired	\$ —	\$114,990	\$2,135,941
Deferred Taxes and Minority Interest Assumed	—	—	(257,946)
Net Working Capital Liabilities Assumed	—	—	(49,354)
Fair Value of Class A Common Stock Issued	—	—	(584,762)
Cash Paid for Acquisitions	<u>\$ —</u>	<u>\$114,990</u>	<u>\$1,243,879</u>
Dispositions:			
Gain on Sale of Investment (See Note 5)	\$ 15,919	\$ —	\$ —
Deferred Gain on Sale of Investment	165	—	—
Bases of Assets Sold	429	—	—
Gain on Sale of Marketable Equity Securities	3,471	—	—
Bases of Property Received	(19,984)	—	—
Proceeds Received from Disposition	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Accretion of Redeemable Common Stock	<u>\$ 14,766</u>	<u>\$ 19,932</u>	<u>\$ 23,736</u>
Accretion of Series A Convertible Preferred Stock	<u>\$ 34,115</u>	<u>\$ 36,800</u>	<u>\$ 39,802</u>
Cash Paid During the Year for Interest	<u>\$261,846</u>	<u>\$299,115</u>	<u>\$ 369,436</u>
Cash Paid During the Year for Income Taxes	<u>\$ 2,370</u>	<u>\$ 2,411</u>	<u>\$ 1,070</u>

3. ACQUISITIONS

All acquisitions have been accounted for as purchases. Results of operations of the companies and businesses acquired have been included in the accompanying consolidated financial statements from their respective dates of acquisition.

In June 1994, the Company purchased cable television systems in Manchester, New Hampshire for approximately \$47,990,000, and in November 1994 purchased cable television systems in Florida for approximately \$67,000,000.

The Company purchased cable television systems in the Chicago, Illinois area for approximately \$168,500,000 in August 1995 and cable television systems in California for approximately \$17,000,000 in September 1995. In October 1995, the Company purchased cable television systems in Michigan for approximately \$155,000,000. Also, in October 1995, the Company, Providence Journal, King Holding Corporation, King Broadcasting Company and The Providence Journal Company consummated a merger (the Merger) in which the Providence Journal (which at the time of the Merger included only the Providence Journal cable businesses and assets) was merged with and into the Company. In connection with the Merger, the Company purchased the cable television businesses and assets of King Broadcasting Company (the King Cable Assets, and collectively with Providence Journal, Providence Journal Cable). The total consideration involved in the Merger consisted of \$405,000,000 in cash, the repayment of approximately \$410,000,000 of existing indebtedness (see Note 7) and the issuance of 30,142,394 shares of the Company's Class A common stock at an ascribed value of \$584,762,000. In December 1995, the Company purchased for \$88,000,000 in cash the non-owned interests in and discharged certain liabilities of N-Com Limited Partnership II (N-Com), which owns and operates cable television systems in Michigan.

The summarized unaudited pro forma results of operations for the years ended December 31, 1994 and 1995, assuming the acquisitions above occurred as of the beginning of each respective period, are as follows:

	Year Ended December 31,	
	1994	1995
	(In Thousands, except per share data)	
Revenues	\$1 586,829	\$1,732,311
Depreciation and Amortization	388,940	440,109
Operating Income	275,652	263,768
Net Loss	(124,592)	(184,671)
Net Loss per Common Share	(0.86)	(1.27)

4. MARKETABLE EQUITY SECURITIES

Effective January 1, 1994, the Company adopted SFAS 115 and classified marketable equity securities as available for sale. These investments had a fair value of \$183,245,000 and a cost of \$42,161,000 at the date of adoption. The unrealized gain of \$141,084,000, less income taxes of \$56,434,000 was reported as an adjustment to stockholders' equity (deficiency). These securities have an aggregate cost basis of \$42,161,000 and \$37,837,000 as of December 31, 1994 and 1995, respectively. During the year ended December 31, 1994, the Company recognized a gross unrealized holding loss of \$60,735,000 and a gross realized gain of \$1,204,000. During the year ended December 31, 1995, the Company recognized a gross unrealized holding gain of \$33,191,000 and a gross realized gain of \$23,032,000.

5. INVESTMENTS

The Company's investments consist of the following:

	Approximate Ownership	December 31,	
		1994	1995
		(In Thousands)	
Equity Method Investments:			
Teleport Communications Group, Inc. (TCG) and {TCG Partners	20%	\$ 93,954	\$100,058
Regional TCG Partnerships	10%-30%	34,609	45,603
PrimeStar Partners L.P. (PrimeStar)	10%	12,500	16,311
Fintelco, S.A.	50%	146,040	164,144
Optus Vision Pty Ltd (Optus Vision)	47%	—	150,232
Singapore Cablevision Private Limited (SCV)	25%	8,484	15,023
Other	20%-50%	6,717	11,318
		302,304	502,689
Cost Method Investments		33,175	35,663
Total		\$335,479	\$538,352

Estimated fair value of cost method investments is \$47,322,000 and \$54,221,000 as of December 31, 1994 and 1995, respectively, based on various valuation methods.

In October 1993, the Company exchanged its equity interest in Insight Communications Company U.K., L.P. for stock representing less than a 5% interest in International CableTel, Incorporated (CableTel), a

telecommunications company operating in the United Kingdom. The Company accounted for the investment in CableTel as a marketable equity security and recorded a gain of \$15,919,000. During the year ended December 31, 1994, the CableTel marketable equity securities were sold at an additional realized gain of \$1,204,000.

As of December 31, 1995, the Company had invested \$66,000,000 in equity and had made commitments to TCG to loan up to \$69,920,000 through 2003, of which \$53,800,000 was outstanding as of December 31, 1995. These loans bear interest at approximately 7% and are due on the earlier of the seventh anniversary of the borrowing or May 2003. TCG and its affiliates are telecommunications companies which operate fiber-optic networks in the United States.

As of December 31, 1995, a wholly owned subsidiary of the Company issued a standby letter of credit of \$56,250,000 on behalf of PrimeStar, a limited partnership that provides direct broadcast satellite services. The standby letter of credit guarantees a portion of the financing PrimeStar incurred to construct a satellite system and is collateralized by certain marketable equity securities with a carrying value of \$151,378,000 as of December 31, 1995. As a result of these commitments and other qualitative factors, the Company accounts for its investment in PrimeStar using the equity method.

As of December 31, 1994 and 1995, the Company had advanced \$114,000,000 and \$150,500,000, respectively, in cash to Fintelco, S.A. which owns and operates cable television systems in Argentina. In addition, the Company has recorded commitments to contribute an additional \$24,164,000 to Fintelco, S.A.

As of December 31, 1995, the Company had invested approximately \$169,087,000 in Optus Vision, a joint venture which is constructing a broadband communications network in Australia. The Company currently holds a 46.5% interest in Optus Vision.

As of December 31, 1995, the Company had invested \$17,614,000 in Singapore Cablevision Pte Ltd (SCV), which owns and operates a cable television system in Singapore. The Company is committed to make additional capital contributions to SCV of approximately \$27,000,000 to be paid over time. In addition, the Company has made commitments to SCV to loan up to approximately \$45,000,000 if third party debt financing cannot be obtained by SCV.

The Company also has various investments in cable television companies which are not individually material to the Company. The Company has approximately a one-third ownership interest in these companies and therefore accounts for these investments using the equity method.

The major components of all equity method investees' combined financial position and results of operations are as follows (reflects the Company's proportionate share for the period which the investments are owned):

	December 31,	
	1994	1995
	(In Thousands)	
Property, Plant and Equipment	\$226,000	\$290,000
Total Assets	495,000	574,000
Total Liabilities	387,000	420,000
Equity	108,000	154,000

	Year Ended December 31,		
	1993	1994	1995
	(In Thousands)		
Revenues	\$ 63,000	\$146,000	\$244,000
Depreciation and Amortization	22,000	27,000	41,000
Operating Loss	(5,000)	(4,000)	(40,000)
Net Loss	(19,000)	(28,000)	(67,000)

6. PROPERTY, PLANT AND EQUIPMENT

The components of property, plant and equipment are as follows:

	December 31,	
	1994	1995
	(In Thousands)	
Land and Buildings	\$ 56,630	\$ 84,254
Reception and Distribution Facilities	2,122,304	2,897,745
Equipment and Fixtures	288,950	377,657
Total	2,467,884	3,359,656
Less—Accumulated Depreciation	1,114,095	1,252,183
Property, Plant and Equipment—net	<u>\$ 1,353,789</u>	<u>\$ 2,107,473</u>

7. DEBT

Total debt outstanding is as follows:

	December 31,	
	1994	1995
	(In Thousands)	
1994 Credit Facility	\$ 1,373,790	\$ 1,586,200
1995 Credit Facility	—	1,039,000
Insurance Company Notes	150,000	125,750
Senior Notes and Debentures	1,400,000	2,000,000
Subordinated Debt	500,000	500,000
Other	26,117	34,209
Total	<u>\$ 3,449,907</u>	<u>\$ 5,285,159</u>

In October 1994, the Company amended and restated its bank indebtedness by entering into a \$2,200,000,000 unsecured reducing revolver credit agreement (the 1994 Credit Facility). Credit availability under the 1994 Credit Facility will decrease annually commencing in December, 1997 with a final maturity in October 2003. Borrowings under the 1994 Credit Facility bear interest at a rate between the agent bank's prime rate (8½% as of December 31, 1994 and 1995) and prime plus ½%, depending on certain financial tests. At the Company's option, most borrowings bear interest at spreads over LIBOR. The Company's obligations under the 1994 Credit Facility are guaranteed by the Company's Restricted Subsidiaries, (collectively with the Company, the Restricted Group) which represent the majority of the Company's owned and operated cable systems, excluding those acquired in the Providence Journal Cable and Michigan acquisitions (collectively, the New Borrowing Group). Prepayments are required from the proceeds of certain sales of Restricted Subsidiaries' assets.

During 1995, certain of the Company's subsidiaries entered into a \$1,200,000,000 unsecured reducing revolver credit facility (the 1995 Credit Facility). Initial borrowings under the 1995 Credit Facility were utilized to finance the acquisitions of Providence Journal Cable and the Michigan cable systems. Credit availability under the 1995 Credit Facility will decrease annually commencing in December 1998 with a final maturity in September 2004. Borrowings under the 1995 Credit Facility bear interest at the agent bank's prime rate (8½% at December 31, 1995) plus ½% or spreads over LIBOR. The New Borrowing Group's obligations under the 1995 Credit Facility are guaranteed by substantially all of the New Borrowing Group subsidiaries. Prepayments are required from the proceeds of certain sales of New Borrowing Group assets.

The Insurance Company Notes are unsecured, bear interest at 10.12%, require increasing semi-annual repayments through July 1, 1999 and rank *pari passu* in right of payment with the 1994 Credit Facility.

The Company's unsecured Senior Notes and Debentures rank *pari passu* in right of payment with the Insurance Company Notes and 1994 Credit Facility (collectively, Senior Debt) and are non-redeemable prior to maturity, except for the 9½% Senior Debentures. The 9½% Senior Debentures are redeemable at the Company's option at par plus declining premiums beginning in 2005. In addition, at any time prior to August 1996, the Company may redeem a portion of the 9½% Senior Debentures at a premium with the proceeds from any offering by the Company of its capital stock. In December 1995, the Company issued \$600,000,000 of 8.30% Senior Notes. No sinking fund is required for any of the Senior Notes and Debentures.

The Senior Notes and Debentures consist of the following:

	December 31,	
	1994	1995
	(In Thousands)	
8½% Senior Notes, Due September 15, 2001	\$ 200,000	\$ 200,000
8¾% Senior Notes, Due August 15, 2003	100,000	100,000
8¾% Senior Debentures, Due September 15, 2005	275,000	275,000
8.30% Senior Notes, Due May 15, 2006	—	600,000
9% Senior Debentures, Due September 1, 2008	300,000	300,000
9½% Senior Debentures, Due August 1, 2013	525,000	525,000
Total	<u>\$1,400,000</u>	<u>\$2,000,000</u>

The Company's Senior Debt limits the Restricted Group with respect to, among other things, payment of dividends, the repurchase of capital stock in excess of \$724,000,000, the creation of liens and additional indebtedness, property dispositions, investments and leases, and requires certain minimum ratios of cash flow to debt and cash flow to related fixed charges. In addition, the 1995 Credit Facility has similar limitations with respect to the New Borrowing Group.

The Company's Subordinated Debt is redeemable at the Company's option at par plus declining premiums at various dates, and is subordinated to the Company's Senior Debt. Subordinated Debt consists of the following:

	December 31,	
	1994	1995
	(In Thousands)	
10½% Senior Subordinated Notes, Due June 15, 2002	\$100,000	\$100,000
Senior Subordinated Floating Rate Debentures, Due November 1, 2004	100,000	100,000
11% Senior Subordinated Debentures, Due June 1, 2007	300,000	300,000
Total	<u>\$500,000</u>	<u>\$500,000</u>

In November 1994, the Company redeemed \$325,000,000 of 12¾% Senior Subordinated Debentures for a price equal to 106.438% of their principal amounts plus accrued interest thereon. As a result of the redemption and the write-off of \$7,176,000 of unamortized deferred financing costs, the Company recorded an extraordinary loss of \$28,100,000, less an income tax benefit of \$9,835,000.

The Senior Subordinated Floating Rate Debentures bear interest at LIBOR plus 3%. In February 1996, the Company redeemed the Senior Floating Rate Debentures for a price equal to the principal amount plus accrued interest thereon.

Derivative financial instruments used to manage interest rate risk include Swaps and Caps. The following table summarizes the terms of the Company's existing Swaps and Caps as of December 31, 1995:

	Notional Amount (In thousands)	Maturities	Average Interest Rate
Fixed to Variable Swaps	\$1,425,000	1998-2003	5.9%
Variable to Fixed Swaps	900,000	1996-2000	8.9%
Caps (carrying value \$1,380,000 in Other Assets)	800,000	1996-1997	8.0%

The Company's credit risk if the counterparties failed to perform under these agreements, would be limited to the periodic settlement of amounts receivable under these agreements. As of December 31, 1994 and 1995, the net amounts payable by the Company in connection with the Swaps were \$5,000,000 and \$6,460,000, respectively.

The Company's variable-rate Swaps, which are indexed to six month LIBOR, include a \$75,000,000 Swap that may be extended by the counterparty at a certain time in the future under the same terms and conditions at the existing contracted rate. The Company entered into this Swap to further manage its interest rate risk. The Swap is related to specific portions of the Company's fixed-rate debt and is with a counterparty that is a lender in both the 1994 Credit Facility and 1995 Credit Facility.

The fair value of total debt, Swaps and Caps is estimated to be \$3,516,588,000 and \$5,418,137,000 as of December 31, 1994 and 1995, respectively, and is based on recent trades and dealer quotes. The components of the fair value are as follows:

	December 31,	
	1994	1995
	(In Thousands)	
Carrying Value of Debt	\$ 3,449,907	\$ 5,285,159
Unrealized (Gain) Loss on Debt	(130,442)	85,195
Unrealized Loss on Floating to Fixed Rate Swaps	14,247	41,495
Unrealized Loss on Fixed to Floating Rate Swaps	184,903	6,177
Unrealized (Gain) Loss on Interest Rate Cap Agreements	(2,027)	111
Total	<u>\$ 3,516,588</u>	<u>\$ 5,418,137</u>

Annual maturities of debt for the five years subsequent to December 31, 1995, are as follows:

	(In Thousands)
1996	\$ 29,641
1997	32,108
1998	33,551
1999	112,267
2000	558,903
Thereafter	<u>4,518,689</u>
Total	<u>\$ 5,285,159</u>

8. COMMITMENTS

The Company and its subsidiaries have entered into various operating lease agreements, with total commitments of \$48,685,000 as of December 31, 1995. Commitments under such agreements for the years 1996-2000 approximate \$11,374,000, \$8,629,000, \$7,024,000, \$5,832,000 and \$3,895,000, respectively. The Company and its subsidiaries also rent pole space from various companies under agreements which are generally terminable on short notice. Lease and rental costs charged to operations for the years ended December 31, 1993, 1994, and 1995 were \$18,378,000, \$20,113,000 and \$21,696,000, respectively.

9. REDEEMABLE COMMON STOCK

Pursuant to a Stock Liquidation Agreement with certain stockholders (the Selling Stockholders), the Company committed to repurchase certain shares of its common stock (Redeemable Common Stock) in December 1998 or January 1999 at a defined purchase price (Purchase Price). The Purchase Price is the greater of the net proceeds per share from the liquidation of the Company less a 22.5% discount or the estimated amount of net proceeds per share from an underwritten public offering of the Company's common stock.

The fair value of the Redeemable Common Stock is estimated at \$329,011,000 and \$353,704,000 as of December 31, 1994 and 1995, respectively, based on the estimate of the Purchase Price at these dates of \$19.72 and \$21.20 per share, respectively, as determined by an investment banker for the Company.

In the event the Company is unable to meet its commitments under the Stock Liquidation Agreement, the Selling Stockholders may cause the sale of all or substantially all of the assets of the Company.

During 1993, the Company repurchased 1,604,400 shares of Redeemable Common Stock for approximately \$31,125,000 and reclassified 411,175 shares of Redeemable Common Stock as Class A Common Stock based on an agreement with a certain stockholder to remove such shares from the 1998-1999 Share Repurchase Program. During 1994, the Company repurchased 27,475 shares of Class A Common Stock and 217,625 shares of Class B Common Stock, of which 82,900 were shares of Redeemable Common Stock.

The initial estimated repurchase cost for the Redeemable Common Stock has been adjusted by periodic accretions through the repurchase dates based on the interest method of the difference between the initial estimate and the subsequent estimates of the Purchase Price.

10. STOCKHOLDERS' EQUITY (DEFICIENCY)

The Company has two classes of stock: Class A Common Stock, which has one vote per share, and Class B Common Stock, which has ten votes per share. At December 31, 1995, there were 38,885,294 and 109,151,550 Class A and Class B shares of common stock outstanding, respectively. Stockholders' Equity (Deficiency) reflects only 38,780,694 and 92,572,000 Class A and Class B shares of common stock outstanding, respectively, due to the classification of 16,684,150 shares as Redeemable Common Stock.

In 1993 and 1994, the Company sold 2,396,900 shares of Class A Common Stock for approximately \$46,500,000 and 1,572,150 shares of Class A Common Stock for approximately \$30,500,000, respectively.

Each share of Series A Convertible Preferred Stock (Convertible Preferred) is entitled to 250 votes per share, shares equally with each common share in all dividends and distributions, and is convertible into 25 shares of common stock, at any time, at the option of the holder. The Convertible Preferred stockholders have the right to sell their shares in a public offering by causing the Company to register such shares under the Securities Act of 1933. Certain other stockholders of the Company have similar registration rights.

The Convertible Preferred has a liquidation preference equal to the greater of its Accreted Value or the amount which would be distributed to common stockholders, assuming conversion of the Convertible Preferred. The Accreted Value assumes a yield of 8% per annum, compounded semi-annually in arrears on the \$350 purchase price per share. During the year, the carrying value of the Convertible Preferred has been increased by \$39,802,000 to reflect the Accreted Value of \$527,578,000 as of December 31, 1995.

After June 1997, if the value of the common stock is greater than 137.5% of the then Accreted Value, the Company will have the right to convert each outstanding share of Convertible Preferred into one share of common stock.

In June 2002, each outstanding share of Convertible Preferred may be converted at the option of the holder or the Company into a number of common shares which will have a value equal to the Accreted Value. The

Company may, at its sole option, purchase for cash at the Accreted Value all or part of the Convertible Preferred instead of accepting or requiring conversion.

The Company paid aggregate fees and underwriting discounts to Lazard Freres & Company (Lazard) of approximately \$7,700,000 during 1993 and \$9,000,000 during 1995 in connection with certain investment banking services. Two directors of the Company are general partners of Lazard and managing directors of Corporate Partners, L.P., which purchased 728,953 shares of Convertible Preferred on the same terms as all other purchasers of Convertible Preferred.

11. RESTRICTED STOCK PURCHASE PROGRAM

The Company maintains a Restricted Stock Purchase Program under which certain employees of the Company, selected by the Board of Directors, are permitted to buy shares of the Company's common stock at the par value of one cent per share. The shares remain wholly or partly subject to forfeiture for seven years, during which time a pro rata portion of the shares becomes "vested" at six-month intervals. Upon termination of employment with the Company, an employee must resell to the Company, for the price paid by the employee, the employee's shares which are not then vested. For financial statement presentation, the difference between the purchase price and the fair market value at the date of issuance (as determined by the Board of Directors) is recorded as additional paid-in capital and unearned compensation, and charged to operations through 2001 as the shares vest. Shares of common stock issued under the program for the years ended December 31, 1993, 1994 and 1995 were 40,000, none and 2,382,925, respectively. At December 31, 1994 and 1995, 1,003,925 and 2,496,025 shares, respectively, were not yet vested. In connection with the Restricted Stock Purchase Program, a wholly-owned subsidiary of the Company has loaned approximately \$13,541,000 and \$27,746,000 at December 31, 1994 and 1995, respectively, to the participating employees to fund their individual tax liabilities. These loans are due through 2001, bear interest at a range from 5% to 8% and are included in Other Assets in the accompanying financial statements.

12. INCOME TAXES

Effective January 1, 1993, the Company implemented the provisions of SFAS 109 and recognized an additional charge of \$184,996,000 for deferred income taxes. Such amount has been reflected in the consolidated financial statements as the cumulative effect of change in accounting for income taxes.

During 1993, the Company revised its estimated annual effective tax rate to reflect a change in the federal statutory rate from 34% to 35%. The income tax benefit for the year decreased approximately \$4,182,000 as a result of applying the newly enacted federal tax rates to deferred tax balances as of January 1, 1993.

The provision (benefit) for income taxes is comprised of:

	Year Ended December 31,		
	1993	1994	1995
	(In Thousands)		
Current:			
Federal	\$ 647	\$ (196)	\$ (238)
State	1,220	2,049	1,112
Deferred:			
Federal	(7,968)	(35,549)	(42,416)
State	(1,820)	(6,723)	(6,367)
Total	<u>\$(7,921)</u>	<u>\$(40,419)</u>	<u>\$(47,909)</u>
Extraordinary Item—Deferred	<u>\$ —</u>	<u>\$ (9,835)</u>	<u>\$ —</u>

Differences between the effective income tax rate and the federal statutory rate are summarized as follows:

	Year Ended December 31,		
	1993	1994	1995
Federal Statutory Rate	(35.0)%	(35.0)%	(35.0)%
Enacted Tax Rate Change	12.4%	—	—
Non-Deductible Equity in Net Losses of Foreign Affiliates	—	—	6.5%
State Income Tax, Net of Federal Income Tax Benefit	(1.2)%	(2.2)%	(2.4)%
Other3%	.5%	.9%
Total	<u>(23.5)%</u>	<u>(36.7)%</u>	<u>(30.0)%</u>

The tax effects of temporary differences and carryforwards that give rise to significant portions of deferred tax assets and liabilities consist of the following:

	December 31,	
	1994	1995
	(In Thousands)	
Deferred Tax Liabilities:		
Depreciation and Amortization	\$(506,560)	\$(801,068)
Unrealized Holding Gain on Marketable Equity Securities	(32,353)	(45,717)
Other	(5,245)	(15,790)
Deferred Tax Assets:		
Net Operating Loss Carryforwards	460,469	570,739
Tax Credit Carryforwards	59,397	57,492
Other	60,836	68,729
Valuation Allowance	(153,026)	(141,426)
Net Deferred Tax Liability	<u>\$(116,482)</u>	<u>\$(307,041)</u>

The Company and its subsidiaries have net operating loss carryforwards of approximately \$1,131,000,000 for federal income tax purposes, expiring through 2010, and investment tax credit carryforwards of approximately \$57,500,000 expiring through 2005.

Valuation allowances have been established for uncertainties in realizing transitional investment tax credit carryforwards, the tax benefit of certain limited use federal net operating losses and certain state net operating losses. If in future periods the realization of tax credit and net operating loss carryforwards acquired as a result of business combinations becomes more likely than not, \$36,000,000 of the valuation allowance will be allocated to reduce goodwill and other intangible assets. The net change of the valuation allowance during 1994 and 1995 was a decrease of \$4,445,000 and \$11,600,000, respectively. The decreases were due primarily to the expiration of state net operating loss carryforwards and investment tax credit carryforwards.

13. RETIREMENT AND MATCHED SAVINGS PLANS

The Company has a non-contributory defined benefit plan covering substantially all employees. Benefits under the plan are determined based on formulas which reflect employees' years of service and the average of the five consecutive years of highest compensation. The Company's policy is to make contributions sufficient to meet the minimum funding requirements of ERISA.

The components of net periodic pension expense are as follows:

	Year Ended December 31,		
	1993	1994	1995
	(In Thousands)		
Service Cost-Benefits Earned During the Year	\$2,584	\$ 2,934	\$ 2,919
Interest Cost on Projected Benefit Obligation	1,336	1,576	1,896
Actual Loss (Return) on Plan Assets	(136)	417	(3,039)
Other Items	(615)	(1,514)	1,672
Total	<u>\$3,169</u>	<u>\$ 3,413</u>	<u>\$ 3,448</u>

The following table sets forth the funded status and amounts recognized in the Company's balance sheet:

	December 31,	
	1994	1995
	(In Thousands)	
Actuarial Present Value of:		
Vested Benefit Obligation	\$ (9,159)	\$(15,341)
Non-Vested Benefit Obligation	(1,201)	(1,465)
Accumulated Benefit Obligation	(10,360)	(16,806)
Effect of Projected Salary Increases	(12,691)	(12,041)
Projected Benefit Obligation	(23,051)	(28,847)
Plan Assets at Market Value	12,397	18,498
Funded Status	(10,654)	(10,349)
Deferred Transition Loss	1,194	1,124
Unrecognized Prior Service Cost	(511)	(483)
Unrecognized Net Loss	2,233	1,963
Accrued Pension Cost	<u>\$ (7,738)</u>	<u>\$ (7,745)</u>

The actuarial assumptions as of the year-end measurement date are as follows:

	December 31,	
	1994	1995
Discount Rate	8.75%	7.25%
Expected Long-Term Rate of Return	9.00%	9.00%
Rate of Increase in Future Salary Levels	5.75%	4.25%

At December 31, 1995, plan assets consist of equity and debt securities, U.S. Government obligations and cash equivalents.

The Company sponsors a defined contribution Matched Savings Plan covering substantially all of its employees. The Company's contribution for this plan is based on a percentage of each participant's salary. Total costs for the years ended December 31, 1993, 1994 and 1995 were approximately \$2,550,000, \$2,652,000 and \$2,907,000, respectively.

Effective in 1995, the Company approved a Supplemental Executive Retirement Plan ("SERP"). The SERP provides additional retirement benefits for any employee of Continental whose accrued benefits under the Continental Retirement Plan are limited by the Internal Revenue Code's (the "Code") limit on compensation which may be taken into account under that plan or by the Code's Section 415 limit on the size of retirement benefits which may be funded under that plan. The SERP is an unfunded, non tax-qualified plan.

The components of net periodic pension cost for the supplemental retirement plan for 1995 are as follows:

	Year Ended December 31, 1995 (In Thousands)
Service Cost—Benefits Earned During the Year	\$ 77
Interest Cost on Projected Benefit Obligation	124
Other Items	79
Total	<u>\$280</u>

The actuarial assumptions as of the year-end measurement date are as follows:

	December 31, 1995
Discount Rate	7.25%
Rate of Increase in Future Salary Levels	4.25%

The funded status of the supplemental retirement plan as of December 31, 1995 is as follows:

	December 31, 1995 (In Thousands)
Actuarial Present Value:	
Vested Benefit Obligation	\$ (651)
Non-Vested Benefit Obligation	(2)
Accumulated Benefit Obligation	(653)
Effect of Projected Salary Increases	(1,146)
Projected Benefit Obligation	(1,799)
Plan Assets at Market	—
Funded Status	(1,799)
Unrecognized Prior Service	1,341
Unrecognized Net Loss	178
Accrued Pension Cost	<u>\$ (280)</u>

14. CONTINGENCIES

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such legal proceedings and claims will not have a material effect on the consolidated financial position and results of operations of the Company.

15. LEGISLATION AND REGULATION

Pursuant to the Cable Television Consumer Protection and Competition Act of 1992, the FCC in April 1993 promulgated rate regulations that establish maximum allowable rates for cable television services, except for services offered on a per-channel or per-program basis. The FCC's regulations require rates for equipment and installations to be cost-based, and require reasonable rates for regulated cable television services to be established based on, at the election of the cable television operator, either application of the FCC's benchmark formula or a cost-of-service showing pursuant to standards adopted by the FCC. In addition, the FCC regulations limit future rate increases for regulated services.

Under current FCC regulations, a rate complaint or certification of a local franchising authority is required to regulate a system. In accordance with the regulations, the Company either reduced rates under the FCC's benchmark methodology or supported current rates by cost-of-service showings for regulated franchises. Certain positions taken by the Company in its cost-of-service filings were based on provisions of the FCC's interim cost-of-service rules that allowed certain "presumptions" in the rules to be overcome on a case-by-case basis. While

the Company believes that its showings in this regard were sufficient, the results of these cases were unknown. As a result, the Company recorded a revenue reserve during 1994.

On August 3, 1995, a social contract between the Company and the FCC (the Social Contract) was adopted. The Social Contract is a six-year agreement covering all of the Company's existing franchises, including those that are currently unregulated, and settles the Company's pending cost-of-service rate cases and benchmark cable programming service tier (CPS) rate case. Benchmark broadcast service tier (BBT) cases will be resolved by the Company and local franchising authorities. As part of the resolution of these cases, the Company agrees to, among other things, (i) invest at least \$1.35 billion in domestic system rebuilds and upgrades in the next six years to expand channel capacity and improve system reliability and picture quality, (ii) reduce its BBT service rates and (iii) make in-kind refunds to affected subscribers totaling a retail value of approximately \$9.5 million. In 1995, the Company adjusted the revenue reserve recorded in 1994 to reflect the impact of the Social Contract. The resolution of pending rate cases was without any finding by the FCC of any wrongdoing by the Company.

The Social Contract also provides for its termination in the future if the laws and regulations applicable to services offered in any Continental franchise change in a manner that would have a material favorable financial impact on Continental. In that instance, the Company may petition the FCC to terminate the Social Contract.

In February 1996, the Telecommunications Act of 1996 was enacted, which deregulates CPS rates after March 31, 1999.

16. EVENTS SUBSEQUENT TO INDEPENDENT AUDITORS' REPORT (UNAUDITED)

In February 1996, the Company signed a definitive Agreement and Plan of Merger (the Merger Agreement) providing for the merger of the Company with and into U S WEST, Inc., with U S WEST, Inc. being the surviving corporation. The Merger Agreement provides for the stockholders of the Company to receive a combination of cash and securities of U S WEST, Inc. valued at approximately \$5.3 billion in exchange for all of the outstanding stock of the Company. Additionally, U S WEST, Inc. will assume the Company's outstanding indebtedness and other liabilities. The merger is contingent, among other things, upon receiving approval from the Company's stockholders and necessary regulatory approvals.

On March 6, 1996, a proposed amendment (the Social Contract Amendment) to the Social Contract was released by the FCC for public comment. If adopted, the Social Contract Amendment would incorporate all franchises acquired during 1995 into the Social Contract, and settle most CPS-rate cases of the acquired franchises. The Social Contract Amendment provides for cash refunds of \$1.6 million (for which reserves were recorded as of December 31, 1995) and increases the Company's investment commitment in domestic system rebuilds and upgrades from \$1.35 billion to \$1.7 billion.

In March 1996, the Company entered into a purchase agreement to acquire the non-owned interests in and discharge or assume certain liabilities of Meredith/New Heritage Strategic Partners, L.P. for approximately \$219,200,000.

17. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly results of operations for 1994 and 1995 are summarized below:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In Thousands, Except Per Share Amounts)			
1994				
Revenues	\$297,764	\$298,626	\$296,246	\$312,341
Depreciation and Amortization	67,458	68,065	71,277	76,383
Restricted Stock Purchase Program	2,838	2,837	2,827	2,814
Operating Income	59,284	61,507	53,565	56,238
Loss Before Extraordinary Item	(13,640)	(9,981)	(21,871)	(23,084)
Extraordinary Item	—	—	—	(18,265)
Net Loss	(13,640)	(9,981)	(21,871)	(41,349)
Loss Applicable to Common Stockholders	(22,518)	(18,990)	(31,309)	(50,824)
Loss Per Common Share:				
Loss Before Extraordinary Item	(0.19)	(0.16)	(0.27)	(0.28)
Extraordinary Item	—	—	—	(0.16)
Net Loss	(0.19)	(0.16)	(0.27)	(0.44)
1995				
Revenues	\$318,576	\$331,472	\$342,445	\$449,899
Depreciation and Amortization	74,422	73,990	82,156	110,603
Restricted Stock Purchase Program	2,850	3,055	3,042	3,058
Operating Income	59,192	61,361	61,400	70,022
Net Loss	(6,902)	(26,165)	(25,065)	(53,895)
Loss Applicable to Common Stockholders	(16,505)	(35,909)	(35,273)	(64,142)
Loss Per Common Share:				
Net Loss	(0.14)	(0.30)	(0.30)	(0.44)

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.
None.

PART III

Item 10. Directors and Executive Officers of the Registrant.

The positions held by each Director and Executive Officer of Continental are shown below. There are no family relationships among the following persons.

<u>Name of Director or Executive Officer</u>	<u>Position with Continental</u>
Amos B. Hostetter, Jr.(1)	Chairman of the Board, Chief Executive Officer and Director
Timothy P. Neher	Vice Chairman of the Board and Director
William T. Schleyer	President and Chief Operating Officer
Roy F. Coppedge III(2)	Director
Stephen Hamblett	Director
Jonathan H. Kagan(1), (2)	Director
Robert B. Luick	Director and Secretary
Henry F. McCance	Director
Trygve E. Myhren(2)	Director
Lester Pollack	Director
Michael J. Ritter	Director
Vincent J. Ryan(1)	Director
Ronald H. Cooper	Executive Vice President
Jeffrey T. DeLorme	Executive Vice President
Nancy Hawthorne	Senior Vice President and Chief Financial Officer

(1) Members of the Executive Committee

(2) Members of the Audit Committee

Continental has a classified Board composed of three classes. Each class serves for three years, with one class being elected each year. The term of the Class A Directors, Messrs. McCance, Coppedge, Ritter and Luick, will expire at the 1996 Annual Meeting of Continental. The term of the Class B Directors, Messrs. Neher, Ryan and Kagan, will expire at the 1997 Annual Meeting of Continental. The term of the Class C Directors, Messrs. Hostetter, Pollack, Hamblett and Myhren, will expire at the 1998 Annual Meeting of Continental. Under the terms of certain stock purchase agreements with Continental, Corporate Advisors, L.P. ("Corporate Advisors"), on behalf of the investors (the "Continental Preferred Stock Investors") who purchased Series A Preferred Stock, currently has the right to designate two persons, and Boston Ventures Limited Partnership III, on behalf of itself and Boston Ventures Limited Partnership IIIA, Boston Ventures Limited Partnership IV and Boston Ventures Limited Partnership IVA (collectively, the "Boston Ventures Investors"), currently has the right to designate one person, to be nominated as members of the Board of Directors. Lester Pollack and Jonathan H. Kagan are the designees of the Continental Preferred Stock Investors, and Roy F. Coppedge III is the designee of the Boston Ventures Investors. The Providence Journal Company has the right to designate two individuals to be nominated as members of Continental's Board for a three-year term after the term of its two designees, Stephen Hamblett and Trygve E. Myhren, expires.

The Executive Officers were elected by the Continental Board of Directors on May 18, 1995. All Executive Officers hold office until the first meeting of the Continental Board following the next annual meeting of stockholders and until their successors are chosen and qualified.

The following is a description of the business experience during the past five years of each Director and Executive Officer and includes, as to Directors, other directorships held in companies required to file periodic

reports with the Securities and Exchange Commission (the "Commission") and registered investment companies.

Directors and Executive Officers

Amos B. Hostetter, Jr. (59), a cofounder of Continental, is the Chairman of the Board and Chief Executive Officer of Continental. He has been a Director since 1963. Mr. Hostetter is a past Chairman of the National Cable Television Association ("NCTA") and currently serves on NCTA's Board and Executive Committee. He is past Chairman and serves on the Executive Committee of the Board of Directors of both Cable in the Classroom and C-SPAN and serves as a Director and Chairman of the Audit Committee of Commodities Corporation (USA).

Timothy B. Neher (48) is the Vice Chairman of the Board of Continental. He has been a Director since 1982 and has been employed by Continental since 1974. Prior to 1991 he was President and Chief Operating Officer of Continental; prior to 1986 he was an Executive Vice President of Continental, and prior to 1982 he was Vice President and Treasurer of Continental. He currently is on the Board of Directors of Turner and The Golf Channel, Inc.

William T. Schleyer (44) is the President and Chief Operating Officer of Continental. Prior to March 15, 1995 he was an Executive Vice President and prior to 1989 he was the Senior Vice President and General Manager of Continental's Northeast region. He is a member of the Boards of Directors of CableLabs, the research and development arm of the cable industry, PPVN and Optus Vision. He has been employed by Continental since 1978.

Roy F. Coppedge III (47) has been a Director of Boston Ventures Management, Inc. since 1983. He currently is on the Board of Directors of American Media, Inc. He was elected to serve as a Director of Continental in 1992.

Stephen Hamblett (61) has been the Chairman of the Board and Chief Executive Officer and a Director of The Providence Journal Company (as successor to Providence Journal) and Publisher of the *Journal-Bulletin* newspapers since 1987. He has been a Director of Continental since October 1995. Mr. Hamblett also serves on the Boards of Directors of the Associated Press and the Inter-American Press Association.

Jonathan H. Kagan (39) is Managing Director of Corporate Advisors and of Centre Partners, L.P., investment partnerships affiliated with Lazard Freres & Co. LLC ("Lazard") and a Managing Director of Lazard. He has been associated with Lazard since 1980. He was elected to serve as a Director of Continental in 1992. Mr. Kagan currently is on the Board of Directors of Tyco Toys, Inc.

Robert B. Luick (84) is of counsel to the law firm of Sullivan & Worcester LLP ("Sullivan & Worcester"), which firm has acted as counsel to Continental since its inception. Prior to 1992, Mr. Luick was a partner at Sullivan & Worcester. Mr. Luick has been with Sullivan & Worcester since 1943. He is a member of the Board of Directors of Ionics, Incorporated, a diversified water treatment company. He has been Secretary and a Director of Continental since 1963.

Henry F. McCance (53) has been general partner of the following venture capital partnerships (either directly or indirectly as the general partner of such partnerships) since their formation: Greylock Ventures Limited Partnership (1983), Greylock Investments Limited Partnership (1985), Greylock Capital Limited Partnership (1987), Greylock Limited Partnership (1990) and Greylock Equity Limited Partnership (1994). He is also President and Treasurer of Greylock Management Corporation, an investment services organization, and a Director of Brookstone, Inc., Manugistics, Inc., Shiva Corporation and CATS Software. Prior to 1990, Mr. McCance was a Vice President and Treasurer of Greylock Management Corporation. Mr. McCance has been a Director of Continental since 1972.

Trygve E. Myhren (59) has been President and Chief Operating Officer and a Director of The Providence Journal Company (as successor to Providence Journal) since 1990. He has been a Director of Continental

since October 1995. Mr. Myhren is a past Chairman of the NCTA and is currently a Director of Advanced Marketing Services, Inc., CableLabs and Peapod Limited, a company that provides consumer on-line grocery shopping services. From 1981 through 1988 he was the Chairman and Chief Executive Officer of American Television & Communications Corporation, which is now part of Time Warner.

Lester Pollack (62) is Senior Managing Director of Corporate Advisors and Chief Executive Officer of Centre Partners, L.P., investment partnerships affiliated with Lazard, as well as a Managing Director of Lazard. He currently is on the Board of Directors of SunAmerica Inc., Kaufman & Broad Home Corporation, Tidewater, Inc., LaSalle Re Holdings Limited, Parlex Corporation, Polaroid Corporation and Sphere Drake Holdings Limited. He was elected to serve as a Director of Continental in 1992.

Michael J. Ritter (54) has been a Director since 1991 and was employed by Continental from 1980 until March 15, 1995, at which time he retired as the President and Chief Operating Officer of Continental. Prior to 1991 he was an Executive Vice President, and prior to 1988 he was the Senior Vice President and General Manager of Continental's Michigan management region.

Vincent J. Ryan (59) has been Chairman of the Board and a Director of Schooner Capital Corporation, a venture capital organization, since 1971. Mr. Ryan is also a Director of Iron Mountain Incorporated, an information-management company. He has been a Director of Continental since 1980.

Ronald H. Cooper (38) is an Executive Vice President of Continental. Prior to 1995, he was the Senior Vice President of Continental's Southern California management region. Prior to 1990 he was the Senior Vice President of Continental's Northern California management region. He is a member of the Boards of Directors of Cable Advertising Partners, TCG and TCG-Los Angeles and serves on the compensation committee of TCG. He has been employed by Continental since 1982.

Jeffrey T. DeLorme (43) is an Executive Vice President of Continental. Prior to February 1993, he was the Senior Vice President and General Manager of Continental's Florida/Georgia management region. He serves on the Partners' Committee of PrimeStar and on the Board of Directors of The Sunshine Network. He has been employed by Continental since 1980.

Nancy Hawthorne (44) is the Chief Financial Officer and a Senior Vice President of Continental. Prior to December 1993, she was also the Treasurer of Continental, in addition to being Chief Financial Officer and a Senior Vice President. Prior to December 1992, she was a Senior Vice President and the Treasurer of Continental. Prior to 1988, she was a Vice-President and the Treasurer of Continental. She is a member of the Boards of Directors of Perini Corporation, a construction company, New England Zenith Fund, a mutual fund, TCG and Optus Vision. She has been employed by Continental since 1982.

Biographical information concerning the Directors and Executive Officers is as of March 1, 1996.

Item 11. Executive Compensation.

The following table (the "Summary Compensation Table") discloses compensation received by Continental's Chief Executive Officer and the four most highly compensated other Executive Officers of Continental (the Chief Executive Officer and the other Executive Officers are hereinafter referred to as the "Named Executive Officers") for the three fiscal years ended December 31, 1993, 1994 and 1995.

Summary Compensation Table

Name and Principal Position	Year #	Annual Compensation				Long Term Compensation
		Salary(\$)	Bonus(\$)(1)	Other Annual Compensation(\$)	Restricted Stock Award(\$)(2)(3)	All Other Compensation(\$)(4)
Amos B. Hostetter, Jr., Chairman and Chief Executive Officer	1995	\$650,000	\$208,848	\$ —	\$4,849,900	\$4,273
	1994	649,876	97,991	—	—	4,273
	1993	624,961	238,653	—	—	4,273
William T. Schleyer, President and Chief Operating Officer	1995	424,077	14,052	—	4,364,910	3,403
	1994	315,815	30,639	—	—	3,403
	1993	291,923	61,418	—	—	3,403
Jeffrey T. DeLorme, Executive Vice President	1995	324,764	105,370	—	2,424,950	3,403
	1994	294,846	49,166	—	—	3,403
	1993	268,484	56,871	111,608(5)	—	3,403
Ronald H. Cooper, Executive Vice President	1995	267,123	34,543	—	2,424,950	3,315
Nancy Hawthorne, Chief Financial Officer and Senior Vice President	1995	274,746	67,488	—	2,085,457	3,403
	1994	241,938	18,331	—	—	3,403
	1993	224,896	46,590	—	—	3,403

- (1) See Note 11 to Consolidated Financial Statements. Continental has made loans to these and other persons in amounts equal to the income taxes incurred by them as a result of their restricted stock purchases. Such loans were financed through cash provided from operating activities and long-term borrowings. Continental charges interest on these loans generally at rates ranging from 5% to 8% per annum and declares bonuses to each of these persons in the amount of the interest due each year. Continental declared no other bonus to any Named Executive Officer during the years presented. As of March 1, 1996, the amounts of the loans outstanding to certain of the Named Executive Officers were as follows: William T. Schleyer (\$1,751,974), Jeffrey T. DeLorme (\$1,311,077), Ronald H. Cooper (\$261,500) and Nancy Hawthorne (\$1,100,277). The outstanding principal balance of each such loan is generally payable upon the earlier to occur of (i) the due date of such loan or (ii) the termination of such person's employment with Continental. Each of Mr. DeLorme and Mr. Cooper has an additional loan from a subsidiary of Continental, of which the current amounts outstanding are: Mr. DeLorme (\$400,000) and Mr. Cooper (\$278,680). Since the beginning of the fiscal year ended December 31, 1993, the largest aggregate amounts of indebtedness of the following Named Executive Officers were as follows: William T. Schleyer (\$1,751,974), Jeffrey T. DeLorme (\$1,711,077), Ronald H. Cooper (\$1,270,997) and Nancy Hawthorne (\$1,100,277). See "Compensation Committee Interlocks and Insider Participation" for loan amounts to certain other Named Executive Officers.
- (2) Shares of restricted stock are entitled to dividends at the same rate as all other shares of Common Stock.
- (3) Shown below are (i) the total number of unvested shares and market value of such shares as of December 31, 1995 and (ii) the vesting schedule of such shares for each of the Named Executive Officers:

Name	Restricted Shares Held as of 12/31/95		Vesting Over Three Years from 12/31/95		
	Shares	Value	Shares Vesting in 1996	Shares Vesting in 1997	Shares Vesting in 1998
Amos B. Hostetter, Jr.	266,250	\$5,165,250	91,250	50,000	50,000
William T. Schleyer	216,250	\$1,195,250	58,750	45,000	45,000
Jeffrey T. DeLorme	124,875	\$2,422,575	37,375	25,000	25,000
Ronald H. Cooper	118,550	\$2,299,870	31,050	25,000	25,000
Nancy Hawthorne	105,550	\$2,047,670	30,300	21,500	21,500

- (4) Includes payment by Continental in the fiscal years ended December 31, 1993, 1994 and 1995, respectively, of premiums for term life insurance on behalf of the Named Executive Officers: Amos B. Hostetter, Jr. (\$1,125 each year), William T. Schleyer (\$255 each year), Jeffrey T. DeLorme (\$255 each year), Ronald H. Cooper (\$165 each year) and Nancy Hawthorne (\$255 each year). The remaining amounts for the Named Executive Officers represents the employer matching contribution under Continental's matched savings plan.
- (5) Represents a one-time reimbursement of moving and related expenses incurred by Mr. DeLorme in connection with his relocation to Continental's Boston, Massachusetts office (grossed up for income taxes incurred by Mr. DeLorme).

Certain Provisions of the Restricted Stock Purchase Agreements. On February 28, 1996, the Company offered to sell restricted stock to certain key employees under the Company's 1995 Restricted Stock Purchase Program (the "Restricted Stock Purchase Program"). At the same time, outstanding agreements pursuant to which employees had purchased restricted stock in the past were amended. In purchasing restricted shares, an employee enters into a Restricted Stock Purchase Agreement (an "RSPA") with the Company containing restrictions on transfer, vesting provisions and a non-competition covenant, among other provisions. All of the RSPAs provide that the Company will repurchase for the amount that the employee has paid, the unvested stock of any employee whose employment terminates for any reason. Vesting occurs over time according to a schedule designated in each RSPA. The RSPA dated February 28, 1996 (the "New RSPA") entered into between certain key employees and the Company and the amendments to outstanding RSPAs provide that if the Merger with U S WEST is consummated, then vesting is accelerated upon the first to occur of the following events after the effective date of the Merger: (i) death or disability; (ii) in the case of an employee based in the existing corporate headquarters of the Company, termination by reason of an involuntary relocation to a place of employment that is more than 25 miles from the existing headquarters, or relocation of the corporate headquarters; (iii) termination of employment within twenty-four months of the effective date of the Merger, other than in connection with the sale, swap or other disposition of a system or other business unit in which the employee is employed, if such termination is by reason of: (a) a diminution in the employee's compensation, including a material adverse change in employee benefits; (b) the assignment to the employee of duties and responsibilities which are materially less than the employee's duties and responsibilities as of the effective date of the Merger; or (c) an involuntary termination of employment other than a "Termination for Cause." "Termination for Cause" means termination because of the employee's (A) refusal or failure (other than for reasons of illness, incapacity due to physical or mental illness or physical injury) to perform, or persistent and material deficiencies in performing, his or her duties, provided such duties are substantially similar to such person's duties prior to the Merger; (B) misappropriation of any funds or property of the Company; (C) conduct which could reasonably result in the employee's conviction of a felony; or (D) conduct which could reasonably result in termination of the employee's employment due to violation of published internal policies. U S WEST will assume the obligations under the RSPAs in connection with the Merger, and any reference to the Company as employer will thereafter be deemed to refer to U S WEST.

In addition, each employee, in connection with the execution of an RSPA, has the option of entering into a tax liability financing agreement, pursuant to which the Company agrees to lend the employee an amount up to the employee's total additional federal, state and local income taxes incurred as a result of the employee's filing an election under Section 83(b) of the Internal Revenue Code. The tax liability financing agreements executed in connection with the New RSPA provide, and the outstanding tax liability financing agreements under existing

RSPAs were amended to provide, that, conditioned upon the consummation of the Merger and continued employment through such date, one-third of the outstanding principal amount of the loans will be forgiven on each January 2, 1997, 1998 and 1999, provided, however, that the loan shall be payable by the employee in full in the case of any violation of the non-competition agreement in the RSPA (even if partially or entirely forgiven at the time of such violation). In addition, if the Merger is consummated, the loan will be forgiven in full upon the occurrence of the same events that would result in acceleration of vesting under the RSPAs described above. The maturity dates of the loans granted to pay taxes were all extended to January 2, 2002.

All of the Named Executive Officers in the Summary Compensation Table entered into such amendments to their outstanding RSPA and the related tax liability financing agreements. In addition, Mr. Cooper and Ms. Hawthorne purchased additional shares of restricted stock under the New RSPA and will receive loans under the related tax liability financing agreements.

Compensation Committee Interlocks and Insider Participation. Base annual compensation for executive officers was determined during the last fiscal year by the Chairman, the Vice Chairman and the President of Continental. Pursuant to authority delegated by the Continental Board of Directors, the Chairman also awarded grants of restricted stock in 1995 and 1996 to key employees designated by the Continental Board in accordance with Continental's Restricted Stock Purchase Program. Amos B. Hostetter, Jr. and Timothy P. Neher, the Chairman and Vice Chairman of Continental, respectively, are Directors and participate in deliberations concerning executive officer compensation.

Continental has made loans to these two executive officers and other persons in amounts equal to the income taxes incurred by them as a result of their restricted stock purchases. Such loans were financed through cash provided from operating activities and long-term borrowings. Continental charges interest on these loans generally at rates ranging from 5% to 8% per annum and declares bonuses to each of these persons in the amount of the interest due each year. As of March 1, 1996, the amounts of the loans outstanding to the two executive officers named above were as follows: Amos B. Hostetter, Jr. (\$3,379,546) and Timothy P. Neher (\$2,669,856). Since the beginning of the fiscal year ended December 31, 1993, the largest aggregate amounts of indebtedness of such executive officers were as follows: Amos B. Hostetter, Jr. (\$3,379,546) and Timothy P. Neher (\$4,057,356). The outstanding principal balance of each such loan is generally payable upon the earlier to occur of (i) the due date of such loan or (ii) the termination of such person's employment with Continental. For information regarding loans to other executive officers, see footnote (1) to the Summary Compensation Table.

On December 31, 1993, Continental accepted payment for loans incurred in connection with restricted stock purchases, pursuant to Continental's 1989 Restricted Stock Purchase Agreement ("RSPA III") which became due on such date by (i) transfer to Continental and cancellation of vested shares of Common Stock with a value equal to the loan outstanding, valued at \$19.40 per share (the "Stock-for-Loan Exchange"), (ii) payment in cash or (iii) a combination of the two. Continental also made an offer (the "RSPA Offer") in January 1994 to purchase shares of Common Stock up to a maximum of 1,334,975 shares at a purchase price of \$19.40 per share. The persons who were eligible to participate in the Stock-for-Loan Exchange and to accept the RSPA Offer were persons who held shares of Common Stock issued pursuant to RSPA III (current or former employees and family members of employees and former employees). The valuation of the shares at \$19.40 was equal to the price last paid in a private placement of shares of Class A Common Stock, which was consummated in November 1993. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources." The two executive officers named above repaid the following loan amounts in shares of Common Stock in the Stock-for-Loan Exchange: Amos B. Hostetter, Jr. (\$1,471,936) and Timothy P. Neher (\$1,387,500), and sold the following number of shares of Common Stock to Continental pursuant to the RSPA Offer: Amos B. Hostetter, Jr. (0) and Timothy P. Neher (29,800). For information regarding other executive officers, see "Certain Transactions." In addition, the Hostetter Foundation, an entity controlled by Mr. Hostetter, sold 29,600 shares of Class B Common Stock to Continental in January 1994 for a purchase price of \$19.40 per share.

Retirement Plans. The following table sets forth, as computed in accordance with the basic benefit formula employed for purposes of Continental's Retirement Plan (the "Continental Retirement Plan") and its Supplemental Executive Retirement Plan ("SERP"), the estimated annual benefits payable upon retirement to employees to Continental in the following compensation and years-of-service classifications. Such benefits are before offset in recognition of the employer contribution toward social security benefits.

Compensation	Years of Service				
	10	15	20	25	30 or more
\$150,000.....	\$14,250	\$21,375	28,500	35,625	42,750
\$200,000.....	19,000	28,500	38,000	47,500	57,000
\$300,000.....	28,500	42,750	57,000	71,250	85,500
\$400,000.....	38,000	57,000	76,000	95,000	114,000
\$500,000.....	47,500	71,250	95,000	118,750	142,500
\$600,000.....	57,000	85,500	114,000	142,500	171,000
\$700,000.....	66,500	99,750	133,000	166,250	199,500

Actual benefits are computed on the basis of (1) .95% of the employee's average annual compensation less .37% of average annual compensation (limited to social security covered compensation) multiplied by (2) the number of years of service (not to exceed thirty years). Average annual compensation is the average of a participant's compensation for the five consecutive years in which compensation was the highest.

The SERP, effective in 1995, provides additional retirement benefits for any employee of Continental whose accrued benefits under the Continental Retirement Plan are limited by the Internal Revenue Code's (the "Code") limit (currently \$150,000) on compensation which may be taken into account under that plan or by the Code's Section 415 limit on the size of retirement benefits which may be funded under the plan. The SERP is an unfunded, non tax-qualified plan which is intended to create for each participant a benefit upon termination of employment generally equal in value to the excess of what his accrued vested benefit in the Continental Retirement Plan would have been without the \$150,000 compensation limit and the Section 415 limit on benefits which may be funded, over the actual benefit under that plan. The benefit under the SERP is payable upon termination of employment, at the participant's election, in a lump sum or in equal annual installments (with interest) over 2, 5 or 10 years. A participant may designate a beneficiary under the SERP to receive his benefit should he die before its complete pay-out.

The covered compensation for each Named Executive Officer is based upon the amounts shown in the "Salary" column of the Summary Compensation Table. For each Named Executive Officer, the current compensation covered by the Continental Retirement Plan does not differ substantially (by more than 10% from the aggregate compensation set forth in the Summary Compensation Table.

The Named Executive Officers have been credited with the following years of service: Mr. Hostetter, 33 years; Mr. Schleyer, 18 years; Mr. DeLorme, 16 years; Mr. Cooper, 14 years and Ms. Hawthorne, 14 years.

Compensation of Directors

The members of the Continental Board of Directors who are not officers of Continental currently receive an annual retainer of \$16,000 and a fee of \$3,500 for each meeting attended. Members of the Audit Committee receive \$1,000 for meetings held separately from Board meetings. In addition, Directors who reside outside the Greater Boston area are reimbursed for their travel expenses incurred in connection with attendance at meetings of the Continental Board of Directors or its Committees.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The following table provides information as of March 15, 1996, with respect to the shares of Common Stock and Series A Preferred Stock beneficially owned by each person known by Continental to own more than 5% of the outstanding Common Stock or Series A Preferred Stock, each Director of Continental, each Named Executive Officer and by all Directors and executive officers of Continental as a group. The number of shares beneficially owned by each Director or executive officer is determined according to rules of the Securities and Exchange Commission, and the information is not necessarily indicative of beneficial ownership for any other purpose. Under such rules, beneficial ownership includes any shares as to which the individual or entity has sole or shared voting power or investment power and also any shares which the individual or entity has the right to acquire within 60 days of March 15, 1996 through the exercise of an option, conversion feature or similar right. Except as noted below, each holder has sole voting and investment power with respect to all shares of Common Stock or Series A Preferred Stock listed as owned by such person or entity.

Name	Number of Shares of Common Stock(1) Beneficially Owned	Percentage of Outstanding Shares of Common Stock	Number of Shares of Series A Preferred Stock(2) Beneficially Owned	Percentage of Outstanding Series A Preferred Stock
Amos B. Hostettler, Jr.(3)	45,205,425	30.43%	—	—
Timothy P. Neher(4)	1,671,725	1.13	—	—
William T. Schleyer	766,200	*	—	—
Roy F. Coppedge III(5)	7,514,075	5.06	—	—
Stephen Hamblett	185,129	*	—	—
Jonathan H. Kagan(6)	28,571,450	16.13	1,142,858	100.00
Robert B. Luick(7)	229,575	*	—	—
Henry F. McCance(8)	258,125	*	—	—
Trygve E. Myhren	36,390	*	—	—
Lester Pollack(6)	28,571,450	16.13	1,142,858	100.00
Michael J. Ritter	589,150	*	—	—
Vincent J. Ryan(9)	5,719,825	3.85	—	—
Jeffrey T. DeLorme	391,525	*	—	—
Ronald H. Cooper	209,275	*	—	—
Nancy Hawthorne	239,325	*	—	—
Directors and Executive Officers as a Group (15 persons)(6)	91,587,194	51.70	1,142,858	100.00
H. Irving Grousbeck(10)	10,033,000	6.75	—	—
Boston Ventures Company Limited Partnership III Boston Ventures Limited Partnership III(11)	3,034,525	2.04	—	—
Boston Ventures Limited Partnership IIIA(11)	799,825	*	—	—
Boston Ventures Company Limited Partnership IV Boston Ventures Limited Partnership IV(11)	2,381,725	1.60	—	—
Boston Ventures Limited Partnership IVA(11)	1,298,000	*	—	—
Total as a group ...	7,514,075	5.06	—	100.00

Name	Number of Shares of Common Stock (1) Beneficially Owned	Percentage of Outstanding Shares of Common Stock	Number of Shares of Series A Preferred Stock (2) Beneficially Owned	Percentage of Outstanding Series A Preferred Stock
LFCP Corp. and Corporate Advisors, L.P.(12) Corporate Partners, L.P.(12)	18,223,825	10.93%	728,953	63.78%
Mellon Bank, N.A. as Trustee for First Plaza Group Trust(12)(13).....	4,285,725	2.80	171,429	15.00
The State Board of Administration of Florida(12)	1,902,100	1.26	76,084	6.66
Vencap Holdings (1992) Pte Ltd(12)	1,785,700	1.19	71,428	6.25
Corporate Offshore Partners, L.P.(12).....	1,302,675	*	52,107	4.56
ContCable Co-Investors, L.P.(12).	1,071,425	*	42,857	3.75
Total as a group	28,571,450	16.13%(14)	1,142,858	100%

* Less than 1% of class.

- (1) The Common Stock includes Class A Common Stock, which has one vote per share, and Class B Common Stock, which has ten votes per share. As the number of shares of Class A Common Stock currently represents 26.18% of the Common Stock and approximately 2.74% of the voting power of the Common Stock, the Class A Common Stock has not been shown as a separate class of stock, but rather Common Stock has been treated as one class. Every greater than 5% beneficial owner of Class B Common Stock would be a greater than 5% beneficial owner of Class A Common Stock.
- (2) Under the rules of determining beneficial ownership promulgated by the Commission, each holder of Series A Preferred Stock is deemed to own currently that number of shares of Common Stock into which the Series A Preferred Stock is convertible. Each share of the Series A Preferred Stock is presently convertible into Common Stock on a 25-for-one basis. The table therefore shows the number of shares of Series A Preferred Stock owned by each holder in the column for the Series A Preferred Stock and includes that number of shares in the column for Common Stock into which the Series A Preferred Stock would be convertible.
- (3) Mr. Hostetter has shared voting and investment power as to 42,843,550 shares of Common Stock held by the Amos B. Hostetter, Jr. 1989 Trust of which Messrs. Hostetter and Neher are the sole trustees. Mr. Hostetter has shared voting and investment power as to a further 446,400 shares of Common Stock; as to 223,200 of such shares, he disclaims beneficial ownership. Additionally, Mr. Hostetter disclaims beneficial ownership of 550,000 shares of Common Stock with respect to which his wife acts as a trustee with Mr. Neher and 49,075 shares of Common Stock held by him as custodian for five minor children. The shares listed in the table as being beneficially owned by Mr. Hostetter include those as to which Mr. Hostetter has shared voting and/or investment power and those as to which Mr. Hostetter disclaims beneficial ownership. Mr. Hostetter's address is The Pilot House, Lewis Wharf, Boston, Massachusetts 02110.
- (4) Mr. Neher has shared voting and investment power as to 550,000 shares of Common Stock with respect to which he acts as a trustee with Mrs. Hostetter, and as to 42,843,550 shares of Common Stock with respect to which he acts as a trustee with Mr. Hostetter. Mr. Neher disclaims beneficial ownership as to such shares, and the table does not indicate such shares as being beneficially owned by Mr. Neher. See footnote (3) above. Additionally, Mr. Neher disclaims beneficial ownership as to 165,000 shares with respect to which he acts as trustee and 55,000 shares held by his wife as custodian for their children, which are included in the table as being beneficially owned by Mr. Neher.

- (5) All the shares listed in the table as beneficially owned by Mr. Coppedge are held by the four limited partnerships described in footnote (11) below. Mr. Coppedge, a partner of each of the general partners of the limited partnerships and a Director of Boston Ventures Management, Inc., which manages the investments of the four limited partnerships, has shared voting and investment power as to these shares. Mr. Coppedge is entitled to beneficial ownership of an indeterminate number of these shares and disclaims beneficial ownership as to the balance. Mr. Coppedge's address is c/o Boston Ventures Management, Inc., 231 Custom House Street, Boston, Massachusetts 02110.
- (6) All shares listed in the table as being beneficially owned by Mr. Pollack and Mr. Kagan are beneficially owned by Corporate Advisors. See footnote (12) below. Mr. Pollack may be deemed to have shared voting and investment power over such shares as the Chairman and Treasurer and as a Director of LFCP Corp., and Mr. Kagan may be deemed to have shared voting and investment power over such shares as the President of LFCP Corp. LFCP Corp. is the sole general partner of Corporate Advisors and a wholly owned subsidiary of Lazard. Mr. Pollack and Mr. Kagan are both Managing Directors of Lazard. Mr. Pollack's and Mr. Kagan's address is c/o Corporate Advisors, L.P., 30 Rockefeller Plaza, New York, New York 10020. Mr. Pollack and Mr. Kagan disclaim beneficial ownership of all such shares.
- (7) The shares listed in the table as being beneficially owned by Mr. Luick include 73,800 shares owned by Mr. Luick's daughter and 37,500 shares with respect to which she acts as trustee of Mr. Luick's grandchildren. Mr. Luick disclaims beneficial ownership of these shares.
- (8) The shares listed in the table as being beneficially owned by Mr. McCance include 225,000 shares held by Greylock Limited partnership, of which Mr. McCance is a general partner. Mr. McCance has shared voting and investment power as to these shares, is entitled to beneficial ownership of an indeterminate number of these shares and disclaims beneficial ownership as to the balance. Of the remaining shares, Mr. McCance disclaims beneficial ownership as to 12,500 shares with respect to which his wife acts as trustee for his daughter and 12,500 shares held by his daughter.
- (9) Mr. Ryan holds 131,125 shares of Common Stock. The remaining shares of Common Stock listed in the table as being beneficially owned by Mr. Ryan are held by Schooner Capital Corporation (and its subsidiaries), over which Mr. Ryan has shared voting and investment power as the Chairman and principal stockholder.
- (10) All of these shares are subject to the Stock Liquidation Agreement pursuant to which Mr. Grousbeck must sell such shares to Continental in either 1998 or 1999. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—1998-1999 Share Repurchase Program." Mr. Grousbeck's address is Room 382, Graduate School of Business, Stanford University, Stanford, California 94305.
- (11) These four limited partnerships may be deemed to be a "group" of persons acting together for the purpose of acquiring, holding, voting or disposing of shares of Common Stock. Boston Ventures Company Limited Partnership III ("BV Co. III"), as the sole general partner of each of Boston Ventures Limited Partnership III and Boston Ventures Limited Partnership IIIA, is deemed to be the beneficial owner of the shares held by such limited partnerships and to have shared voting and investment power with respect to such shares. Boston Ventures Company Limited Partnership IV ("BV Co. IV"), as the sole general partner of each of Boston Ventures Limited Partnership IV and Boston Ventures Limited Partnership IVA, is deemed to be the beneficial owner of the shares held by such limited partnerships and to have shared voting and investment power with respect to such shares. BV Co. III disclaims beneficial ownership of the shares beneficially owned by BV Co. IV; and BV Co. IV disclaims beneficial ownership of the shares beneficially owned by BV Co. III. Mr. Coppedge may be deemed to beneficially own all such shares. See footnote (5).
- (12) These stockholders may be deemed to be a "group" of persons acting together for the purpose of acquiring, holding, voting or disposing of shares of Series A Preferred Stock. Corporate Advisors, as the general partner of Corporate Partners, L.P. ("Corporate Partners") and Corporate Offshore Partners, L.P. ("Corporate Offshore Partners"), has sole voting and investment power as to the shares held by them. Corporate Advisors serves as investment manager over a certain investment management account for The State Board of Administration of Florida ("SBA") and has sole voting and dispositive power with respect to the shares of Series A Preferred Stock held by SBA. Pursuant to the Co-Investment Agreement dated as of April 27, 1992 (the "Co-Investment Agreement") by and among Corporate Advisors, Corporate

Partners, Corporate Offshore Partners, First Plaza Group Trust ("FPGT"), Vencap Holdings (1992) Pte. Ltd. ("Vencap") and ContCable Co-Investors, L.P. ("ContCable"), Corporate Advisors has sole voting and dispositive power with respect to the shares held by Vencap and ContCable. The address of Corporate Advisors, Corporate Partners, Corporate Offshore Partners, FPGT, SBA, ContCable and Vencap is: c/o Corporate Advisors, L.P., 30 Rockefeller Plaza, New York, New York 10020. See footnote (6) above.

- (13) Mellon Bank, N.A. acts as the trustee for FPGT, a trust under and for the benefit of certain employee benefit plans of General Motors Corporation and its subsidiaries. The shares listed in the table may be deemed to be beneficially owned by General Motors Investment Management Corporation ("GMIMC"), a wholly owned subsidiary of General Motors Corporation. GMIMC's principal business is providing investment advice and investment management services with respect to the assets of certain employee benefit plans of General Motors Corporation and its subsidiaries and with respect to the assets of certain direct and indirect subsidiaries of General Motors Corporation and associated entities. GMIMC is serving as FPGT's investment manager with respect to these shares and, in that capacity, it has the sole power to direct Mellon Bank, N.A. as to the voting and disposition of these shares. Because of its limited role as trustee, Mellon Bank, N.A. disclaims beneficial ownership of these shares. Pursuant to the Co-Investment Agreement, FPGT is obligated, subject to its fiduciary duties under the Employee Retirement Income Security Act of 1974, as amended, (i) to transfer shares held by it only in a transaction in which the other parties to the Co-Investment Agreement participate on a pro rata basis and (ii) to exercise all voting and other rights with respect to such shares in the same manner as is done by Corporate Advisors on behalf of the Corporate Partners and Corporate Offshore Partners.
- (14) The percentage ownership for the group assumes the conversion of shares of Series A Preferred Stock into Common Stock by all members of the group. The percentage ownership for each individual member of the group assumes conversion by only that stockholder.

Item 13. Certain Relationships and Related Transactions.

Lester Pollack, a Director of Continental, is Senior Managing Director of Corporate Advisors and a Managing Director of Lazard. Jonathan H. Kagan, a Director of Continental, is Managing Director of Corporate Advisors and a Managing Director of Lazard. Corporate Advisors is the sole general partner of Corporate Partners and Corporate Offshore Partners. A wholly owned subsidiary of Lazard is the sole general partner of Corporate Advisors.

Lazard received fees and underwriting discounts from Continental in an aggregate amount of \$7.4 million for its services as an underwriter to Continental of \$1.4 billion of senior notes and debentures during the year ended December 31, 1993.

Lazard acted as a financial advisor to Continental in connection with the negotiations and the consummation of the Providence Journal Merger, and, for such services, received a fee of \$5.5 million. Continental also reimbursed Lazard for its reasonable out-of-pocket expenses, including fees and expenses of legal counsel.

Lazard acted as a Placement Agent in the sale of the 8.30% Senior Notes, and, for such services received underwriting discounts and commissions totalling approximately \$3.5 million.

Lazard also acted as financial adviser to the Company in connection with the proposed Merger with U S WEST and received a fee of \$4,000,000 upon its announcement. Lazard will receive an additional fee upon the consummation of the Merger.

For a discussion of loans made to Executive Officers of Continental in connection with Continental's Restricted Stock Purchase Program, see footnote (1) to the Summary Compensation Table and "Compensation Committee Interlocks and Insider Participation." For a description of Continental's Stock-for-Loan Exchange and the RSPA Offer to repurchase shares of Common Stock, and information regarding certain Executive Officers who are Directors participating therein, see "Compensation Committee Interlocks and Insider Participation." The following Executive Officers who are not Directors of Continental participated in the Stock-for-Loan Exchange in the following amounts: William T. Schleyer (\$291,000), Jeffrey T. DeLorme (\$155,000),

Ronald H. Cooper (\$159,497) and Nancy Hawthorne (\$274,464). In addition, William T. Schleyer made a cash payment for the remaining \$141,063 of his outstanding loan incurred in connection with restricted stock purchases pursuant to RSPA III.

PART IV

Item 14. Exhibits, Financial Statements, Schedules and Reports on Form 8-K.

(a)(1) Financial Statements:

The following consolidated financial statements of the Company and the Independent Auditors' Report relating thereto are filed under Item 8 in Part II of this report:

Independent Auditors' Report

Consolidated Balance Sheets, December 31, 1994 and 1995

Statements of Consolidated Operations, Years Ended December 31, 1993, 1994 and 1995

Statements of Consolidated Stockholders' Equity (Deficiency), Years Ended December 31, 1993, 1994 and 1995

Statements of Consolidated Cash Flows, Years Ended December 31, 1993, 1994 and 1995

Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules:

The following financial statement schedules of the Company and the Independent Auditors' Report relating thereto are filed as part of this report:

Schedule II—Valuation and Qualifying Accounts and Reserves

Schedule IV—Condensed Financial Information of Registrant

Financial Statement Schedules not included are omitted due to the lack of conditions under which they are required.

(a)(3) Exhibits filed as part of this report:

As listed in the Exhibit Index beginning on page 81 hereof.

(b) Reports on Form 8-K.

The Company filed a current report on Form 8-K under item 2 on October 18, 1995 pertaining to the consummation of the transactions contemplated by the Amended and Restated Agreement and Plan of Merger dated as of August 1, 1995 by and among Providence Journal Company, The Providence Journal Company, King Broadcasting Company, King Holding Corp. and the Registrant (item 2). No financial statements were filed as they were previously reported in the Joint Proxy Statement—Prospectus dated August 31, 1995 included as part of the Registrant's Registration Statement (Registration No. 33-57471).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CONTINENTAL CABLEVISION, INC.

By: /s/ AMOS B. HOSTETTER, JR.
 AMOS B. Hostetter, Jr.
 Chairman of the Board

Dated: March 27, 1996

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ AMOS B. HOSTETTER, JR.</u> Amos B. Hostetter, Jr.	Director and Chairman of the Board (principal executive officer)	March 27, 1996
<u>/s/ TIMOTHY P. NEHER</u> Timothy P. Neher	Director and Vice Chairman of the Board	March 27, 1996
<u>/s/ WILLIAM T. SCHLEYER</u> William T. Schleyer	President and Chief Operating Officer	March 27, 1996
<u>/s/ NANCY HAWTHORNE</u> Nancy Hawthorne	Chief Financial Officer and Senior Vice President (principal financial officer)	March 27, 1996
<u>/s/ RICHARD A. HOFFSTEIN</u> Richard A. Hoffstein	Senior Vice President and Controller (principal accounting officer)	March 27, 1996
<u>Michael J. Ritter</u>	Director	March 27, 1996
<u>Roy F. Coppedge III</u>	Director	March 27, 1996

<u>Signature</u>	<u>Title</u>	<u>Date</u>
_____ Jonathan H. Kagan	Director	March 27, 1996
_____ Robert B. Luick	Director	March 27, 1996
_____ /s/ HENRY F. McCANCE Henry F. McCance	Director	March 27, 1996
_____ /s/ LESTER POLLACK Lester Pollack	Director	March 27, 1996
_____ /s/ VINCENT J. RYAN Vincent J. Ryan	Director	March 27, 1996
_____ /s/ STEPHEN HAMBLETT Stephen Hamblett	Director	March 27, 1996
_____ /s/ TRYGVE E. MYHREN Trygve E. Myhren	Director	March 27, 1996

INDEX TO EXHIBITS

Listed below are the exhibits which are filed as part of this report (according to the number assigned to them in Item 601 of Regulation S-K). Each exhibit marked¹ is incorporated by reference to the Company's Registration Statement No. 33-46510 (as amended), declared effective by the Securities and Exchange Commission on June 15, 1992, each exhibit marked by² is incorporated by reference to the Company's Registration Statement No. 33-59806, declared effective by the Securities and Exchange Commission on May 27, 1993, each exhibit marked by³ is incorporated by reference to the Company's Registration Statement No. 33-65798, declared effective by the Securities and Exchange Commission on August 6, 1993, each exhibit marked by⁴ is incorporated by reference to the Company's Registration Statement No. 33-57471, declared effective by the Commission on August 31, 1995 and each exhibit marked by⁵ is incorporated by reference to the Company's Registration Statement No. 33-63529 filed with the Commission on October 19, 1995. Exhibit numbers in parentheses refer to the exhibit numbers in Registration Statements. Each exhibit marked by a pound sign (#) is a management contract or compensatory plan.

<u>Exhibit No.</u>	<u>Page No.</u>
2.1	Agreement and Plan of Merger dated as of November 18, 1994, by and among the Company, Providence Journal Company, The Providence Journal Company, King Holding Corp. and King Broadcasting Company, as amended and restated as of August 1, 1995. ⁴ (2.1)
2.2	Agreement and Plan of Merger between US WEST, Inc. and Continental Cablevision, Inc. dated as of February 27, 1996 . . . Filed herewith as Exhibit 2.2.
3.1	Restated Certificate of Incorporation of the Company . . . Filed herewith as Exhibit 3.1.
3.1A	Certificate of Designation of the Company relating to the Series A Preferred Stock. ⁴ (3.1A)
3.1B	Form of Amendment to Company's Restated Certificate of Incorporation pertaining to merger consideration included as Exhibit A to the Merger Agreement filed as Exhibit 2.2.
3.2	By-Laws of the Company . . . Filed herewith as Exhibit 3.2.
4.1	Indenture dated as of June 22, 1992 between the Company and Morgan Guaranty Trust Company of New York as Trustee, pertaining to the Company's 10½% Senior Subordinated Notes due 2002. ¹ (4.1)
4.2	Indenture, dated as of June 22, 1992 between the Company and Morgan Guaranty Trust Company of New York as Trustee, pertaining to the Company's 11% Senior Subordinated Debentures due 2007. ¹ (4.2)
4.3	Amended and Restated Note Agreement dated as of October 17, 1994 by and among the Company and certain of its direct and indirect Subsidiaries as Guarantors and The Prudential Insurance Company of America. ⁴ (4.5)
4.4	Indenture dated as of June 1, 1993 between the Company and The First National Bank of Chicago, as Trustee, pertaining to the Company's 8½% Senior Notes due 2003. ² (4.1C)
4.5	Indenture dated as of June 1, 1993 between the Company and The First National Bank of Chicago, as Trustee, pertaining to the Company's 9% Senior Debentures due 2008. ² (4.11)
4.6	Indenture dated as of August 1, 1993 between the Company and the Bank of New York, as Trustee, pertaining to the Company's 8¾% Senior Debentures due 2005. ³ (4.11)
4.7	Indenture dated as of August 1, 1993 between the Company and the Bank of New York, as Trustee, pertaining to the Company's 9½% Senior Debentures due 2013. ³ (4.12)

- 4.8 Indenture dated as of August 1, 1993 between the Company and the Bank of New York, as Trustee, pertaining to the Company's 8½% Senior Notes due 2001.³ (4.13)
- 4.9 Indenture dated December 13, 1995 between the Company and the Bank of Montreal, as Trustee, pertaining to the Company's 8.30% Senior Notes due 2006. . . . Filed herewith as Exhibit 4.9.
- 10.1 Stock Liquidation Agreement dated as of March 6, 1989, as amended as of September 28, 1990, replacing and restating the Stock Acquisition Agreement made as of December 19, 1988 by and among the Company, H. Irving Grousbeck, MD Co., Burr, Egan, Deleage & Co., Roderick A. MacLeod and Amos B. Hostetter, Jr.¹ (10.2)
- 10.2 Second Amendment to Stock Liquidation Agreement dated as of July 7, 1992 by and among the Company, Amos B. Hostetter, Jr., H. Irving Grousbeck, MD Co., Burr, Egan, Deleage & Co. and Roderick A. MacLeod.² (10.2)
- 10.3 Form of Restricted Stock Purchase Agreement.¹ (10.3)
- 10.4 Stock Purchase Agreement dated April 27, 1992 among the Company, Corporate Partners, L.P., Corporate Offshore Partners, L.P., The State Board of Administration of Florida, Chemical Equity Associates, Mellon Bank, N.A. as Trustee for First Plaza Group Trust, Vencap Holdings (1992) Pte Ltd and Corporate Advisors, L.P.¹ (10.4)
- 10.5 Registration Rights Agreement dated June 22, 1992 among the Company, Corporate Partners, L.P., Corporate Offshore Partners, L.P., The State Board of Administration of Florida, Chemical Equity Associates, Mellon Bank, N.A. as Trustee for First Plaza Group Trust, Vencap Holdings (1992) Pte Ltd and Corporate Advisors, L.P.¹ (10.5)
- 10.6 Amendment to Registration Rights Agreement dated July 15, 1992 among the Company and Corporate Advisors, L.P. on behalf of Corporate Partners, L.P., Corporate Offshore Partners, L.P., The State Board of Administration of Florida, ContCable Co-Investors, L.P., Mellon Bank, N.A., as Trustee for First Plaza Group Trust, and Vencap Holdings (1992) PTE Ltd.² (10.6)
- 10.7 Stock Purchase Agreement dated July 15, 1992, as amended on November 17, 1992, among the Company, Boston Ventures Limited Partnership III, Boston Ventures Limited Partnership IIIA, Boston Ventures Limited Partnership IV and Boston Ventures Limited Partnership IVA.² (10.7)
- 10.8 Stock Purchase Agreement dated July 15, 1992 among the Company, Thomas H. Lee Equity Partners, L.P., THL-CCI Investors Limited Partnership, Providence Media Partners L.P., Alta V Limited Partnership, Customs House Partners and Ontario Teachers' Pension Plan Board.² (10.8)
- 10.9 Registration Rights Agreement dated July 15, 1992 among the Company, Boston Ventures Limited Partnership III, Boston Ventures Limited Partnership IIIA, Boston Ventures Limited Partnership IV, Boston Ventures Limited Partnership IVA, Thomas H. Lee Equity Partners, L.P., THL-CCI Investors Limited Partnership, Providence Media Partners L.P., Alta V Limited Partnership, Customs House Partners and Ontario Teachers' Pension Plan Board.² (10.9)
- 10.10 Liquidation Rights Agreement dated as of July 7, 1992 by and between the Company and MD Co.² (10.10)
- 10.11 Stock Purchase Agreement dated as of December 17, 1992 by and among Teleport Communications Group Inc., Comcast Corporation, Comcast Teleport, Inc., the Company and Continental Teleport, Inc.² (10.11)

- 10.12 Optus Vision Joint Venture-Optus Vision Shareholders Agreement dated May 19, 1995 by and among Continental Cablevision of Australia, Inc., Optus Communications Pty Limited, Pay TV Holdings Pty Limited, Tallglen Pty Limited, Optus Vision Pty Limited, Optus Networks Pty Limited and Optus Administration Pty Limited.⁴ (10.12)
- 10.13 Management Incentive Plan.⁴ (10.13)
- 10.14 Purchase Agreement dated as of November 1, 1994 by and among Columbia Associates, L.P., Columbia Cable of Michigan, Inc., and Continental Cablevision of Manchester, Inc.⁴ (10.14)
- 10.15 Supplemental Executive Retirement Plan.⁴ (10.15)
- 10.16 Registration Rights Agreement with The Providence Journal Company.³ (10.16)
- 10.17 Form of Restricted Stock Purchase Agreements for 1995.⁴ (10.17)
- 10.18 First Amendment to the Purchase Agreement dated March 24, 1995 by and among Columbia Associates, L.P., Columbia Cable of Michigan, Inc., and Continental Cablevision of Manchester, Inc.⁴ (10.19)
- 10.18A Second Amendment to the Purchase Agreement dated September 30, 1995, by and among Columbia Associates, L.P., Columbia Cable of Michigan, Inc. and Continental Cablevision of Manchester.³ (10.19A)
- 10.19 Purchase Agreement dated January 6, 1995 by and between Continental Cablevision, Inc. and Cablevision of Chicago.⁴ (10.20)
- 10.20 Purchase Agreement dated March 29, 1995 between N-COM Limited Partnership II and Continental Cablevision Investments, Inc.⁴ (10.21)
- 10.21 Amended and Restated Credit Agreement dated as of October 1, 1994 among the Company and certain of its direct and indirect Subsidiaries as Guarantors and The First National Bank of Boston, for itself and as Administrative and Managing Agent, and certain financial institutions named therein.⁴ (4.4)
- 10.21A Amendment Number 1 dated as of September 29, 1995 to the Amended and Restated Credit Agreement dated as of October 1, 1994 among the Company and certain of its direct and indirect Subsidiaries as Guarantors and The First National Bank of Boston, for itself and as Administrative and Managing Agent, and certain financial institutions named therein. . . . Filed herewith as Exhibit 10.21A.
- 10.22 Credit Agreement dated as of July 18, 1995 among PJC Financing Corporation, Colony Communications, Inc., Columbia Cable of Michigan, N-COM Acquisition Corporation and their respective Subsidiaries and The Toronto Dominion Bank as Documentation Agent and managing Agent, The First National Bank of Boston for itself and as Administrative and Managing Agent and The Bank of New York for itself and as Syndication and Managing Agent and certain financial institutions named therein.⁴ (4.11)
- 10.23 Amendment to Credit Agreement dated September 22, 1995 among PJC Financing Corporation and certain of its direct and indirect Subsidiaries and The First National Bank of Boston, and certain financial institutions named therein.³ (10.24)
- 10.24 Registration Rights Agreement dated December 13, 1995 among the Company, Lazard Freres & Co. LLC and Morgan Stanley & Co. Incorporated. . . . Filed herewith as Exhibit 10.24.
- 10.25 Asset Exchange Agreement dated December 20, 1995 by and between Continental Cablevision of St. Louis County, Inc. and TCI Cable Partners of St. Louis, L.P. . . . Filed herewith as Exhibit 10.25.

Exhibit No.Page No.

- | | |
|-------|--|
| 10.26 | Forms of Restricted Stock Purchase Agreements for 1996 and amendments to Restricted Stock Purchase Agreements and related agreements.#...Filed herewith as Exhibit 10.26. |
| 10.27 | Purchase Agreement dated as of March 15, 1996 among Meredith/New Heritage Partnership and New Heritage Associates and the Company....Filed herewith as Exhibit 10.27. |
| 10.28 | Stockholders Agreement dated as of February 27, 1995 among Amos B. Hostetter, Jr., the Amos B. Hostetter, Jr. 1989 Trust, Timothy P. Neher, Corporate Advisors, L.P. and certain stockholders of the Company named therein and U S WEST...Filed herewith as Exhibit 10.28. |
| 11.1 | Schedule of computation of earnings per share.... Filed herewith as Exhibit 11.1. |
| 21 | Subsidiaries of the Company.... Filed herewith as Exhibit 21. |
| 27 | Financial Data Schedules.... Filed herewith as Exhibit 27. |

ATTACHMENT D

Form 10-K of

U S WEST, Inc.

For the Period Ending December 31, 1995

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K



ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

for the fiscal year ended December 31, 1995

OR



TRANSACTION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

for the transition period from to

Commission File No. 1-8611

U S WEST, Inc.

A Delaware Corporation

I.R.S. Employer Identification
No. 84-0926774

7800 East Orchard Road, Englewood, Colorado 80111

Telephone Number (303) 793-6500

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
U S WEST Communications Group Common Stock (\$0.01 per share, par value)	New York Stock Exchange
U S WEST Media Group Common Stock (\$0.01 per share, par value)	Pacific Stock Exchange
Liquid Yield Option Notes, due 2011 (convertible to common stock under certain circumstances)	New York Stock Exchange
Trust Originated Preferred Securities ("TOPRS") (Service Mark)	Pacific Stock Exchange
	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

At January 31, 1996, 474,269,030 shares of U S WEST Communications Group common stock and 472,654,874 shares of U S WEST Media Group common stock were outstanding.

At January 31, 1996, the aggregate market value of the U S WEST Communications Group voting stock held by non-affiliates was approximately \$16,439,488,720, and the aggregate market value of the U S WEST Media Group voting stock held by non-affiliates was approximately \$9,917,108,166.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the Registrant's 1995 Annual Report to Shareowners are incorporated by reference into Parts I, II and IV.

Portions of the Registrant's definitive Proxy Statement dated March 16, 1995, to be issued in connection with the 1996 Annual Meeting of Shareowners are incorporated by reference into Parts II and III.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ☒.

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PART I

ITEM 1. Business

General

U S WEST, Inc. ("U S WEST" or the "Company") is incorporated under the laws of the State of Delaware and has its principal executive offices at 7800 East Orchard Road, Englewood, Colorado 80111, telephone number (303) 793-6500. U S WEST is a diversified global communications company, and conducts its operations through U S WEST Communications Group ("Communications Group") and U S WEST Media Group ("Media Group"). (Financial information concerning U S WEST's operations is set forth in the Consolidated Financial Statements and Notes thereto, which begin on page B-29.) U S WEST and its subsidiaries had 61,047 employees at December 31, 1995.

Communications Group. The major component of the Communications Group is U S WEST Communications, Inc. ("U S WEST Communications"), which provides telecommunications services to more than 25 million residential and business customers in the states of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming (collectively, the "Communications Group Region"). U S WEST Communications serves approximately 80 percent of the Communications Group Region's population and approximately 40 percent of its geographic area.

Media Group. The Media Group is comprised of: (i) cable and telecommunications network businesses outside of the Communications Group Region and internationally, (ii) domestic and international wireless communications network businesses and (iii) domestic and international directory and information services businesses, including telephone directories.

Recent Developments

Agreement to Acquire Continental Cablevision, Inc. On February 27, 1996, U S WEST announced a definitive agreement under which Continental Cablevision, Inc. ("Continental") will be merged with and into the Company. Continental, the nation's third-largest cable operator, serves 4.2 million U.S. customers, passes more than seven million U.S. households and owns significant other domestic and international assets. The Company will purchase all of Continental's stock for approximately \$5.3 billion, and will assume Continental's debt and other obligations, which amount to approximately \$5.5 billion. Consideration of the \$5.3 billion in equity will consist of approximately \$1 billion in U S WEST preferred stock, convertible to Media Stock; \$2.8 billion to \$3.3 billion in shares of Media Stock; and, at U S WEST's option, between \$1 billion and \$1.5 billion in cash. The transaction, which is expected to close in the fourth quarter, is subject to a number of conditions, including regulatory and other approvals such as that of Continental's shareholders. There can be no assurance that these conditions will be satisfied.

Recapitalization Plan. On October 31, 1995, the shareholders of U S WEST, Inc., a Colorado corporation ("U S WEST Colorado") voted to approve a proposal (the "Recapitalization Plan") adopted by the Board of Directors to reincorporate from Colorado to Delaware and create two classes of common stock that are intended to reflect separately the performance of the communications and multimedia businesses. Under the Recapitalization Plan, shareholders approved an Agreement and Plan of Merger between U S WEST Colorado and U S WEST, pursuant to which U S WEST continues as the surviving corporation. In connection with the merger, the Certificate of Incorporation of U S WEST has been amended and restated to, among other things, designate two classes of common stock of U S WEST, one class of which is authorized as U S WEST Communications Group Common Stock ("Communications Stock"), and the other class is authorized as U S WEST Media Group Common Stock ("Media Stock"). Effective November 1, 1995, each share of common stock of U S WEST Colorado converted into one share of Communications Stock and one share of Media Stock.

The Communications Stock and Media Stock are designed to provide shareholders with separate securities that are intended to reflect separately the communications businesses of U S WEST Communications and certain other subsidiaries of the Communications Group, and the multimedia businesses of the Media Group.

The Communications Group is comprised of U S WEST Communications, U S WEST Communications Services, Inc., U S WEST Federal Services, Inc., U S WEST Advanced Technologies, Inc. and U S WEST Business Resources, Inc. U S WEST Communications comprised approximately 97 percent of the revenues and 98 percent of the assets of the Communications Group in 1995.

The Media Group is comprised of U S WEST Marketing Resources Group, Inc., a publisher of White and Yellow Pages telephone directories and other information services including database marketing and other interactive services, U S WEST NewVector Group, Inc., which provides communications and information products and services over wireless networks, U S WEST Multimedia Communications, Inc., which owns domestic cable television operations and investments, and U S WEST International Holdings, Inc., which primarily owns investments in international cable and telecommunications, wireless communications and directory publishing operations.

Dividends paid to the holders of Communications Stock are currently \$0.535 per share per quarter. Dividends on the Communications Stock will be paid at the discretion of the Board of Directors of U S WEST, based primarily upon the financial condition, results of operations and business requirements of the Communications Group and the Company as a whole. With regard to the Media Stock, the Board of Directors of U S WEST currently intends to retain future earnings, if any, for the development of the Media Group's businesses and does not anticipate paying dividends on the Media Stock in the foreseeable future.

Telecommunications Act of 1996. On February 1, 1996, the House of Representatives and the Senate approved a final bill that is intended to promote competition between local telephone companies, long-distance carriers and cable television operators. This bill was signed into law on February 8, 1996, and replaces the antitrust consent decree that broke up the "Bell System" in 1984. Major provisions of the legislation include the pre-emption of state regulations that prohibit competition. The Act allows local telephone companies, long-distance carriers and cable television companies to enter each other's lines of business. To participate in the interLATA long-distance business within their regions, the Regional Bell Operating Companies must first open their local networks to facilities-based competition by satisfying a detailed list of requirements, including interconnection and number portability. The legislation also eliminates within three years most regulation of cable television rates. The Act lifts the ban on cross-ownership between cable television and telephone companies, permitting the Regional Bell Operating Companies to enter into the cable business within their respective service territories, but prohibits them from doing so through the purchase of existing cable companies, except in rural communities. The legislation reaffirms the concept of universal service and directs the Federal Communications Commission and the states to determine universal service funding policy. The Federal Communications Commission and state regulators have been given the responsibility to interpret and oversee the implementation of this legislation.

Communications Group

Operations. The principal types of telecommunications services offered by the Communications Group are (i) local service, (ii) exchange access service (which connects customers to the facilities of interLATA service providers), and (iii) intraLATA long-distance network service. For the year ended December 31, 1995, local service, exchange access service and intraLATA long distance network service accounted for 46%, 33% and 13%, respectively, of the sales and other revenues of the Communications Group. At December 31, 1995, U S WEST Communications had approximately 14,847,000 telephone network access lines in service, a 3.6% increase over year end 1994. Excluding the effect of the sale of approximately 95,000 rural telephone access lines during 1995, access lines increased 4.2% over year end 1994. In 1995, revenues from a single customer, AT&T, accounted for approximately

11% of the sales and other revenues of the Communications Group, and 9% of the sales and other revenues of U S WEST. The Communications Group expensed \$22 million, \$31 million and \$42 million for research and development costs in 1995, 1994 and 1993, respectively.

U S WEST Communications incurred capital expenditures of approximately \$2.7 billion in 1995 and expects to incur approximately \$2.5 billion in 1996. The 1995 capital expenditures of U S WEST Communications were substantially devoted to the continued modernization of telephone plant, to improve customer services and to accommodate additional line capability in several states.

Development of Broadband Network. A market trial for a broadband network capable of providing voice, data and video services to customers commenced in the Omaha area in August, 1995. The Communications Group does not intend to expand this service offering beyond the Omaha area because of service cost and pricing issues. The Communications Group does plan to continue to provide the system that delivers basic, premium and pay-per-view video services in the Omaha area. The Communications Group is evaluating the relative costs of alternative video technologies, as well as the near-term feasibility of interactive services. To satisfy anticipated demand for combined video and telephony services on a cost-effective basis, the Communications Group's strategy may include selective investments in wireless cable technologies.

The Restructuring Plan. U S WEST announced in 1993 that U S WEST Communications would implement a plan (the "Restructuring Plan") designed to provide faster, more responsive customer service and improved repair capabilities while reducing the cost of providing these services. As part of the Restructuring Plan, the Communications Group is developing new systems and enhanced system functionality that will enable it to monitor networks to reduce the risk of service interruptions, activate telephone service on demand, rapidly design and engineer products and services for customers, and centralize its service centers. The Communications Group has consolidated its 560 customer service centers into 26 centers in ten cities and plans on reducing its work force by approximately 10,000 employees in connection with the Restructuring Plan. Work force reductions under the Restructuring Plan will be partially offset by the effects of higher than anticipated volumes of business and the achievement of customer service objectives. All service centers are operational and supported by new systems and system functionality. The Restructuring Plan is expected to be substantially completed by the end of 1997. Implementation has been affected by growth in the business and related service issues, new business opportunities, revisions to system delivery schedules and productivity issues caused by the major rearrangement of resources due to restructuring. These issues will continue to affect the timing of employee separations. See "Costs and Expenses" and "Restructuring Charge" under Management's Discussion and Analysis of Financial Condition and Results of Operations on p. B-9 and p. B-10.

Regulation. U S WEST Communications is subject to varying degrees of regulation by state commissions with respect to intrastate rates and service, and access charge tariffs. U S WEST is also subject to the jurisdiction of the FCC with respect to interstate access tariffs (that specify the charges for the origination and termination of interstate communications) and other matters.

U S WEST's interstate services have been subject to price-cap regulation by the FCC since January 1991. Price caps are an alternative form of regulation designed to limit prices rather than profits. However, the FCC's price cap plan includes sharing of earnings in excess of authorized levels. In March, 1995, the FCC issued an interim order on price cap regulation. The price cap index for most services is annually adjusted for inflation, productivity level and exogenous costs, and has resulted in reduced access prices paid by interexchange carriers to local telephone companies. The interim order also provides for three productivity options, including a no-sharing option, and for increased flexibility for adjusting prices downward in response to competition. In 1995, the Communications Group selected the lowest productivity option while, prior to this interim order, the Communications Group used an optional higher productivity factor in determining prices. Consequently, the Communications Group expects the order to have no significant near-term impact.

U S WEST Communications is currently working with state regulators to gain approval of initiatives, including efforts to rebalance prices, advance competitive parity and implement simplified forms of price and service quality regulation. State and local regulatory authorities may also regulate certain terms and conditions of the offering of wireless services, such as the siting and construction of transmitter towers, antennas and equipment shelters and zoning and building permit approvals. See "Competitive and Regulatory Environment" under Management's Discussion and Analysis of Financial Condition and Results of Operations on p. B-22.

Competition. The Communications Group faces competition in the local exchange business, exchange access and intraLATA long-distance markets, primarily from competitive access providers ("CAPS") and interexchange carriers. CAPs compete with the Communications Group by providing large business customers with high-capacity network services that connect to interexchange carrier facilities or other business locations within a serving LATA. Interexchange carriers compete with the Communications Group by providing intraLATA long-distance services. Such competition is eroding U S WEST Communications' market share of intraLATA long-distance services, including Wide Area Telephone Service and "800" services. Interexchange carriers are competing in this area by offering lower prices and packaging these services on an intraLATA and interLATA basis.

Technological advancements and regulatory changes will increase competition in the future. Current competitors, including CAPs and interexchange carriers, are positioning themselves to offer local exchange services. New competitors that are affiliates of cable television companies and power companies also are expected to play a greater role in offering local exchange services. In addition to local exchange services, competitors are expected to offer services that will compete with those U S WEST Communications plans to offer, including video programming and interactive multimedia services. Services offered by cellular and PCS operators also will compete with existing and future services of U S WEST Communications, including future wireless services. AT&T's entrance into the wireless communications business through its acquisition of McCaw Cellular Communications, Inc. may create increased competition in local exchange as well as wireless services. The loss of local exchange customers to competitors would affect multiple revenue streams of U S WEST Communications.

The adoption of the Telecommunications Act of 1996 will have an impact on the competition faced by the Communications Group. See "Recent Developments — Telecommunications Act of 1996," and "Competitive and Regulatory Environment" under Management's Discussion and Analysis of Financial Condition and Results of Operations on p. B-22.

Media Group

Operations. The Media Group is comprised of (i) cable and telecommunications network businesses outside of the Communications Group Region and internationally, (ii) domestic and international wireless communications network businesses and (iii) domestic and international directory and information services businesses. For the year ended December 31, 1995, domestic and international directory and information services businesses accounted for 10% of the sales and other revenues of U S WEST. The Media Group expensed \$3 million, \$6 million and \$5 million for research and development costs in 1995, 1994 and 1993, respectively.

Cable and Telecommunications. The Media Group's domestic cable and telecommunications operations are conducted through U S WEST Multimedia Communications, Inc. ("U S WEST Multimedia") and consist of domestic cable properties and investments outside of the Communications Group Region, including U S WEST Multimedia's ownership of cable systems in the Atlanta, Georgia metropolitan area (the "Atlanta Systems") and its investment in Time Warner Entertainment Company L.P. ("TWE" or "Time-Warner Entertainment"), the second largest provider of cable television services in the United States.

On February 27, 1996, U S WEST announced a definitive agreement to merge with Continental Cablevision, Inc. for a combination of cash, U S WEST preferred stock (convertible to Media Stock)

and shares of Media Stock valued at \$5.3 billion. The transaction also involves an assumption of debt and other obligations amounting to approximately \$5.5 billion. See "Recent Developments — Agreement to Acquire Continental Cablevision, Inc."

The Media Group's international cable and telecommunications operations are conducted through U S WEST International Holdings, Inc. ("U S WEST International") and include investments in cable and telecommunications that focus on serving mass market business and residential customers in key geographic markets. To decrease investment risk and gain access to technical skills and capabilities, U S WEST International's strategy has been to make these investments with other major cable television companies, including Time Warner Inc. and Tele-Communications, Inc. In certain circumstances, foreign laws require the participation of local partners in these ventures.

U S WEST International, through subsidiaries, owns a 26.8 percent interest in TeleWest plc ("TeleWest"), the largest provider of combined cable television and residential and business telecommunications services in the United Kingdom. In 1995, TeleWest Communications plc merged its cable television and telephony interests with SBC CableComms (UK) to form TeleWest. An affiliate of Tele-Communications, Inc., ("TCI International") also owns a 26.8 percent interest in TeleWest, with the remaining interests held by the public.

Wireless Communications. U S WEST NewVector Group, Inc. ("NewVector") provides cellular services to customers over wireless networks in 26 metropolitan service areas and 28 rural service areas located primarily in the Communications Group Region. NewVector's cellular services provide customers with high-quality and readily available two-way communications services that interconnect with local and long-distance telephone networks. As of December 31, 1995, NewVector had approximately 1,463,000 cellular customers, a 51 percent increase from December 31, 1994.

In 1994, the Company entered into a definitive agreement with AirTouch Communications to combine their domestic cellular assets. AirTouch's initial equity ownership of the joint venture will be approximately 70 percent and the Media Group's will be approximately 30 percent. The combination will take place in two phases. During Phase I, which U S WEST entered effective November 1, 1995, the two companies are operating their cellular properties separately. A Wireless Management Company ("WMC") has been formed and is providing centralized services to both companies on a contract basis. In Phase II, AirTouch and U S WEST will contribute their domestic cellular assets to the WMC. The recent passage of the Telecommunications Act of 1996 has removed significant regulatory barriers to completion of Phase II of the business combination, and the Company expects that Phase II closing could take place by the end of 1996 or in early 1997.

U S WEST has entered into a venture with AirTouch Communications, Bell Atlantic and NYNEX Corporation to form a strategic national wireless alliance. U S WEST has entered into a separate venture with the same partners to provide personal communications services ("PCS"). This PCS venture, known as PCS PrimeCo, acquired rights to 11 licenses in 1995 in the Federal Communications Commission's auction of PCS radio spectrum. The 11 licenses cover 57 million people in Chicago, Dallas, Honolulu, Houston, Jacksonville, Miami, Milwaukee, New Orleans, Richmond, San Antonio and Tampa.

U S WEST International owns interests in wireless communications systems or investments in several countries, including the United Kingdom, Malaysia, Russia, Hungary, the Czech Republic, the Slovak Republic and Japan.

U S WEST International, through subsidiaries, owns 50 percent of Mercury One 2 One, a 50-50 joint venture between subsidiaries of U S WEST International and Cable & Wireless plc. Mercury One 2 One operates a PCS system in the United Kingdom. Mercury One 2 One's PCS is a digital cellular communications service designed to offer consumers higher quality service, increased privacy and more features at lower prices than existing cellular communications systems. To meet growing customer demand, Mercury One 2 One has expanded its coverage to reach 30 percent of the United Kingdom's population.

Directory and Information Services. The Media Group, through Marketing Resources, provides directory publishing as well as database marketing and interactive services. Marketing Resources publishes, prints and sells advertising in more than 300 White and Yellow Pages directories in the Communications Group Region. Marketing Resources' growth strategy is to increase its advertiser base through expanded marketing efforts, the expansion of core products, such as new targeted directories for specific neighborhoods or industries and development of new directory features, and the development and packaging of new information products, such as local audiotext services. Marketing Resources' yellow pages directory advertising business had revenue growth of approximately 6.4 percent in 1995.

Marketing Resources also provides database marketing services that enable businesses to segment and target customers and is developing the capability to provide one-to-one marketing over interactive networks. In the future Marketing Resources plans to develop, package, market and distribute integrated, interactive communications, entertainment, information and transaction services over networks operated by the Media Group and others, including the networks of the Communications Group in the Communications Group Region.

U S WEST International owns 100 percent of Thomson Directories, which it acquired in 1994. Thomson Directories annually publishes 156 directories in the United Kingdom, reaching 46 million people, or 80 percent of all households, in the United Kingdom. U S WEST International owns a 50 percent interest in Listel, Brazil's largest telephone directory publisher, which it acquired in 1994. U S WEST International also owns 100 percent of Polska, which publishes 32 directories in Poland with a combined circulation of approximately 1.7 million.

In June 1995, a subsidiary of U S WEST International purchased a 9.01% interest in Flextech plc ("Flextech"), one of the United Kingdom's largest providers of cable television and satellite programming. U S WEST International has the right to appoint one representative to Flextech's board of directors.

Regulation. The products and services of the Media Group are subject to varying degrees of regulation. Under the Telecommunications Act of 1996, the regulation of cable television rates will be discontinued effective March 31, 1999, or earlier if competition exists. The same Act also (i) eliminates certain cross-ownership restrictions among cable operators, broadcasters and multichannel, multi-point distribution system operators, (ii) removes barriers to competition with local exchange providers, and (iii) eliminates restrictions that previously applied to the Media Group relating to long-distance services.

Cable television systems are also subject to local regulation, typically imposed through the franchising process. Local officials may be involved in the initial franchise selection, system design and construction, safety, rate regulation, customer service standards, billing practices, community-related programming and services, franchise renewal and imposition of franchise fees.

The Media Group is subject to various regulations in the foreign countries in which it has operations. In the United Kingdom, the licensing, construction, operation, sale and acquisition of cable and wireline and wireless communications systems are regulated by various governmental entities, including the Department of Trade and Industry and the Department of National Heritage.

Competition. U S WEST Multimedia's cable television systems generally compete for viewer attention with programming from a variety of sources, including the direct reception of broadcast television signals by the viewer's own antenna, subscription and low power television stations, multichannel multipoint distribution systems ("MMDS" or "wireless cable"), satellite master antenna ("SMATV") service, direct broadcast satellite ("DBS") services, telephone companies, including other RBOC's, and other cable companies within an operating area. The extent of such competition in any franchise area is dependent, in part, upon the quality, variety and price of the programming provided by these technologies. Many of these competitive technologies are generally not subject to the same local government regulation that affects cable television. Cable television

systems are also in competition for both viewers and advertising in varying degrees with other communications and entertainment media, and such competition may increase with the development and growth of new technologies. TeleWest's cable television services compete with broadcast television stations, DBS services, SMATV systems and certain narrowband operators in the United Kingdom.

U S WEST Multimedia will be offering telecommunications services in competition with the dominant local exchange carriers ("LFCs"), CAPs and other potential providers of telephone services in local domestic markets, including the interexchange carriers such as AT&T, MCI Communications and Sprint Corp. The degree of competition will be dependent upon the state and federal regulations concerning entry, interconnection requirements, and the degree of unbundling of the LECs' networks. Competition will be based upon price, service quality and breadth of services offered. TeleWest's telecommunications services compete with domestic telephone companies in the United Kingdom, such as British Telecommunications plc.

New Vector's wireless business is subject to FCC regulation and licensing requirements. To assure competition, the FCC has awarded two competitive cellular licenses in each market. Many competing cellular providers are substantial businesses with experience in broadcasting, telecommunications, cable television and radio common carrier services. In many markets, competing cellular service is provided by businesses owned or controlled by a LEC, AT&T or other major telephone companies. Competition is based upon the price of cellular service, the quality of the service and the size of the geographic area served. The development of PCS services will create multiple new competitors for NewVector's wireless businesses. Competition for the provision of wireless services is also provided by providers of enhanced specialized mobile radio services. In the United Kingdom, Mercury One 2 One's operations compete with two established cellular providers and one PCS provider. In addition, Mercury One 2 One competes in the consumer market with telephone companies such as British Telecommunications plc.

Marketing Resources' directory publishing businesses continue to face significant competition from local and national publishers of directories, as well as other advertising media such as newspapers, magazines, broadcast media, direct mail and operator assisted services. Directory listings are now offered in electronic data bases through telephone company and third party networks. As such offerings expand and are enhanced through interactivity and other features, the Company will experience heightened competition in its directory publishing businesses. Marketing Resources will continue to expand its core products and develop and package new information products to meet its customers' needs. Marketing Resources' database marketing services also continue to face competition from direct mail list providers, co-op direct mail programs and coupon programs. Marketing Resources will also face emerging competition in the provision of interactive services from cable and entertainment companies, on-line services, advertising agencies specializing in interactive advertising and many small companies who are information providers. Many of these potential competitors may also be joint venture partners, suppliers or distributors.

The actions of public policy makers play an important role in determining how increased competition affects the Media Group. The Media Group is working with regulators and legislators to help ensure that public policies are fair and in the best interests of customers.

See "Competitive and Regulatory Environment" under Management's Discussion and Analysis of Financial Condition and Results of Operation on p. B-22.

ITEM 2. Properties.

The properties of U S WEST do not lend themselves to description by character and location of principal units. At December 31, 1995, the majority of U S WEST property was utilized in providing telecommunications services by U S WEST Communications. Substantially all of U S WEST Communications' central office equipment is located in owned buildings situated on land owned in fee, while many garages and administrative and business offices are in leased quarters.

ITEM 3. Legal Proceedings.

U S WEST and its subsidiaries are subject to claims and proceedings arising in the ordinary course of business. While complete assurance cannot be given as to the outcome of any contingent liabilities, in the opinion of U S WEST, any financial impact to which U S WEST and its subsidiaries are subject is not expected to be material in amount to U S WEST's operating results or its financial position.

On September 22, 1995, U S WEST filed a lawsuit in Delaware Chancery Court to enjoin the proposed merger of Time Warner and Turner Broadcasting. U S WEST has alleged breaches of contract and fiduciary duties by Time Warner in connection with this proposed merger. Time Warner filed a countersuit against U S WEST on October 11, 1995, alleging misrepresentation, breach of contract and other misconduct on the part of U S WEST. Time Warner's countersuit seeks a reformation of the Time Warner Entertainment partnership agreement, an order that enjoins U S WEST from breaching the partnership agreement and unspecified compensatory damages. U S WEST has denied each of the claims in Time Warner's countersuit. Trial for this action concluded on March 22, 1996. A ruling by the Delaware Chancery Court is expected in June 1996.

ITEM 4. Submission of Matters to a Vote of Security Holders.

Not applicable.

EXECUTIVE OFFICERS OF U S WEST

Pursuant to General Instructions G(3), the following information is included as an additional item in Part I:

	<u>Position</u>	<u>Age</u>	<u>Date Assumed Present Position</u>
James T. Anderson	Acting Executive Vice President & Chief Financial Officer	56	1984(1)
Charles M. Lillis	Executive Vice President & President and Chief Executive Officer, U S WEST Media Group	54	1987(2)
Richard D. McCormick	Chairman of the Board, Chief Executive Officer & President	55	1986(3)
Charles P. Russ, III	Executive Vice President-Law and Human Resources, General Counsel & Secretary	51	1992
James H. Stever	Executive Vice President - Public Policy	52	1993
Solomon D. Trujillo	Executive Vice President & President and Chief Executive Officer, U S WEST Communications, Inc.	44	1995(4)

(1)Mr. Anderson was elected Acting Executive Vice President and Chief Financial Officer effective October 6, 1995; he has been Vice President and Treasurer since 1984.

(2)Mr. Lillis was elected President and Chief Executive Officer, U S WEST Media Group effective August 22, 1995.

(3)Mr. McCormick was appointed Chief Executive Officer on January 1, 1991, and was elected Chairman of the Board effective May 1, 1992.

(4)Mr. Trujillo was elected President and Chief Executive Officer of U S WEST Communications, Inc. effective July 1, 1995, and Executive Vice President, U S WEST, Inc. effective October 6, 1995. Previously, Mr. Trujillo was President and Chief Executive Officer of U S WEST Marketing Resources Group, Inc.

Executive Officers are not elected for a fixed term of office, but serve at the discretion of the Board of Directors.

Each of the above executive officers has held a managerial position with U S WEST or an affiliate of U S WEST since 1991, except for Mr. Russ. Mr. Russ was Vice President, Secretary and General Counsel of NCR Corporation from February, 1984 to June, 1992.

PART II

ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters.

The information required by this item is included in Note 21, Quarterly Financial Data, on page B-63. The U.S. markets for trading in U S WEST common stock are the New York Stock Exchange and the Pacific Stock Exchange. As of December 31, 1995, U S WEST Communications Group common stock was held by approximately 775,125 shareholders of record and U S WEST Media Group common stock was held by approximately 770,346 shareholders of record.

ITEM 6. Selected Financial Data.

Reference is made to the information set forth on pages B-1 through B-2.

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

Reference is made to the information set forth on pages B-3 through B-26.

ITEM 8. Consolidated Financial Statements and Supplementary Data.

Reference is made to the information set forth on pages B-29 through B-63.

ITEM 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.

Coopers & Lybrand L.L.P. has served as the Company's independent auditor, and Arthur Andersen LLP has served as the primary auditing firm for major subsidiaries within U S WEST Media Group, since 1984. In view of the Company's new targeted stock structure, the Company determined, following a recommendation of the Audit Committee, that it will be more efficient and effective for the Company to have a single firm perform the auditing function for the entire business.

During the Company's two most recent fiscal years ended December 31, 1995 and December 31, 1994, the reports of Coopers & Lybrand L.L.P. on the Company's financial statements contained no adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles. In addition, during such fiscal years and the interim periods thereafter: (1) no disagreements with Coopers & Lybrand L.L.P. have occurred on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Coopers & Lybrand L.L.P., would have caused it to make reference to the subject matter of the disagreement in connection with its report on the Company's financial statements; (2) no reportable events involving Coopers & Lybrand L.L.P. have occurred that must be disclosed under applicable securities laws; and (3) the Company has not consulted with Arthur Andersen LLP on items that concerned the application of accounting principles to a specific transaction, either completed or proposed, or on the type of audit opinion that might be rendered on the Company's financial statements.

PART III

ITEM 10. Directors and Executive Officers of the Registrant.

The information required by this item with respect to executive officers is set forth in Part I, page 8, under the caption "Executive Officers of U S WEST."

The information required by this item with respect to Directors is included in the U S WEST definitive Proxy Statement dated April 8, 1996 ("Proxy Statement") under "Election of Directors" on pages 4 through 6 and is incorporated herein by reference.

ITEM 11. Executive Compensation.

The information required by this item is included in the Proxy Statement under "Executive Compensation" on pages 8 through 20 and "Compensation of Directors" on pages 3 and 4 and is incorporated herein by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management.

The information required by this item is included in the Proxy Statement under "Securities Owned by Management" on page 4 and is incorporated herein by reference.

ITEM 13. Certain Relationships and Related Transactions.

Not applicable.

PART IV**ITEM 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.**

(a) Documents filed as part of this report:

	Page Number
(1) — Report of Independent Accountants	B-27
(2) — Consolidated Financial Statements:	
Consolidated Statements of Operations — for the years ended December 31, 1995, 1994 and 1993	B-29 through B-30
Consolidated Balance Sheets as of December 31, 1995 and 1994	B-31
Consolidated Statements of Cash Flows — for the years ended December 31, 1995, 1994 and 1993	B-32
Notes to Consolidated Financial Statements	B-33 through B-63
(3) — Consolidated Financial Statement Schedule:	
Report of Independent Accountants	—
II — Valuation and Qualifying Accounts	S-1
(4) — U S WEST Communications Group Combined Financial Statements:	
Report of Independent Accountants	C-16
Combined Statements of Operations — for the years ended December 31, 1995, 1994 and 1993	C-17
Combined Balance Sheets as of December 31, 1995 and 1994 .	C-18
Combined Statements of Cash Flows — for the years ended December 31, 1995, 1994 and 1993	C-19
Notes to the Combined Financial Statements	C-20 through C-38
(5) — U S WEST Media Group Combined Financial Statements:	
Report of Independent Accountants	D-22
Combined Statements of Operations — for the years ended December 31, 1995, 1994 and 1993	D-23
Combined Balance Sheets as of December 31, 1995 and 1994 .	D-24
Combined Statements of Cash Flows — for the years ended December 31, 1995, 1994 and 1993	D-25
Notes to the Combined Financial Statements	D-26 through D-55

Financial statement schedules other than those listed above have been omitted because the required information is contained in the financial statements and notes thereto, or because such schedules are not required or applicable.

(b) Reports on Form 8-K:

U S WEST filed the following reports on Form 8-K during the fourth quarter of 1995:

(i) report dated October 6, 1995, reporting the resignation of Richard B. Cheney from the U S WEST board of directors and filing a Form of Underwriting Agreement and a Form of Note concerning the 6¼% Notes due October 1, 2005, issued by U S WEST Capital Funding, Inc.;

(ii) report dated October 27, 1995, relating to a release of earnings for the period ended September 30, 1995, reporting a change in U S WEST's certifying accountant, and filing a Form of Note, a Form of Distribution Agreement, a Form of Fixed-Rate Medium-Term Note, and Form of Floating Rate Medium-Term Note concerning the U S WEST Capital Funding, Inc. 6.31% Notes due November 1, 2005, unconditionally guaranteed as to payment of principal and interest by U S WEST, Inc.; and

(iii) report dated November 2, 1995, filing a Form of Fixed Rate Global Note and a Form of Floating Rate Global Note concerning the \$500,000,000 U S WEST Capital Funding, Inc. Medium-Term Notes due nine months or more from the date of issue, unconditionally guaranteed as to payment of principal, premium, if any, and interest, by U S WEST, Inc.

(c) Exhibits:

Exhibits identified in parentheses below, on file with the Securities and Exchange Commission ("SEC"), are incorporated herein by reference as exhibits hereto.

Exhibit
Number

- (3a) — Restated Certificate of Incorporation of U S WEST, Inc. (originally incorporated May 12, 1995 under the same name) executed October 31, 1995 (Annex II to Registration Statement No. 33-59315).
- 3b — Bylaws of U S WEST, Inc. as amended March 15, 1996.
- (4a) — Form of Amended and Restated Rights Agreement between U S WEST, Inc. and State Street Bank and Trust Company, as Rights Agent (Exhibit 4-A to Registration Statement No. 33-59315)
- 4b — No instrument which defines the rights of holders of long and intermediate term debt of U S WEST, Inc. and all of its subsidiaries is filed herewith pursuant to Regulation S-K, Item 601(b)(4)(iii)(A). Pursuant to this regulation, the Registrant hereby agrees to furnish a copy of any such instrument to the SEC upon request.
- (10a) — Reorganization and Divestiture Agreement dated as of November 1, 1983, between American Telephone and Telegraph Company and its affiliates, U S WEST, Inc., The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, Pacific Northwest Bell Telephone Company and NewVector Communications, Inc. (Exhibit 10a to Form 10-K, date of report March 8, 1984, File No. 1-3501).
- (10b) — Shared Network Facilities Agreement dated as of January 1, 1984, between American Telephone and Telegraph Company, AT&T Communications of the Midwest, Inc., The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company (Exhibit 10b to Form 10-K, date of report March 8, 1984, File No. 1-3501).
- (10c) — Agreement Concerning Termination of the Standard Supply Contract effective December 31, 1983, between American Telephone and Telegraph Company, Western Electric Company, Incorporated, The Mountain States Telephone and Telegraph

Exhibit
Number

- Company, Northwestern Bell Telephone Company, Pacific Northwest Bell Telephone Company and Central Services Organization (Exhibit 10d to Form 10-K, date of report March 8, 1984, File No. 1-3501).
- (10d) — Agreement Concerning Certain Centrally Developed Computer Systems effective December 31, 1983, between American Telephone and Telegraph Company, Western Electric Company, Incorporated, The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, Pacific Northwest Bell Telephone Company and Central Services Organization (Exhibit 10e to Form 10-K, date of report March 8, 1984, File No. 1-3501).
- (10e) — Agreement Concerning Patents, Technical Information and Copyrights effective December 31, 1983, between American Telephone and Telegraph Company and U S WEST, Inc. (Exhibit 10f to Form 10-K, date of report March 8, 1984, File No. 1-3501).
- (10f) — AMPS Software Agreement effective December 31, 1983, between American Telephone and Telegraph Company and NewVector Communications, Inc. (Exhibit 10h to Form 10-K, date of report March 28, 1984, File No. 1-8611).
- (10g) — Agreement Concerning Contingent Liabilities, Tax Matters and Termination of Certain Agreements dated as of November 1, 1983, between American Telephone and Telegraph Company, U S WEST, Inc., The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, Pacific Northwest Bell Telephone Company and NewVector Communications, Inc. (Exhibit 10h to Form 10-K, date of report March 8, 1984, File No. 1-3501).
- (10h) — Agreement Concerning Trademarks, Trade Names and Service Marks effective December 31, 1983, between American Telephone and Telegraph Company, American Information Technologies Corporation, Bell Atlantic Corporation, BellSouth Corporation, Cincinnati Bell, Inc., NYNEX Corporation, Pacific Telesis Group, The Southern New England Telephone Company, Southwestern Bell Corporation and U S WEST, Inc. (Exhibit 10i to Form 10-K, date of report March 8, 1984, File No. 1-3501).
- (10i) — U S WEST, Inc. Short-Term Incentive Plan (Exhibit 10i to Form 10-K filed March 19, 1993, File No. 1-8611).
- (10j) — Financial Counseling Program for Officers of U S WEST (Exhibit 10-ee to Registration Statement No. 2-87861).
- (10k) — U S WEST Deferred Compensation Plan for Non-Employee Directors (Exhibit 10-ff to Registration Statement No. 2-87861).
- (10l) — Description of U S WEST Insurance Plan of Non-Employee Directors' Travel and Accident Insurance (Exhibit 10-gg to Registration Statement No. 2-87861).
- (10m) — Extract from the U S WEST Management Pension Plan regarding limitations on and payments of pension amounts which exceed the limitations contained in the Employee Retirement Income Security Act (Exhibit 10-hh to Registration Statement No. 2-87861).
- (10n) — U S WEST Executive Non-Qualified Pension Plan (Exhibit 10o to Form 10-K, date of report March 29, 1989, File No. 1-8611).
- (10o) — Amended U S WEST Deferred Compensation Plan (Annex X to Registration Statement No. 33-59315).
- (10p) — Description of U S WEST Directors' Retirement Benefit Plan (Exhibit 10p to Form SE filed March 5, 1992, File No. 1-8611).
- (10q) — Amended U S WEST 1994 Stock Plan (Annex IX to Registration Statement No. 33-59315).
- (10r) — Shareholders' Agreement dated as of January 1, 1988 among Ameritech Services, Inc., Bell Atlantic Management Services, Inc., BellSouth Services Incorporated, NYNEX

Exhibit
Number

- Service Company, Pacific Bell, Southwestern Bell Telephone Company, The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company (Exhibit 10r to Form SE filed March 5, 1992, File No. 1-8611).
- (10s) — U S WEST Senior Management Long Term Disability and Survivor Protection Plan (Exhibit 10-dd to Registration Statement No. 2-87861).
 - (10t) — U S WEST Mid-Career Pension Plan (Exhibit 10u to Form 10-K, date of report March 29, 1989, File No. 1-8611).
 - 10u — Form of U S WEST, Inc. Non-Qualified Stock Option Agreement.
 - 10v — Form of U S WEST, Inc. Restricted Stock Agreement.
 - (10w) — Employment letter from Richard D. McCormick to Charles P. Russ, III dated May 11, 1992 (Exhibit 10w to Form 10-K, date of report March 7, 1995).
 - (10x) — Admission Agreement dated as of May 16, 1993 between Time Warner Entertainment Company, L.P. and U S WEST, Inc. (Exhibit 10 to Form 8-K filed May 24, 1993).
 - 10y — Form of U S WEST, Inc. Executive Change of Control Agreement.
 - 10z — Form of Change of Control Agreement for Chief Executive Officer.
 - 10aa — Form of Group Executive Change of Control Agreement.
 - 10ab — Form of Executive Severance Agreement.
 - (10ac) — U S WEST, Inc. Executive Long-Term Incentive Plan (Exhibit 10ad to Form 10-K, date of report March 7, 1995).
 - (10ad) — U S WEST, Inc. Executive Short-Term Incentive Plan (Exhibit 10ae to Form 10-K, date of report March 7, 1995).
 - 10ae — Agreement and Plan of Merger between U S WEST, Inc. and Continental Cablevision Inc., dated February 27, 1996.
 - 10af — Stockholders' Agreement among certain stockholders of Continental Cablevision, Inc. and U S WEST, Inc. dated February 27, 1996.
 - 11 — Statement Re Computation of Per Share Earnings.
 - 12 — Computation of Ratio of Earnings to Fixed Charges of U S WEST, Inc. and U S WEST Financial Services, Inc.
 - 21 — Subsidiaries of U S WEST, Inc.
 - 23 — Consent of Independent Accountants.
 - 24 — Powers of Attorney.
 - 27 — Financial Data Schedule.
 - 99 — Annual Report on Form 11-K for the U S WEST Savings Plan/ESOP for the year ended December 31, 1995, to be filed by amendment.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Englewood, State of Colorado, on March 28, 1996.

U F WEST, Inc.

By: /s/ JAMES T. ANDERSON

James T. Anderson
*Acting Executive Vice President and
Chief Financial Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Principal Executive Officer:

/s/ Richard D. McCormick*

Chairman of the Board, President and Chief
Executive Officer

Principal Financial Officer:

/s/ James T. Anderson

Acting Executive Vice President and Chief
Financial Officer

Directors:

/s/ Remedios Diaz-Oliver*

/s/ Grant A. Dove*

/s/ Allan D. Gilmour*

/s/ Pierson M. Grieve*

/s/ Shirley M. Hufstedler*

/s/ Allen F. Jacobson*

/s/ Richard D. McCormick*

/s/ Marilyn C. Nelson*

/s/ Frank Popoff*

/s/ Jerry O. Williams*

*By /s/ JAMES T. ANDERSON

James T. Anderson
(for himself and as Attorney-in-Fact)

Dated March 28, 1996

INDEPENDENT ACCOUNTANTS' REPORT

Our report on the consolidated financial statements of U S WEST, Inc., which includes an explanatory paragraph regarding the discontinuance of accounting for the operations of U S WEST Communications, Inc. in accordance with Statement of Financial Accounting Standard No. 71, "Accounting for the Effects of Certain Types of Regulation," in 1993, is included on page B-45 of this Form 10-K. In connection with our audits of such consolidated financial statements, we have also audited the related consolidated financial statement schedule listed in the index on page S-1 of this Form 10-K for the years ended December 31, 1995, 1994 and 1993.

In our opinion, the consolidated financial statement schedules referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information required to be included therein.

COOPERS & LYBRAND L.L.P.
Denver, Colorado
February 12, 1996

U S WEST, INC.

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
(Dollars in millions)

	Balance at beginning of period	Charged to expense	Charged to other accounts	Deductions	Balance at end of period
ALLOWANCE FOR CREDIT LOSSES					
Year 1995	\$ 62	\$ 122 ^a	\$ 13	\$109 ^b	\$ 88
Year 1994	54	91 ^a	3	86 ^b	62
Year 1993	59	83 ^a	1	89 ^b	54
RESERVES RELATED TO 1993 BUSINESS RESTRUCTURING, INCLUDING FORCE AND FACILITY CONSOLIDATION					
Year 1995	702	—	—	334	368
Year 1994	935	—	—	233	702
Year 1993	—	1,000	—	65	935
RESERVES RELATED TO 1991 BUSINESS RESTRUCTURING, INCLUDING FORCE REDUCTIONS AND THE WRITE OFF OF CERTAIN INTANGIBLE ASSETS					
Year 1995	—	—	—	—	—
Year 1994	95	—	—	95	—
Year 1993	215	—	—	120	95
CAPITAL ASSETS SEGMENT: REAL ESTATE VALUATION ALLOWANCE AND 1993 PROVISION FOR LOSS ON DISPOSAL OF THE CAPITAL ASSETS SEGMENT					
Year 1995	119	—	—	49	70
Year 1994	336	—	—	217	119
Year 1993	402	120 ^c	—	186	336

Note: Certain reclassifications within the schedule have been made to conform to the current year presentation.

- ^a Does not include amounts charged directly to expense. These amounts were \$6, \$10 and \$10 for 1995, 1994 and 1993, respectively.
- ^b Represents credit losses written off during the period, less collection of amounts previously written off.
- ^c Provision for estimated loss on disposal of the capital assets segment of \$100 and an additional provision of \$20 to reflect the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates.

U S WEST, INC.
FINANCIAL HIGHLIGHTS

	Year Ended December 31,				
	1995	1994	1993	1992	1991
	Dollars in millions (except per share amounts)				
Sales and other revenues	\$11,746	\$10,953	\$10,294	\$ 9,823	\$ 9,528
Income from continuing operations ¹	1,329	1,426	476	1076	840
Net income (loss) ²	1,317	1,426	(2,806)	(614)	553
Total assets	25,071	23,204	20,680	23,461	23,375
Total debt ³	8,855	7,938	7,199	5,430	5,969
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely Company-guaranteed debentures	600	—	—	—	—
Preferred stock subject to mandatory redemption	51	51	—	—	—
Shareowners' equity	7,948	7,382	5,861	8,268	9,587
Earnings per common share (continuing operations) ^{1,4}	—	3.14	1.13	2.61	2.09
Earnings (loss) per common share ^{1,4}	—	3.14	(6.69)	(1.49)	1.38
Weighted average common shares outstanding (thousands) ⁴	—	453,316	419,365	412,518	401,332
Dividends per common share ⁴	—	\$ 2.14	\$ 2.14	\$ 2.12	\$ 2.08
Number of common shareowners ⁴	—	816,099	836,328	867,773	899,092
Return on common shareowners' equity ⁵	17.2%	21.6%	—	14.4%	5.7%
Percentage of debt to total capital ³	50.7%	51.6%	55.1%	39.6%	38.4%
Capital expenditures ³	\$ 3,140	\$ 2,820	\$ 2,441	\$ 2,554	\$ 2,425
Employees	61,047	61,505	60,778	63,707	65,829
PRO FORMA INFORMATION —					
COMMUNICATIONS GROUP: ⁴					
Earnings per common share	\$ 2.50				
Dividends per common share	2.14				
Average common shares outstanding (thousands)	470,716				
Number of common shareowners	775,125*				
PRO FORMA INFORMATION —					
MEDIA GROUP: ⁴					
Earnings per common share	\$ 0.29				
Average common shares outstanding (thousands)	470,549				
Number of common shareowners	770,346*				

* Actual

¹ 1995 income from continuing operations includes a gain of \$95 (\$0.20 per Media share) from the merger of U S WEST's joint venture interest in TeleWest plc with SBC CableComms (UK), a gain of \$85 (\$0.18 per Communications share) on the sales of certain rural telephone exchanges and \$17 (\$0.01 per Communications share and \$0.02 per Media share) for expenses associated with the November 1, 1995 recapitalization. 1994 income from continuing operations includes a gain of \$105 (\$0.23 per share) on the partial sale of U S WEST's joint venture interest in TeleWest plc, a gain of \$41 (\$0.09 per share) on the sale of the Company's paging operations and a gain of \$51 (\$0.11 per share) on the sales of certain rural telephone exchanges. 1993 income from continuing operations was reduced by a restructuring charge of \$610 (\$1.46 per share) and a charge of \$54 (\$0.13 per share) for the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates. 1991 income from continuing operations was reduced by a restructuring charge of \$230 (\$0.57 per share).

² 1995 net income was reduced by extraordinary items of \$12 (\$0.02 per Communications share and \$0.01 per Media share) for the early extinguishment of debt. 1993 net income was reduced by extraordinary charges of \$3,123 (\$7.45 per share) for the discontinuance of Statement of Financial Accounting Standards ("SFAS") No. 71 and \$77 (\$0.18 per share) for the early extinguishment of debt. 1993 net income also includes a charge of \$120 (\$0.28 per share) for U S WEST's decision to discontinue the operations of its

capital assets segment. 1992 net income includes a charge of \$1,793 (\$4.35 per share) for the cumulative effect of change in accounting principles. Discontinued operations provided net income (loss) of \$38 (\$0.09 per share), \$103 (\$0.25 per share) and \$(287) (\$0.71 per share) in 1993, 1992 and 1991, respectively.

- ³ Capital expenditures, debt and the percentage of debt to total capital excludes the capital assets segment, which has been discontinued and is held for sale.
- ⁴ Effective November 1, 1995, each share of U S WEST, Inc. common stock was converted into one share each of U S WEST Communications Group common stock and U S WEST Media Group common stock. Earnings per common share have been presented on a pro forma basis to reflect the two classes of stock as if they had been outstanding since January 1, 1995. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST, Inc.
- ⁵ 1995 return on shareowners' equity is based on income before extraordinary items. 1993 return on shareowners' equity is not presented. Return on shareowners' equity for fourth-quarter 1993 was 19.9 percent based on income from continuing operations. 1992 return on shareowners' equity is based on income before the cumulative effect of change in accounting principles.

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(Dollars in millions, except per share amounts)

The Recapitalization Plan

On October 31, 1995, the shareholders of U S WEST, Inc., a Colorado corporation ("U S WEST Colorado"), voted to approve a proposal (the "Recapitalization Plan") adopted by the Board of Directors to reincorporate in Delaware and create two classes of common stock. Under the Recapitalization Plan, shareholders approved an Agreement and Plan of Merger between U S WEST Colorado and U S WEST, Inc., a Delaware corporation ("U S WEST" or the "Company"), pursuant to which U S WEST continues as the surviving corporation. In connection with the merger, the Certificate of Incorporation of U S WEST has been amended and restated to designate two classes of common stock of U S WEST, one class of which is authorized as U S WEST Communications Group Common Stock ("Communications Stock") and the other class which is authorized as U S WEST Media Group Common Stock ("Media Stock").

The Communications Stock and Media Stock provide shareholders with two distinct securities that are intended to reflect separately the communications businesses of U S WEST (the "Communications Group") and the multimedia businesses of U S WEST (the "Media Group" and, together with the Communications Group, the "Groups").

The Communications Group

The Communications Group primarily provides regulated communications services to more than 25 million residential and business customers in the Communications Group Region (the "Region"). The Region includes the states of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming. Services offered by the Communications Group include local telephone services, exchange access services (which connect customers to the facilities of carriers, including long-distance providers and wireless operators), and long-distance services within Local Access and Transport Areas ("LATAs") in the Region. The Communications Group provides other products and services, including custom calling features, voice messaging, caller identification, high-speed data applications, customer premises equipment and certain communications services to business customers and governmental agencies both inside and outside the Region. The Telecommunications Act of 1996, enacted into law on February 8, 1996, will dramatically alter the competitive landscape of the telecommunications industry and will further change the nature of services the Communications Group will offer. These future service offerings include interLATA long-distance service, wireless services, cable television and interconnection services provided to competing providers of local services.

The Media Group

The Media Group is comprised of: (i) cable and telecommunications network businesses outside of the Communications Group Region and internationally, (ii) domestic and international wireless communications network businesses and (iii) domestic and international directory and information services businesses.

The Media Group's cable and telecommunications businesses include U S WEST's investment in Time Warner Entertainment Company L.P. ("TWE" or "Time Warner Entertainment"), the second largest provider of cable television services in the United States, its cable systems in the Atlanta, Georgia metropolitan area ("the Atlanta Systems"), and international cable and telecommunications investments, including TeleWest plc ("TeleWest"). In 1995, TeleWest Communications plc merged its cable television and telephony interests with SBC CableComms (UK) to form TeleWest, the largest provider of combined cable and telecommunications services in the United Kingdom. The Media Group also owns interests in cable and/or telecommunications properties in the Netherlands, Sweden, Norway, Hungary, Czech Republic, Malaysia and Indonesia.

The Media Group provides domestic wireless communications services, including cellular services, in 13 western and midwestern states to a rapidly growing customer base. The Media Group also provides

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wireless communications services internationally through its Mercury One 2 One ("One 2 One") joint venture, the world's first personal communications service located in the United Kingdom. The Media Group also owns interests in wireless properties in Hungary, the Czech and Slovak Republics, Russia, Malaysia, India and Poland.

The Media Group's directory and information services businesses develop and package content and information services, including telephone directories, database marketing and other interactive services in domestic and international markets. The Media Group publishes more than 300 White and Yellow Pages directories in 14 western and midwestern states and nearly 200 directories in the United Kingdom and Poland. The Media Group also has a 50 percent interest in Listel, Brazil's largest telephone directory publisher.

AirTouch Merger

During 1994, U S WEST signed a definitive agreement with AirTouch Communications to combine their domestic cellular assets. The initial equity ownership of this cellular joint venture will be approximately 70 percent AirTouch and approximately 30 percent U S WEST. The combination will take place in two phases. During Phase I, which U S WEST entered effective November 1, 1995, the two companies are operating their cellular properties separately. A Wireless Management Company (the "WMC") has been formed and is providing centralized services to both companies on a contract basis. In Phase II, AirTouch and U S WEST will contribute their domestic cellular assets to the WMC. In this phase, the Company will reflect its share of the combined operating results of the WMC using the equity method of accounting. The recent passage of the Telecommunications Act of 1996 has removed significant regulatory barriers to completion of Phase II of the business combination. U S WEST expects that Phase II closing could take place by the end of 1996 or early 1997.

Personal Communications Services

U S WEST partnered with AirTouch Communications, Bell Atlantic and NYNEX to form a strategic national wireless alliance and formed a venture to provide personal communications services ("PCS"). This venture, PCS PrimeCo, purchased 11 licenses in the Federal Communication Commission's (the "FCC") PCS auction, covering 57 million people in Chicago, Dallas, Honolulu, Houston, Jacksonville, Miami, Milwaukee, New Orleans, Richmond, San Antonio and Tampa.

Subsequent Event

On February 27, 1996, the Company announced a definitive agreement to merge with Continental Cablevision, Inc. ("Continental"). Continental, the nation's third-largest cable operator, serves 4.2 million domestic customers, passes more than seven million domestic homes and holds significant other domestic and international properties. U S WEST will purchase all of Continental's stock for approximately \$5.3 billion and will assume Continental's debt and other obligations, which amount to approximately \$5.5 billion. Consideration for the \$5.3 billion in equity will consist of approximately \$1 billion in U S WEST preferred stock, convertible to Media Stock; and, at U S WEST's option, between \$1 billion and \$1.5 billion in cash, and \$2.8 billion to \$3.3 billion in shares of Media Stock. The transaction, which is expected to close in the fourth quarter of 1996, is subject to a number of conditions and approvals, including approvals from Continental shareholders and local franchising and government authorities.

Continental's 4.2 million domestic customers are highly clustered in five large markets — New England, California, Chicago, Michigan, Ohio and Florida. Upon closing, U S WEST will own or share management of cable systems in 60 of the top 100 American markets and serve nearly one of every three cable households. In addition, Continental has interests in cable properties in Australia, Argentina and Singapore; a 10 percent interest in PRIMESTAR (a direct broadcast satellite service); telephone access businesses in Florida and Virginia; and interests in programming that include Turner Broadcasting System, E! Entertainment Television, the Golf Channel, and the Food Channel.

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Results of Operations — 1995 Compared with 1994

Comparative details of income from continuing operations for 1995 and 1994 follow:

	Percent Ownership	1995	1994	Increase (Decrease)	
				\$	%
Communications Group: ¹					
U S WEST Communications, Inc.	100	\$1,219	\$1,175	\$ 44	3.7
Other operations	100	(35)	(25)	(10)	(40.0)
Total Communications Group		1,184	1,150	34	3.0
Media Group: ²					
Consolidated:					
Directory and information services	100	240	247	(7)	(2.8)
Wireless communications	100	62	67	(5)	(7.5)
Cable and telecommunications	100	(7)	(2)	(5)	—
Unconsolidated equity investments:					
Time Warner Entertainment ³	25.5	(32)	(30)	(2)	(6.7)
TeleWest	26.8	53	76	(23)	(30.3)
One 2 One	50.0	(81)	(58)	(23)	(40.0)
Other ⁴		(90)	(24)	(66)	—
Total Media Group		145	276	(131)	(47.5)
Income from continuing operations		<u>\$1,329</u>	<u>\$1,426</u>	<u>\$ (97)</u>	<u>(6.8)</u>
Pro forma earnings per common share from continuing operations: ⁵					
Communications Stock		\$ 2.52	—		
Media Stock		0.30	—		
Earnings per common U S WEST share ⁵		—	\$ 3.14		

¹ 1995 Communications Group income from continuing operations includes a gain of \$85 (\$0.18 per Communications share) on the sales of certain rural telephone exchanges and \$8 (\$0.01 per Communications share) for costs associated with the Recapitalization Plan. 1994 Communications Group income from continuing operations includes a gain of \$51 (\$0.11 per U S WEST share) on the sales of certain rural telephone exchanges.

² 1995 Media Group income from continuing operations includes a gain of \$95 (\$0.20 per Media share) from the merger of TeleWest with SBC CableComms (UK) and \$9 (\$0.02 per Media share) for costs associated with the Recapitalization Plan. 1994 Media Group income from continuing operations includes a gain of \$105 (\$0.23 per U S WEST share) from the partial sale of the Company's joint venture interest in TeleWest and a gain of \$41 (\$0.09 per U S WEST share) from the sale of the Company's paging operations.

³ Percent ownership represents pro-rata priority capital and residual equity interests.

⁴ Primarily includes interest expense and divisional expenses associated with equity investments.

⁵ Earnings per common share from continuing operations have been presented on a pro forma basis as if the Communications Stock and Media Stock had been outstanding since January 1, 1995. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST, Inc.

Communications Group

The Communications Group's 1995 income from continuing operations, excluding the effects of one-time items described in Note 1 to the table above, was \$1,107, an increase of \$8, or 0.7 percent, compared with \$1,099 in 1994, also excluding the effects of one-time items. Total revenue growth of 3.4 percent was largely offset by significantly higher costs incurred to improve customer service and meet greater than

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expected business growth. Net income growth will also be limited in 1996 while the Communications Group continues to commit significant resources to meet customer service objectives and broaden its range of product and service offerings.

Excluding the effects of one-time items described in Note 1 to the table above, pro forma earnings per Communications Group common share from continuing operations were \$2.35 in 1995.

During 1995, the Communications Group refinanced \$145 of long-term debt. Expenses associated with the refinancings resulted in extraordinary charges of \$8, net of tax benefits of \$5.

Media Group

During 1995, income from continuing operations declined 55 percent, to \$59, excluding the effects of the one-time items described in Note 2 to the table above. The decline is due primarily to higher equity losses related to international growth initiatives and increased amortization and interest expense. Interest expense increases relate to debt issued in connection with the Atlanta Systems acquisition and expansion of international investments. The declines were partially offset by improvement in the domestic cellular and Yellow Pages operations.

Excluding the effects of one-time items described in Note 2 to the table above, pro forma earnings per Media Group common share from continuing operations were \$0.12 in 1995.

During 1995, the Media Group incurred an extraordinary loss of \$4, net of a tax benefit of \$2, related to the early retirement of debt by TWE.

Sales and Other Revenues

An analysis of the change in U S WEST's consolidated sales and other revenues follows:

	1995	1994	Increase	
			\$	%
Communications Group	\$ 9,484	\$ 9,176	\$308	3.4
Media Group	2,374	1,908	466	24.4
Intergroup eliminations	(112)	(131)	19	14.5
Total	<u>\$11,746</u>	<u>\$10,953</u>	<u>\$793</u>	<u>7.2</u>

Communications Group Operating Revenues

An analysis of changes in Communications Group operating revenues follows:

	1995	1994	Price Changes	Lower (Higher) Refunds	Demand	Other	Increase (Decrease)	
							\$	%
Local service	\$4,344	\$4,067	\$ 35	\$(10)	\$273	\$(21)	\$ 277	6.8
Interstate access	2,378	2,269	(66)	(2)	191	(14)	109	4.8
Intrastate access	747	729	(31)	8	36	5	18	2.5
Long-distance network	1,189	1,329	(23)	(1)	(54)	(62)	(140)	(10.5)
Other services	826	782	—	—	—	44	44	5.6
Total Communications Group	<u>\$9,484</u>	<u>\$9,176</u>	<u>\$(85)</u>	<u>\$ (5)</u>	<u>\$446</u>	<u>\$(48)</u>	<u>\$ 308</u>	<u>3.4</u>

Approximately 97 percent of the revenues of the Communications Group are attributable to the operations of U S WEST Communications, Inc. ("U S WEST Communications"), of which approximately 59 percent are derived from the states of Arizona, Colorado, Minnesota and Washington. Approximately 29 percent of the access lines in service are devoted to providing services to business customers. The access

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line growth rate for business customers, who tend to be heavier users of the network, has consistently exceeded the growth rate of residential customers. During 1995, business access lines grew 5.4 percent while residential access lines increased 2.8 percent.

The primary factors that influence changes in revenues are customer demand for products and services, price changes (including those related to regulatory proceeding) and refunds. During 1995, revenues from new product and service offerings were \$534, an increase of 58 percent compared with 1994. These revenues primarily consist of caller identification, voice messaging, call waiting and high-speed data network transmission services.

Local service revenues include local telephone exchange, local private line and public telephone services. In 1995, local service revenues increased principally as a result of higher demand for new and existing services, and demand for second lines. Local service revenues from new services increased \$92, or 78 percent, compared with 1994. Reported total access lines increased 511,000, or 3.6 percent, of which 161,000 were second lines. Second line installations increased 25.5 percent compared with 1994. Access line growth was 4.2 percent adjusted for the sale of approximately 95,000 rural telephone access lines during the last 12 months.

Access charges are collected primarily from interexchange carriers for their use of the local exchange network. For interstate access services there is also a fee collected directly from telephone customers. Approximately 33 percent of access revenues and 11 percent of total revenues are derived from providing access services to AT&T.

Higher revenues from interstate access services were driven by an increase of 9.2 percent in interstate billed access minutes of use. The increased business volume more than offset the effects of price reductions and refunds. The Communications Group reduced prices for interstate access services in both 1995 and 1994 as a result of Federal Communications Commission ("FCC") orders and competitive pressures. Intrastate access revenues increased primarily due to the impact of increased business volume and multiple toll carrier plans, partially offset by the impact of rate changes.

Long-distance revenues are derived from calls made within the LATA boundaries of the Region. During 1995 and 1994, long-distance revenues were impacted by the implementation of multiple toll carrier plans ("MTCPs") in Oregon and Washington in May and July 1994, respectively. The MTCPs essentially allow independent telephone companies to act as toll carriers. The 1995 impact of the MTCPs was long-distance revenue losses of \$62, partially offset by increases in intrastate access revenues of \$12 and decreases in other operating expenses (i.e. access expense) of \$42 compared with 1994. These regulatory arrangements have decreased annual net income by approximately \$10. Similar changes in other states could occur, though the impact on 1996 net income would not be material.

Excluding the effects of the MTCPs, long-distance revenues decreased by 5.9 percent in 1995, primarily due to the effects of competition and rate reductions. Long-distance revenues have declined over the last several years as customers have migrated to interexchange carriers that have the ability to offer these services on both an intraLATA and interLATA basis. A portion of revenues lost to competition, however, is recovered through access charges paid by the interexchange carriers. Erosion in long-distance revenue will continue due to the loss of 1+ dialing in Minnesota, effective in February 1996, and in Arizona, effective in April 1996. Annual long-distance revenue losses could approximate \$30 as a result of these changes. The Communications Group is partially mitigating competitive losses through competitive pricing of intraLATA long-distance services.

Revenues from other services primarily consist of billing and collection services provided to interexchange carriers, voice messaging services, high-speed data transmission services, sales of service agreements related to inside wiring and the provision of customer premises equipment.

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During 1995, revenues from other services increased \$44, primarily as a result of continued market penetration in voice messaging services and sales of high-speed data transmission services. Revenue growth from other services is also attributable to maintenance contracts for inside wire services and a large contract related to a wire installation project. These increases were partially offset by a decrease of \$20 in revenues from billing and collection services. The decline in billing and collection revenues is primarily related to lower contract prices and a decrease in the volume of services provided to AT&T.

Media Group Sales and Other Revenues

An analysis of the Media Group's sales and other revenues follows:

	1995	1994	Increase (Decrease)	
			\$	%
Directory and information services:				
Domestic	\$1,058	\$ 997	\$ 61	6.1
International	122	78	44	56.4
	1,180	1,075	105	9.8
Wireless communications:				
Cellular service	845	633	212	33.5
Cellular equipment	96	120	(24)	(20.0)
Paging sales and service ¹	—	28	(28)	—
	941	781	160	20.5
Cable and telecommunications	215	18	197	—
Other	38	34	4	11.8
Total Media Group	\$2,374	\$1,908	\$466	24.4

¹ The Company's paging business was sold in June 1994. Results reflect operations for the six months ending June 30, 1994.

Media Group sales and other revenues increased 15 percent, to \$2,374 in 1995, excluding the effects of the 1994 Atlanta Systems acquisition and paging sale. The increase was primarily due to strong growth in cellular service revenue.

Directory and Information Services Revenues related to Yellow Pages directory advertising increased 6.4 percent to \$1,026 in 1995, due to price increases of 4.5 percent, higher revenue per advertiser and an increase in Yellow Pages advertising volume.

International directory publishing revenues increased \$44 in 1995, primarily due to U S WEST's May 1994 purchase of Thomson Directories in the United Kingdom. The remaining increase is due to an increase in advertisers and revenue per advertiser.

Wireless Communications Cellular service revenues increased 34 percent, to \$845 in 1995, due to a 51 percent increase in subscribers during the last twelve months (with 20 percent of the additions occurring in December), partially offset by a 13 percent drop in average revenue per subscriber to \$60.00 per month. The increase in subscribers relates to continued growth in demand for wireless services. The Media Group anticipates continued growth in its subscriber base, although at slightly decreased rates.

New distribution programs are being developed which increase availability of cellular products and simplify the cellular service activation process. These programs have contributed to the shift in the customer base from businesses to consumers. This shift, combined with competitive pressures on pricing, will cause the average revenue per subscriber to continue to decline.

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Cellular equipment revenues decreased 20 percent, to \$96 in 1995, as a result of lower cellular equipment costs. These lower equipment costs are being passed on to retailers and to new customers. The Media Group expects this trend to continue in 1996 as the cost of equipment continues to decline and as penetration into the consumer market increases.

Revenues related to the paging sales and service operations, which were sold in 1994, approximated \$28 in 1994.

Cable and Telecommunications Domestic cable and telecommunications revenues increased \$197 in 1995, due to the December 1994 acquisition of the Atlanta Systems.

Costs and Expenses

	1995	1994	Increase (Decrease)	
			\$	%
Employee-related expenses	\$4,071	\$3,779	\$292	7.7
Other operating expenses	2,323	2,203	120	5.4
Taxes other than income taxes	416	412	4	1.0
Depreciation and amortization	2,291	2,052	239	11.6
Interest expense	527	442	85	19.2
Equity losses in unconsolidated ventures	207	121	86	71.1
Other income (expense) — net	(36)	25	(61)	—

Employee-Related Expenses

Employee-related expenses include basic salaries and wages, overtime, benefits (including pension and health care), payroll taxes and contract labor. During 1995, improving customer service was the Communications Group's first priority. Overtime payments and contract labor expense associated with customer service initiatives at the Communications Group increased employee-related costs by approximately \$168 compared with 1994. Expenses related to the addition of approximately 1,700 employees in 1995 and 1,000 employees in 1994 at the Communications Group also increased employee-related costs. These expenses were incurred to handle the higher than anticipated volume of business and to meet new business opportunities. Partially offsetting these increases was a \$34 reduction in the accrual for postretirement benefits, a \$22 decrease in travel expense and reduced expenses related to employee separations under reengineering and streamlining initiatives. The Communications Group will continue to add employees to address customer service issues and growth in the core business. Costs related to these work-force additions will partially offset the benefits of employee separations achieved through restructuring. (See "Restructuring Charge.")

Employee-related expenses also increased due to the 1994 purchases of the Atlanta Systems and Thomson Directories, and growth initiatives in the directory and information services segment.

Other Operating Expenses

Other operating expenses include access charges (incurred for the routing of long-distance traffic through the facilities of independent companies), network software expenses, wireless marketing and operating costs, and marketing and related costs associated with publishing activities. The increase in other operating expenses is primarily attributed to the Media Group's 1994 purchases of the Atlanta Systems and Thomson Directories and expansion of the cellular customer base.

During 1995, other operating expenses decreased at the Communications Group primarily due to the effects of the multiple toll carrier plans and a reduction in expenses related to project funding at Bell Communications Research, Inc. ("Bellcore"), of which U S WEST Communications has a one-seventh ownership interest. These decreases in other operating expenses were partially offset by increases in costs associated with increased sales of products and services, including bad debt expense.

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Taxes Other Than Income Taxes

Taxes other than income taxes, which consist primarily of property taxes, were relatively flat compared with 1994. Increased taxes associated with the domestic cellular operations were offset by lower taxes at the Communications Group. Lower taxes at the Communications Group were primarily due to favorable property tax valuations and mill levies as compared with 1994. As a result of these valuations and mill levies, 1995 fourth-quarter accruals at the Communications Group decreased by \$20 compared with fourth-quarter 1994.

Depreciation and Amortization

Increased depreciation and amortization expense was attributable to the effects of a higher depreciable asset base at the Communications Group, expansion of the Media Group's domestic cellular network and the purchase of the Atlanta Systems. These increases were partially offset by the effects of the sales of certain rural telephone exchanges at U S WEST Communications.

Interest Expense and Other

Interest expense increased primarily as a result of increased debt financing at the Communications Group, the December 1994 acquisition of the Atlanta Systems, new domestic and international investments and a reclassification of debt from net investment in assets held for sale. The average borrowing cost was 6.7 percent in 1995, compared with 6.6 percent in 1994. (See "Liquidity and Capital Resources.")

Equity losses increased \$86 in 1995, primarily due to costs related to the expansion of the network and additional financing costs at TeleWest and additional costs associated with the significant increase in customers at One 2 One. Start-up and other costs associated with new international cable and telecommunications investments primarily located in the Czech Republic and Malaysia contributed to the increase. These increased losses were partially offset by earnings in the European wireless operations. Losses related to domestic investments in TWE and PCS PrimeCo also increased. The Media Group expects the PCS partnership to experience several years of operating losses associated with the start-up phase of the PCS business.

The decrease in other income is largely attributable to \$17 of costs associated with the Recapitalization Plan in 1995, increased minority interest expense associated with domestic cellular operations and a 1994 gain on sale of nonstrategic operations.

Provision for Income Taxes

	1995	1994	(Decrease)	
			\$	%
Provision for income taxes	\$825	\$857	\$(32)	(3.7)
Effective tax rate	38.3	37.5	—	—

The increase in the effective tax rate reflects the impacts of goodwill amortization related to the acquisition of the Atlanta Systems, higher state and foreign income taxes, and expenses associated with the Recapitalization Plan. Additionally, a tax benefit was recorded in 1994, related to the sale of paging assets, which contributed to the increase in the effective tax rate. These impacts were partially offset by lower pretax income and the effects of a research and experimentation credit, and adjustments for prior periods.

Restructuring Charge

U S WEST's 1993 results reflected a \$1 billion restructuring charge (pretax). The related restructuring plan (the "Restructuring Plan") is designed to provide faster, more responsive customer services while reducing the costs of providing these services. As part of the Restructuring Plan, the Company is developing new systems and enhanced system functionality that will enable it to monitor networks to reduce the risk of service interruptions, activate telephone service on demand, rapidly design and engineer products and

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services for customers, and centralize its service centers. The Company has consolidated its 560 customer service centers at U S WEST Communications into 26 centers in 10 cities and plans on reducing its work force by approximately 10,000 employees. All service centers are operational and supported by new systems and enhanced system functionality.

The Restructuring Plan is expected to be substantially complete by the end of 1997. Implementation of the Restructuring Plan has been impacted by growth in the business and related service issues, new business opportunities, revisions to system delivery schedules and productivity issues caused by the major rearrangement of resources due to restructuring. These issues will continue to affect the timing of employee separations.

The Company estimates that full implementation of the 1993 Restructuring Plan will reduce employee-related expenses by approximately \$400 per year. The savings related to work-force reductions will be offset by the effects of inflation and a variety of other factors. These factors include costs related to the achievement of customer service objectives and increased demand for existing services. (See "Employee-Related Expenses.")

Following is a schedule of the costs included in the Restructuring Plan:

	1993 Actual	1994 Actual	1995 Actual	1996 Estimate	1997 Estimate	Total
Cash expenditures:						
Employee separation ¹	\$—	\$ 19	\$ 76	\$ 36	\$129	\$ 260
Systems development	—	127	145	128	—	400
Real estate	—	50	66	14	—	130
Relocation	—	21	24	20	15	80
Retraining and other	—	16	23	22	4	65
Total cash expenditures	—	233	334	220	148	935
Asset write-down	65	—	—	—	—	65
Total 1993 Restructuring Plan	65	233	334	220	148	1,000
Remaining 1991 plan employee costs ¹	—	56	—	—	—	56
Total	\$ 65	\$289	\$334	\$220	\$148	\$1,056

¹ Employee separation costs, including the balance of a 1991 restructuring reserve at December 31, 1993, aggregate \$316.

Employee separation costs include severance payments, health-care coverage and postemployment education benefits. Systems development costs include new systems and the application of enhanced system functionality to existing, single-purpose systems to provide integrated, end-to-end customer service. Real estate costs include preparation costs for the new service centers. The relocation and retraining costs are related to moving employees to the new service centers and retraining employees on the methods and systems required in the new, restructured mode of operation.

Employee Separation Under the Restructuring Plan, the Company anticipates the separation of 10,000 employees. Approximately 1,000 employees that were originally expected to relocate have chosen separation or other job assignments and have been replaced. This increased the number of employee separations to 10,000 from 9,000, and increased the estimated total cost for employee separations to \$316 from \$286, as compared with the original estimate. The \$30 cost associated with these additional employee separations was reclassified from relocation to the reserve for employee separations during 1995.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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Annual employee separations and employee-separation amounts under the Restructuring Plan follow:

	1994		1995		1996	1997	Total
	Estimate	Actual ¹	Estimate	Actual	Estimate ²	Estimate ²	
Employee separations:							
Managerial	1,061	497	612	682	202	1,357	2,738
Occupational	1,887	1,683	1,608	1,643	798	3,138	7,262
Total	<u>2,948</u>	<u>2,180</u>	<u>2,250</u>	<u>2,325</u>	<u>1,000</u>	<u>4,495</u>	<u>10,000</u>
	1994		1995		1996	1997	Total
	Estimate	Actual ¹	Estimate	Actual	Estimate ²	Estimate ²	
Employee separation amounts:							
Managerial	\$ 25	\$ 5	\$ 22	\$ 30	\$ 12	\$ 56	\$ 103
Occupational	15	14	54	46	24	73	157
Total	40	19	76	76	36	129	260
Remaining 1991 reserve	56	56	—	—	—	—	56
Total	<u>\$ 96</u>	<u>\$ 75</u>	<u>\$ 76</u>	<u>\$ 76</u>	<u>\$ 36</u>	<u>\$ 129</u>	<u>\$ 316</u>

¹ Includes the remaining employees and the separation amounts associated with the balance of a 1991 restructuring reserve at December 31, 1993.

² A significant number of the employee reductions originally scheduled for 1996 will be delayed while the Company focuses on overtime and contract-labor expenses. The Restructuring Plan is expected to be substantially complete by the end of 1997.

Compared with the original estimates, employee reduction and separation amounts shown above have been reduced by 1,600 employees and \$51 in 1996, and increased by 4,495 employees and \$129 in 1997.

Systems Development The existing information management systems were largely developed to support a monopoly environment. These systems were inadequate due to the effects of increased competition, new forms of regulation and changing technology that have driven consumer demand for products and services that can be delivered quickly, reliably and economically. The Company believes that improved customer service, delivered at lower cost, can be achieved by a combination of new systems and introducing new functionality to existing systems. This is a change from the initial strategy which placed more emphasis on the development of new systems.

The systems development program involves new systems and enhanced system functionality for systems that support the following core processes:

Service Delivery — to support service on demand for all products and services. These new systems and enhanced system functionality will permit customer calls to be directed to those service representatives who can meet their requirements. This process will provide enhanced information to the service representatives regarding the customer requests and the ability of the Communications Group to fulfill them.

Service Assurance — for performance monitoring from one location and remote testing in the new environment, including identification and resolution of faults prior to customer impact.

Capacity Provisioning — for integrated planning of future network capacity, including the installation of software controllable service components.

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Certain of the new systems and enhanced system functionality have been implemented in the service centers and have simplified the labor-intensive interfaces between systems processes in existence prior to the Restructuring Plan. Enhanced system functionality introduced under the Restructuring Plan since its inception includes the following:

- The ability to determine facilities' availability while the customer is placing an order;
- Automated engineering of central office facilities and automated updating of central office facilities' records;
- The ability to track the status of complex network design jobs from the customer's perspective; and
- Systems that accurately diagnose network problems and prepare repair packages to correct the problems identified.

The direct, incremental and nonrecurring costs of providing new systems and enhanced system functionality follow:

	1994		1995		1996	Total
	Estimate	Actual	Estimate	Actual	Estimate	
Service delivery	\$ 35	\$ 21	\$ 21	\$ 19	\$ 44	\$ 84
Service assurance	45	12	24	22	26	60
Capacity provisioning	17	57	92	85	42	184
All other	28	37	24	19	16	72
Total	<u>\$125</u>	<u>\$127</u>	<u>\$161</u>	<u>\$145</u>	<u>\$128</u>	<u>\$400</u>

Systems expenses charged to current operations consist of costs associated with the information management function, including planning, developing, testing and maintaining databases for general purpose computers, in addition to systems costs related to maintenance of telephone network applications. Other systems expenses are for administrative (i.e. general purpose) systems which include customer service, order entry, billing and collection, accounts payable, payroll, human resources and property records. Ongoing systems costs at U S WEST Communications comprised approximately six percent of total operating expenses in 1995, 1994 and 1993. The Company expects systems costs charged to current operations as a percent of total operating expenses to approximate the current level throughout 1996. Systems costs could increase relative to other operating costs as the business becomes more technology dependent.

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Progress Under the Restructuring Plan

Following is a reconciliation of restructuring reserve activity since December 1993:

	Reserve Balance 12/31/93	1994 Activity	Reserve Balance 12/31/94	1995 Activity	Change in Estimate	Reserve Balance 12/31/95
Employee separation:						
Managerial	\$ 80	\$ 5	\$ 75	\$ 30	\$ 23	\$ 68
Occupational	150	14	136	46	7	97
Total employee separation	230	19	211	76	30	165
Systems development:						
Service delivery	73	21	52	19	11	44
Service assurance	64	12	52	22	(4)	26
Capacity provisioning	179	57	122	85	5	42
All other	84	37	47	19	(12)	16
Total systems development	400	127	273	145	—	128
Real estate	130	50	80	66	—	14
Relocation	110	21	89	24	(30)	35
Retraining and other	65	16	49	23	—	26
Total 1993 Restructuring Plan	935	233	702	334	—	368
Remaining 1991 plan expenditures	56	56	—	—	—	—
Total	<u>\$991</u>	<u>\$289</u>	<u>\$702</u>	<u>\$334</u>	<u>\$—</u>	<u>\$368</u>
		1994 Separations	1995 Separations	Cumulative Separations At December 31, 1995		
Employee separations:						
Managerial		497	682		1,179	
Occupational		1,683	1,643		3,326	
Total		<u>2,180</u>	<u>2,325</u>		<u>4,505</u>	

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Results of Operations — 1994 Compared with 1993

Comparative details of income from continuing operations for 1994 and 1993 follow:

	Percent Ownership	1994	1993	Increase (Decrease) \$
Communications Group: ¹				
U S WEST Communications, Inc.	100	\$1,175	\$ 435	\$ 740
Other operations	100	(25)	(44)	19
Total Communications Group		1,150	391	759
Media Group: ²				
Consolidated:				
Directory and information services	100	247	220	27
Wireless communications	100	67	(43)	110
Cable and telecommunications	100	(2)	—	(2)
Unconsolidated equity investments:				
Time Warner Entertainment ³	25.5	(30)	(19)	(11)
TeleWest	37.8	76	(21)	97
One 2 One	50.0	(58)	(22)	(36)
Other ⁴		(24)	(30)	6
Total Media Group		276	85	191
Income from continuing operations		<u>\$1,426</u>	<u>\$ 476</u>	<u>\$ 950</u>
Earnings per common U S WEST share from continuing operations		\$ 3.14	\$1.13	\$2.01

¹ 1994 income from continuing operations includes a gain of \$51 (\$0.11 per share) on the sales of certain rural telephone exchanges. 1993 income from continuing operations was reduced by \$534 (\$1.28 per share) for a restructuring charge and \$54 (\$0.13 per share) for the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates.

² 1994 income from continuing operations includes a gain of \$105 (\$0.23 per share) on the partial sale of U S WEST's joint venture interest in TeleWest, and a gain of \$41 (\$0.09 per share) for the sale of the Company's paging operations. 1993 income from continuing operations was reduced by \$76 (\$0.18 per share) for a restructuring charge.

³ Percent ownership represents pro-rata priority capital and residual equity interests.

⁴ Primarily includes interest expense and divisional expenses associated with equity investments.

Communications Group

The Communications Group's 1994 income from continuing operations was \$1,099, an increase of \$120, or 12.3 percent, over 1993, excluding the one-time effects described in Note 1 to the table above. The increase was primarily attributable to increased demand for telecommunications services.

In 1993, U S WEST Communications incurred extraordinary charges for the discontinuance of Statement of Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation," and the early extinguishment of debt. An extraordinary, noncash charge of \$3.1 billion (after tax) was incurred in conjunction with the decision to discontinue accounting for the operations of U S WEST Communications in accordance with SFAS No. 71. SFAS No. 71 generally applies to regulated companies that meet certain requirements, including a requirement that a company be able to recover its costs, competition notwithstanding, by charging its customers at prices established by its regulators. This decision to discontinue the application of SFAS No. 71 was based on the belief that competition, market conditions and technological advances, more than prices established by regulators, will determine the future cost recovery by U S WEST Communications. As a result of this change, the remaining asset lives of U S WEST

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Communications' telephone plant were shortened to more closely reflect the useful (economic) lives of such plant. U S WEST Communications' accounting and reporting for regulatory purposes were not affected by the change.

During 1993, U S WEST Communications refinanced long-term debt issues aggregating \$2.7 billion in principal amount. These refinancings allowed U S WEST Communications to take advantage of favorable interest rates. Extraordinary costs associated with the redemptions reduced 1993 income by \$77 (after tax).

Media Group

During 1994, income from continuing operations decreased 19 percent, to \$130, excluding the effects of the one-time items described in Note 2 to the table above. The decline in income is primarily a result of increased start-up losses associated with international businesses, partially offset by income growth in domestic wireless operations attributable to rapid growth in customer demand.

During 1993, the Board approved a plan to dispose of the capital assets segment, which includes activities related to financial services, financial guarantee insurance operations and real estate. Until January 1, 1995, the capital assets segment was accounted for as discontinued operations in accordance with Accounting Principles Board Opinion No. 30, which provides for the reporting of the operating results of discontinued operations separately from continuing operations. The Company recorded a provision of \$100 (after tax) for the estimated loss on disposal of the discontinued operations and an additional provision of \$20 to reflect the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates. Income from discontinued operations prior to June 1, 1993, was \$38, net of \$15 in income taxes. Income from discontinued operations subsequent to June 1, 1993, is being deferred and was included within the provision for loss on disposal of the capital assets segment.

Sales and Other Revenues

An analysis of the change in U S WEST's consolidated sales and other revenues follows:

	1994	1993	Increase (Decrease)	
			\$	%
Communications Group	\$ 9,176	\$ 8,870	\$306	3.4
Media Group	1,908	1,549	359	23.2
Intergroup eliminations	(131)	(125)	(6)	(4.8)
Total	<u>\$10,953</u>	<u>\$10,294</u>	<u>\$659</u>	<u>6.4</u>

Communications Group Operating Revenues

An analysis of changes in the Communications Group's revenues follows:

	1994	1993	Price Changes	Lower (Higher) Refunds	Demand	Other	Increase (Decrease)	
							\$	%
Local service	\$4,067	\$3,829	\$(12)	\$30	\$216	\$ 4	\$ 238	6.2
Interstate access	2,269	2,147	(15)	(6)	148	(5)	122	5.7
Intrastate access	729	682	(10)	(4)	51	10	47	6.9
Long-distance network	1,329	1,442	(8)	1	(43)	(63)	(113)	(7.8)
Other services	782	770	—	—	—	12	12	1.6
Total Communications Group	<u>\$9,176</u>	<u>\$8,870</u>	<u>\$(45)</u>	<u>\$21</u>	<u>\$372</u>	<u>\$(42)</u>	<u>\$ 306</u>	<u>3.4</u>

In 1994, local service revenues increased principally as a result of higher demand for services. Reported access lines increased by 3.6 percent. Excluding the sale of approximately 60,000 rural telephone access lines during 1994, access line growth was 4.0 percent.

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Higher revenues from interstate access services were primarily attributable to an increase of 7.8 percent in interstate billed access minutes of use, which more than offset the effects of price decreases. Intrastate access charges increased primarily as a result of higher demand, including demand for private line services.

Long-distance revenues decreased principally due to the effects of the MTCPs implemented in Oregon and Washington. The 1994 impact was a loss of \$68 in long-distance revenues, partially offset by a decrease of \$48 in other operating expenses and an increase of \$10 in intrastate access revenue. These regulatory arrangements decreased net income by approximately \$6 in 1994.

During 1994, revenues from other services increased due to higher revenue from billing and collection services and increased market penetration of new service offerings. Partially offsetting the increase in other services revenues was the 1993 sale of telephone equipment distribution operations, completion of large telephone network installation contracts and lower revenue from customer premises equipment installations.

Media Group Sales and Other Revenues

An analysis of the Media Group's sales and other revenues follows:

	1994	1993	Increase (Decrease)	
			\$	%
Directory and information services:				
Domestic	\$ 997	\$ 949	\$ 48	5.1
International	78	7	71	—
	1,075	956	119	12.4
Wireless communications:				
Cellular service	633	443	190	42.9
Cellular equipment	120	63	57	90.5
Paging sales and service ¹	28	55	(27)	(49.1)
	781	561	220	39.2
Cable and telecommunications	18	—	18	—
Other	34	32	2	6.2
Total Media Group	<u>\$1,908</u>	<u>\$1,549</u>	<u>\$359</u>	<u>23.2</u>

¹ The Company's paging business was sold in June 1994. Results reflect operations for the six months ending June 30, 1994.

During 1994, Media Group sales and other revenues increased 25 percent to \$1,862, excluding the effect of the 1994 Atlanta Systems acquisition and paging sale. The increase was primarily due to strong growth in cellular service revenue.

Directory and Information Services Revenues related to Yellow Pages directory advertising increased approximately \$59, or 6.5 percent, due primarily to pricing. Product enhancements and the effect of improved marketing programs on business volume also contributed to the increase in revenues. Non-Yellow Pages revenues increased \$11, including \$7 related to new products. Partially offsetting these increases was the absence of revenues related to certain publishing, software development and marketing operations that were sold, which reduced revenues by \$22.

The increase in international directory publishing revenue is attributable to U S WEST's May 1994 purchase of Thomson Directories.

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Wireless Communications Cellular service revenues increased 43 percent, to \$633 in 1994, due to a 61 percent increase in subscribers (with 24 percent of the additions occurring in December), partially offset by an 8 percent drop in average revenue per subscriber to \$70.00 per month.

Cellular equipment revenues increased 9 percent, to \$120 in 1994, primarily due to an 83 percent increase in gross customer additions, with a higher percentage of those customers purchasing equipment than in 1993. This increase was partially offset by a 13 percent decline in the average selling price of wireless phones.

Cable and Telecommunications Domestic cable and telecommunications revenues reflect the December 1994 acquisition of the Atlanta Systems.

Costs and Expenses

	1994	1993	Increase (Decrease)	
			\$	%
Employee-related expenses	\$3,779	\$3,584	\$ 195	5.4
Other operating expenses	2,203	2,065	138	6.7
Taxes other than income taxes	412	417	(5)	(1.2)
Depreciation and amortization	2,052	1,955	97	5.0
Restructuring charge	—	1,000	(1,000)	—
Interest expense	442	439	3	0.7
Equity losses in unconsolidated ventures	121	74	47	63.5
Other income (expense) — net	25	(15)	40	—

A reduction in the pension credit of approximately \$80 contributed to the increase in employee-related expenses. Actuarial assumptions, which include decreases in the discount rate and the expected long-term rate of return on plan assets, contributed to the pension credit reduction. Approximately \$150 for overtime payments, contract labor and basic salaries and wages, all related to the implementation of the Restructuring Plan at U S WEST Communications, also contributed to the increase. Additionally, employee-related expenses at the Company's publishing operations increased in connection with new product initiatives. Partially offsetting these increases were the effects of employees leaving the Company under the Restructuring Plan, lower health-care benefit costs, including a reduction in the accrual for postretirement benefits, and lower incentive compensation payments to employees.

Selling and other operating costs related to growth in the cellular subscriber base increased other operating expenses by approximately \$166 in 1994. Partially offsetting this increase was a \$48 decrease in access expense related to the effects of the multiple toll carrier plan arrangements.

The increase in depreciation and amortization expense was primarily a result of a higher depreciable asset base and increased rates of depreciation at U S WEST Communications.

Interest expense in 1994 was essentially unchanged from 1993. Incremental financing costs associated with the September 1993 TWE investment were offset by the effects of refinancing debt at lower rates in 1993 at U S WEST Communications, and a reclassification of capitalized interest in 1994. Since the discontinuance of SFAS No. 71, interest capitalized as a component of telephone plant construction is recorded as an offset against interest expense rather than to other income (expense). U S WEST's average borrowing cost decreased to 6.6 percent in 1994, from 6.7 percent in 1993.

Equity losses in unconsolidated ventures increased over 1993, primarily due to start-up costs related to the build out of TeleWest's network and costs related to the expansion of the customer base at One 2 One.

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Other income increased over 1993 primarily due to an increase in the management fee associated with the Company's TWE investment and a gain on the sale of certain publishing operations, partially offset by the reclassification of capitalized interest to interest expense.

Provision for Income Taxes

	<u>1994</u>	<u>1993</u>	<u>Increase</u>
Provision for income taxes	\$857	\$269	\$588
Effective tax rate	37.5%	36.1%	—

The increase in the effective tax rate resulted primarily from the effects of discontinuing SFAS No. 71, an increase in 1994 income before income taxes and the 1993 restructuring charge, partially offset by the cumulative effect on deferred income taxes of the 1993 federally mandated increase in income tax rates.

Liquidity and Capital Resources — Three Years Ended December 31, 1995

Operating Activities

Cash provided by operations increased \$173 in 1995. Business growth in the Communications Group and the cellular business, and the acquisition of the Atlanta Systems contributed to the increase in cash provided by operations. This increase was partially offset by increases in Restructuring Plan expenditures and higher income tax and interest payments, including approximately \$60 related to the partial sale of the Company's joint venture interest in TeleWest.

Cash from operations in 1994 remained relatively flat compared with 1993. Business growth and a decrease in the cash funding for postretirement benefits was offset by increased Restructuring Plan payments.

Investing Activities

Total capital expenditures were \$3,140 in 1995, \$2,820 in 1994 and \$2,441 in 1993. The 1995 capital expenditures exceeded the 1994 and 1993 levels due to the Communications Group's efforts to improve customer service (including reductions in held orders) and to accommodate additional line capability in several states, and the enhancement and expansion of the cellular network. In 1996, capital expenditures are expected to approximate \$3.1 billion. Included in the 1996 capital expenditures estimate are costs to enter new markets as allowed under the Telecommunications Act of 1996, upgrade the Atlanta Systems and expand the cellular network.

The Company received cash proceeds of \$214 and \$93 in 1995 and 1994, respectively, for the sales of certain rural telephone exchanges. Since implementing its rural telephone exchange sales program, the Company has sold approximately 155,000 access lines. Planned sales of rural exchanges for 1996 and beyond aggregate approximately 180,000 lines.

Investing activities of the Company also include equity investments in international ventures. In 1995, the Company invested \$681 in international ventures, primarily investments in Malaysia, the Netherlands, the Czech Republic and the United Kingdom. The Company invested approximately \$444 in developing international businesses in 1994, including the acquisition of Thomson Directories. The Company anticipates that investments in international ventures will approximate \$400 in 1996. This includes investments for recently awarded licenses to provide cellular service using digital technology in India and Poland. At December 31, 1995, U S WEST guaranteed debt in the principal amount of approximately \$140 related to international ventures.

In March 1995, PCS PrimeCo was awarded PCS licenses in 11 markets. The Company's share of the cost of the licenses was approximately \$268, all of which was funded in 1995. Under the PCS PrimeCo partnership

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agreement, U S WEST is required to fund approximately 24 percent of PCS PrimeCo's operating and capital costs, including licensing costs. U S WEST anticipates that its total funding obligations to PCS PrimeCo during the next three years will be approximately \$400.

In 1994, the Company received cash proceeds of \$143 from the sale of its paging operations. In 1993, cash proceeds of \$30 were received from the sale of certain nonstrategic lines of business. The Company did not receive cash from the 1994 partial sale of its joint venture interest in TeleWest or from the 1995 merger. All proceeds from the 1994 sale have been used by TeleWest for general business purposes, including financing both construction and operations, and repaying debt.

On February 27, 1996, U S West announced a definitive agreement to merge with Continental. Continental, the nation's third-largest cable operator, serves 4.2 million domestic customers, passes more than seven million domestic homes and holds significant other domestic and international properties. U S WEST will purchase all of Continental's stock for approximately \$5.3 billion and will assume Continental's debt and other obligations, which amount to approximately \$5.5 billion. Consideration for the \$5.3 billion in equity will consist of approximately \$1 billion in U S WEST preferred stock, convertible to Media Stock; and, at U S WEST's option, between \$1 billion and \$1.5 billion in cash, and \$2.8 billion to \$3.3 billion in shares of Media Stock. The transaction, which is expected to close in the fourth quarter of 1996, is subject to a number of conditions and approvals, including approvals from Continental shareholders and local franchising and government authorities.

Financing Activities

During 1995, debt increased \$917 primarily due to the increase in capital expenditures, new investments in international ventures, cash funding of the PCS licenses and a reclassification of debt from net investment in assets held for sale.

During fourth-quarter 1995, U S WEST issued \$130 of exchangeable notes, or Debt Exchangeable for Common Stock ("DECS"), due December 15, 1998. Upon maturity, each DECS will be mandatorily exchanged by U S WEST for shares of Enhance Financial Services Group, Inc. ("Enhance") or, at U S WEST's option, redeemed at the cash equivalent. The capital assets segment currently holds approximately 31.5 percent of the outstanding Enhance common stock.

These increases in debt were partially offset by reductions of debt related to the investment in TWE and a refinancing of commercial paper by issuing Company-obligated mandatorily redeemable preferred securities of a subsidiary trust holding solely Company-guaranteed debentures ("Preferred Securities"). U S WEST issued \$600 of Preferred Securities in 1995. The payment of interest and redemption amounts to holders of the securities are fully and unconditionally guaranteed by U S WEST.

During 1995, U S WEST refinanced \$2.6 billion of commercial paper to take advantage of favorable long-term interest rates. In addition to the commercial paper, U S WEST Communications refinanced \$145 of long-term debt. In 1993, U S WEST Communications refinanced \$2.7 billion of long-term debt. Expenses associated with the refinancing of long-term debt resulted in extraordinary after-tax charges to income of \$8 and \$77, net of tax benefits of \$5 and \$48 in 1995 and 1993, respectively.

Debt increased \$739 in 1994, primarily due to the December 1994 acquisition of the Atlanta Systems, partially offset by reductions in debt related to the investment in TWE. The cash investment related to the acquisition of the Atlanta Systems was \$745, obtained through short-term borrowing.

Excluding debt associated with the capital assets segment, the Company's percentage of debt to total capital at December 31, 1995, was 50.7 percent compared with 51.6 percent at December 31, 1994 and 55.1 percent at December 31, 1993. Including debt associated with the capital assets segment, Preferred Securities and other preferred stock, the Company's percentage of debt to total capital was 56.4 percent at

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December 31, 1995, 55.7 percent at December 31, 1994 and 59.7 percent at December 31, 1993. The decrease in the 1994 percentage of debt to total capital is primarily attributable to higher net income and the effects of an increase in common shares outstanding.

U S WEST maintains a commercial paper program to finance short-term cash flow requirements as well as to maintain a presence in the short-term debt market. In addition, U S WEST maintains lines of credit aggregating approximately \$1.9 billion, all of which was available at December 31, 1995. Under registration statements filed with the SEC, as of December 31, 1995, U S WEST is permitted to issue up to approximately \$1.5 billion of new debt securities.

Debt related to discontinued operations decreased \$487 in 1995 and \$213 in 1994. Cash to the capital assets segment of \$101 in 1994 primarily reflects the payment of debt, net of \$154 in proceeds from the sale of 8.1 million shares of Financial Security Assurance Holdings, Ltd. ("FSA"), an investment of the capital assets segment. For financial reporting purposes debt of the capital assets segment is netted against the related assets. See Consolidated Financial Statements — Note 20: Net Investment in Assets Held for Sale.

In connection with U S WEST's February 27, 1996 announcement of a planned merger with Continental, U S WEST, Inc.'s credit rating is being reviewed by credit rating agencies, which may result in a downgrading. The credit rating of U S WEST Communications was not placed under review by Moody's, has been reaffirmed by Duff and Phelps, and is under review by Fitch and Standard & Poors.

Subsequent to the acquisition of the Atlanta Systems (See Note 4 to the Consolidated Financial Statements) the Company announced its intention to purchase U S WEST common shares in the open market up to an amount equal to those issued in conjunction with the acquisition, subject to market conditions. In first-quarter 1995, the Company purchased 1,704,700 shares of U S WEST common stock at an average price per share of \$37.02. In December 1994, the Company purchased 550,400 shares of U S WEST common stock at an average price per share of \$36.30.

Risk Management

The Company is exposed to market risks arising from changes in interest rates and foreign exchange rates. Derivative financial instruments are used to manage these risks. U S WEST does not use derivative financial instruments for trading purposes.

Interest Rate Risk Management

The objective of the interest rate risk management program is to minimize the total cost of debt. Interest rate swaps are used to adjust the ratio of fixed- to variable-rate debt. The market value of the debt portfolio, including the interest rate swaps, is monitored and compared with predetermined benchmarks to evaluate the effectiveness of the risk management program.

Notional amounts of interest rate swaps outstanding were \$1.6 billion at December 31, 1995 and 1994, with various maturities extending to 2004. The estimated effect of interest rate derivative transactions was to adjust the level of fixed-rate debt from 88 percent to 94 percent of the total debt portfolio at December 31, 1995, and from 73 percent to 82 percent of the total debt portfolio at December 31, 1994 (including debt associated with the capital assets segment).

In conjunction with the 1993 debt refinancing, the Company executed forward contracts to sell U.S. Treasury bonds to lock in the U. S. Treasury rate component of \$1.5 billion of the future debt issue. At December 31, 1995, deferred credits of \$8 and deferred charges of \$51 on closed forward contracts are included as part of the carrying value of the underlying debt. The deferred credits and charges are being recognized as a yield adjustment over the life of the debt, which matures at various dates through 2043. The net deferred charge is directly offset by the lower coupon rate achieved on the new debt.

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Foreign Exchange Risk Management

U S WEST has entered into forward and option contracts to manage the market risks associated with fluctuations in foreign exchange rates after consideration of offsetting foreign exposures among international operations. The use of forward and option contracts allow U S WEST to fix or cap the cost of firm foreign investment commitments in countries with freely convertible currencies. The market values of the foreign exchange positions, including the hedging instruments, are continuously monitored and compared with predetermined levels of acceptable risk.

Notional amounts of foreign exchange forward and option contracts outstanding were \$456 and \$170 as of December 31, 1995 and 1994, respectively, with maturities of one year or less. These contracts were primarily for the purchase of Dutch guilders and British pounds in 1995 and British pounds in 1994.

The Company had foreign exchange risks associated with a Dutch guilder-denominated payable in the translated principal amount of \$216 at December 31, 1995, and British pound-denominated receivables in the translated principal amounts of \$139 and \$48 at December 31, 1995 and 1994, respectively, of which \$63 and \$48 of these respective balances are with a wholly owned subsidiary. These positions were hedged in 1995.

Disposition of the Capital Assets Segment

U S WEST announced a plan of disposition of the capital assets segment in June 1993. See the Consolidated Financial Statements — Note 20: Net Investment in Assets Held for Sale. In December 1993, U S WEST sold \$2.0 billion of finance receivables and the business of U S WEST Financial Services, Inc. to NationsBank Corporation. Proceeds from the sale of \$2.1 billion were used to repay related debt.

During 1994, U S WEST reduced its ownership interest in FSA, a member of the capital assets segment, to 60.9 percent and its voting interest to 49.8 percent through a series of transactions. In May and June 1994, U S WEST sold 8.1 million shares of FSA common stock and received \$154 in net proceeds from the public offering. In December 1995, FSA merged with Capital Guaranty Corporation for shares of FSA and cash of \$51. The transaction was valued at approximately \$203 and reduced U S WEST's ownership interest in FSA to 50.3 percent and its voting interest to 41.7 percent. U S WEST expects to monetize and ultimately reduce its ownership in FSA through the issuance of Debt Exchangeable for Common Stock ("DECS") in 1996. At maturity, each DECS will be mandatorily exchanged by U S WEST for FSA common stock held by U S WEST or, at U S WEST's option, redeemed at the cash equivalent.

On September 2, 1994, U S WEST issued to Fund American Enterprises Holdings Inc. ("FFC") 50,000 shares of cumulative redeemable preferred stock for a total of \$50. The shares are mandatorily redeemable in year ten and, at the option of FFC, the preferred stock also can be redeemed for common shares of FSA.

U S WEST Real Estate, Inc. has sold various properties totaling \$120, \$327 and \$66 in 1995, 1994 and 1993, respectively. The sales proceeds were in line with estimates. Proceeds from building sales were primarily used to repay related debt. U S WEST has completed construction of existing buildings in the commercial real estate portfolio and expects to substantially complete liquidation of this portfolio by 1998. The remaining balance of assets subject to sale is approximately \$490, net of reserves, as of December 31, 1995.

Competitive and Regulatory Environment

The Telecommunications Act of 1996

On February 1, 1996, the House and Senate approved the Telecommunications Act of 1996 (the "1996 Act") which is intended to promote competition between local telephone companies, long-distance carriers and cable television operators. The 1996 Act was signed into law on February 8, 1996, and replaces the antitrust consent decree that broke up the "Bell System" in 1984. A major provision of the legislation includes the preemption of state regulations that govern competition by allowing local telephone companies,

U S WEST, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

long-distance carriers and cable television companies to enter each other's lines of business. Consequently, the Regional Bell Operating Companies ("RBOCs") are immediately permitted to offer wireline interLATA toll services out of their regions. However, to participate in the interLATA long-distance market within their regions, the RBOCs must first open their local networks to facilities-based competition by satisfying a detailed checklist of requirements, including requirements related to interconnection and number portability.

Other key provisions of the 1996 Act: (1) eliminate most of the regulation of cable television rates within three years and eliminate the ban on cross-ownership between cable television and telephone companies in small communities; (2) permit the RBOCs to develop new, competitive cable systems within their regions and to acquire or build wireless cable systems; (3) provide partial relief from the ban against manufacturing telecommunications equipment by the RBOCs; and (4) permit wireless operators to provide interLATA toll service in and out of region without a separate subsidiary and to jointly market or resell cellular service.

The FCC and state regulators have been given latitude in interpreting and overseeing the implementation of this legislation, including developing universal service funding policy. The extent and timing of future competition, including the Communications Group's ability to offer in-region interLATA long-distance services, will depend in part on the implementation guidelines determined by the FCC and state regulators, and how quickly the Communications Group can satisfy requirements of the checklist. The Communications Group estimates that fulfillment of the checklist requirements could occur in the majority of its states within 12 to 18 months.

The Communications Group

Markets served by the Communications Group, including markets for local, access and long-distance services, are being impacted by the rapid technological and regulatory changes occurring within the telecommunications industry. Current and potential competitors include local telephone companies, interexchange carriers, competitive access providers ("CAPs"), cable television companies and providers of personal communications services ("PCS").

The Communications Group believes that competitors will initially target high-volume business customers in densely populated urban areas. The resulting loss of local service customers will affect multiple revenue streams and could have a material, adverse effect on the Communications Group's operations. The resulting revenue losses, however, could be at least partially offset by the Communications Group's ability to bundle local, long-distance and wireless services, and provide interconnection services.

The Communications Group's strategy is to offer integrated communications, entertainment, information and transaction services over both wired and wireless networks to its customers primarily within its Region. The key initiatives to support this strategy include five key elements:

- Providing superior customer service
- Building customer loyalty
- Enhancing network capability and capacity
- Expanding the product and service portfolio
- Ensuring a fair competitive environment

Strategic initiatives to attract and retain customers include: (1) enhancing existing services with products such as caller identification, call waiting and voice messaging; (2) aggressive expansion of data services; (3) pursuing opportunities to offer paging, wireless and cable television services; and (4) rapid entry into the interLATA long-distance market.

U S WEST, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

A market trial for a broadband network capable of providing voice, data and video services to customers commenced in the Omaha area in August 1995. The Communications Group does not intend to expand this service offering beyond the Omaha area because of service cost and pricing issues. The Communications Group does plan to continue to provide the system that delivers basic, premium and pay-per-view video services in the Omaha area. The Communications Group is evaluating the relative costs of alternative video technologies, as well as the near-term feasibility of interactive services. To satisfy anticipated demand for combined video and telephony services on a cost-effective basis, the Communications Group's strategy may include selective investments in wireless cable technologies.

The Communications Group is subject to varying degrees of federal and state regulation. The Communications Group's regulatory strategy includes working to:

- Achieve accelerated capital recovery;
- Reprice local services to cover costs and ensure these services are subsidy free, while lowering toll and access rates to meet competition; and
- Ensure that the new rules associated with the Telecommunications Act of 1996 concerning the unbundling of interconnection, resale of services and universal service do not advantage one competitor over another.

The Communications Group is currently working with state regulators to gain approval of these initiatives.

The Media Group

The Media Group's strategy is based on the belief that communication and commerce are migrating from other mediums to electronic networks. Over time, this global phenomenon will result in networks replacing traditional distribution channels. To meet the needs of this growing market, the Media Group provides local connections and then integrates market-based service offerings to meet the needs of end users. The Media Group executes this strategy through three lines of business — cable and telecommunications, wireless and directory and information services — in selected high-growth markets worldwide.

Cable and Telecommunications The 1996 Act will enable the Media Group to provide "one-stop shopping" for voice, video and data services, a key objective of the Media Group. The Media Group is currently in the process of negotiating reasonable and nondiscriminatory local interconnection rates, terms and conditions with BellSouth and is planning on entering the local exchange market, through the Atlanta Systems, on a competitive basis by the end of 1996.

The Atlanta Systems generally compete for viewer attention with programming from a variety of sources, including the direct reception of broadcast television signals by the viewer's own antenna, satellite master antenna service and direct broadcast satellite services. Cable television systems are also in competition for both viewers and advertising in varying degrees with other communications and entertainment media. Such competition may increase with the development and growth of new technologies.

The 1996 Act has amended certain aspects of the Cable Television Consumer Protection and Competition Act of 1992 ("the 1992 Cable Act"). Under the 1996 Act, cable rates are deregulated effective March 31, 1999, or earlier if competition exists. In addition, the provisions of the 1996 Act simplify the process of filing rate complaints, relax uniform rate requirements and subscriber notice provisions, expand the definition of effective competition and eliminate certain restrictions on the sale of cable systems. Current program access restrictions applying to cable operators are extended to common carriers by the 1996 Act. The 1996 Act also eliminates certain cross-ownership restrictions between cable operators, broadcasters and multichannel, multipoint distribution system operators.

U S WEST, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Cable television systems are also subject to local regulation, typically imposed through the franchising process. Local officials may be involved in the initial franchise selection, system design and construction, safety, rate regulation, customer service standards, billing practices, community-related programming and services, franchise renewal and imposition of franchise fees.

In 1995, the Georgia legislature removed the legal prohibition on local telephone competition by authorizing competition in local telephone exchange service. The Media Group has received certification from the Georgia Public Service Commission to provide local switched and nonswitched telephone service in Georgia and, with the passage of the 1996 Act, certain long-distance services.

Wireless Communications There are two competitive cellular licenses in each market. Competition is based on the price of cellular service, the quality of the service and the size of the geographic area served. The development of PCS services will increase the number of competitors and the level of competition. The Media Group is unable to estimate the impact of the availability of PCS services on its cellular operations, though it could be significant.

The wireless operations are subject to regulation by federal and some state and local authorities. The construction and transfer of cellular systems in the United States are regulated by the FCC pursuant to the Communications Act of 1934. The FCC regulates construction and operation of cellular systems and licensing and technical standards for the provision of cellular telephone service. Pursuant to Congress' 1993 Omnibus Budget Reconciliation Act, the FCC adopted rules preempting state and local governments from regulating wireless entry and most rates.

The passage of the 1996 Act eliminates long-distance restrictions imposed by the Modified Final Judgment ("MFJ"). As a result, the Media Group, including its wireless partners, are now able to offer integrated local and long-distance services to its wireless customers. The 1996 Act also permits the Media Group to enter into activities related to the manufacture of telecommunications equipment.

Directory and Information Services The Media Group may face emerging competition in the provision of interactive services from cable and entertainment companies, on-line services and other information providers. Directory listings are beginning to be offered via electronic databases through telephone company and third party networks. As such offerings expand and are enhanced through interactivity and other features, the Media Group may experience heightened competition in its directory publishing businesses. With the passage of the 1996 Act, the Media Group will be able to provide certain information services across LATA boundaries. The Media Group will continue to expand its core products and develop and package new information products to meet its customers' needs.

Other Issues

The Communications Group's interstate services have been subject to price cap regulation since January 1991. Price caps are an alternative form of regulation designed to limit prices rather than profits. However, the FCC's price cap plan includes sharing of earnings in excess of authorized levels. In March 1995, the FCC issued an interim order on price cap regulation. The price cap index for most services is annually adjusted for inflation, productivity level and exogenous costs, and has resulted in reduced access prices paid by interexchange carriers to local telephone companies. The interim order also provides for three productivity options, including a no-sharing option, and for increased flexibility for adjusting prices downward in response to competition. In 1995, the Communications Group selected the lowest productivity option, while prior to this interim order, the Communications Group used an optional higher productivity factor in determining its prices. Consequently, the Communications Group expects the order to have no significant near-term impact.

There are pending regulatory actions in local regulatory jurisdictions that call for price decreases, refunds or both. In one such instance, the Utah Supreme Court has remanded a Utah Public Service Commission ("PSC") order to the PSC for reconsideration, thereby establishing two exceptions to the

U S WEST, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

rule against retroactive ratemaking: 1) unforeseen and extraordinary events, and 2) misconduct. The PSC's initial order denied a refund request from interexchange carriers and other parties related to the Tax Reform Act of 1986. This action is still in the discovery process. If a formal filing — made in accordance with the remand from the Supreme Court — alleges that the exceptions apply, the range of possible risk is \$0 to \$150.

On September 22, 1995, U S WEST filed a lawsuit in Delaware Chancery Court to enjoin the proposed merger of Time Warner and Turner Broadcasting. U S WEST has alleged breaches of contract and fiduciary duties by Time Warner in connection with this proposed merger. Time Warner filed a countersuit against U S WEST on October 11, 1995, alleging misrepresentation, breach of contract and other misconduct on the part of U S WEST. Time Warner's countersuit seeks a reformation of the Time Warner Entertainment partnership agreement, an order that enjoins U S WEST from breaching the partnership agreement, and unspecified compensatory damages. U S WEST has denied each of the claims in Time Warner's countersuit. The trial for this action concluded on March 22, 1996. A ruling by the Delaware Chancery Court is expected in June 1996.

On October 2, 1995, union members approved a new three-year contract with U S WEST. The contract provides for salary increases of 10.6 percent over three years effective January 1 of each year. The contract also provides employees with a lump sum payment of \$1,500 in lieu of wage increases becoming effective in August of each year. This lump sum payment is being recognized over the life of the contract. The agreement covers approximately 30,000 Communications Workers of America ("CWA") members who work for the Communications Group.

On October 15, 1995, U S WEST Direct and the CWA reached a tentative agreement on their contract, subject to ratification by the CWA membership. This contract would provide for salary increases of 10.5 percent over three years and provides employees with a lump sum payment of \$850.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareowners of U S WEST, Inc.:

We have audited the Consolidated Balance Sheets of U S WEST, Inc. as of December 31, 1995 and 1994, and the related Consolidated Statements of Operations and Cash Flows for each of the three years in the period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of U S WEST, Inc. as of December 31, 1995 and 1994, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

As discussed in Note 8 to the Consolidated Financial Statements, the Company discontinued accounting for the operations of U S WEST Communications, Inc. in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation," in 1993.

COOPERS & LYBRAND L.L.P.

Denver, Colorado

February 12, 1996, except for Note 4, paragraph 3, as to which
the date is February 27, 1996

REPORT OF MANAGEMENT

The Consolidated Financial Statements of U S WEST have been prepared in conformity with generally accepted accounting principles applied on a consistent basis. The integrity and objectivity of information in these financial statements, including estimates and judgments, are the responsibility of management, as is all other financial information included in this report.

U S WEST maintains a system of internal accounting controls designed to provide a reasonable assurance as to the integrity and reliability of financial statements, the safeguarding of assets and the prevention and detection of material errors or fraudulent financial reporting. Monitoring of such systems includes an internal audit program designed to assess objectively the effectiveness of internal controls and recommend improvements therein.

Limitations exist in any system of internal accounting controls based on the recognition that the cost of the system should not exceed the benefits derived. U S WEST believes that the Company's system provides reasonable assurance that transactions are executed in accordance with management's general or specific authorizations and is adequate to accomplish the stated objectives.

The independent certified public accountants, whose report is included herein, are engaged to express an opinion on our Consolidated Financial Statements. Their opinion is based on procedures performed in accordance with generally accepted auditing standards, including examining, on a test basis, evidence supporting the amounts and disclosures in the Consolidated Financial Statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation.

In an attempt to assure objectivity, the financial information contained in this report is subject to review by the Audit Committee of the board of directors. The Audit Committee is composed of outside directors who meet regularly with management, internal auditors and independent auditors to review financial reporting matters, the scope of audit activities and the resolution of audit findings.

Richard D. McCormick
Chairman and Chief Executive Officer

James T. Anderson
*Acting Executive Vice President
and Chief Financial Officer*

February 12, 1996

U S WEST, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	1995	1994	1993
	Dollars in millions		
Sales and other revenues	\$11,746	\$10,953	\$10,294
Operating expenses:			
Employee-related expenses	4,071	3,779	3,584
Other operating expenses	2,323	2,203	2,065
Taxes other than income taxes	416	412	417
Depreciation and amortization	2,291	2,052	1,955
Restructuring charge	—	—	1,000
Total operating expenses	9,101	8,446	9,021
Income from operations	2,645	2,507	1,273
Interest expense	527	442	439
Equity losses in unconsolidated ventures	207	121	74
Gains on asset sales:			
Merger and partial sale of joint venture interest	157	164	—
Rural telephone exchanges	136	82	—
Paging assets	—	68	—
Guaranteed minority interest expense	14	—	—
Other income (expense) — net	(36)	25	(15)
Income from continuing operations before income taxes and extraordinary items	2,154	2,283	745
Provision for income taxes	825	857	269
Income from continuing operations before extraordinary items	1,329	1,426	476
Discontinued operations:			
Estimated loss from June 1, 1993 through disposal, net of tax	—	—	(100)
Income tax rate change	—	—	(20)
Income, net of tax (to June 1, 1993)	—	—	38
Income before extraordinary items	1,329	1,426	394
Extraordinary items:			
Discontinuance of SFAS No. 71, net of tax	—	—	(3,123)
Early extinguishment of debt, net of tax	(12)	—	(7)
NET INCOME (LOSS)	\$ 1,317	\$ 1,426	\$ (2,806)
Dividends on preferred stock	3	—	—
EARNINGS (LOSS) AVAILABLE FOR COMMON STOCK	\$ 1,314	\$ 1,426	\$ (2,806)

U S WEST, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (Continued)

	Year Ended December 31,		
	1995	1994	1993
	In thousands (except per share amounts)		
PRO FORMA COMMUNICATIONS GROUP EARNINGS PER COMMON SHARE:			
Income before extraordinary item	\$ 2.52		
Extraordinary item — early extinguishment of debt	(0.02)		
PRO FORMA COMMUNICATIONS GROUP EARNINGS PER COMMON SHARE	\$ 2.50		
PRO FORMA COMMUNICATIONS GROUP AVERAGE COMMON SHARES OUTSTANDING	470,716		
PRO FORMA MEDIA GROUP EARNINGS PER COMMON SHARE:			
Income before extraordinary item	\$ 0.30		
Extraordinary item — early extinguishment of debt	(0.01)		
PRO FORMA MEDIA GROUP EARNINGS PER COMMON SHARE	\$ 0.29		
PRO FORMA MEDIA GROUP AVERAGE COMMON SHARES OUTSTANDING	470,549		
U S WEST, INC. EARNINGS (LOSS) PER COMMON SHARE:			
Continuing operations available for common stock	—	\$ 3.14	\$ 1.13
Discontinued operations:			
Estimated loss from June 1, 1993 through disposal	—	—	(0.24)
Income tax rate change	—	—	(0.04)
Income (to June 1, 1993)	—	—	0.09
Extraordinary items:			
Discontinuance of SFAS No. 71	—	—	(7.45)
Early extinguishment of debt	—	—	(0.18)
U S WEST, INC. EARNINGS (LOSS) PER COMMON SHARE	—	\$ 3.14	\$ (6.69)
U S WEST, INC. AVERAGE COMMON SHARES OUTSTANDING	—	453,316	419,365

The accompanying notes are an integral part of the Consolidated Financial Statements.

U S WEST, INC.
CONSOLIDATED BALANCE SHEETS
ASSETS

	December 31,	
	1995	1994
	Dollars in millions	
Current assets:		
Cash and cash equivalents	\$ 192	\$ 209
Accounts and notes receivable, less allowance for credit losses of \$88 and \$62, respectively	1,886	1,693
Inventories and supplies	227	189
Deferred tax asset	282	352
Prepaid and other	322	323
Total current assets	2,909	2,766
Property, plant and equipment — net	14,677	13,997
Investment in Time Warner Entertainment	2,483	2,522
Intangible assets — net	1,798	1,858
Investments in international ventures	1,511	881
Net investment in assets held for sale	429	302
Other assets	1,264	878
Total assets	\$25,071	\$23,204

LIABILITIES AND SHAREOWNERS' EQUITY

Current liabilities:		
Short-term debt	\$ 1,901	\$ 2,837
Accounts payable	975	944
Employee compensation	385	367
Dividends payable	254	251
Current portion of restructuring charge	282	337
Other	1,255	1,278
Total current liabilities	5,052	6,014
Long-term debt	6,954	5,101
Postretirement and other postemployment benefit obligations	2,433	2,502
Deferred income taxes	1,071	890
Unamortized investment tax credits	199	231
Deferred credits and other	763	1,033
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely Company-guaranteed debentures	600	—
Preferred stock subject to mandatory redemption	51	51
Common shareowners' equity:		
Common shares — At 12/31/95-Communications Stock- \$0.01 per share par value, 2,000,000,000 authorized, 482,877,097 issued and 473,635,025 outstanding. Media Stock — \$0.01 per share par value, 2,000,000,000 authorized, 481,556,451 issued and 472,314,379 outstanding. At 12/31/94-U S WEST, Inc. no par, 2,000,000,000 authorized, 476,880,420 issued and 469,343,048 outstanding	8,228	8,056
Cumulative deficit	(115)	(458)
LESOP guarantee	(127)	(187)
Foreign currency translation adjustments	(38)	(29)
Total common shareowners' equity	7,948	7,382
Total liabilities and shareowners' equity	\$25,071	\$23,204
Contingencies (See Note 19 to the Consolidated Financial Statements)		

The accompanying notes are an integral part of the Consolidated Financial Statements.

U S WEST, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1995	1994	1993
	Dollars 'n millions		
OPERATING ACTIVITIES			
Net income (loss)	\$1,317	\$1,426	\$(2,306)
Adjustments to net income (loss):			
Discontinuance of SFAS No. 71	—	—	3,123
Restructuring charge	—	—	1,000
Depreciation and amortization	2,291	2,052	1,955
Gains on asset sales:			
Merger and partial sale of joint venture interest	(157)	(164)	—
Rural telephone exchanges	(136)	(82)	—
Paging assets	—	(68)	—
Equity losses in unconsolidated ventures	207	121	74
Discontinued operations	—	—	82
Deferred income taxes and amortization of investment tax credits	274	373	(225)
Changes in operating assets and liabilities:			
Restructuring payments	(334)	(289)	(120)
Postretirement medical and life costs, net of cash fundings	(24)	(5)	(122)
Accounts and notes receivable	(169)	(104)	(90)
Inventories, supplies and other	(79)	(81)	(56)
Accounts payable and accrued liabilities	45	(4)	216
Other — net	185	72	169
Cash provided by operating activities	<u>3,420</u>	<u>3,247</u>	<u>3,200</u>
INVESTING ACTIVITIES			
Expenditures for property, plant and equipment	(2,825)	(2,603)	(2,427)
Investment in Time Warner Entertainment	—	—	(1,557)
Investment in Atlanta Systems	—	(745)	—
Investments in international ventures	(681)	(350)	(230)
Proceeds from disposals of property, plant and equipment	201	96	45
Proceeds from sale of paging assets	—	143	—
Other — net	(201)	(119)	(10)
Cash (used for) investing activities	<u>(3,506)</u>	<u>(3,578)</u>	<u>(4,179)</u>
FINANCING ACTIVITIES			
Net (repayments of) proceeds from issuance of short-term debt	(1,281)	1,280	687
Proceeds from issuance of long-term debt	2,732	251	2,282
Repayments of long-term debt	(1,058)	(526)	(2,969)
Proceeds from issuance of trust originated preferred securities — net	581	—	—
Dividends paid on common stock	(929)	(886)	(812)
Proceeds from issuance of common stock	87	364	1,150
Proceeds from issuance of preferred stock	—	50	—
Purchases of treasury stock	(63)	(20)	—
Cash provided by financing activities	<u>69</u>	<u>513</u>	<u>338</u>
Cash (used for) provided by continuing operations	<u>(17)</u>	<u>182</u>	<u>(641)</u>
Cash (to) from discontinued operations	—	(101)	610
CASH AND CASH EQUIVALENTS			
Increase (decrease)	(17)	81	(31)
Beginning balance	209	128	159
Ending balance	<u>\$ 192</u>	<u>\$ 209</u>	<u>\$ 128</u>

The accompanying notes are an integral part of the Consolidated Financial Statements.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 1995, 1994 and 1993
(Dollars in millions, except per share amounts)

NOTE 1: RECAPITALIZATION PLAN

On October 31, 1995, the shareholders of U S WEST, Inc., a Colorado corporation ("U S WEST Colorado"), voted to approve a proposal (the "Recapitalization Plan") adopted by the Board of Directors of U S WEST, Inc. (the "Board") to reincorporate in Delaware and create two classes of common stock that are intended to reflect separately the performance of the communications and multimedia businesses. Under the Recapitalization Plan, shareholders approved an Agreement and Plan of Merger between U S WEST Colorado and U S WEST, Inc., a Delaware corporation ("U S WEST" or "Company"), pursuant to which U S WEST continues as the surviving corporation. In connection with the merger, the Certificate of Incorporation of U S WEST has been amended and restated to designate two classes of common stock of U S WEST, one class of which is authorized as U S WEST Communications Group Common Stock ("Communications Stock"), and the other class which is authorized as U S WEST Media Group Common Stock ("Media Stock"). Effective November 1, 1995, each share of common stock of U S WEST Colorado was converted into one share each of Communications Stock and Media Stock.

The Communications Stock and Media Stock provide shareholders with two distinct securities that are intended to reflect separately the communications businesses of U S WEST (the "Communications Group") and the multimedia businesses of U S WEST (the "Media Group" and, together with the Communications Group, the "Groups").

The Communications Group is comprised of U S WEST Communications, Inc. ("U S WEST Communications"), U S WEST Communications Services, Inc., U S WEST Federal Services, Inc., U S WEST Advanced Technologies, Inc. and U S WEST Business Resources, Inc. The Communications Group primarily provides regulated communications services to more than 25 million residential and business customers within a 14 state region.

The Media Group is comprised of U S WEST Marketing Resources Group, Inc., which publishes White and Yellow Pages telephone directories, and provides directory and information services, U S WEST NewVector Group, Inc., which provides communications and information products and services over wireless networks, U S WEST Multimedia Communications, Inc., which owns domestic cable television operations and investments, and U S WEST International Holdings, Inc., which primarily owns investments in international cable and telecommunications, wireless communications and directory publishing operations.

Dividends to be paid on Communications Stock are initially \$0.535 per share per quarter. Dividends on the Communications Stock will be paid at the discretion of the Board, based primarily on the financial condition, results of operations and business requirements of the Communications Group and the Company as a whole. With regard to the Media Stock, the Board currently intends to retain future earnings, if any, for the development of the Media Group's businesses and does not anticipate paying dividends on the Media Stock in the foreseeable future.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The Consolidated Financial Statements include the accounts of U S WEST and its majority-owned subsidiaries, except for the capital assets segment, which is held for sale. All significant intercompany amounts and transactions have been eliminated. Investments in less than majority-owned ventures are accounted for using the equity method.

Certain reclassifications within the Consolidated Financial Statements have been made to conform to the current year presentation.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In third-quarter 1993, U S WEST discontinued accounting for its regulated telephone operations. U S WEST Communications, under Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." (See Note 8 to the Consolidated Financial Statements.)

Industry Segments U S WEST consists of two Groups — the Communications Group and the Media Group. The Communications Group operates in one industry segment (communications and related services) and the Media Group operates in four industry segments (directory and information services, wireless communications, cable and telecommunications, and the capital assets segment, which is held for sale) as defined in SFAS No. 14, "Financial Reporting for Segments of a Business Enterprise."

Prior to January 1, 1995, the capital assets segment was accounted for as discontinued operations. Effective January 1, 1995, the capital assets segment has been accounted for as a net investment in assets held for sale, as discussed in Note 20 to the Consolidated Financial Statements.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents Cash and cash equivalents include highly liquid investments with original maturities of three months or less that are readily convertible into cash and are not subject to significant risk from fluctuations in interest rates.

Inventories and Supplies New and reusable materials of U S WEST Communications are carried at average cost, except for significant individual items that are valued based on specific costs. Nonreusable material is carried at its estimated salvage value. Inventories of all other U S WEST subsidiaries are carried at the lower of cost or market on a first-in, first-out basis.

Property, Plant and Equipment The investment in property, plant and equipment is carried at cost, less accumulated depreciation. Additions, replacements and substantial betterments are capitalized. Costs for normal repair and maintenance of property, plant and equipment are expensed as incurred.

U S WEST Communications' provision for depreciation of property, plant and equipment is based on various straight-line group methods using remaining useful (economic) lives based on industry-wide studies. Prior to discontinuing SFAS No. 71, depreciation was based on lives specified by regulators. When the depreciable property, plant and equipment of U S WEST Communications is retired or sold, the original cost less the net salvage value is generally charged to accumulated depreciation.

The other subsidiaries of U S WEST provide for depreciation using the straight-line method. When such depreciable property, plant and equipment is retired or sold, the resulting gain or loss is included in income.

Depreciation expense was \$2,215, \$2,029 and \$1,941 in 1995, 1994 and 1993, respectively.

Interest related to qualifying construction projects, including construction projects of equity method investees, is capitalized and reflected as a reduction of interest expense. At U S WEST Communications, prior to discontinuing SFAS No. 71, capitalized interest was included as an element of other income. Amounts capitalized by U S WEST were \$72, \$44 and \$20 in 1995, 1994 and 1993, respectively.

Intangible Assets Intangible assets are recorded when the cost of acquired companies exceeds the fair value of their tangible assets. The costs of identified intangible assets and goodwill are amortized by the

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

straight-line method over periods ranging from five to forty years. These assets are evaluated, with other related assets, for impairment using a discounted cash flow methodology. Amortization expense was \$76, \$23 and \$14 in 1995, 1994 and 1993, respectively.

Foreign Currency Translation Assets and liabilities of international investments are translated at year-end exchange rates, and income statement items are translated at average exchange rates for the year. Resulting translation adjustments are recorded as a separate component of equity. Gains and losses resulting from foreign currency transactions are included in income.

Revenue Recognition Local telephone service, cellular access and cable television revenues are generally billed monthly, in advance, and revenues are recognized the following month when services are provided. Revenues derived from other telephone services, including exchange access, long-distance and cellular airtime usage, are billed and recorded monthly as services are provided.

Directory advertising revenues and related directory costs of selling, composition, printing and distribution are generally deferred and recognized over the period during which directories are used, normally 12 months. For international operations, directory advertising revenues and related directory costs are deferred and recognized upon publication. The balance of deferred directory costs included in prepaid and other is \$247 and \$234 at December 31, 1995 and 1994, respectively.

Financial Instruments Net interest received or paid on interest rate swaps is recognized over the life of the swaps as an adjustment to interest expense. Foreign exchange contracts designated as hedges of firm equity investment commitments are carried at market value, with gains and losses recorded in equity until sale of the investment. Forward contracts designated as hedges of foreign denominated loans are recorded at market value, with gains and losses recorded in income.

Investments in Debt Securities Debt securities are classified as available for sale and are carried at fair market value with unrealized gains and losses included in equity.

Computer Software The cost of computer software, whether purchased or developed internally, is charged to expense with two exceptions. Initial operating systems software is capitalized and amortized over the life of the related hardware, and initial network applications software is capitalized and amortized over three years. Subsequent upgrades to capitalized software are expensed. Capitalized computer software of \$190 and \$146 at December 31, 1995 and 1994, respectively, is recorded in property, plant and equipment. The Company amortized capitalized computer software costs of \$70, \$62 and \$37 in 1995, 1994 and 1993, respectively.

Income Taxes The provision for income taxes consists of an amount for taxes currently payable and an amount for tax consequences deferred to future periods in accordance with SFAS No. 109. U S WEST implemented SFAS No. 109, "Accounting for Income Taxes," in 1993. Adoption of the new standard did not have a material effect on the financial position or results of operations, primarily because of the Company's earlier adoption of SFAS No. 96.

For financial statement purposes, investment tax credits of U S WEST Communications are being amortized over the economic lives of the related property, plant and equipment in accordance with the deferred method of accounting for such credits.

Earnings (Loss) Per Common Share For 1995, earnings per common share for Communications Stock and Media Stock are presented on a pro forma basis to reflect the two classes of stock as if they had been outstanding since January 1, 1995. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST. For 1994 and 1993, earnings (loss) per common share are computed on the basis of the weighted average number of shares of U S WEST common stock outstanding during each year.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

New Accounting Standards In 1996, U S WEST will adopt SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." SFAS No. 121 requires that long-lived assets and associated intangibles be written down to fair value whenever an impairment review indicates that the carrying value cannot be recovered on an undiscounted cash flow basis. SFAS No. 121 also requires that a company no longer record depreciation expense on assets held for sale. U S WEST expects that the adoption of SFAS No. 121 will not have a material effect on its financial position or results of operations.

In 1996, U S WEST will adopt SFAS No. 123, "Accounting for Stock-Based Compensation." This standard establishes a fair value method for accounting for stock-based compensation plans either through recognition or disclosure. U S WEST will adopt this standard through compliance with the disclosure requirements set forth in SFAS No. 123. Adoption of the standard will have no impact on the financial position or results of operations of U S WEST.

NOTE 3: INDUSTRY SEGMENTS

Industry segment data is presented for the consolidated operations of U S WEST. The Company's equity method investments and the capital assets segment, which is held for sale, are included in "Corporate and other."

The businesses comprising the Communications Group operate in a single industry segment — communications and related services. The Communications Group primarily provides regulated communications services to more than 25 million residential and business customers in the Communications Group region (the "Region"). The Region includes the states of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming. Services offered by the Communications Group include local telephone services, exchange access services (which connect customers to the facilities of carriers, including long-distance providers and wireless operators), and long-distance services within Local Access and Transport Areas ("LATAs") in the Region. The Communications Group provides other products and services, including custom calling, voice messaging, caller identification, high-speed data applications, customer premises equipment and certain communications services to business customers and governmental agencies both inside and outside the Region.

Approximately 97 percent of the revenues of the Communications Group are attributable to the operations of U S WEST Communications, of which approximately 59 percent are derived from the states of Arizona, Colorado, Minnesota and Washington.

The Media Group operates in four industry segments, including the capital assets segment, which is held for sale. The directory and information services segment consists of the publishing of White and Yellow Pages telephone directories, database marketing services and interactive services in domestic and international markets. The wireless communications segment provides information products and services over wireless networks in 13 western and midwestern states. The cable and telecommunications segment was created with the December 6, 1994 acquisition of cable television systems in the Atlanta Metropolitan area. (See Note 4 to the Consolidated Financial Statements.)

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: INDUSTRY SEGMENTS (Continued)

Industry segment financial information follows:

	Communi- cations and Related Services	Directory and Information Services ¹	Wireless Communi- cations	Cable and Telecommuni- cations ²	Corporate and other ³	Intersegment Eliminations	Consolidated
1995							
Sales and other revenues	\$ 9,484	\$1,180	\$ 941	\$ 215	\$ 38	\$(112)	\$11,746
Operating income (loss)	2,178	398	147	23	(101)	—	2,645
Identifiable assets	16,585	583	1,439	1,466	5,127	(129)	25,071
Depreciation and amortization	2,042	36	121	77	15	—	2,291
Capital expenditures	2,739	37	277	64	23	—	3,140
1994							
Sales and other revenues	9,176	1,075	781	18	34	(131)	10,953
Operating income (loss) from continuing operations	2,118	396	88	—	(95)	—	2,507
Identifiable assets	15,944	613	1,286	1,459	4,036	(134)	23,204
Depreciation and amortization	1,908	30	102	6	6	—	2,052
Capital expenditures	2,477	42	274	2	25	—	2,820
1993							
Sales and other revenues	8,870	956	561	—	32	(125)	10,294
Operating income (loss) from continuing operations ⁴	1,035	356	(29)	—	(89)	—	1,273
Identifiable assets	15,423	450	1,175	—	3,821	(189)	20,680
Depreciation and amortization	1,828	16	104	—	7	—	1,955
Capital expenditures	2,226	32	175	—	8	—	2,441

¹ Includes revenue from directory publishing activities in Europe of \$122, \$78 and \$7, and identifiable assets of \$133, \$124 and \$4 for 1995, 1994 and 1993, respectively.

² Results of operations have been included since the date of acquisition of the Atlanta Systems.

³ Includes U S WEST's equity method investments and the capital assets segment, which has been discontinued and is held for sale.

⁴ Includes pretax restructuring charges of \$880, \$50 and \$70 for the communications and related services, directory and information services and wireless communications segments, respectively.

Operating income represents sales and other revenues less operating expenses, and excludes interest expense, equity losses in unconsolidated ventures, other income (expense) and income taxes. Identifiable assets are those assets used in each segment's operations. Corporate and other assets consist primarily of cash, debt securities, investments in international ventures, the investment in Time Warner Entertainment, the net investment in assets held for sale and other assets. Corporate and other operating losses include general corporate expenses and administrative costs primarily associated with the Media Group equity investments.

Significant Concentrations The largest volume of the Communications Group's services are provided to AT&T. During 1995, 1994 and 1993, revenues related to those services provided to AT&T were \$1,085, \$1,130 and \$1,159, respectively. Related accounts receivable at December 31, 1995 and 1994, totaled \$91 and \$98, respectively. As of December 31, 1995, the Communications Group is not aware of any other significant concentration of business transacted with a particular customer, supplier or lender that could, if suddenly eliminated, severely impact operations.

To ensure consistency and quality of service, the wireless segment uses Motorola as its primary vendor for infrastructure equipment and cellular mobile telephone equipment and accessories. In addition, Motorola provides ongoing technological support for the infrastructure equipment. The infrastructure of approximately 75 percent of the Media Group's major cellular markets is comprised of Motorola equipment.

Wireless Communications Segment During 1994, U S WEST signed a definitive agreement with AirTouch Communications to combine their domestic cellular assets. The initial equity ownership of this cellular joint venture will be approximately 70 percent AirTouch and approximately 30 percent U S WEST.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: INDUSTRY SEGMENTS (Continued)

The combination will take place in two phases. During Phase I, which U S WEST entered effective November 1, 1995, the two companies are operating their cellular properties separately. A Wireless Management Company (the "WMC") has been formed and is providing centralized services to both companies on a contract basis. In Phase II, AirTouch and U S WEST will contribute their domestic cellular assets to the WMC. In this phase, the Company will reflect its share of the combined operating results of the WMC using the equity method of accounting. The recent passage of the Telecommunications Act of 1996 has removed significant regulatory barriers to completion of Phase II of the business combination. U S WEST expects that Phase II closing could take place by the end of 1996 or early 1997.

NOTE 4: ACQUISITION OF CABLE SYSTEMS

Atlanta Systems On December 6, 1994, U S WEST acquired the stock of Wometco Cable Corp. and subsidiaries, and the assets of Georgia Cable Partners and Atlanta Cable Partners L.P. (the "Atlanta Systems"), for cash of \$745 and 12,779,206 U S WEST common shares valued at \$459, for a total purchase price of approximately \$1.2 billion. The Atlanta Systems' results of operations have been included in the consolidated results of operations of the Company since the date of acquisition. Had the acquisition occurred as of January 1, 1994, the Company's revenue, net income and earnings per common share for 1994 would have been \$11,143, \$1,415 and \$3.04, respectively.

The acquisition was accounted for using the purchase method. Accordingly, the purchase price was allocated to assets acquired (primarily identified intangibles) based on their estimated fair values. The identified intangibles and goodwill are being amortized on a straight-line basis over 25 years.

Continental Cablevision, Inc. (Subsequent Event) On February 27, 1996, the Company announced a definitive agreement to merge with Continental Cablevision, Inc. ("Continental"). Continental, the nation's third-largest cable operator, serves 4.2 million domestic customers, passes more than seven million domestic homes and holds significant other domestic and international properties. U S WEST will purchase all of Continental's stock for approximately \$5.3 billion and will assume Continental's debt and other obligations, which amount to approximately \$5.5 billion. Consideration for the \$5.3 billion in equity will consist of approximately \$1 billion in U S WEST preferred stock, convertible to Media Stock; and, at U S WEST's option, between \$1 billion and \$1.5 billion in cash, and \$2.8 billion to \$3.3 billion in shares of Media Stock. The transaction, which is expected to close in the fourth quarter of 1996, is subject to a number of conditions and approvals, including approvals from Continental shareholders and local franchising and government authorities.

NOTE 5: INVESTMENT IN TIME WARNER ENTERTAINMENT

On September 15, 1993, U S WEST acquired 25.51 percent pro-rata priority capital and residual equity interests ("equity interests") in Time Warner Entertainment Company L.P. ("TWE" or "Time Warner Entertainment") for an aggregate purchase price of \$2.553 billion. TWE owns and operates substantially all of the entertainment assets previously owned by Time Warner Inc. ("Time Warner"), consisting primarily of its filmed entertainment, programming-HBO and cable businesses.

Upon U S WEST's admission to the partnership, certain wholly owned subsidiaries of Time Warner ("General Partners") and subsidiaries of Toshiba Corporation and ITOCHU Corporation held pro-rata priority capital and residual equity interests of 63.27, 5.61 and 5.61 percent, respectively. In 1995, Time Warner acquired the limited partnership interests previously held by subsidiaries of each of ITOCHU Corporation and Toshiba Corporation.

U S WEST has an option to increase its pro-rata priority capital and residual equity interests in TWE from 25.51 percent up to 31.84 percent depending upon cable operating performance. The option is

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5: INVESTMENT IN TIME WARNER ENTERTAINMENT (Continued)

exercisable, in whole or part, between January 1, 1999, and May 31, 2005, for an aggregate cash exercise price ranging from \$1.25 billion to \$1.8 billion, depending upon the year of exercise. Either TWE or U S WEST may elect that the exercise price for the option be paid with partnership interests rather than cash.

Pursuant to the TWE Partnership Agreement, there are four levels of capital. From the most to least senior, the capital accounts are: senior preferred (held by the General Partners); pro-rata priority capital (A preferred — held pro rata by the general and limited partners); junior priority capital (B preferred — held by the General Partners); and common (residual equity interests held pro rata by the general and limited partners). Of the \$2.553 billion contributed by U S WEST, \$1.658 billion represents A preferred capital and \$895 represents common capital. The TWE Partnership Agreement provides for special allocations of income and distributions of partnership capital. Partnership income, to the extent earned, is allocated as follows: (1) to the partners so that the economic burden of the income tax consequences of partnership operations is borne as though the partnership was taxed as a corporation ("special tax allocations"); (2) to the partners' preferred capital accounts in order of priority described above, at various rates of return ranging from 8 percent to 13.25 percent; and (3) to the partners' common capital according to their residual partnership interests. To the extent partnership income is insufficient to satisfy all special allocations in a particular accounting period, the unearned portion is carried over until satisfied out of future partnership income. Partnership losses generally are allocated in reverse order, first to eliminate prior allocations of partnership income, except senior preferred and special tax income, next to reduce initial capital amounts, other than senior preferred, then to reduce the senior preferred account and finally, to eliminate special tax allocations.

A summary of the contributed capital and priority capital rates of return follows:

Priority of Contributed Capital	Contributed Capital ^a	Priority Capital Rates of Return ^b (% per annum compounded quarterly)	Time Warner General Partners	Limited Partners	
				Time Warner (ownership %)	U S WEST
Senior preferred	\$1,400 ^c	8.00%	100.00%	—	—
Pro-rata priority capital	5,600	13.00% ^d	63.27%	11.22%	25.51%
Junior priority capital	2,900 ^e	13.25% ^f	100.00%	—	—
Residual equity capital	3,300	—	63.27%	11.22%	25.51%

^a Estimated fair value of net assets contributed excluding partnership income or loss allocated thereto.

^b Income allocations related to priority capital rates of return are based on partnership income after any special tax allocations.

^c The senior preferred is scheduled to be distributed in three annual installments beginning July 1, 1997.

^d 11.00 percent to the extent concurrently distributed.

^e Includes \$300 for the September 1995 reacquisition of assets previously excluded from the partnership (the Time Warner service partnership assets) for regulatory reasons.

^f 11.25 percent to the extent concurrently distributed.

Cash distributions are required to be made to the partners to permit them to pay income taxes at statutory rates based on their allocable taxable income from TWE ("Tax Distributions"). The aggregate amount of such Tax Distributions is computed generally by reference to the taxes that TWE would have been required to pay if it were a corporation. Tax Distributions were previously subject to restrictions until July 1995, and are now paid to the partners on a current basis. For distributions other than those related to taxes or the senior preferred, the TWE Partnership Agreement requires certain cash distribution thresholds be met to the limited partners before the General Partners receive their full share of distributions. No cash distributions have been made to U S WEST.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5: INVESTMENT IN TIME WARNER ENTERTAINMENT (Continued)

U S WEST accounts for its investment in TWE under the equity method of accounting. The excess of fair market value over the book value of total partnership net assets implied by U S WEST's initial investment was \$5.7 billion. This excess is being amortized on a straight-line basis over 25 years. The Company's recorded share of TWE operating results represents allocated TWE net income or loss adjusted for the amortization of the excess of fair market value over the book value of the partnership net assets. As a result of this amortization and the special income allocations described above, the Company's recorded pretax share of TWE operating results before extraordinary item was \$(31), \$(18) and \$(20) in 1995, 1994 and 1993, respectively. In addition, TWE recorded an extraordinary loss for the early extinguishment of debt in 1995. The Company's share of this extraordinary loss was \$4, net of an income tax benefit of \$2.

As consideration for its expertise and participation in the cable operations of TWE, the Company earns a management fee of \$130 over five years, which is payable over a four-year period beginning in 1995. Management fees of \$26, \$26 and \$8 were recorded to other income in 1995, 1994 and 1993, respectively. Included in the U S WEST Consolidated Balance Sheet is a note payable to TWE of \$169 and \$771 and management fee receivables of \$50 and \$34 at December 31, 1995 and 1994, respectively.

Summarized financial information for TWE is presented below:

<u>Summarized Operating Results</u>	<u>Year Ended December 31,</u>		
	<u>1995</u>	<u>1994</u>	<u>1993</u>
Revenues	\$9,517	\$8,460	\$7,946
Operating expenses ¹	8,557	7,612	7,063
Interest and other expense, net ²	777	647	611
Income before income taxes and extraordinary item	\$ 183	\$ 201	\$ 272
Income before extraordinary item	97	161	208
Net income	\$ 73	\$ 161	\$ 198

¹ Includes depreciation and amortization of \$1,039, \$943 and \$902 in 1995, 1994 and 1993, respectively.

² Includes corporate services of \$64, \$60 and \$60 in 1995, 1994 and 1993, respectively.

<u>Summarized Financial Position</u>	<u>Year Ended December 31,</u>	
	<u>1995</u>	<u>1994</u>
Current assets ³	\$ 2,909	\$ 3,573
Noncurrent assets ⁴	15,996	15,089
Current liabilities	3,214	2,857
Noncurrent liabilities, including minority interest	7,787	7,909
Senior preferred capital	1,426	1,663
Partners' capital ^{5,6}	6,478	6,233

³ Includes cash of \$209 and \$1,071 at December 31, 1995 and 1994, respectively.

⁴ Includes a loan receivable from Time Warner of \$400 at December 31, 1995 and 1994.

⁵ Net of a note receivable from U S WEST of \$169 and \$771 at December 31, 1995 and 1994, respectively.

⁶ Contributed capital is based on the estimated fair value of the net assets that each partner contributed to the partnership. The aggregate of such amounts is significantly higher than TWE's partner's capital as reflected in the Summarized Financial Position, which is based on the historical cost of the contributed net assets.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5: INVESTMENT IN TIME WARNER ENTERTAINMENT (Continued)

In early 1995, Time Warner announced its intention to simplify its corporate structure by establishing an enterprise that will be responsible for the overall management and financing of the cable and telecommunications properties. Any change in the structure of TWE would require U S WEST's approval in addition to certain creditors' and regulatory approvals. (See Note 19 to the Consolidated Financial Statements for disclosure related to litigation with Time Warner.)

NOTE 6: RESTRUCTURING CHARGE

The Company's 1993 results reflect a \$1 billion restructuring charge (pretax). The related restructuring plan (the "Restructuring Plan") is designed to provide faster, more responsive customer services, while reducing the costs of providing these services. As part of the Restructuring Plan, the Company is developing new systems and enhanced system functionality that will enable it to monitor networks to reduce the risk of service interruptions, activate telephone service on demand, rapidly design and engineer new services for customers and centralize its service centers. The Company has consolidated its 560 customer service centers into 26 centers in 10 cities and reducing its total work force by approximately 10,000 employees. This increased the number of employee separations to 10,000 from 9,000, and increased the estimated total cost for employee separations to \$316, compared with \$286 in the original estimate. Approximately 1,000 employees that were originally expected to relocate have chosen separation or other job assignments and have been replaced. The \$30 cost associated with these additional employee separations was reclassified from relocation to the reserve for employee separations during 1995.

Following is a schedule of the costs included in the 1993 restructuring charge:

	1993 Restructuring Charge	Change in Estimate	December 31, 1995 Estimate
Employee separation ¹	\$ 230	\$ 30	\$ 260
Systems development	400	—	400
Real estate	130	—	130
Relocation	110	(30)	80
Retraining and other	65	—	65
Asset write-down	65	—	65
Total	<u>\$1,000</u>	<u>\$—</u>	<u>\$1,000</u>

¹Employee separation costs, including the balance of a 1991 restructuring reserve at December 31, 1993, aggregate \$316.

Employee separation costs include severance payments, health-care coverage and postemployment education benefits. System development costs include new systems and the application of enhanced system functionality to existing single-purpose systems to provide integrated end-to-end customer service. Real estate costs include preparation costs for the new service centers. The relocation and retraining costs are related to moving employees to the new service centers and retraining employees on the methods and systems required in the new, restructured mode of operation.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6: RESTRUCTURING CHARGE (Continued)

The following table shows amounts charged to the restructuring reserve:

	1993 Restructuring Reserve	1994 Activity	1995 Activity	Change in Estimate	December 31, 1995 Balance
Employee separation ¹	\$286	\$ 75	\$ 76	\$ 30	\$165
Systems development	400	127	145	—	128
Real estate	130	50	66	—	14
Relocation	110	21	24	(30)	35
Retraining and other	65	16	23	—	26
Total	<u>\$991</u>	<u>\$289</u>	<u>\$334</u>	<u>\$—</u>	<u>\$368</u>

¹ Includes \$56 associated with work-force reductions under a 1991 restructuring plan.

Employee separations under the Restructuring Plan in 1995 and 1994 were as follows:

	1994 Separations	1995 Separations	Cumulative Separations at December 31, 1995
Employee separations:			
Managerial	497	682	1,179
Occupational	1,683	1,643	3,326
Total	<u>2,180</u>	<u>2,325</u>	<u>4,505</u>

The Restructuring Plan is expected to be substantially completed by the end of 1997. Implementation of the Restructuring Plan has been impacted by growth in the business and related service issues, new business opportunities, revisions to system delivery schedules and productivity issues caused by the major rearrangement of resources due to restructuring. These issues will continue to affect the timing of employee separations.

NOTE 7: INVESTMENTS IN INTERNATIONAL VENTURES

The significant investments in international ventures follows:

Venture	Location	Line of Business	Ownership Percentage	Net Investment at December 31,	
				1995	1994
TeleWest	United Kingdom	C&T	26.8	\$ 540	\$456
Binariang Sdn Bhd	Malaysia	C&T	20	224	50
A2000 (KTA)	Netherlands	C&T	50	218	—
One 2 One	United Kingdom	W	50	73	123
All other				456	252
Total				<u>\$1,511</u>	<u>\$881</u>

C&T Cable and Telecommunications

W Wireless

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7: INVESTMENTS IN INTERNATIONAL VENTURES (Continued)

The following table shows summarized combined financial information for the Company's significant equity method investments in international ventures:

	Year Ended December 31,		
	1995	1994	1993
Combined Operations			
Revenue	\$1,163	\$ 580	\$ 296
Operating expenses	1,264	684	354
Depreciation and amortization	272	140	60
Operating loss	(373)	(244)	(118)
Interest and other, net	(141)	(75)	(40)
Loss before extraordinary item	(514)	(319)	(158)
Extraordinary gain — interest rate swaps	—	11	—
Net loss	\$ (514)	\$ (308)	\$ (158)
Combined Financial Position			
	Year Ended December 31,		
	1995	1994	
Current assets	\$1,469	\$ 714	
Property, plant and equipment — net	3,545	1,462	
Other assets	1,644	343	
Total assets	\$6,658	\$2,519	
Current liabilities	\$1,260	\$ 344	
Long-term debt	2,065	463	
Other liabilities	58	71	
Owners' equity	3,275	1,641	
Total liabilities and equity	\$6,658	\$2,519	

In November 1994, TeleWest plc ("TeleWest") made an initial public offering of its ordinary shares. Following the offering, in which U S WEST sold part of its 50 percent joint venture interest, U S WEST owned approximately 37.8 percent of TeleWest. Net proceeds of approximately \$650 were used by TeleWest to finance construction and operating costs, invest in affiliated companies and repay debt. It is U S WEST's policy to recognize as income any gains or losses related to the sale of stock to the public. The Company recognized a gain of \$105 in 1994, net of \$59 in deferred taxes, for the partial sale of its joint venture interest in TeleWest.

On October 2, 1995, TeleWest and SBC CableComms (UK) completed a merger of their UK cable television and telecommunications interests, creating the largest provider of combined cable and telecommunications services in the United Kingdom. Following completion of the merger, U S WEST and TeleCommunications, Inc., the major shareholders, each own 26.8 percent of the combined company. The Company recognized a gain of \$95 in 1995, net of \$62 in deferred income taxes, in conjunction with the merger.

TeleWest, which is the only equity method investment for which a quoted market price is available, had a market value of \$914 at December 31, 1995, and \$1,004 at December 31, 1994.

Foreign Currency Transactions U S WEST enters into forward and zero-cost combination option contracts to manage foreign currency risk. Under a forward contract, U S WEST agrees with another party to exchange a foreign currency and U.S. dollars at a specified price at a future date. Under combination

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7: INVESTMENTS IN INTERNATIONAL VENTURES (Continued)

options, U S WEST combines purchased options to cap the foreign exchange rate to be paid at a future date with written options to finance the premium of the purchased options. The commitments, forward contracts and combination options are for periods up to one year.

Forward exchange contracts are carried at market value. Gains or losses on the portion of the contracts designated as hedges of firm equity investment commitments are deferred as a component of equity and are recognized in income upon sale of the investment. Gains or losses on the portion of the contracts designated to offset translation of investee net income are recorded in income.

Forward contracts are also used to hedge foreign denominated loans. These contracts are carried at market value with gains or losses recorded in income.

Foreign exchange contracts outstanding follow:

	Type	U.S. Equivalent December 31.	
		1995	1994
Forwards:			
Dutch Guilders	Buy	\$225	\$—
British pounds	Buy	130	135
British pounds	Sell	37	—
Japanese yen	Buy	25	—
French francs	Buy	19	—
Combination options:			
British pounds	—	\$—	\$ 35
French francs	—	20	—

Cumulative deferred gains on foreign exchange contracts of \$9 and deferred losses of \$25, including deferred taxes (benefits) of \$4 and (\$10), respectively, are included in equity at December 31, 1995. Cumulative deferred gains on foreign exchange contracts of \$7 and deferred losses of \$25, including deferred taxes (benefits) of \$3 and (\$10), respectively, are included in equity at December 31, 1994.

The counterparties to these contracts are major financial institutions. U S WEST is exposed to credit loss in the event of nonperformance by these counterparties. The Company does not have significant exposure to an individual counterparty and does not anticipate nonperformance by any counterparty.

NOTE 8: PROPERTY, PLANT AND EQUIPMENT

The composition of property, plant and equipment follows:

	December 31.	
	1995	1994
Land and buildings	\$ 2,627	\$ 2,604
Telephone network equipment	12,019	11,622
Telephone outside plant	12,353	11,897
Cellular systems	733	585
Cable distribution systems	167	148
General purpose computers and other	4,051	3,425
Construction in progress	934	733
	32,884	31,014
Less accumulated depreciation	18,207	17,017
Property, plant and equipment — net	<u>\$14,677</u>	<u>\$13,997</u>

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8: PROPERTY, PLANT AND EQUIPMENT (Continued)

In 1995, U S WEST Communications sold certain rural telephone exchanges with a cost basis of \$258. U S WEST Communications received consideration for the sales of \$388, including \$214 in cash. In 1994, U S WEST Communications sold certain rural telephone exchanges with a cost basis of \$122 and received consideration of \$204, including \$93 in cash.

The Media Group businesses depreciate buildings between 15 to 35 years, cellular and cable distribution systems between 5 to 15 years, and general purpose computers and other between 3 to 20 years. See "Discontinuance of SFAS No. 71" for depreciation rates used by the Communications Group.

Discontinuance of SFAS No. 71

U S WEST Communications incurred a noncash, extraordinary charge of \$3.1 billion, net of an income tax benefit of \$2.3 billion, in conjunction with its decision to discontinue accounting for the operations of U S WEST Communications in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," as of September 30, 1993. SFAS No. 71 generally applies to regulated companies that meet certain requirements, including a requirement that a company be able to recover its costs, notwithstanding competition, by charging its customers at prices established by its regulators. U S WEST Communications' decision to discontinue application of SFAS No. 71 was based on the belief that competition, market conditions and technological advances, more than prices established by regulators, will determine the future cost recovery by U S WEST Communications. As a result of this change, the remaining asset lives of U S WEST Communications' plant were shortened to more closely reflect the useful (economic) lives of such plant.

Following is a list of the major categories of telephone property, plant and equipment and the manner in which depreciable lives were affected by the discontinuance of SFAS No. 71:

Category	Average Life (years)	
	Before Discontinuance	After Discontinuance
Digital switch	17-18	10
Digital circuit	11-13	10
Aerial copper cable	18-28	15
Underground copper cable	25-30	15
Buried copper cable	25-28	20
Fiber cable	30	20
Buildings	27-49	27-49
General purpose computers	6	6

U S WEST Communications employed two methods to determine the amount of the extraordinary charge. The "economic life" method assumed that a portion of the plant-related effect is a regulatory asset that was created by the under-depreciation of plant under regulation. This method yielded the plant-related adjustment that was confirmed by the second method, a discounted cash flows analysis.

Following is a schedule of the nature and amounts of the after-tax charge recognized as a result of U S WEST Communications' discontinuance of SFAS No. 71:

Plant related	\$3,124
Tax-related regulatory assets and liabilities	(208)
Other regulatory assets and liabilities	207
Total	<u>\$3,123</u>

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9: INTANGIBLE ASSETS

The composition of intangible assets follows:

	December 31,	
	1995	1994
Identified intangibles, primarily franchise value	\$1,183	\$1,166
Goodwill	743	762
Total	1,926	1,928
Less accumulated amortization	128	70
Total intangible assets — net	<u>\$1,798</u>	<u>\$1,858</u>

NOTE 10: DEBT

Short-term Debt

The components of short-term debt follow:

	December 31,	
	1995	1994
Notes payable:		
Commercial paper	\$ 807	\$2,305
Bank loan	216	—
Current portion of long-term debt	1,029	732
Allocated to the capital assets segment — net	(151)	(200)
Total	<u>\$1,901</u>	<u>\$2,837</u>

The weighted average interest rate on commercial paper was 5.79 percent and 5.97 percent at December 31, 1995 and 1994, respectively.

The bank loan, in the translated principal amount of \$216, is denominated in Dutch guilders. The loan was entered into in connection with U S WEST's investment in a cable television venture in the Netherlands and was repaid in February 1996.

U S WEST maintains a commercial paper program to finance short-term cash flow requirements, as well as to maintain a presence in the short-term debt market. U S WEST is permitted to borrow up to approximately \$1.9 billion under lines of credit, all of which was available at December 31, 1995.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10: DEBT (Continued)

Long-term Debt

Interest rates and maturities of long-term debt at December 31 follow:

Interest rates	Maturities					Total 1995	Total 1994
	1997	1998	1999	2000	Thereafter		
Up to 5%	\$—	\$ 35	\$—	\$ 90	\$ 150	\$ 275	\$ 546
Above 5% to 6%	—	430	—	—	261	691	574
Above 6% to 7%	—	—	126	363	2,773	3,262	1,361
Above 7% to 8%	16	—	—	—	3,214	3,230	3,193
Above 8% to 9%	—	—	107	—	290	397	444
Above 9% to 10%	29	—	15	200	10	254	399
Above 10%	1	1	—	—	—	2	—
Variable rate debt (indexed to two- and ten-year constant maturity Treasury rates)	25	—	155	—	—	180	180
	<u>\$ 71</u>	<u>\$466</u>	<u>\$403</u>	<u>\$653</u>	<u>\$6,698</u>	<u>8,291</u>	<u>6,697</u>
Capital lease obligations and other						197	153
Unamortized discount — net						(1,178)	(1,239)
Allocated to the capital assets segment — net						(356)	(510)
Total						<u>\$ 6,954</u>	<u>\$ 5,101</u>

Long-term debt consists principally of debentures, medium-term notes, debt associated with the Company's Leveraged Employee Stock Ownership Plans ("LESOP"), and zero coupon subordinated notes convertible at any time into equal shares of Communications Stock and Media Stock. The zero coupon notes have a yield to maturity of approximately 7.3 percent. The zero coupon notes are recorded at a discounted value of \$521 and \$498 at December 31, 1995 and 1994, respectively.

In 1995, U S WEST issued \$130 of Debt Exchangeable for Common Stock ("DECS"), due December 15, 1998, in the principal amount of \$24.00 per note. The notes bear interest at 7.625 percent, of which 1.775 percent has been included in the assets held for sale reserve. Upon maturity, each DECS will be mandatorily redeemed by U S WEST for shares of Enhance Financial Services Group, Inc. ("Enhance") held by U S WEST or the cash equivalent, at U S WEST's option. The number of shares to be delivered at maturity varies based on the per share market price of Enhance. If the market price is \$24.00 per share or less, one share of Enhance will be delivered for each note; if the market price is between \$24.00 and \$28.32 per share, a fractional share equal to \$24.00 is delivered; if the market value is greater than \$28.32 per share, .8475 shares are delivered. The capital assets segment currently owns approximately 31.5 percent of the outstanding Enhance common stock.

During 1995, U S WEST refinanced \$2.6 billion of commercial paper to take advantage of favorable long-term interest rates. In addition to the commercial paper, U S WEST refinanced \$145 of long-term debt. Expenses associated with the refinancing of long-term debt resulted in extraordinary charges to income of \$8, net of an income tax benefit of \$5.

During 1993, U S WEST refinanced long-term debt issues aggregating \$2.7 billion in principal amount. Expenses associated with the refinancing resulted in an extraordinary charge to income of \$77, net of a tax benefit of \$48.

At December 31, 1995, U S WEST guaranteed debt in the principal amount of approximately \$140, primarily related to international ventures.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10: DEBT (Continued)

Interest payments, net of amounts capitalized, were \$518, \$523 and \$670 in 1995, 1994 and 1993, respectively, of which \$87, \$134 and \$272, respectively, relate to the capital assets segment.

Interest Rate Risk Management

Interest rate swap agreements are primarily used to effectively convert existing commercial paper to fixed-rate debt. This allows U S WEST to achieve interest savings over issuing fixed-rate debt directly.

Under an interest rate swap, U S WEST agrees with another party to exchange interest payments at specified intervals over a defined term. Interest payments are calculated by reference to the notional amount based on the fixed- and variable-rate terms of the swap agreements. The net interest received or paid as part of the interest rate swap is accounted for as an adjustment to interest expense.

During 1995 and 1994, U S WEST Communications entered into currency swaps to convert Swiss franc-denominated debt to dollar-denominated debt. This allowed U S WEST Communications to achieve interest savings over issuing fixed-rate, dollar-denominated debt. The currency swap and foreign currency debt are combined and accounted for as if fixed-rate, dollar-denominated debt were issued directly.

The following table summarizes terms of swaps. Variable rates are indexed to two- and ten-year constant maturity Treasury and 30-day commercial paper rates.

	December 31,							
	1995				1994			
	Notional Amount	Maturities	Weighted Average Rate		Notional Amount	Maturities	Weighted Average Rate	
			Receive	Pay			Receive	Pay
Variable to fixed	\$635	1996-2004	5.72	6.80	\$785	1995-2004	6.14	6.47
Fixed to variable	—	—	—	—	5	1995	6.61	5.87
Currency	204	1999-2001	—	6.55	71	1999	—	6.53

In 1993, U S WEST Communications executed forward contracts to sell U.S. Treasury bonds to lock in the U.S. Treasury rate component of the future debt issue. At December 31, 1995, deferred credits of \$8 and deferred charges of \$51 on closed forward contracts are included as part of the carrying value of the underlying debt. The deferred credits and charges are being recognized as a yield adjustment over the life of the debt, which matures at various dates through 2043. The net deferred charge is directly offset by the lower coupon rate achieved on the debt issuance. At December 31, 1995, there were no open forward contracts.

The counterparties to these interest rate contracts are major financial institutions. U S WEST is exposed to credit loss in the event of nonperformance by these counterparties. U S WEST manages this exposure by monitoring the credit standing of the counterparty and establishing dollar and term limitations which correspond to the respective credit rating of each counterparty. U S WEST does not have significant exposure to an individual counterparty and does not anticipate nonperformance by any counterparty.

NOTE 11: FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair values of cash equivalents, other current amounts receivable and payable, and short-term debt approximate carrying values due to their short-term nature.

The fair values of mandatorily redeemable preferred stock and long-term receivables, based on discounting future cash flows, approximate the carrying values. The fair value of foreign exchange contracts, based on estimated amounts U S WEST would receive or pay to terminate such agreements, approximate the carrying values. It is not practicable to estimate the fair value of financial guarantees associated with international operations because there are no quoted market prices for similar transactions.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11: FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The fair values of interest rate swaps, including swaps associated with the capital assets segment, are based on estimated amounts U S WEST would receive or pay to terminate such agreements taking into account current interest rates and creditworthiness of the counterparties.

The fair values of long-term debt, including debt associated with the capital assets segment, are based on quoted market prices where available or, if not available, are based on discounting future cash flows using current interest rates.

	December 31,			
	1995		1994	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Debt (includes short-term portion)	\$9,651	\$10,050	\$9,221	\$8,700
Interest rate swap agreements — assets	—	(32)	—	(15)
Interest rate swap agreements — liabilities	—	51	—	20
Debt — net	<u>\$9,651</u>	<u>\$10,069</u>	<u>\$9,221</u>	<u>\$8,705</u>
Preferred Securities	\$ 600	\$ 636	\$ —	\$ —
Preferred stock	<u>51</u>	<u>55</u>	<u>51</u>	<u>51</u>

Investments in debt securities are classified as available for sale and are carried at market value. These securities have various maturity dates through the year 2001. The market value of these securities is based on quoted market prices where available or, if not available, is based on discounting future cash flows using current interest rates.

The amortized cost and estimated market value of debt securities follow:

Debt Securities	December 31,							
	1995				1994			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate debt	\$20	\$—	\$—	\$20	\$19	\$—	\$—	\$19
Securitized loan	55	—	(5)	50	—	—	—	—
Total	<u>\$75</u>	<u>\$—</u>	<u>\$ (5)</u>	<u>\$70</u>	<u>\$19</u>	<u>\$—</u>	<u>\$—</u>	<u>\$19</u>

The 1995 net unrealized losses of \$3 (net of a deferred tax benefit of \$2) are included in equity.

NOTE 12: LEASING ARRANGEMENTS

U S WEST has entered into operating leases for office facilities, equipment and real estate. Rent expense under operating leases was \$263, \$288 and \$275 in 1995, 1994 and 1993, respectively. Minimum future lease payments as of December 31, 1994, under noncancelable operating leases, follow:

Year	
1996	\$ 159
1997	152
1998	145
1999	127
2000	117
Thereafter	<u>777</u>
Total	<u>\$1,477</u>

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13: PREFERRED STOCK

U S WEST has 200,000,000 authorized shares of preferred stock, 10,000,000 shares of which are designated as Series A Junior Participating Cumulative Preferred Stock, par value \$1.00 per share, 10,000,000 shares of which are designated as Series B Junior Participating Cumulative Preferred Stock, par value \$1.00 per share, and 50,000 shares of which are designated as Series C Preferred Stock, par value \$1.00 per share.

Preferred Stock Subject to Mandatory Redemption

On September 2, 1994, the Company issued to Fund American Enterprises Holdings Inc. ("FFE") 50,000 shares of 7 percent Series C Cumulative Redeemable Preferred Stock for a total of \$50. (See Note 20 to the Consolidated Financial Statements.) Upon issuance, the preferred stock was recorded at fair market value of \$51. U S WEST has the right, commencing five years from September 2, 1994, to redeem the shares for one thousand dollars per share plus unpaid dividends and a redemption premium. The shares are mandatorily redeemable in year ten at face value plus unpaid dividends. At the option of FFE, the preferred stock also can be redeemed for common shares of Financial Security Assurance, an investment held by the capital assets segment. The market value of the option was \$20 and \$22 (based on the Black-Scholes Model) at December 31, 1995 and 1994, with no carrying value.

**NOTE 14: COMPANY-OBLIGATED MANDATORILY REDEEMABLE PREFERRED SECURITIES
OF SUBSIDIARY TRUST HOLDING SOLELY COMPANY-GUARANTEED DEBENTURES**

On September 11, 1995, U S WEST Financing I, a wholly owned subsidiary of U S WEST ("Financing I"), issued \$600 million of 7.96 percent Trust Originated Preferred Securities (the "Preferred Securities") and \$19 of common securities. U S WEST holds all of the outstanding common securities of Financing I. Financing I used the proceeds from such issuance to purchase from U S WEST Capital Funding, Inc., a wholly owned subsidiary of U S WEST ("Capital Funding"), \$619 principal amount of Capital Funding's 7.96 percent Subordinated Deferrable Interest Notes due 2025 (the "Subordinated Debt Securities"), the obligations under which are fully and unconditionally guaranteed by U S WEST (the "Debt Guarantee"). The sole assets of Financing I are and will be the Subordinated Debt Securities and the Debt Guarantee.

In addition, U S WEST has guaranteed the payment of interest and redemption amounts to holders of Preferred Securities when Financing I has funds available for such payments (the "Payment Guarantee") as well as Capital Funding's undertaking to pay all of Financing I's costs, expenses and other obligations (the "Expense Undertaking"). The Payment Guarantee and the Expense Undertaking, including U S WEST's guarantee with respect thereto, considered together with Capital Funding's obligations under the indenture and Subordinated Debt Securities and U S WEST's obligations under the indenture, declaration and Debt Guarantee, constitute a full and unconditional guarantee by U S WEST of Financing I's obligations under the Preferred Securities. The interest and other payment dates on the Subordinated Debt Securities correspond to the distribution and other payment dates on the Preferred Securities. Under certain circumstances, the Subordinated Debt Securities may be distributed to the holders of Preferred Securities and common securities in liquidation of Financing I. The Subordinated Debt Securities are redeemable in whole or in part by Capital Funding at any time on or after September 11, 2000, at a redemption price of \$25.00 per Subordinated Debt Security plus accrued and unpaid interest. If Capital Funding redeems the Subordinated Debt Securities, Financing I is required to redeem the Preferred Securities concurrently at \$25.00 per share plus accrued and unpaid distributions. As of December 31, 1995, 24,000,000 Preferred Securities were outstanding.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 15: SHAREOWNERS' EQUITY

	Communications Stock Shares	Media Stock Shares	U S WEST Stock Shares	Amount	Cumulative Deficit	Foreign Currency Translation	LESOP Guarantee
Balance December 31, 1992			414,462	\$5,770	\$ 2,826	\$(34)	\$(294)
Issuance of common stock			26,516	1,224			
Issuance of treasury stock			162	6			
Net income					(2,806)		
Common dividends declared (\$2.12 per share)					(905)		
Market value adjustment for debt securities					35		
Foreign currency translation						(1)	
Other				(4)	(7)		51
Balance December 31, 1993			441,140	6,996	(857)	(35)	(243)
Issuance of common stock			18,647	694			
Settlement of litigation			5,506	210			
Benefit trust contribution (OPEB)			4,600	185			
Purchase of treasury stock			(550)	(20)			
Net income					1,426		
Common dividends declared (\$2.14 per share)					(980)		
Market value adjustment for debt securities					(64)		
Foreign currency translation						6	
Other				(9)	17		56
Balance December 31, 1994			469,343	8,056	(458)	(29)	(187)
Issuance of common stock			2,791	117			
Benefit trust contribution (OPEB)			1,500	61			
Purchase of treasury stock			(1,705)	(63)			
Other				3			
November 1, 1995 Recapitalization Plan	471,929	471,922	(471,929)				
Recapitalization Plan dissenters ¹	(6)						
Issuance of common stock	1,712	392		59			
Net income					1,317		
Common dividends declared (\$2.14 per share)					(1,010)		
Preferred dividends					(3)		
Market value adjustment for debt securities					36		
Foreign currency translation						(9)	
Other				(5)	3		60
Balance December 31, 1995	473,635	472,314	—	\$8,228	\$(115)	\$(38)	\$(127)

¹ Under the Recapitalization Plan, Media Stock was not issued to shareowners who elected to receive cash rather than Communications Stock and Media Stock. Dissenting shareowners were paid \$47.9375 per U S WEST share on December 15, 1995.

Common Stock On December 6, 1994, 12,779,206 shares of U S WEST common stock were issued to, or in the name of, the holders of Wometco Cable Corp. in accordance with a merger agreement. (See Note 4 to the Consolidated Financial Statements.) In connection with the settlement of shareowner litigation ("Rosenbaum v. U S WEST, Inc. et al."), the Company issued approximately 5.5 million shares of U S WEST common stock in March 1994 to class members connected with this litigation. U S WEST issued, to certified class members, nontransferable rights to purchase shares of common stock directly from U S WEST, on a commission-free basis, at a 3 percent discount from the average of the high and low trading prices of such stock on the New York Stock Exchange on February 23, 1994, the pricing date designated in accordance with the settlement. U S WEST received net proceeds of \$210 from the offering.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 15: SHAREOWNERS' EQUITY (Continued)

During fourth-quarter 1993, the Company issued 22 million additional shares of U S WEST common stock for net cash proceeds of \$1,020. The Company used the net proceeds to reduce short-term indebtedness, including indebtedness incurred from the TWE investment, and for general corporate purposes.

Leveraged Employee Stock Ownership Plan ("LESOP") U S WEST maintains a defined contribution savings plan for substantially all management and occupational employees of the Company. The Company matches a certain percentage of eligible employee contributions with shares of Communications Stock and/or Media Stock in accordance with participant elections. Participants may also elect to reallocate past Company contributions between Communications Stock and Media Stock. In 1989, U S WEST established two LESOPs to provide Company stock for matching contributions to the savings plan. At December 31, 1995, 10,145,485 shares each of Communications Stock and Media Stock has been allocated from the LESOP, while 2,839,435 shares each of Communications Stock and Media Stock remained unallocated.

The borrowings associated with the LESOP, which are unconditionally guaranteed by U S WEST, are included in the accompanying Consolidated Balance Sheets and corresponding amounts have been recorded as reductions to common shareowners' equity. Contributions from the Company as well as dividends on unallocated shares held by the LESOP (\$8, \$11 and \$14 in 1995, 1994 and 1993, respectively) are used for debt service. Beginning with the dividend paid in fourth-quarter 1995, dividends on allocated shares are being paid annually to participants. Previously, dividends on allocated shares were used for debt service with participants receiving additional shares from the LESOP.

U S WEST recognizes expense based on the cash payments method. Total Company contributions to the plan (excluding dividends) were \$86, \$80 and \$75 in 1995, 1994 and 1993, respectively, of which \$15, \$19 and \$24, respectively, have been classified as interest expense.

Shareholder Rights Plan The Board has adopted a shareholder rights plan which, in the event of a takeover attempt, would entitle existing shareowners to certain preferential rights. The rights expire on April 6, 1999, and are redeemable by the Company at any time prior to the date they would become effective.

Share Repurchase Subsequent to the acquisition of the Atlanta Systems (See Note 4 to the Consolidated Financial Statements) the Company announced its intention to purchase U S WEST common shares in the open market up to an amount equal to those issued in conjunction with the acquisition, subject to market conditions. In first-quarter 1995, the Company purchased 1,704,700 shares of U S WEST common stock at an average price per share of \$37.02. In December 1994, the Company purchased 550,400 shares of U S WEST common stock at an average price per share of \$36.30.

NOTE 16: STOCK INCENTIVE PLANS

U S WEST maintains stock incentive plans for executives and key employees, and nonemployees. The Amended 1994 Stock Plan (the "Plan") was approved by shareowners on October 31, 1995 in connection with the Recapitalization Plan. The Plan is a successor plan to the U S WEST, Inc. Stock Incentive Plan and the U S WEST 1991 Stock Incentive Plan (the "Predecessor Plans"). No further grants of options or restricted stock may be made under the Predecessor Plans. The Plan is administered by the Human Resources Committee of the board of directors with respect to officers, executive officers and outside directors and by a special committee with respect to all other eligible employees and eligible nonemployees.

During calendar year 1995, up to 2,200,000 shares of Communications Stock and 1,485,000 shares of Media Stock were available for grant. The maximum aggregate number of shares of Communications Stock and Media Stock that may be granted in any other calendar year for all purposes under the Plan is nine-tenths of one percent (0.90 percent) and three-quarters of one percent (0.75 percent), respectively, of the shares of such class outstanding (excluding shares held in the Company's treasury) on the first day of such calendar year. In the event that fewer than the full aggregate number of shares of either class available for

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 16: STOCK INCENTIVE PLANS (Continued)

issuance in any calendar year are issued in any such year, the shares not issued shall be added to the shares of such class available for issuance in any subsequent year or years. Options may be exercised no later than 10 years after the date on which the option was granted.

Data for outstanding options under the Plan is summarized as follows:

	Communications Group		Media Group		U S WEST, Inc.	
	Number of Shares	Average Option Price	Number of Shares	Average Option Price	Number of Shares*	Average Option Price
Outstanding January 1, 1993					4,450,150	\$ 35.81
Granted					1,486,106	48.83
Exercised					(412,444)	31.73
Canceled or expired					(222,273)	36.87
Outstanding December 31, 1993					5,301,539	\$ 39.76
Granted					2,438,409	36.15
Exercised					(139,762)	33.72
Canceled or expired					(214,149)	40.71
Outstanding December 31, 1994					7,386,037	\$ 38.66
Granted					3,062,920	43.63
Exercised					(430,631)	34.03
Canceled or expired					(175,147)	39.76
Outstanding October 31, 1995					9,843,179	\$ 40.39
Recapitalization Plan	9,843,179	\$24.11	9,843,179	\$16.28	(9,843,179)	\$(40.39)
Granted	138,309	32.16	71,580	18.51		
Exercised	(543,037)	21.23	(191,243)	14.71		
Canceled or expired	(15,350)	24.91	(15,350)	16.82		
Outstanding December 31, 1995	9,423,101	\$24.39	9,708,166	\$16.33	—	—

* Includes options granted in tandem with SARs.

Options to purchase 2,672,666 shares of Communications Stock and 3,021,166 shares of Media Stock were exercisable at December 31, 1995. Options to purchase 2,374,394 shares of U S WEST stock were exercisable at December 31, 1994. A total of 2,050,466 shares of Communications Stock and 1,419,795 shares of Media Stock were available for grant under the plans in effect at December 31, 1995. A total of 914,816 shares of U S WEST common stock were available for grant under the plans in effect at December 31, 1994. A total of 11,484,792 shares of Communications Stock and 11,121,186 shares of Media Stock were reserved for issuance under the Plan at December 31, 1995.

NOTE 17: EMPLOYEE BENEFITS

Pension Plan

U S WEST sponsors a defined benefit pension plan covering substantially all management and occupational employees of the Company. Management benefits are based on a final pay formula, while occupational benefits are based on a flat benefit formula. U S WEST uses the projected unit credit method for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. The Company's policy is to fund amounts required under the Employee Retirement Security Act of 1974 ("ERISA") and no funding was required in 1995, 1994 or 1993.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 17: EMPLOYEE BENEFITS (Continued)

The composition of the net pension cost and the actuarial assumptions of the plan follow:

	Year Ended December 31,		
	1995	1994	1993
Details of pension cost:			
Service cost — benefits earned during the period	\$ 173	\$ 197	\$ 148
Interest cost on projected benefit obligation	558	561	514
Actual return on plan assets	(1,918)	188	(1,320)
Net amortization and deferral	1,185	(946)	578
Net pension cost	<u>\$ (2)</u>	<u>\$ 0</u>	<u>\$ (80)</u>

The expected long-term rate of return on plan assets used in determining net pension cost was 8.50 percent for 1995, 8.50 percent for 1994 and 9.00 percent for 1993.

The funded status of the plan follows:

	December 31,	
	1995	1994
Accumulated benefit obligation, including vested benefits of \$5,839 and \$5,044, respectively	\$ 6,617	\$ 5,616
Plan assets at fair value, primarily stocks and bonds	\$ 9,874	\$ 8,388
Less: Projected benefit obligation	8,450	7,149
Plan assets in excess of projected benefit obligation	1,424	1,239
Unrecognized net (gain) loss	(101)	161
Prior service cost not yet recognized in net periodic pension cost	(62)	(67)
Balance of unrecognized net asset at January 1, 1987	(705)	(785)
Prepaid pension cost	<u>\$ 556</u>	<u>\$ 548</u>

The actuarial assumptions used to calculate the projected benefit obligation follow:

	December 31,	
	1995	1994
Discount rate	7.00%	8.00%
Weighted average rate of compensation increase	5.50%	5.50%

Anticipated future benefit changes have been reflected in the above calculations.

Postretirement Benefits Other Than Pensions

U S WEST and most of its subsidiaries provide certain health care and life insurance benefits to retired employees. In conjunction with the Company's 1992 adoption of SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," U S WEST elected to immediately recognize the accumulated postretirement benefit obligation for current and future retirees. However, the Federal Communications Commission and certain state jurisdictions permit amortization of the transition obligation over the average remaining service period of active employees for regulatory accounting purposes with most jurisdictions requiring funding as a stipulation for rate recovery.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 17: EMPLOYEE BENEFITS (Continued)

U S WEST uses the projected unit credit method for the determination of postretirement medical and life costs for financial reporting purposes. The composition of net postretirement benefit costs and actuarial assumptions underlying plan benefits follow:

	Year Ended December 31,								
	1995			1994			1993		
	Medical	Life	Total	Medical	Life	Total	Medical	Life	Total
Service cost — benefits earned during the period	\$ 59	\$ 6	\$ 65	\$ 62	\$ 13	\$ 75	\$ 60	\$ 11	\$ 71
Interest on accumulated benefit obligation	235	32	267	221	39	260	235	36	271
Actual return on plan assets . . .	(319)	(96)	(415)	3	1	4	(73)	(52)	(125)
Net amortization and deferral . .	228	50	286	(68)	(31)	(99)	27	22	49
Net postretirement benefit costs	<u>\$ 203</u>	<u>\$ 0</u>	<u>\$ 203</u>	<u>\$ 218</u>	<u>\$ 22</u>	<u>\$ 240</u>	<u>\$ 249</u>	<u>\$ 17</u>	<u>\$ 266</u>

The expected long-term rate of return on plan assets used in determining postretirement benefit costs was 8.50 percent for 1995, 8.50 percent in 1994 and 9.00 percent in 1993.

The funded status of the plans follows:

	December 31,					
	1995			1994		
	Medical	Life	Total	Medical	Life	Total
Accumulated postretirement benefit obligation attributable to:						
Retirees	\$ 1,866	\$ 271	\$ 2,137	\$ 1,733	\$ 248	\$ 1,981
Fully eligible plan participants	293	34	327	264	38	302
Other active plan participants	1,059	165	1,224	940	135	1,075
Total accumulated postretirement benefit obligation	3,218	470	3,688	2,937	421	3,358
Unrecognized net gain	378	161	539	243	90	333
Unamortized prior service cost	—	(34)	(34)	—	—	—
Fair value of plan assets, primarily stocks, bonds and life insurance ¹	(1,385)	(460)	(1,845)	(894)	(374)	(1,268)
Accrued postretirement benefit obligation	<u>\$ 2,211</u>	<u>\$ 137</u>	<u>\$ 2,348</u>	<u>\$ 2,286</u>	<u>\$ 137</u>	<u>\$ 2,423</u>

¹ Medical plan assets include Communications Stock of \$210 and Media Stock of \$112 in 1995, and U S WEST common stock of \$164 in 1994.

The actuarial assumptions used to calculate the accumulated postretirement benefit obligation follow:

	December 31,	
	1995	1994
Discount rate	7.00%	8.00%
Medical trend*	9.00%	9.70%

* Medical cost trend rate gradually declines to an ultimate rate of 5 percent in 2011.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 17: EMPLOYEE BENEFITS (Continued)

A one-percent increase in the assumed health care cost trend rate for each future year would have increased the aggregate of the service and interest cost components of 1995 net postretirement benefit cost by approximately \$40 and increased the 1995 accumulated postretirement benefit obligation by approximately \$350.

For U S WEST, the annual funding amount is based on its cash requirements, with the funding at U S WEST Communications based on regulatory accounting requirements.

Anticipated future benefit changes have been reflected in these postretirement benefit calculations.

NOTE 18: INCOME TAXES

The components of the provision for income taxes follow:

	Year Ended December 31,		
	1995	1994	1993
Federal:			
Current	\$481	\$418	\$ 422
Deferred	225	337	(147)
Investment tax credits — net	(38)	(47)	(56)
	668	708	219
State and local:			
Current	64	52	71
Deferred	54	83	(23)
	118	135	48
Foreign:			
Current	6	—	—
Deferred	33	14	2
	39	14	2
Provision for income taxes	<u>\$825</u>	<u>\$857</u>	<u>\$ 269</u>

The unamortized balance of investment tax credits at December 31, 1995 and 1994, was \$199 and \$231, respectively.

Amounts paid for income taxes were \$566, \$313 and \$391 in 1995, 1994 and 1993, respectively, inclusive of the capital assets segment.

The effective tax rate differs from the statutory tax rate as follows:

	Year Ended December 31,		
	1995	1994	1993
	In percent		
Federal statutory tax rate	35.0	35.0	35.0
Investment tax credit amortization	(1.2)	(1.3)	(3.0)
State income taxes — net of federal effect	3.5	3.9	4.0
Foreign taxes — net of federal effect	1.2	0.4	—
Rate differential on reversing temporary differences	—	—	(2.2)
Depreciation on capitalized overheads — net	—	—	1.4
Tax law change — catch-up adjustment	—	—	3.1
Restructuring charge	—	—	(1.5)
Other	(0.2)	(0.5)	(0.7)
Effective tax rate	<u>38.3</u>	<u>37.5</u>	<u>36.1</u>

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 18: INCOME TAXES (Continued)

The components of the net deferred tax liability follow:

	December 31,	
	1995	1994
Property, plant and equipment	\$1,540	\$1,504
Leases	668	690
State deferred taxes — net of federal effect	358	395
Intangible assets	112	164
Investments in partnerships	213	142
Other	74	84
Deferred tax liabilities	<u>2,965</u>	<u>2,979</u>
Postemployment benefits, including pension	697	718
Restructuring, assets held for sale and other	329	417
Unamortized investment tax credit	70	79
State deferred taxes — net of federal effect	166	232
Other	<u>229</u>	<u>317</u>
Deferred tax assets	<u>1,491</u>	<u>1,763</u>
Net deferred tax liability	<u>\$1,474</u>	<u>\$1,216</u>

The current portion of the deferred tax asset was \$282 and \$352 at December 31, 1995 and 1994, respectively, resulting primarily from restructuring charges and compensation-related items.

On August 10, 1993, federal legislation was enacted which increased the corporate tax rate from 34 percent to 35 percent retroactive to January 1, 1993. The cumulative effect on deferred taxes of the 1993 increase in income tax rates was \$74, including \$20 for the capital assets segment.

The net deferred tax liability includes \$686 in 1995 and \$678 in 1994 related to the capital assets segment.

NOTE 19: CONTINGENCIES

At U S WEST Communications there are pending regulatory actions in local regulatory jurisdictions that call for price decreases, refunds or both. In one such instance, the Utah Supreme Court has remanded a Utah Public Service Commission ("PSC") order to the PSC for reconsideration, thereby establishing two exceptions to the rule against retroactive ratemaking: 1) unforeseen and extraordinary events, and 2) misconduct. The PSC's initial order denied a refund request from interexchange carriers and other parties related to the Tax Reform Act of 1986. This action is still in the discovery process. If a formal filing — made in accordance with the remand from the Supreme Court — alleges that the exceptions apply, the range of possible risk to U S WEST Communications is \$0 to \$150.

On September 22, 1995, U S WEST filed a lawsuit in Delaware Chancery Court to enjoin the proposed merger of Time Warner and Turner Broadcasting. U S WEST has alleged breaches of contract and fiduciary duties by Time Warner in connection with this proposed merger. Time Warner filed a countersuit against U S WEST on October 11, 1995, alleging misrepresentation, breach of contract and other misconduct on the part of U S WEST. Time Warner's countersuit seeks a reformation of the Time Warner Entertainment partnership agreement, an order that enjoins U S WEST from breaching the partnership agreement, and unspecified compensatory damages. U S WEST has denied each of the claims in Time Warner's countersuit. The trial for this action concluded on March 22, 1996. A ruling by the Delaware Chancery Court is expected in June 1996.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE

The Consolidated Financial Statements include the discontinued operations of the capital assets segment. During the second quarter of 1993, the U S WEST Board of Directors approved a plan to dispose of the capital assets segment through the sale of segment assets and businesses. Accordingly, the Company recorded an after-tax charge of \$100 for the estimated loss on disposition. An additional provision of \$20 is related to the effect of the 1993 increase in federal income tax rates. The capital assets segment includes activities related to financial services and financial guarantee insurance operations. Also included in the segment is U S WEST Real Estate, Inc., for which disposition was announced in 1991 and a \$500 valuation allowance was established to cover both carrying costs and losses on disposal of related properties.

Effective January 1, 1995, the capital assets segment has been accounted for in accordance with Staff Accounting Bulletin No. 93, issued by the Securities Exchange Commission, which requires discontinued operations not disposed of within one year of the measurement date to be accounted for prospectively in continuing operations as a "net investment in assets held for sale." The net realizable value of the assets is reevaluated on an ongoing basis with adjustments to the existing reserve, if any, charged to continuing operations. No such adjustment was required in 1995. Prior to January 1, 1995, the entire capital assets segment was accounted for as discontinued operations in accordance with Accounting Principles Board Opinion No. 30.

During 1994, U S WEST reduced its ownership interest in Financial Security Assurance Holdings, Ltd. ("FSA"), a member of the capital assets segment, to 60.9 percent, and its voting interest to 49.8 percent through a series of transactions. In May and June 1994, U S WEST sold 8.1 million shares of FSA, including 2 million shares sold to Fund American Enterprises Holdings Inc. ("FFC"), in an initial public offering of FSA common stock. U S WEST received \$154 in net proceeds from the offering. The Media Group retained certain risks in asset-backed obligations related to the commercial real estate portfolio. On September 2, 1994, U S WEST issued to FFC 50,000 shares of cumulative redeemable preferred stock for a total of \$50. (See Note 13 to the Consolidated Financial Statements.) In December 1995, FSA merged with Capital Guaranty Corporation for shares of FSA and cash of \$51. The transaction was valued at approximately \$203 and reduced U S WEST's ownership interest in FSA to 50.3 percent and its voting interest to 41.7 percent. U S WEST expects to monetize and ultimately reduce its ownership in FSA through the issuance of Debt Exchangeable for Common Stock ("DECS") in 1996. At maturity, each DECS will be mandatorily exchanged by U S WEST for shares of FSA common stock held by U S WEST or, at U S WEST's option, redeemed at the cash equivalent.

U S WEST entered into a transaction to reduce its investment in Enhance Financial Services Group, Inc. ("Enhance") during fourth-quarter 1995. U S WEST issued DECS due December 15, 1998. Upon maturity, each DECS will be mandatorily exchanged by U S WEST for shares of Enhance common stock or, at U S WEST's option, redeemed at the cash equivalent. The capital assets segment currently owns approximately 31.5 percent of the outstanding Enhance common stock. (See Note 10 to the Consolidated Financial Statements.)

U S WEST Real Estate, Inc. has sold various properties totaling \$120, \$327 and \$66 in each of the three years ended December 31, 1995, respectively. The sales proceeds were in line with estimates. Proceeds from building sales were primarily used to repay related debt. U S WEST has completed construction of existing buildings in the commercial real estate portfolio and expects to substantially complete the liquidation of this portfolio by 1998. The remaining balance of assets subject to sale is approximately \$490, net of reserves, as of December 31, 1995.

In December 1993, U S WEST sold \$2.0 billion of finance receivables and the business of U S WEST Financial Services, Inc. to NationsBank Corporation. Sales proceeds of \$2.1 billion were used primarily to repay related debt. The pretax gain on the sale of approximately \$100, net of selling expenses, was in line

U S WEST, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE (Continued)

with management's estimate and was included in the Company's estimate of provision for loss on disposal. The management team that previously operated the entire capital assets segment transferred to NationsBank.

Building sales and operating revenues of the capital assets segment were \$237, \$553 and \$710 in 1995, 1994 and 1993, respectively. Income from discontinued operations for 1993 (to June 1) totaled \$38. Income (loss) from the capital assets segment subsequent to June 1, 1993 is being deferred and is included within the reserve for assets held for sale.

The assets and liabilities of the capital assets segment have been separately classified on the Consolidated Balance Sheets as net investment in assets held for sale.

The components of net investment in assets held for sale follow:

	December 31,	
	1995	1994
	Dollars in millions	
ASSETS		
Cash and cash equivalents	\$ 38	\$ 7
Finance receivables — net	953	1,073
Investment in real estate — net of valuation allowance	368	465
Bonds, at market value	149	155
Investment in FSA	384	329
Other assets	177	347
Total assets	<u>\$2,069</u>	<u>\$2,376</u>
LIABILITIES		
Debt	\$ 796	\$1,283
Deferred income taxes	686	678
Accounts payable, accrued liabilities and other	148	103
Minority interests	10	10
Total liabilities	<u>1,640</u>	<u>2,074</u>
Net investment in assets held for sale	<u>\$ 429</u>	<u>\$ 302</u>

Finance receivables primarily consist of contractual obligations under long-term leases that U S WEST intends to run off. These long-term leases consist mostly of leveraged leases related to aircraft and power plants. For leveraged leases, the cost of the assets leased is financed primarily through nonrecourse debt which is netted against the related lease receivable.

The components of finance receivables follow:

	December 31,	
	1995	1994
Receivables	\$ 921	\$1,095
Unguaranteed estimated residual values	447	467
	<u>1,368</u>	<u>1,562</u>
Less: Unearned income	390	459
Credit loss and other allowances	25	30
Finance receivables — net	<u>\$ 953</u>	<u>\$1,073</u>

Investments in debt securities are classified as available for sale and are carried at market value. Any resulting unrealized holding gains or losses, net of applicable deferred income taxes, are reflected as a component of equity.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE (Continued)

The amortized cost and estimated market value of investments in debt securities are as follows:

Debt Securities	December 31,							
	1995				1994			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal	\$ 91	\$ 1	\$ 1	\$ 91	\$113	\$—	\$13	\$100
Other	58	—	—	58	65	—	10	55
Total	<u>\$149</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$149</u>	<u>\$178</u>	<u>\$—</u>	<u>\$23</u>	<u>\$155</u>

Note: Also included in equity are unrealized gains and losses on debt securities associated with U S WEST's equity investment in FSA. 1995 includes unrealized gains of \$24, net of deferred taxes of \$13, and 1994 includes unrealized losses of \$49, net of deferred tax benefits of \$26.

The 1995 net unrealized gains of \$39 (net of deferred taxes of \$21) and the 1994 net unrealized losses of \$64 (net of deferred tax benefits of \$34), are included in equity.

Debt

Interest rates and maturities of debt associated with the capital assets segment at December 31 follow:

Interest rates	Maturities				Total 1995	Total 1994
	1997	1998	1999	2000		
Up to 5%	\$—	\$—	\$—	\$—	\$—	\$ 55
Above 5% to 6%	10	—	—	—	10	15
Above 6% to 7%	54	—	—	—	54	154
Above 7% to 8%	5	—	—	—	5	17
Above 8% to 9%	—	—	134	4	138	189
Above 9% to 10%	48	5	—	—	53	114
Above 10% to 11%	—	29	—	—	29	29
	<u>\$117</u>	<u>\$ 34</u>	<u>\$134</u>	<u>\$ 4</u>	<u>289</u>	<u>573</u>
Allocated to the capital assets segment — net					507	710
Total					<u>\$796</u>	<u>\$1,283</u>

Debt of \$71 and \$119 at December 31, 1995 and 1994, respectively, was collateralized by first deeds of trust on associated real estate and assignment of rents from leases.

The following table summarizes terms of swaps associated with the capital assets segment. Variable rates are indexed to three- and six-month LIBOR.

	December 31, 1995 and 1994					
	Notional Amount	Maturities	Weighted Average Receive Rate		Weighted Average Pay Rate	
			1995	1994	1995	1994
Variable to fixed ¹	\$380	1996-1997	5.96	5.69	9.03	9.03
Fixed to variable ¹	380	1996-1997	7.29	7.29	5.87	5.80
Variable rate basis adjustment ²	10	1997	5.92	5.89	5.85	7.04

¹ The fixed to variable swaps have the same terms as the variable to fixed swaps and were entered into to terminate the variable to fixed swaps. The net loss on the swaps is deferred and amortized over the remaining life of the swaps and is included in the reserve for assets held for sale.

² Variable rate debt based on Treasuries is swapped to a LIBOR-based interest rate.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE (Continued)

Financial Instruments with Off-Balance Sheet Credit Risk — Financial Guarantees

The Company retained certain risks in asset-backed obligations related to the commercial real estate portfolio. The principal amounts insured on the asset-backed obligations follow:

<u>Terms to Maturity</u>	<u>December 31,</u>	
	<u>1995</u>	<u>1994</u>
0 to 5 Years	\$ 639	\$ 540
5 to 10 Years	450	537
10 to 15 Years	10	391
Total	<u>\$1,099</u>	<u>\$1,468</u>

Concentrations of collateral associated with insured asset-backed obligations follow:

<u>Type of Collateral</u>	<u>December 31,</u>	
	<u>1995</u>	<u>1994</u>
Commercial mortgages:		
Commercial real estate	\$ 442	\$ 530
Corporate secured	657	888
Other asset-backed	—	50
Total	<u>\$1,099</u>	<u>\$1,468</u>

Additional Financial Information

Information for U S WEST Financial Services, Inc., a member of the capital assets segment, follows:

<u>Summarized Financial Information</u>	<u>Year Ended December 31,</u>		
	<u>1995</u>	<u>1994</u>	<u>1993</u>
Revenue	\$ 44	\$ 54	\$ 410
Net finance receivables	931	981	1,020
Total assets	1,085	1,331	1,797
Total debt	274	533	957
Total liabilities	1,024	1,282	1,748
Equity	61	49	49

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 21: QUARTERLY FINANCIAL DATA (UNAUDITED)

	Quarterly Financial Data			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1995				
Sales and other revenues	\$2,828	\$2,894	\$2,964	\$3,060
Income before income taxes and extraordinary items	538	514	538	564
Income before extraordinary items	330	318	325	356
Net income	330	318	316	353
Pro forma earnings per common share:				
Communications Group earnings per common share before extraordinary item	0.67	0.62	0.62	0.60
Communications Group earnings per common share	0.67	0.62	0.61	0.59
Media Group earnings per common share before extraordinary item	0.03	0.05	0.07	0.15
Media Group earnings per common share	0.03	0.05	0.06	0.15
1994				
Sales and other revenues	\$2,641	\$2,708	\$2,765	\$2,839
Income from continuing operations before income taxes	522	609	514	638
Income from continuing operations and net income	324	375	318	409
Earnings per common share	0.73	0.83	0.70	0.89

Effective November 1, 1995, each share of U S WEST, Inc. common stock was converted into one share each of Communications Stock and Media Stock. Earnings per common share for 1995 have been presented on a pro forma basis to reflect the two classes of stock as if they had been outstanding since January 1, 1995. For periods prior to the recapitalization, the average common shares outstanding for the two classes of stock are assumed to be equal to the average common shares outstanding for U S WEST, Inc.

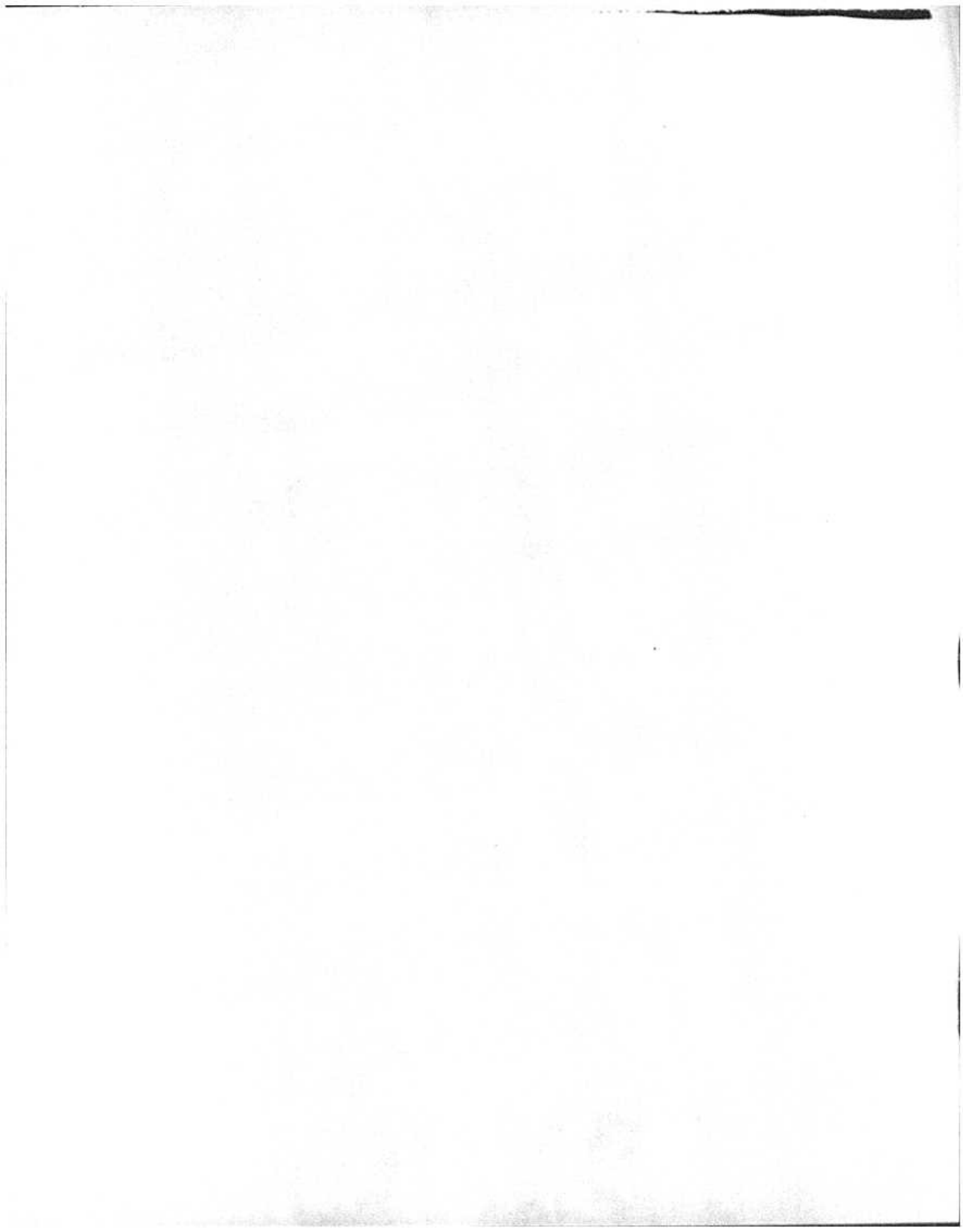
1995 first-quarter net income includes \$39 (\$0.08 per Communications share) from a gain on the sales of certain rural telephone exchanges. 1995 second-quarter net income includes \$10 (\$0.02 per Communications share) from a gain on the sales of certain rural telephone exchanges. 1995 third-quarter net income includes \$21 (\$0.04 per Communications share) from a gain on the sales of certain rural telephone exchanges and \$10 (\$0.01 per Communications share and \$0.01 per Media share) for expenses associated with the Recapitalization Plan. 1995 third-quarter net income also includes charges of \$9 (\$0.01 per Communications share and \$0.01 per Media share) for the early extinguishment of debt. 1995 fourth-quarter net income includes \$15 (\$0.03 per Communications share) from a gain on the sales of certain rural telephone exchanges and \$95 (\$0.20 per Media share) from the merger of U S WEST's joint venture interest in TeleWest. 1995 fourth-quarter net income also includes other charges of \$10 (\$0.01 per Communications share and \$0.01 per Media share), including \$7 for expenses associated with the Recapitalization Plan and an extraordinary charge of \$3 for the early extinguishment of debt.

1994 first-quarter net income includes \$15 (\$0.03 per share) from a gain on the sales of certain rural telephone exchanges. 1994 second-quarter net income includes gains of \$16 (\$0.04 per share) and \$41 (\$0.09 per share) on the sales of certain rural telephone exchanges and paging operations, respectively. 1994 fourth-quarter net income includes gains of \$105 (\$0.23 per share) for the partial sale of a joint venture interest in TeleWest and \$20 (\$0.04 per share) on the sales of certain rural telephone exchanges.

U S WEST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 21: QUARTERLY FINANCIAL DATA (UNAUDITED) (Continued)

<u>Per Share Market and Dividend Data</u>	<u>Market Price</u>			<u>Dividends</u>
	<u>High</u>	<u>Low</u>	<u>Close</u>	
	(Whole dollars)			
1995				
U S WEST Stock				
First	\$41.375	\$35.125	\$40.125	\$0.535
Second	42.875	39.125	41.625	0.535
Third	48.375	40.875	47.125	0.535
Fourth (through October 31, 1995)	48.375	45.625	47.875	—
Communications Stock				
Fourth (November 1, 1995 through December 31, 1995) ...	\$36.375	\$28.375	\$35.625	\$0.535
Media Stock				
Fourth (November 1, 1995 through December 31, 1995) ...	\$20.000	\$17.375	\$19.000	\$ —
1994				
First	\$46.250	\$38.500	\$40.750	\$0.535
Second	43.750	38.250	41.875	0.535
Third	43.125	38.250	38.750	0.535
Fourth	38.875	34.625	35.625	0.535



U S WEST COMMUNICATIONS GROUP FINANCIAL HIGHLIGHTS

	Year Ended December 31,				
	1995	1994	1993	1992	1991
	Dollars in millions (except per share amounts)				
Operating revenues	\$ 9,484	\$ 9,176	\$ 8,870	\$ 8,530	\$ 8,345
Net income (loss) ¹	1,176	1,150	(2,809)	(815)	771
Pro forma earnings per common share ²	2.50	2.53	—	—	—
Pro forma dividends per common share ²	2.14	2.14	—	—	—
EBITDA ³	4,220	4,026	3,743	3,553	3,547
EBITDA margin ³	44.5%	43.9%	42.2%	41.7%	42.5%
Total assets	\$16,585	\$15,944	\$15,423	\$20,655	\$20,244
Total debt	6,754	6,124	5,673	5,181	5,287
Communications Group equity ⁴	3,476	3,179	2,722	6,003	7,530
Return on Communications Group equity ^{4,5}	35.6%	39.0%	22.5%	13.7%	12.8%
Percentage of debt to total capital ⁴	66.0%	65.8%	67.6%	46.3%	41.3%
Capital expenditures	\$ 2,739	\$ 2,477	\$ 2,226	\$ 2,385	\$ 2,194
Telephone network access lines in service (thousands)	14,847	14,336	13,843	13,345	12,935
Billed access minutes of use — interstate (millions)	47,801	43,768	40,594	37,413	35,144
Billed access minutes of use — intrastate (millions)	9,504	8,507	7,529	6,956	6,557
Communications Group employees	50,825	51,402	52,598	55,352	57,725
Telephone company employees	47,934	47,493	49,668	52,423	54,923
Telephone company employees per ten thousand access lines	32.3	33.1	35.9	39.3	42.5
Pro forma average common shares outstanding (thousands) ²	470,716	453,316			
Pro forma common shares outstanding (thousands) ²	473,635*	469,343			

* Actual

¹ 1995 net income includes a gain of \$85 (\$0.18 per share) on the sales of certain rural telephone exchanges and other charges of \$16 (\$0.03 per share), including an extraordinary charge of \$8 for the early extinguishment of debt and \$8 for costs associated with the November 1, 1995 recapitalization. 1994 net income includes a gain of \$51 (\$0.11 per share) on the sales of certain rural telephone exchanges. 1993 net income was reduced by a \$534 restructuring charge and \$54 for the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates. 1993 net income was also reduced by extraordinary charges of \$3,123 for the discontinuance of Statement of Financial Accounting Standards ("SFAS") No. 71 and \$77 for the early extinguishment of debt. 1992 net income was reduced by \$1,745 for the cumulative effect of change in accounting principles. 1991 net income was reduced by a \$173 restructuring charge.

² Effective November 1, 1995, each share of U S WEST, Inc. common stock was converted into one share each of U S WEST Communications Group common stock and U S WEST Media Group common stock. Earnings per common share have been presented on a pro forma basis to reflect the two classes of stock as if they had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST, Inc.

³ Earnings before interest, taxes, depreciation, amortization and other ("EBITDA"). EBITDA also excludes the gain on sales of rural telephone exchanges and restructuring charges. The Communications Group considers EBITDA an important indicator of the operational strength and performance of its businesses. EBITDA, however, should not be considered as an alternative to operating or net income as an indicator of the performance of the Communications Group's businesses or as an alternative to cash flows from operating activities as a measure of liquidity, in each case determined in accordance with generally accepted accounting principles.

⁴ The increases in the percentage of debt to total capital and return on Communications Group equity, and the decrease in Communications Group equity since 1992, are primarily due to the effects of discontinuing SFAS No. 71 in 1993 and the cumulative effect of change in accounting principles in 1992.

⁵ 1995 return on Communications Group equity is based on income before extraordinary items. For 1994, there are no adjustments to net income for this calculation. 1993 return on Communications Group equity is based on income excluding extraordinary items, a restructuring charge and the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates. 1992 return on Communications Group equity is based on income before cumulative effect of change in accounting principles. 1991 return on Communications Group equity is based on income excluding the effects of a restructuring charge.

**U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**
(Dollars in millions, except per share amounts)

The Recapitalization Plan

On October 31, 1995, the shareholders of U S WEST, Inc., a Colorado corporation ("U S WEST Colorado"), voted to approve a proposal (the "Recapitalization Plan") adopted by the Board of Directors to reincorporate in Delaware and create two classes of common stock. Under the Recapitalization Plan, shareholders approved an Agreement and Plan of Merger between U S WEST Colorado and U S WEST, Inc., a Delaware corporation ("U S WEST" or the "Company"), pursuant to which U S WEST continues as the surviving corporation. In connection with the merger, the Certificate of Incorporation of U S WEST has been amended and restated to designate two classes of common stock of U S WEST, one class of which is authorized as U S WEST Communications Group Common Stock ("Communications Stock") and the other class which is authorized as U S WEST Media Group Common Stock ("Media Stock").

The Communications Stock and Media Stock provide shareholders with two distinct securities that are intended to reflect separately the communications businesses of U S WEST (the "Communications Group") and the multimedia businesses of U S WEST (the "Media Group" and, together with the Communications Group, the "Groups").

The Communications Group

The Communications Group primarily provides regulated communications services to more than 25 million residential and business customers in the Communications Group Region (the "Region"). The Region includes the states of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming. Services offered by the Communications Group include local telephone services, exchange access services (which connect customers to the facilities of carriers, including long-distance providers and wireless operators), and long-distance services within Local Access and Transport Areas ("LATAs") in the Region. The Communications Group provides other products and services, including custom calling features, voice messaging, caller identification, high-speed data applications, customer premises equipment and certain communications services to business customers and governmental agencies both inside and outside the Region. The Telecommunications Act of 1996, enacted into law on February 8, 1996, will dramatically alter the competitive landscape of the telecommunications industry and will further change the nature of services the Communications Group will offer. These future service offerings include interLATA long-distance service, wireless services, cable TV and interconnection services provided to competing providers of local services.

The Combined Financial Statements of the Communications Group include: (i) the combined historical balance sheets, results of operations and cash flows of the businesses that comprise the Communications Group; (ii) corporate assets and liabilities and related transactions of U S WEST identified with the Communications Group; and (iii) an allocated portion of the corporate expenses of U S WEST. All significant intra-group financial transactions have been eliminated. Transactions between the Communications Group and the Media Group have not been eliminated. For a more complete discussion of U S WEST's corporate allocation policies, see the U S WEST Communications Group Combined Financial Statements — Note 2: Summary of Significant Accounting Policies.

The following discussion is based on the U S WEST Communications Group Combined Financial Statements prepared in accordance with generally accepted accounting principles ("GAAP"). The discussion should be read in conjunction with the U S WEST, Inc. Consolidated Financial Statements.

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations — 1995 Compared with 1994

Comparative details of income before extraordinary items for 1995 and 1994 follow:

	1995 ¹	1994 ¹	Increase (Decrease)	
			\$	%
U S WEST Communications, Inc.	\$1,219	\$1,175	\$ 44	3.7
Other operations	(35)	(25)	(10)	(40.0)
Income before extraordinary items	<u>\$1,184</u>	<u>\$1,150</u>	<u>\$ 34</u>	<u>3.0</u>
Pro forma earnings per common share before extraordinary items ³ ..	<u>\$ 2.52</u>	<u>\$ 2.53</u>	<u>\$(0.01)</u>	<u>(0.4)</u>

¹ 1995 income before extraordinary items includes a gain of \$85 (\$0.18 per share) on the sales of certain rural telephone exchanges and \$8 (\$0.01 per share) for costs associated with the Recapitalization Plan.

² 1994 income before extraordinary items includes a gain of \$51 (\$0.11 per share) on the sales of certain rural telephone exchanges.

³ Earnings per common share have been presented on a pro forma basis as if the Communications Stock had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST.

The Communications Group's 1995 income before extraordinary items, excluding the effects of one-time items described in Note 1 to the table above, was \$1,107, an increase of \$8, or 0.7 percent, compared with \$1,099 in 1994, also excluding the effects of one-time items. Total revenue growth of 3.4 percent was largely offset by significantly higher costs incurred to improve customer service and meet greater than expected business growth. Net income growth will also be limited in 1996 while the Communications Group continues to commit significant resources to meet customer service objectives and broaden its range of product and service offerings.

Excluding the effects of one-time items described in Note 1 to the table above, pro forma earnings per common share before extraordinary items ("earnings per share") were \$2.35 in 1995, a decrease of \$0.07, or 2.9 percent, compared with \$2.42 in 1994, similarly adjusted. Earnings per share in 1995 reflect approximately 17 million additional average common shares outstanding, of which 12.8 million were issued in December 1994.

During 1995, the Communications Group refinanced \$145 of long-term debt. Expenses associated with the refinancings resulted in extraordinary charges of \$8, net of tax benefits of \$5.

Increased demand for services resulted in growth in earnings before interest, taxes, depreciation, amortization and other ("EBITDA") of 4.8 percent in 1995. The Communications Group believes EBITDA is an important indicator of the operational strength of its businesses. EBITDA, however, should not be considered as an alternative to operating or net income as an indicator of performance or as an alternative to cash flows from operating activities as a measure of liquidity, in each case determined in accordance with generally accepted accounting principles ("GAAP").

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Operating Revenues

An analysis of changes in operating revenues follows:

	1995	1994	Price Changes	Lower (Higher) Refunds	Demand	Other	Increase (Decrease)	
							\$	%
Local service	\$4,344	\$4,061	\$ 35	\$(10)	\$273	\$(21)	\$277	6.8
Interstate access	2,378	2,269	(66)	(2)	191	(14)	109	4.8
Intrastate access	747	729	(31)	8	36	5	18	2.5
Long-distance network	1,189	1,329	(23)	(1)	(54)	(62)	(140)	(10.5)
Other services	826	782	—	—	—	44	44	5.6
Total	\$9,484	\$9,176	\$(85)	\$(5)	\$446	\$(48)	\$308	3.4

Approximately 97 percent of the revenues of the Communications Group are attributable to the operations of U S WEST Communications, Inc. ("U S WEST Communications"), of which approximately 59 percent are derived from the states of Arizona, Colorado, Minnesota and Washington. Approximately 29 percent of the access lines in service are devoted to providing services to business customers. The access line growth rate for business customers, who tend to be heavier users of the network, has consistently exceeded the growth rate of residential customers. During 1995, business access lines grew 5.4 percent while residential access lines increased 2.8 percent.

The primary factors that influence changes in revenues are customer demand for products and services, price changes (including those related to regulatory proceedings) and refunds. During 1995, revenues from new product and service offerings were \$534, an increase of 58 percent compared with 1994. These revenues primarily consist of caller identification, voice messaging, call waiting and high-speed data network transmission services.

Local service revenues include local telephone exchange, local private line and public telephone services. In 1995, local service revenues increased principally as a result of higher demand for new and existing services, and demand for second lines. Local service revenues from new services increased \$92, or 78 percent, compared with 1994. Reported total access lines increased 511,000, or 3.6 percent, of which 161,000 were second lines. Second line installations increased 25.5 percent compared with 1994. Access line growth was 4.2 percent adjusted for the sale of approximately 95,000 rural telephone access lines during the last 12 months.

Access charges are collected primarily from interexchange carriers for their use of the local exchange network. For interstate access services there is also a fee collected directly from telephone customers. Approximately 33 percent of access revenues and 11 percent of total revenues are derived from providing access services to AT&T.

Higher revenues from interstate access services were driven by an increase of 9.2 percent in interstate billed access minutes of use. The increased business volume more than offset the effects of price reductions and refunds. The Communications Group reduced prices for interstate access services in both 1995 and 1994 as a result of Federal Communications Commission ("FCC") orders and competitive pressures. Intrastate access revenues increased primarily due to the impact of increased business volume and multiple toll carrier plans, partially offset by the impact of rate changes.

Long-distance revenues are derived from calls made within the LATA boundaries of the Region. During 1995 and 1994, long-distance revenues were impacted by the implementation of multiple toll carrier plans ("MTCPs") in Oregon and Washington in May and July 1994, respectively. The MTCPs essentially allow independent telephone companies to act as toll carriers. The 1995 impact of the MTCPs was long-distance revenue losses of \$62, partially offset by increases in intrastate access revenues of \$12 and decreases in other

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

operating expenses (i.e. access expense) of \$42 compared with 1994. These regulatory arrangements have decreased annual net income by approximately \$10. Similar changes in other states could occur, though the impact on 1996 net income would not be material.

Excluding the effects of the MTCs, long-distance revenues decreased by 5.9 percent in 1995, primarily due to the effects of competition and rate reductions. Long-distance revenues have declined over the last several years as customers have migrated to interexchange carriers that have the ability to offer these services on both an intraLATA and interLATA basis. A portion of revenues lost to competition, however, is recovered through access charges paid by the interexchange carriers. Erosion in long-distance revenue will continue due to the loss of 1+ dialing in Minnesota, effective in February 1996, and in Arizona, effective in April 1996. Annual long-distance revenue losses could approximate \$30 as a result of these changes. The Communications Group is partially mitigating competitive losses through competitive pricing of intraLATA long-distance services.

Revenues from other services primarily consist of billing and collection services provided to interexchange carriers, voice messaging services, high-speed data transmission services, sales of service agreements related to inside wiring and the provision of customer premises equipment. Revenues from other services also include directory listings, customer lists, billing and collection and other services provided to the Media Group. These services are sold at market price. However, the Communications Group's accounting and reporting for regulatory purposes is in accordance with regulatory requirements. Revenues for services provided to Media Group were \$20 in 1995 and \$29 in 1994.

During 1995, revenues from other services increased \$44, primarily as a result of continued market penetration in voice messaging services and sales of high-speed data transmission services. Revenue growth from other services is also attributable to maintenance contracts for inside wire services and a large contract related to a wire installation project. These increases were partially offset by a decrease of \$20 in revenues from billing and collection services. The decline in billing and collection revenues is primarily related to lower contract prices and a decrease in the volume of services provided to AT&T.

Costs and Expenses

	1995	1994	Increase (Decrease)	
			\$	%
Employee-related expenses	\$3,341	\$3,215	\$126	3.9
Other operating expenses	1,543	1,547	(4)	(0.3)
Taxes other than income taxes	380	388	(8)	(2.1)
Depreciation and amortization	2,042	1,908	134	7.0
Interest expense	427	376	51	13.6
Other expense — net	41	21	20	95.2

Employee-related expenses include basic salaries and wages, overtime, benefits (including pension and health care), payroll taxes and contract labor. During 1995, improving customer service was the Communications Group's first priority. Overtime payments and contract labor expense associated with customer service initiatives increased employee-related costs by approximately \$168 compared with 1994. Expenses related to the addition of approximately 1,700 employees in 1995 and 1,000 employees in 1994 also increased employee-related costs. These expenses were incurred to handle the higher than anticipated volume of business and to meet new business opportunities. Partially offsetting these increases was a \$34 reduction in the accrual for postretirement benefits, a \$22 decrease in travel expense and reduced expenses related to employee separations under reengineering and streamlining initiatives. The Communications Group will continue to add employees to address customer service issues and growth in the core business. Costs related to these work-force additions will partially offset the benefits of employee separations achieved through restructuring. (See "Restructuring Charge.")

**U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

Other operating expenses include access charges (incurred for the routing of long-distance traffic through the facilities of independent companies), network software expenses and other general and administrative costs, including allocated costs from U S WEST. During 1995, other operating expenses decreased primarily due to the effects of the multiple toll carrier plans and a reduction in expenses related to project funding at Bell Communications Research, Inc. ("Bellcore"), of which U S WEST Communications has a one-seventh ownership interest. These decreases in other operating expenses were partially offset by increases in costs associated with increased sales, including bad debt expense. Allocated costs from U S WEST were \$116 and \$110 in 1995 and 1994, respectively.

Taxes other than income taxes, which consist primarily of property taxes, decreased 2.1 percent in 1995, primarily due to favorable property tax valuations and mill levies as compared with 1994. As a result of these valuations and mill levies, 1995 fourth-quarter accruals decreased by \$20 compared with fourth-quarter 1994.

Increased depreciation and amortization expense was attributable to the effects of a higher depreciable asset base, partially offset by the effects of the sales of certain rural telephone exchanges.

Interest expense increased primarily as a result of an increased use of debt financing. The average borrowing cost was 6.9 percent in 1995, compared with 6.8 percent in 1994. (See "Liquidity and Capital Resources.") The increase in other expense is largely attributable to \$8 of costs associated with the Recapitalization Plan in 1995.

Provision for Income Taxes

	1995	1994	Increase	
			\$	%
Provision for income taxes	\$ 662	\$ 653	\$ 9	1.4
Effective tax rate	35.9%	36.2%	—	—

The decrease in the effective tax rate resulted primarily from the effects of a research and experimentation credit and adjustments for prior periods.

Restructuring Charge

The Communications Group's 1993 results reflected an \$880 restructuring charge (pretax). The related restructuring plan (the "Restructuring Plan") is designed to provide faster, more responsive customer services while reducing the costs of providing these services. As part of the Restructuring Plan, the Communications Group is developing new systems and enhanced system functionality that will enable it to monitor networks to reduce the risk of service interruptions, activate telephone service on demand, rapidly design and engineer products and services for customers, and centralize its service centers. The Communications Group has consolidated its 560 customer service centers into 26 centers in 10 cities and plans on reducing its work force by approximately 10,000 employees. All service centers are operational and supported by new systems and enhanced system functionality.

The Restructuring Plan is expected to be substantially complete by the end of 1997. Implementation of the Restructuring Plan has been impacted by growth in the business and related service issues, new business opportunities, revisions to system delivery schedules and productivity issues caused by the major rearrangement of resources due to restructuring. These issues will continue to affect the timing of employee separations.

The Communications Group estimates that full implementation of the 1993 Restructuring Plan will reduce employee-related expenses by approximately \$400 per year. The savings related to work-force reductions will be offset by the effects of inflation and a variety of other factors. These factors include costs related to the achievement of customer service objectives and increased demand for existing services. (See "Costs and Expenses.")

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Following is a schedule of the costs included in the Restructuring Plan:

	1994 Actual	1995 Actual	1996 Estimate	1997 Estimate	Total
Employee separation ¹	\$ 19	\$ 76	\$ 33	\$127	\$255
Systems development	118	129	113	—	360
Real estate	50	66	14	—	130
Relocation	21	21	20	13	75
Retraining and other	8	23	22	7	60
Total 1993 Restructuring Plan	216	315	202	147	880
Remaining 1991 plan employee costs ¹	56	—	—	—	56
Total	<u>\$272</u>	<u>\$315</u>	<u>\$202</u>	<u>\$147</u>	<u>\$936</u>

¹ Employee separation costs, including the balance of a 1991 restructuring reserve at December 31, 1993, aggregate \$311.

Employee separation costs include severance payments, health-care coverage and postemployment education benefits. Systems development costs include new systems and the application of enhanced system functionality to existing, single-purpose systems to provide integrated, end-to-end customer service. Real estate costs include preparation costs for the new service centers. The relocation and retraining costs are related to moving employees to the new service centers and retraining employees on the methods and systems required in the new, restructured mode of operation.

Employee Separation. Under the Restructuring Plan, the Communications Group anticipates the separation of 10,000 employees. Approximately 1,000 employees that were originally expected to relocate have chosen separation or other job assignments and have been replaced. This increased the number of employee separations to 10,000 from 9,000, and increased the estimated total cost for employee separations to \$311 from \$281, as compared with the original estimate. The \$30 cost associated with these additional employee separations was reclassified from relocation to the reserve for employee separations during 1995.

Annual employee separations and employee-separation amounts under the Restructuring Plan follow:

	1994 ¹		1995		1996	1997	Total
	Estimate	Actual	Estimate	Actual	Estimate ²	Estimate ²	
Employee separation:							
Managerial	1,061	497	612	682	202	1,357	2,738
Occupational	1,887	1,683	1,638	1,643	798	3,138	7,262
Total	<u>2,948</u>	<u>2,180</u>	<u>2,250</u>	<u>2,325</u>	<u>1,000</u>	<u>4,495</u>	<u>10,000</u>
	1994 ¹		1995		1996	1997	Total
	Estimate	Actual	Estimate	Actual	Estimate ²	Estimate ²	
Employee-separation amounts:							
Managerial	\$ 22	\$ 5	\$ 21	\$ 30	\$ 9	\$ 54	\$ 98
Occupational	15	14	54	46	24	73	157
Total	<u>37</u>	<u>19</u>	<u>75</u>	<u>76</u>	<u>33</u>	<u>127</u>	<u>255</u>
Remaining 1991 reserve	56	56	—	—	—	—	56
Total	<u>\$ 93</u>	<u>\$ 75</u>	<u>\$ 75</u>	<u>\$ 76</u>	<u>\$ 33</u>	<u>\$127</u>	<u>\$ 311</u>

¹ Includes the remaining employees and the separation amounts associated with the balance of a 1991 restructuring reserve at December 31, 1993.

² A significant number of the employee reductions originally scheduled for 1996 will be delayed while the Communications Group focuses on overtime and contract-labor expenses. The Restructuring Plan is expected to be substantially complete by the end of 1997.

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Compared with the original estimates, employee reductions and separation amounts shown above have been reduced by 1,600 employees and \$53, respectively, in 1996, and increased by 4,495 employees and \$127, respectively, in 1997.

Systems Development. The existing information management systems were largely developed to support a monopoly environment. These systems were inadequate due to the effects of increased competition, new forms of regulation and changing technology that have driven consumer demand for products and services that can be delivered quickly, reliably and economically. The Communications Group believes that improved customer service, delivered at lower cost, can be achieved by a combination of new systems and introducing new functionality to existing systems. This is a change from the initial strategy which placed more emphasis on the development of new systems.

The systems development program involves new systems and enhanced system functionality for systems that support the following core processes:

Service Delivery — to support service on demand for all products and services. These new systems and enhanced system functionality will permit customer calls to be directed to those service representatives who can meet their requirements. This process will provide enhanced information to the service representatives regarding the customer requests and the ability of the Communications Group to fulfill them.

Service Assurance — for performance monitoring from one location and remote testing in the new environment, including identification and resolution of faults prior to customer impact.

Capacity Provisioning — for integrated planning of future network capacity, including the installation of software controllable service components.

Certain of the new systems and enhanced system functionality have been implemented in the service centers and have simplified the labor-intensive interfaces between systems processes in existence prior to the Restructuring Plan. Enhanced system functionality introduced under the Restructuring Plan since its inception includes the following:

- The ability to determine facilities' availability while the customer is placing an order;
- Automated engineering of central office facilities and automated updating of central office facilities' records;
- The ability to track the status of complex network design jobs from the customer's perspective; and
- Systems that accurately diagnose network problems and prepare repair packages to correct the problems identified.

The direct, incremental and nonrecurring costs of providing new systems and enhanced system functionality follow:

	1994		1995		1996	
	Estimate	Actual	Estimate	Actual	Estimate	Total
Service delivery	\$ 35	\$ 21	\$ 21	\$ 19	\$ 44	\$ 84
Service assurance	45	12	24	22	26	60
Capacity provisioning	17	57	92	85	42	184
All other	8	28	8	3	1	32
Total	<u>\$105</u>	<u>\$118</u>	<u>\$145</u>	<u>\$129</u>	<u>\$113</u>	<u>\$360</u>

Systems expenses charged to current operations consist of costs associated with the information management function, including planning, developing, testing and maintaining databases for general purpose

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

computers, in addition to systems costs related to maintenance of telephone network applications. Other systems expenses are for administrative (i.e. general purpose) systems which include customer service, order entry, billing and collection, accounts payable, payroll, human resources and property records. Ongoing systems costs comprised approximately six percent of total operating expenses in 1995, 1994 and 1993. The Communications Group expects systems costs charged to current operations as a percent of total operating expenses to approximate the current level throughout 1996. Systems costs could increase relative to other operating costs as the business becomes more technology dependent.

Progress Under the Restructuring Plan

Following is a reconciliation of restructuring reserve activity since December 1993:

	<u>Reserve Balance 12/31/93</u>	<u>1994 Activity</u>	<u>Reserve Balance 12/31/94</u>	<u>1995 Activity</u>	<u>Change in Estimate</u>	<u>Reserve Balance 12/31/95</u>
Employee separation:						
Managerial	\$ 75	\$ 5	\$ 70	\$ 30	\$ 23	\$ 63
Occupational	150	14	136	46	7	97
Total employee separation	225	19	206	76	30	160
Systems development:						
Service delivery	73	21	52	19	11	44
Service assurance	64	12	52	22	(4)	26
Capacity provisioning	179	57	122	85	5	42
All other	44	28	16	3	(12)	1
Total systems development	360	118	242	129	—	113
Real estate	130	50	80	66	—	14
Relocation	105	21	84	21	(30)	33
Retraining and other	60	8	52	23	—	29
Total 1993 Restructuring Plan	880	216	664	315	—	349
Remaining 1991 plan expenditures	56	56	—	—	—	—
Total	<u>\$936</u>	<u>\$272</u>	<u>\$664</u>	<u>\$315</u>	<u>\$—</u>	<u>\$349</u>

	<u>1994 Separations</u>	<u>1995 Separations</u>	<u>Cumulative Separations at December 31, 1995</u>
Employee separations:			
Managerial	497	682	1,179
Occupational	1,683	1,643	3,326
Total	<u>2,180</u>	<u>2,325</u>	<u>4,505</u>

Results of Operations — 1994 Compared with 1993

Comparative details of income before extraordinary items for 1994 and 1993 follow:

	<u>1994¹</u>	<u>1993²</u>	<u>Increase</u>
U S WEST Communications, Inc.	\$1,175	\$ 435	\$740
Other operations	(25)	(44)	19
Income before extraordinary items	<u>\$1,150</u>	<u>\$ 391</u>	<u>\$759</u>

¹ 1994 income before extraordinary items includes a gain of \$51 on the sales of certain rural telephone exchanges.

² 1993 income before extraordinary items was reduced by \$534 for a restructuring charge and \$54 for the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates.

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Communications Group's 1994 income before extraordinary items was \$1,099, an increase of \$120, or 12.3 percent, over 1993, excluding the one-time effects described in Notes 1 and 2 to the table above. The increase was primarily attributable to increased demand for telecommunications services.

In 1993, U S WEST Communications incurred extraordinary charges for the discontinuance of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation," and the early extinguishment of debt. An extraordinary, noncash charge of \$3.1 billion (after tax) was incurred in conjunction with the decision to discontinue accounting for the operations of U S WEST Communications in accordance with SFAS No. 71. SFAS No. 71 generally applies to regulated companies that meet certain requirements, including a requirement that a company be able to recover its costs, competition notwithstanding, by charging its customers at prices established by its regulators. This decision to discontinue the application of SFAS No. 71 was based on the belief that competition, market conditions and technological advances, more than prices established by regulators, will determine the future cost recovery by U S WEST Communications. As a result of this change, the remaining asset lives of U S WEST Communications' telephone plant were shortened to more closely reflect the useful (economic) lives of such plant. U S WEST Communications' accounting and reporting for regulatory purposes were not affected by the change.

During 1993, U S WEST Communications refinanced long-term debt issues aggregating \$2.7 billion in principal amount. These refinancings allowed U S WEST Communications to take advantage of favorable interest rates. Extraordinary costs associated with the redemptions reduced 1993 income by \$77 (after tax).

Revenue growth, partially offset by higher operating expenses, provided a 7.6 percent increase in EBITDA.

Operating Revenues

An analysis of changes in operating revenues follows:

	1994	1993	Price Changes	Lower (Higher) Refunds	Demand	Other	Increase (Decrease)	
							\$	%
Local service	\$4,067	\$3,829	\$(12)	\$30	\$216	\$ 4	\$238	6.2
Interstate access	2,269	2,147	(15)	(6)	148	(5)	122	5.7
Intrastate access	729	682	(10)	(4)	51	10	47	6.9
Long-distance network	1,329	1,442	(8)	1	(43)	(63)	(113)	(7.8)
Other services	782	770	—	—	—	12	12	1.6
Total	\$9,176	\$8,870	\$(45)	\$21	\$372	\$(42)	\$306	3.4

In 1994, local service revenues increased principally as a result of higher demand for services. Reported access lines increased by 3.6 percent. Excluding the sale of approximately 60,000 rural telephone access lines during 1994, access line growth was 4.0 percent.

Higher revenues from interstate access services were primarily attributable to an increase of 7.8 percent in interstate billed access minutes of use, which more than offset the effects of price decreases. Intrastate access charges increased primarily as a result of higher demand, including demand for private line services.

Long-distance revenues decreased principally due to the effects of the MTCPs implemented in Oregon and Washington. The 1994 impact was a loss of \$68 in long-distance revenues, partially offset by a decrease of \$48 in other operating expenses and an increase of \$10 in intrastate access revenue. These regulatory arrangements decreased net income by approximately \$6 in 1994.

During 1994, revenues from other services increased due to higher revenue from billing and collection services and increased market penetration of new service offerings. Partially offsetting the increase in other services revenues was the 1993 sale of telephone equipment distribution operations, completion of large telephone network installation contracts and lower revenue from customer premises equipment installations. Revenues for services provided to the Media Group were \$29 in 1994 and \$26 in 1993.

U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in millions, except per share amounts)

Costs and Expenses

	1994	1993	Increase (Decrease)	
			\$	%
Employee-related expenses	\$3,215	\$3,068	\$ 147	4.8
Other operating expenses	1,547	1,671	(124)	(7.4)
Taxes other than income taxes	388	388	—	—
Depreciation and amortization	1,908	1,828	80	4.4
Restructuring charge	—	880	(880)	—
Interest expense	376	412	(36)	(8.7)
Other expense — net	21	24	(3)	(12.5)

In 1994, overtime payments, contract labor and basic salaries and wages, all related to the implementation of major customer service and streamlining initiatives, increased by \$150. A \$71 reduction in the amount of pension credit allocated to the Communications Group also contributed to the increase in employee-related expenses. Actuarial assumptions, which include decreases in the discount rate and the expected long-term rate of return on plan assets, contributed to the pension credit reduction. Partially offsetting these increases were the effects of employees leaving under the Restructuring Plan, lower health-care benefit costs, including a reduction in the accrual for postretirement benefits, and lower incentive compensation payments to employees.

Other operating expenses decreased primarily due to the effect of the MTCPs. Lower customer premises equipment installations and lower expenses at Bellcore also contributed to the decrease. Allocated costs assigned from U S WEST to the Communications Group totaled \$110 and \$117 in 1994 and 1993, respectively. The increase in depreciation and amortization expense was primarily the result of a higher depreciable asset base and increased rates of depreciation.

Interest expense decreased due to the effects of refinancing debt at lower rates in 1993 at U S WEST Communications, and a reclassification of capitalized interest in 1994. Since the discontinuance of SFAS No. 71, interest capitalized as a component of telephone plant construction is recorded as an offset against interest expense rather than to other expense. The Communications Group's average borrowing cost was 6.8 percent in 1994 compared with 6.9 percent in 1993.

Provision for Income Taxes

	1994	1993	Increase
Provision for income taxes	\$ 653	\$ 208	\$445
Effective tax rate	36.2%	34.7%	—

The increase in the effective tax rate resulted primarily from the effects of discontinuing SFAS No. 71, an increase in 1994 income before income taxes and the 1993 restructuring charge, partially offset by the cumulative effect on deferred income taxes of the 1993 federally mandated increase in income tax rates.

Liquidity and Capital Resources — Three Years Ended December 31, 1995

Operating Activities

Cash from operations increased \$210 in 1995 primarily due to the increase in EBITDA and a decrease in the cash funding for postretirement benefits, partially offset by higher payments for restructuring charges. Cash provided by operating activities decreased by \$168 in 1994 compared with 1993, largely due to cash payments for restructuring activities of \$279 in 1994, compared with \$120 in 1993. Further details of cash provided by operating activities are provided in the Combined Statements of Cash Flows.

**U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The future cash needs of the Communications Group may increase as a result of new business opportunities, including wireless services, and requirements related to the recently enacted Telecommunications Act of 1996.

Investing Activities

Total capital expenditures were \$2,739 in 1995, \$2,477 in 1994 and \$2,226 in 1993. The 1995 capital expenditures exceeded the 1994 and 1993 levels due to the Communications Group's efforts to improve customer service (including reductions in held orders) and to accommodate additional line capability in several states. Capital expenditures related to the Restructuring Plan were approximately \$190 in 1995 as compared to \$265 in 1994. In 1996, capital expenditures are expected to approximate \$2.5 billion. Included in the 1996 capital expenditures estimate are costs to enter new markets as allowed under the Telecommunications Act of 1996.

The Communications Group received cash proceeds of \$214 and \$93 in 1995 and 1994, respectively, for the sales of certain rural telephone exchanges. Since implementing its rural telephone exchange sales program, the Communications Group has sold approximately 155,000 access lines. Planned sales of rural exchanges for 1996 and beyond aggregate approximately 180,000 lines.

Financing Activities

Debt increased by \$630 in 1995, primarily due to the increase in capital expenditures. The percentage of debt to total capital at year-end 1995 was 66.0. During 1994, debt increased \$451, though the percentage of debt to total capital declined to 65.8 at year-end 1994 from 67.6 at year-end 1993. The decrease in the percentage of debt to total capital in 1994 was primarily attributable to higher net income and issuances of equity.

During 1995, U S WEST Communications refinanced \$1.5 billion of commercial paper to take advantage of favorable long-term interest rates. In addition to the commercial paper, U S WEST Communications refinanced \$145 of long-term debt. In 1993, U S WEST Communications refinanced \$2.7 billion of long-term debt. Expenses associated with the refinancing of long-term debt resulted in extraordinary after-tax charges to income of \$8 and \$77, net of tax benefits of \$5 and \$48, in 1995 and 1993, respectively.

U S WEST and U S WEST Communications maintain commercial paper programs to finance short-term cash flow requirements, as well as to maintain a presence in the short-term debt market. In addition, U S WEST Communications is permitted to borrow up to \$600 under short-term lines of credit, all of which was available at December 31, 1995. Additional lines of credit aggregating approximately \$1.3 billion are available to both the Media Group and the nonregulated subsidiaries in the Communications Group in accordance with their borrowing needs. Under registration statements filed with the Securities and Exchange Commission ("SEC"), as of December 31, 1995, U S WEST Communications is permitted to issue up to \$320 of new debt securities. An additional \$1.2 billion in securities is permitted to be issued under registration statements filed with the SEC to support the requirements of the Media Group and the nonregulated subsidiaries in the Communications Group.

In connection with U S WEST's February 27, 1996 announcement of a planned merger with Continental Cablevision, U S WEST, Inc.'s credit rating is being reviewed by credit rating agencies, which may result in a downgrading. The credit rating of U S WEST Communications was not placed under review by Moody's, has been reaffirmed by Duff and Phelps and is under review by Fitch and Standard & Poors.

Financing activities for the nonregulated Communications Group businesses and the Media Group, including the issuance, repayment and repurchase of short-term and long-term debt, and the issuance and repurchase of preferred securities, are managed by U S WEST on a centralized basis. Notwithstanding such centralized management, financing activities for U S WEST Communications are separately identified and accounted for in U S WEST's records and U S WEST Communications continues to conduct its own

**U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

borrowing activities. Debt incurred and investments made by U S WEST and its subsidiaries on behalf of the nonregulated Communications Group businesses and all debt incurred and investments made by U S WEST Communications are specifically allocated and reflected on the financial statements of the Communications Group. All other debt incurred and investments made by U S WEST and its subsidiaries on behalf of the Media Group are specifically allocated to and reflected on the financial statements of the Media Group. Debt incurred by U S WEST or a subsidiary on behalf of a Group is charged to such Group at the borrowing rate of U S WEST or such subsidiary.

Interest Rate Risk Management

The Communications Group is exposed to market risks arising from changes in interest rates. Derivative financial instruments are used to manage this risk. The Communications Group does not use derivative financial instruments for trading purposes.

The objective of the interest rate risk management program is to minimize the total cost of debt. Interest rate swaps are used to adjust the ratio of fixed-to variable-rate debt. The market value of the debt portfolio including the interest rate swaps is monitored and compared with predetermined benchmarks to evaluate the effectiveness of the risk management program.

Notional amounts of interest rate swaps outstanding were \$784 and \$781 at December 31, 1995 and 1994, respectively, with various maturities extending to 2001. The estimated effect of U S WEST Communications' interest rate derivative transactions was to adjust the level of fixed-rate debt from 88 percent to 97 percent of the total debt portfolio at December 31, 1995, and from 76 percent to 86 percent of the total debt portfolio at December 31, 1994.

In conjunction with the 1993 debt refinancing, the Communications Group executed forward contracts to sell U.S. Treasury bonds to lock in the U.S. Treasury rate component of \$1.5 billion of the future debt issue. At December 31, 1995, deferred credits of \$8 and deferred charges of \$51 on closed forward contracts are included as part of the carrying value of the underlying debt. The deferred credits and charges are being recognized as a yield adjustment over the life of the debt, which matures at various dates through 2043. The net deferred charge is directly offset by the lower coupon rate achieved on the new debt.

Competitive and Regulatory Environment

Markets served by the Communications Group, including markets for local, access and long-distance services, are being impacted by the rapid technological and regulatory changes occurring within the telecommunications industry. Current and potential competitors include local telephone companies, interexchange carriers, competitive access providers ("CAPs"), cable television companies and providers of personal communications services ("PCS").

On February 1, 1996, the House and Senate approved the Telecommunications Act of 1996 (the "1996 Act") which is intended to promote competition between local telephone companies, long-distance carriers and cable television operators. The 1996 Act was signed into law on February 8, 1996, and replaces the antitrust consent decree that broke up the "Bell System" in 1984. A major provision of the legislation includes the preemption of state regulations that govern competition by allowing local telephone companies, long-distance carriers and cable television companies to enter each other's lines of business. Consequently, the Regional Bell Operating Companies ("RBOCs") are immediately permitted to offer wireline interLATA toll services out of their regions. However, to participate in the interLATA long-distance market within their regions, the RBOCs must first open their local networks to facilities-based competition by satisfying a detailed checklist of requirements, including requirements related to interconnection and number portability.

Other key provisions of the 1996 Act: (1) eliminate most of the regulation of cable television rates within three years and eliminate the ban on cross-ownership between cable television and telephone

**U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

companies in small communities; (2) permit the RBOCs to develop new, competitive cable systems within their regions and to acquire or build wireless cable systems; (3) provide partial relief from the ban against manufacturing telecommunications equipment by the RBOCs; and (4) permit wireless operators to provide interLATA toll service in and out of region without a separate subsidiary and to jointly market or resell cellular service.

The FCC and state regulators have been given latitude in interpreting and overseeing the implementation of this legislation, including developing universal service funding policy. The extent and timing of future competition, including the Communications Group's ability to offer in-region interLATA long-distance services, will depend in part on the implementation guidelines determined by the FCC and state regulators, and how quickly the Communications Group can satisfy requirements of the checklist. The Communications Group estimates that fulfillment of the checklist requirements could occur in the majority of its states within 12 to 18 months.

The Communications Group believes that competitors will initially target high-volume business customers in densely populated urban areas. The resulting loss of local service customers will affect multiple revenue streams and could have a material, adverse effect on the Communications Group's operations. The resulting revenue losses, however, could be at least partially offset by the Communications Group's ability to bundle local, long-distance and wireless services, and provide interconnection services.

The Communications Group's strategy is to offer integrated communications, entertainment, information and transaction services over both wired and wireless networks to its customers primarily within its Region. The key initiatives to support this strategy include five key elements:

- Providing superior customer service
- Building customer loyalty
- Enhancing network capability and capacity
- Expanding the product and service portfolio
- Ensuring a fair competitive environment

Strategic initiatives to attract and retain customers include: (1) enhancing existing services with products such as caller identification, call waiting and voice messaging; (2) aggressive expansion of data services; (3) pursuing opportunities to offer paging, wireless and cable television services; and (4) rapid entry into the interLATA long-distance market.

A market trial for a broadband network capable of providing voice, data and video services to customers commenced in the Omaha area in August 1995. The Communications Group does not intend to expand this service offering beyond the Omaha area because of service cost and pricing issues. The Communications Group does plan to continue to provide the system that delivers basic, premium and pay-per-view video services in the Omaha area. The Communications Group is evaluating the relative costs of alternative video technologies, as well as the near-term feasibility of interactive services. To satisfy anticipated demand for combined video and telephony services on a cost-effective basis, the Communications Group's strategy may include selective investments in wireless cable technologies.

The Communications Group is subject to varying degrees of federal and state regulation. The Communications Group's regulatory strategy includes working to:

- Achieve accelerated capital recovery;
- Reprice local services to cover costs and ensure these services are subsidy free, while lowering toll and access rates to meet competition; and

**U S WEST COMMUNICATIONS GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

- Ensure that the new rules associated with the Telecommunications Act of 1996 concerning the unbundling of interconnection, resale of services and universal service do not advantage one competitor over another.

The Communications Group is currently working with state regulators to gain approval of these initiatives.

Other Regulatory Issues

The Communications Group's interstate services have been subject to price cap regulation since January 1991. Price caps are an alternative form of regulation designed to limit prices rather than profits. However, the FCC's price cap plan includes sharing of earnings in excess of authorized levels. In March 1995, the FCC issued an interim order on price cap regulation. The price cap index for most services is annually adjusted for inflation, productivity level and exogenous costs, and has resulted in reduced access prices paid by interexchange carriers to local telephone companies. The interim order also provides for three productivity options, including a no-sharing option, and for increased flexibility for adjusting prices downward in response to competition. In 1995, the Communications Group selected the lowest productivity option while, prior to this interim order, the Communications Group used an optional higher productivity factor in determining its prices. Consequently, the Communications Group expects the order to have no significant near-term impact.

There are pending regulatory actions in local regulatory jurisdictions that call for price decreases, refunds or both. In one such instance, the Utah Supreme Court has remanded a Utah Public Service Commission ("PSC") order to the PSC for reconsideration, thereby establishing two exceptions to the rule against retroactive ratemaking: 1) unforeseen and extraordinary events, and 2) misconduct. The PSC's initial order denied a refund request from interexchange carriers and other parties related to the Tax Reform Act of 1986. This action is still in the discovery process. If a formal filing — made in accordance with the remand from the Supreme Court — alleges that the exceptions apply, the range of possible risk is \$0 to \$150.

Union Contract

On October 2, 1995, union members approved a new three-year contract with U S WEST. The contract provides for salary increases of 10.6 percent over three years effective January 1 of each year. The contract also provides employees with a lump sum payment of \$1,500 in lieu of wage increases becoming effective in August of each year. This lump sum payment is being recognized over the life of the contract. The agreement covers approximately 30,000 Communications Workers of America members who work for the Communications Group.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareowners of U S WEST, Inc.:

We have audited the Combined Balance Sheets of U S WEST Communications Group (as described in Note 2 to the Combined Financial Statements) as of December 31, 1995 and 1994, and the related Combined Statements of Operations and Cash Flows for each of the three years in the period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of U S WEST Communications Group as of December 31, 1995 and 1994, and the combined results of its operations and its cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

As more fully discussed in Note 2, the Combined Financial Statements of U S WEST Communications Group should be read in connection with the audited Consolidated Financial Statements of U S WEST, Inc.

As discussed in Note 5 to the Combined Financial Statements, U S WEST Communications Group discontinued accounting for the operations of U S WEST Communications, Inc. in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation," in 1993.

COOPERS & LYBRAND L.L.P.

Denver, Colorado
February 12, 1996

U S WEST COMMUNICATIONS GROUP
COMBINED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	1995	1994	1993
	Dollars in millions (except per share amounts)		
Operating revenues:			
Local service	\$ 4,344	\$ 4,067	\$ 3,829
Interstate access service	2,378	2,269	2,147
Intrastate access service	747	729	682
Long-distance network services	1,189	1,329	1,442
Other services	826	782	770
Total operating revenues	9,484	9,176	8,870
Operating expenses:			
Employee-related expenses	3,341	3,215	3,068
Other operating expenses	1,543	1,547	1,671
Taxes other than income taxes	380	388	388
Depreciation and amortization	2,042	1,908	1,828
Restructuring charge	—	—	880
Total operating expenses	7,306	7,058	7,835
Income from operations	2,178	2,118	1,035
Interest expense	427	376	412
Gains on sales of rural telephone exchanges	136	82	—
Other expense — net	41	21	24
Income before income taxes and extraordinary items	1,846	1,803	599
Provision for income taxes	662	653	208
Income before extraordinary items	1,184	1,150	391
Extraordinary items:			
Discontinuance of SFAS No. 71, net of tax	—	—	(3,123)
Early extinguishment of debt, net of tax	(8)	—	(77)
NET INCOME (LOSS)	\$ 1,176	\$ 1,150	\$(2,809)
Pro forma earnings per common share:			
Income before extraordinary items	\$ 2.52	\$ 2.53	
Extraordinary items — early extinguishment of debt	(0.02)	—	
PRO FORMA EARNINGS PER COMMON SHARE	\$ 2.50	\$ 2.53	
PRO FORMA AVERAGE COMMON SHARES OUTSTANDING (thousands)	470,716	453,316	

The accompanying notes are an integral part of the Combined Financial Statements.

**U S WEST COMMUNICATIONS GROUP
COMBINED BALANCE SHEETS**

ASSETS

	December 31,	
	1995	1994
	Dollars in millions	
Current assets:		
Cash and cash equivalents	\$ 172	\$ 116
Accounts and notes receivable, less allowance for credit losses of \$30 and \$29, respectively	1,617	1,500
Inventories and supplies	193	166
Deferred tax asset	259	300
Prepaid and other	51	56
Total current assets	<u>2,292</u>	<u>2,138</u>
Property, plant and equipment — net	13,529	13,041
Other assets	764	765
Total assets	<u>\$16,585</u>	<u>\$15,944</u>

LIABILITIES AND EQUITY

Current liabilities:		
Short-term debt	\$ 1,065	\$ 1,608
Accounts payable	851	888
Employee compensation	316	313
Dividends payable	254	250
Current portion of restructuring charge	270	318
Advanced billing and customer deposits	223	211
Other	628	620
Total current liabilities	<u>3,607</u>	<u>4,208</u>
Long-term debt	5,689	4,516
Postretirement and other postemployment benefit obligations	2,351	2,427
Deferred income taxes	689	547
Unamortized investment tax credits	199	231
Deferred credits and other	574	836
Communications Group equity	3,476	3,179
Total liabilities and equity	<u>\$16,585</u>	<u>\$15,944</u>
Contingencies (see Note 13 to the Combined Financial Statements)		

The accompanying notes are an integral part of the Combined Financial Statements.

U S WEST COMMUNICATIONS GROUP
COMBINED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1995	1994	1993
	Dollars in millions		
OPERATING ACTIVITIES			
Net income (loss)	\$ 1,176	\$ 1,150	\$(2,809)
Adjustments to net income (loss):			
Discontinuance of SFAS No. 71	—	—	3,123
Restructuring charge	—	—	880
Depreciation and amortization	2,042	1,908	1,828
Gains on sales of rural telephone exchanges	(136)	(82)	—
Deferred income taxes and amortization of investment tax credits	172	226	(191)
Changes in operating assets and liabilities:			
Restructuring payments	(315)	(279)	(120)
Postretirement medical and life costs, net of cash fundings	(90)	(197)	(135)
Accounts receivable	(117)	(64)	(78)
Inventories, supplies and other	(51)	(29)	(23)
Accounts payable and accrued liabilities	7	(147)	153
Other — net	31	23	49
Cash provided by operating activities	<u>2,719</u>	<u>2,509</u>	<u>2,677</u>
INVESTING ACTIVITIES			
Expenditures for property, plant and equipment	(2,462)	(2,254)	(2,234)
Proceeds from (payments on) disposals of property, plant and equipment	(18)	3	42
Proceeds from sales of rural telephone exchanges	214	93	—
Other — net	(2)	2	—
Cash (used for) investing activities	<u>(2,268)</u>	<u>(2,156)</u>	<u>(2,192)</u>
FINANCING ACTIVITIES			
Net (repayments of) proceeds from issuance of short-term debt	(832)	344	687
Proceeds from issuance of long-term debt	1,647	326	2,408
Repayments of long-term debt	(334)	(285)	(2,952)
Dividends paid on common stock	(926)	(886)	(812)
Proceeds from issuance of equity	50	208	356
Advance from/(repayment to) Media Group	—	—	(153)
Cash (used for) financing activities	<u>(395)</u>	<u>(293)</u>	<u>(466)</u>
CASH AND CASH EQUIVALENTS			
Increase	56	60	19
Beginning balance	116	56	37
Ending balance	<u>\$ 172</u>	<u>\$ 116</u>	<u>\$ 56</u>

The accompanying notes are an integral part of the Combined Financial Statements.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS
For the Years Ended December 31, 1995, 1994 and 1993
(Dollars in millions, except per share amounts)

NOTE 1: RECAPITALIZATION PLAN

On October 31, 1995, the shareholders of U S WEST, Inc., a Colorado corporation ("U S WEST Colorado"), voted to approve a proposal (the "Recapitalization Plan") adopted by the Board of Directors of U S WEST, Inc. (the "Board") to reincorporate in Delaware and create two classes of common stock that are intended to reflect separately the performance of the communications and multimedia businesses. Under the Recapitalization Plan, shareholders approved an Agreement and Plan of Merger between U S WEST Colorado and U S WEST, Inc., a Delaware corporation ("U S WEST" or "Company"), pursuant to which U S WEST continues as the surviving corporation. In connection with the merger, the Certificate of Incorporation of U S WEST has been amended and restated to designate two classes of common stock of U S WEST, one class of which is authorized as U S WEST Communications Group Common Stock ("Communications Stock"), and the other class which is authorized as U S WEST Media Group Common Stock ("Media Stock"). Effective November 1, 1995, each share of common stock of U S WEST Colorado was converted into one share each of Communications Stock and Media Stock.

The Communications Stock and Media Stock provide shareholders with two distinct securities that are intended to reflect separately the communications businesses of U S WEST (the "Communications Group") and the multimedia businesses of U S WEST (the "Media Group" and, together with the Communications Group, the "Groups").

The Communications Group is comprised of U S WEST Communications, Inc. ("U S WEST Communications"), U S WEST Communications Services, Inc., U S WEST Federal Services, Inc., U S WEST Advanced Technologies, Inc. and U S WEST Business Resources, Inc. The Communications Group primarily provides regulated communications services to more than 25 million residential and business customers within a 14 state region.

The Media Group is comprised of U S WEST Marketing Resources Group, Inc., which publishes White and Yellow Pages telephone directories, and provides directory and information services, U S WEST NewVector Group, Inc., which provides communications and information products and services over wire-less networks, U S WEST Multimedia Communications, Inc., which owns domestic cable television operations and investments, and U S WEST International Holdings, Inc., which primarily owns investments in international cable and telecommunications, wire-less communications and directory publishing operations.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The Combined Financial Statements of the Groups comprise all of the accounts included in the corresponding Consolidated Financial Statements of U S WEST. Investments in less than majority-owned ventures are generally accounted for using the equity method. The separate Group Combined Financial Statements have been prepared on a basis that management believes to be reasonable and appropriate and include: (i) the combined historical balance sheets, results of operations and cash flows of the businesses that comprise each of the Groups, with all significant intra-group amounts and transactions eliminated; (ii) in the case of the Communications Group Combined Financial Statements, certain corporate assets and liabilities of U S WEST and related transactions identified with the Communications Group; (iii) in the case of the Media Group Combined Financial Statements, all other corporate assets and liabilities and related transactions of U S WEST; and (iv) an allocated portion of the corporate expense of U S WEST. Transactions between the Communications Group and the Media Group have not been eliminated.

Notwithstanding the allocation of assets and liabilities (including contingent liabilities) and stockholders' equity between the Communications Group and the Media Group for the purpose of preparing the respective financial statements of such Group, holders of Communications Stock and Media Stock are subject to risks associated with an investment in a single company and all of U S WEST's businesses, assets and liabilities. Such allocation of assets and liabilities and change in the equity structure of U S WEST does

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

not result in a distribution or spin-off to shareholders of any assets or liabilities of U S WEST or any of its subsidiaries or otherwise affect responsibility for the liabilities of U S WEST or such subsidiaries. As a result, the rights of the holders of U S WEST or any of its subsidiaries' debt are not affected. Financial effects arising from either Group that affect U S WEST's results of operations or financial condition could, if significant, affect the results of operations or financial position of the other Group or the market price of the class of common stock relating to the other Group. Any net losses of the Communications Group or the Media Group, and dividends or distributions on, or repurchases of Communications Stock, Media Stock or preferred stock, will reduce the funds of U S WEST legally available for payment of dividends on both the Communications Stock and Media Stock. Accordingly, the Communications Group Combined Financial Statements should be read in conjunction with U S WEST's Consolidated Financial Statements and the Media Group Combined Financial Statements.

The accounting policies described herein applicable to the preparation of the Combined Financial Statements of the Communications Group may be modified or rescinded at the sole discretion of the Board without approval of the stockholders, although there is no present intention to do so. The Board may also adopt additional policies depending on the circumstances. Any determination of the Board to modify or rescind such policies, or to add additional policies, including any decision that would have disparate impacts upon holders of Communications Stock and Media Stock, would be made by the Board in good faith and in the honest belief that such decision is in the best interests of all U S WEST stockholders, including the holders of Communications Stock and the holders of Media Stock. In making such determination, the Board may also consider regulatory requirements imposed on U S WEST Communications by the public utility commissions of various states and the Federal Communications Commission. In addition, generally accepted accounting principles require that any change in accounting policy be preferable (in accordance with such principles) to the policy previously established.

Certain reclassifications within the Combined Financial Statements have been made to conform to the current year presentation.

Allocation of Shared Services Certain costs relating to U S WEST's general and administrative services (including certain executive management, legal, tax, accounting and auditing, treasury, strategic planning and public policy services) are directly assigned by U S WEST to each Group based on actual utilization or are allocated based on each Group's operating expenses, number of employees, external revenues, average capital and/or average equity. U S WEST charges each Group for such services at fully distributed cost. These direct and indirect allocations were \$116, \$110 and \$117 in 1995, 1994 and 1993, respectively. In 1995, the direct allocations comprised approximately 37 percent of the total shared corporate services allocated to the Communications Group. It is not practicable to provide a detailed estimate of the expenses which would be recognized if the Communications Group was a separate legal entity. However, U S WEST believes that under the Recapitalization Plan, each Group benefits from synergies with the other, including having lower operating costs than might be incurred if each Group was a separate legal entity.

Allocation of Income Taxes Federal, state and local income taxes, which are determined on a consolidated or combined basis, are allocated to each Group in accordance with tax sharing agreements between U S WEST and the entities within the Groups. The allocations will generally reflect each Group's contribution (positive or negative) to consolidated taxable income and consolidated tax credits. A Group will be compensated only at such time as, and to the extent that, its tax attributes are utilized by U S WEST in a combined or consolidated income tax filing. Federal and state tax refunds and carryforwards or carrybacks of tax attributes will generally be allocated to the group to which such tax attributes relate.

Group Financing Financing activities for the nonregulated Communications Group businesses and the Media Group, including the issuance, repayment and repurchase of short-term and long-term debt, and the issuance and repurchase of preferred securities are managed by U S WEST on a centralized basis. Financing

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

activities for U S WEST Communications are separately identified and accounted for in U S WEST's records and U S WEST Communications conducts its own borrowing activities. Debt incurred and investments made by U S WEST and its subsidiaries on behalf of the nonregulated Communications Group businesses and all debt incurred and investments made by U S WEST Communications are specifically allocated to and reflected on the financial statements of the Communications Group. All debt incurred and investments made by U S WEST and its subsidiaries on behalf of the Media Group are specifically allocated to and reflected on the financial statements of the Media Group. Debt incurred by U S WEST or a subsidiary on behalf of a Group is charged to such Group at the borrowing rate of U S WEST or such subsidiary.

As of November 1, 1995, the effective date of the Recapitalization Plan, U S WEST does not intend to transfer funds between the Groups, except for certain short-term, ordinary course advances of funds at market rates associated with U S WEST's centralized cash management program for the nonregulated businesses. Such short-term transfers of funds will be accounted for as short-term loans between the Groups bearing interest at the market rate at which management determines the borrowing Group could obtain funds on a short-term basis. If the Board, in its sole discretion, determines that a transfer of funds between the Groups should be accounted for as a long-term loan, the Board would establish the terms on which such loan would be made, including the interest rate, amortization schedule, maturity and redemption terms. Such terms would generally reflect the then prevailing terms upon which management determines such Group could borrow funds on a similar basis. The financial statements of the lending Group will be credited, and the financial statements of the borrowing Group will be charged, with the amount of any such loan, as well as with periodic interest accruing thereon. The Board may determine that a transfer of funds from the Communications Group to the Media Group should be accounted for as an equity contribution, in which case an inter-group interest (determined by the Board based on the then current market value of shares of Media Stock) will either be created or increased, as applicable. Similarly, if an inter-group interest exists, the Board may determine that a transfer of funds from the Media Group to the Communications Group should be accounted for as a reduction in the inter-group interest.

Dividends Dividends on the Communications Stock will be paid at the discretion of the Board based primarily upon the financial condition, results of operations and business requirements of the Communications Group and U S WEST as a whole. Dividends will be payable out of the lesser of: 1) the funds of U S WEST legally available for the payment of dividends; and 2) the Communications Group Available Dividend Amount.

The Communications Group Available Dividend Amount on any date, shall mean the excess, if any, of: 1) the amount equal to the fair market value of the total assets attributed to the Communications Group less the total amount of the liabilities attributed to the Communications Group (provided that preferred stock shall not be treated as a liability), in each case as of such date and determined on a basis consistent with that applied in determining the Communications Group net earnings (loss) over; 2) the aggregate par value of, or any greater amount determined to be capital in respect of, all outstanding shares of Communications Stock and each class or series of preferred stock attributed to the Communications Group.

Earnings per Common Share Earnings per common share for 1995 and 1994 have been presented on a pro forma basis to reflect the Communications Stock as if it had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST.

Industry Segment The businesses comprising the Communications Group operate in a single industry segment as defined in Statement of Financial Accounting Standards ("SFAS") No. 14, "Financial Reporting for Segments of a Business Enterprise." The Communications Group primarily provides regulated communications services to more than 25 million residential and business customers in the Communications Group region (the "Region"). The Region includes the states of Arizona, Colorado, Idaho, Iowa, Minnesota,

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming. Services offered by the Communications Group include local telephone services, exchange access services (which connect customers to the facilities of carriers, including long-distance providers and wireless operators), and long-distance services within Local Access and Transport Areas ("LATAs") in the Region. The Communications Group provides other products and services, including custom calling, voice messaging, caller identification, high-speed data applications, customer premises equipment and certain communications services to business customers and governmental agencies both inside and outside the Region.

Approximately 97 percent of the revenues of the Communications Group are attributable to the operations of U S WEST Communications, of which approximately 59 percent are derived from the states of Arizona, Colorado, Minnesota and Washington.

Significant Concentrations The largest volume of the Communications Group's services are provided to AT&T. During 1995, 1994 and 1993, revenues related to those services provided to AT&T were \$1,085, \$1,130 and \$1,159, respectively. Related accounts receivable at December 31, 1995 and 1994, totaled \$91 and \$98, respectively. As of December 31, 1995, the Communications Group is not aware of any other significant concentration of business transacted with a particular customer, supplier or lender that could, if suddenly eliminated, severely impact operations.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents Cash and cash equivalents include highly liquid investments with original maturities of three months or less that are readily convertible into cash and are not subject to significant risk from fluctuations in interest rates.

Inventories and Supplies New and reusable materials of U S WEST Communications are carried at average cost, except for significant individual items that are valued based on specific costs. Nonreusable material is carried at its estimated salvage value. Inventories of the Communications Group's nontelephone operations are carried at the lower of cost or market on a first-in, first-out basis.

Property, Plant and Equipment The investment in property, plant and equipment is carried at cost, less accumulated depreciation. Additions, replacements and substantial betterments are capitalized. Costs for normal repair and maintenance of property, plant and equipment are expensed as incurred.

U S WEST Communications' provision for depreciation of property, plant and equipment is based on various straight-line group methods using remaining useful (economic) lives based on industry-wide studies. In third quarter 1993, U S WEST Communications discontinued accounting for its regulated telephone operations under SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." (See Note 5 to the Combined Financial Statements.) Prior to discontinuing SFAS No. 71, depreciation was based on lives specified by regulators.

When the depreciable property, plant and equipment of U S WEST Communications is retired or sold, the original cost less the net salvage value is generally charged to accumulated depreciation. The nontelephone operations of the Communications Group provide for depreciation using the straight-line method. When such depreciable property, plant and equipment is retired or sold, the resulting gain or loss is included in income.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interest related to qualifying construction projects is capitalized and reflected as a reduction of interest expense. At U S WEST Communications, prior to discontinuing SFAS No. 71, capitalized interest was included as an element of other income. Amounts capitalized by the Communications Group were \$39, \$36 and \$15 in 1995, 1994 and 1993, respectively.

Revenue Recognition Local telephone service revenues are generally billed monthly, in advance, and revenues are recognized the following month when services are provided. Revenues derived from exchange access and long-distance services are billed and recorded monthly as services are provided.

Financial Instruments Net interest received or paid on interest rate swaps is recognized over the life of the swaps as an adjustment to interest expense. Gains and losses on forward contracts are deferred and recognized as an adjustment to interest expense over the life of the underlying debt. Currency swaps entered into to convert foreign debt to dollar-denominated debt are combined with the foreign currency debt and accounted for as if fixed-rate, dollar-denominated debt were issued directly.

Computer Software The cost of computer software, whether purchased or developed internally, is charged to expense with two exceptions. Initial operating systems software is capitalized and amortized over the life of the related hardware, and initial network applications software is capitalized and amortized over three years. Subsequent upgrades to capitalized software are expensed. Capitalized computer software of \$183 and \$146 at December 31, 1995 and 1994, respectively, is recorded in property, plant and equipment. Amortization of capitalized computer software costs totaled \$69, \$61 and \$37 in 1995, 1994 and 1993, respectively.

Income Taxes The provision for income taxes consists of an amount for taxes currently payable and an amount for tax consequences deferred to future periods in accordance with SFAS No. 109. The Communications Group implemented SFAS No. 109, "Accounting for Income Taxes," in 1993. Adoption of the new standard did not have a material effect on the financial position or results of operations, primarily because of U S WEST's earlier adoption of SFAS No. 96.

For financial statement purposes, investment tax credits of U S WEST Communications are being amortized over the economic lives of the related property, plant and equipment in accordance with the deferred method of accounting for such credits.

New Accounting Standards In 1996, U S WEST will adopt SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." SFAS No. 121 requires that long-lived assets and associated intangibles be written down to fair value whenever an impairment review indicates that the carrying value cannot be recovered on an undiscounted cash flow basis. SFAS No. 121 also requires that a company no longer record depreciation expense on assets held for sale. U S WEST expects that the adoption of SFAS No. 121 will not have a material effect on its financial position or results of operations.

In 1996, U S WEST will adopt SFAS No. 123, "Accounting for Stock-Based Compensation." This standard establishes a fair value method for accounting for stock-based compensation plans either through recognition or disclosure. U S WEST will adopt this standard through compliance with the disclosure requirements set forth in SFAS No. 123. Adoption of the standard will have no impact on the financial position or results of operations of U S WEST.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 3: RELATED PARTY TRANSACTIONS

Customer Lists, Billing and Collection Services, and Other Services U S WEST Communications sells customer lists, billing and collection services, and other services to the domestic publishing operations of the Media Group. These data and services are sold at market price. However, the accounting and reporting for regulatory purposes is in accordance with regulatory requirements. U S WEST Communications charged \$20, \$29 and \$26 for these services in 1995, 1994 and 1993, respectively.

Telecommunications Services U S WEST Communications sells telecommunications network access and usage to the domestic cellular operations of the Media Group. U S WEST Communications charged \$40, \$30 and \$24 in 1995, 1994 and 1993, respectively, for these services.

Bell Communications Research, Inc. ("Bellcore") Charges relating to research, development and maintenance of existing technologies performed by Bellcore, of which U S WEST Communications has a one-seventh ownership interest, were \$84, \$111 and \$113 in 1995, 1994 and 1993, respectively.

NOTE 4: RESTRUCTURING CHARGE

The Communications Group's 1993 results reflected an \$880 restructuring charge (pretax). The related restructuring plan (the "Restructuring Plan") is designed to provide faster, more responsive customer services while reducing the costs of providing these services. As part of the Restructuring Plan, the Communications Group is developing new systems and enhanced system functionality that will enable it to monitor networks to reduce the risk of service interruptions, activate telephone service on demand, rapidly design and engineer new products and services for customers, and centralize its service centers. The Communications Group has consolidated its 560 customer service centers into 26 centers in 10 cities and plans on reducing its work force by approximately 10,000 employees. Approximately 1,000 employees that were originally expected to relocate have chosen separation or other job assignments and have been replaced. This increased the number of employee separations to 10,000 from 9,000, and increased the estimated total cost for employee separations to \$311, compared with \$281 in the original estimate. The \$30 cost associated with these additional employee separations was reclassified from relocation to the reserve for employee separations during 1995.

Following is a schedule of the costs included in the 1993 restructuring charge:

	1993 Restructuring Charge	Change in Estimate	December 31, 1995 Estimate
Employee separation ¹	\$225	\$ 30	\$255
Systems development	360	—	360
Real estate	130	—	130
Relocation	105	(30)	75
Retraining and other	60	—	60
Total	<u>\$880</u>	<u>—</u>	<u>\$880</u>

¹ Employee-separation costs, including the balance of a 1991 restructuring reserve at December 31, 1993, aggregate \$311.

Employee separation costs include severance payments, health-care coverage and postemployment education benefits. Systems development costs include new systems and the application of enhanced system functionality to existing single purpose systems to provide integrated end-to-end customer service. Real estate costs include preparation costs for the new service centers. The relocation and retraining costs are related to moving employees to the new service centers and retraining employees on the methods and systems required in the new, restructured mode of operation.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 4: RESTRUCTURING CHARGE (Continued)

The following table shows amounts charged to the restructuring reserve:

	1993 Restructuring Reserve	1994 Activity	1995 Activity	Change in Estimate	December 31, 1995 Balance
Employee separation ¹	\$281	\$ 75	\$ 76	\$ 30	\$160
Systems development	360	118	129	—	113
Real estate	130	50	66	—	14
Relocation	105	21	21	(30)	33
Retraining and other	60	8	23	—	29
Total	<u>\$936</u>	<u>\$272</u>	<u>\$315</u>	<u>\$—</u>	<u>\$349</u>

¹ Includes \$56 associated with work-force reductions under a 1991 restructuring plan.

Employee separations under the Restructuring Plan in 1995 and 1994 were as follows:

	1994 Separations	1995 Separations	Cumulative Separations at December 31, 1995
Employee separations:			
Managerial	497	682	1,179
Occupational	<u>1,683</u>	<u>1,643</u>	<u>3,326</u>
Total	<u>2,180</u>	<u>2,325</u>	<u>4,505</u>

The Restructuring Plan is expected to be substantially completed by the end of 1997. Implementation of the Restructuring Plan has been impacted by growth in the business and related service issues, new business opportunities, revisions to system delivery schedules and productivity issues caused by the major rearrangement of resources due to restructuring. These issues will continue to affect the timing of employee separations.

NOTE 5: PROPERTY, PLANT AND EQUIPMENT

The composition of property, plant and equipment follows:

	December 31,	
	1995	1994
Land and buildings	\$ 2,459	\$ 2,453
Telephone network equipment	12,019	11,622
Telephone outside plant	12,353	11,897
General purpose computers and other	3,580	3,013
Construction in progress	767	593
	<u>31,178</u>	<u>29,578</u>
Less accumulated depreciation		
Buildings	686	657
Telephone network equipment	7,221	6,733
Telephone outside plant	7,851	7,442
General purpose computers and other	1,891	1,705
	<u>17,649</u>	<u>16,537</u>
Property, plant and equipment — net	<u>\$13,529</u>	<u>\$13,041</u>

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 5: PROPERTY, PLANT AND EQUIPMENT (Continued)

In 1995, U S WEST Communications sold certain rural telephone exchanges with a cost basis of \$258. U S WEST Communications received consideration for the sales of \$388, including \$214 in cash. In 1994, U S WEST Communications sold certain rural telephone exchanges with a cost basis of \$122 and received consideration of \$204, including \$93 in cash.

Discontinuance of SFAS No. 71

U S WEST Communications incurred a noncash, extraordinary charge of \$3.1 billion, net of an income tax benefit of \$2.3 billion, in conjunction with its decision to discontinue accounting for the operations of U S WEST Communications in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," as of September 30, 1993. SFAS No. 71 generally applies to regulated companies that meet certain requirements, including a requirement that a company be able to recover its costs, notwithstanding competition, by charging its customers at prices established by its regulators. U S WEST Communications' decision to discontinue application of SFAS No. 71 was based on the belief that competition, market conditions and technological advances, more than prices established by regulators, will determine the future cost recovery by U S WEST Communications. As a result of this change, the remaining asset lives of U S WEST Communications' plant were shortened to more closely reflect the useful (economic) lives of such plant.

Following is a list of the major categories of telephone property, plant and equipment and the manner in which depreciable lives were affected by the discontinuance of SFAS No. 71:

Category	Average Life (years)	
	Before Discontinuance	After Discontinuance
Digital switch	17-18	10
Digital circuit	11-13	10
Aerial copper cable	18-28	15
Underground copper cable	25-30	15
Buried copper cable	25-28	20
Fiber cable	30	20
Buildings	27-49	27-49
General purpose computers	6	6

U S WEST Communications employed two methods to determine the amount of the extraordinary charge. The "economic life" method assumed that a portion of the plant-related effect is a regulatory asset that was created by the under-depreciation of plant under regulation. This method yielded the plant-related adjustment that was confirmed by the second method, a discounted cash flows analysis.

Following is a schedule of the nature and amounts of the after-tax charge recognized as a result of U S WEST Communications' discontinuance of SFAS No. 71:

Plant related	\$3,124
Tax-related regulatory assets and liabilities	(208)
Other regulatory assets and liabilities	207
Total	<u>\$3,123</u>

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 6: DEBT

Short-term Debt

The components of short-term debt follow:

	December 31,	
	1995	1994
Notes payable:		
Commercial paper	\$ 542	\$1,321
Other	62	116
Current portion of long-term debt	461	171
Total	<u>\$1,065</u>	<u>\$1,608</u>

The weighted average interest rate on commercial paper was 5.79 percent and 5.92 percent at December 31, 1995 and 1994, respectively.

U S WEST and U S WEST Communications maintain commercial paper programs to finance short-term cash flow requirements, as well as to maintain a presence in the short-term debt market. In addition, U S WEST Communications, which conducts its own borrowing activities, is permitted to borrow up to \$600 under short-term lines of credit, all of which was available at December 31, 1995. Additional lines of credit aggregating approximately \$1.3 billion are available to both the Media Group and the nonregulated subsidiaries of the Communications Group in accordance with their borrowing needs.

Long-term Debt

Interest rates and maturities of long-term debt at December 31 follow:

Interest rates	Maturities					Total 1995	Total 1994
	1997	1998	1999	2000	Thereafter		
Up to 5%	\$—	\$ 35	\$—	\$ 90	\$ 150	\$ 275	\$ 275
Above 5% to 6%	—	300	—	—	261	561	561
Above 6% to 7%	—	—	71	257	1,916	2,244	1,361
Above 7% to 8%	16	—	—	—	2,477	2,493	2,136
Above 8% to 9%	—	—	—	—	250	250	250
Above 9% to 10%	—	—	—	175	—	175	320
Variable rate debt indexed to two- and ten-year constant maturity Treasury rates	25	—	155	—	—	180	180
	<u>\$ 41</u>	<u>\$335</u>	<u>\$226</u>	<u>\$522</u>	<u>\$5,054</u>	<u>6,178</u>	<u>5,083</u>
Capital lease obligations and other						195	148
Unamortized discount — net						(684)	(715)
Total						<u>\$5,689</u>	<u>\$4,516</u>

Long-term debt consists principally of debentures, medium-term notes and zero coupon subordinated notes convertible at any time into equal shares of Communications Stock and Media Stock. The zero coupon notes have a yield to maturity of approximately 7.3 percent. The zero coupon notes are recorded at a discounted value of \$276 and \$264 at December 31, 1995 and 1994, respectively.

During 1995, U S WEST Communications refinanced \$1.5 billion of commercial paper to take advantage of favorable long-term interest rates. In addition to the commercial paper, U S WEST Communications refinanced \$145 of long-term debt. Expenses associated with the refinancing of long-term debt resulted in extraordinary charges to income of \$8, net of tax benefits of \$5.

During 1993, U S WEST Communications refinanced long-term debt issues aggregating \$2.7 billion in principal amount. Expenses associated with the refinancing resulted in an extraordinary charge to income of \$77, net of a tax benefit of \$48.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 6: DEBT (Continued)

Interest payments by the Communications Group, net of amounts capitalized, were \$378, \$356 and \$398 in 1995, 1994 and 1993, respectively.

Interest Rate Risk Management

U S WEST Communications enters into interest rate swap agreements to effectively convert existing commercial paper to fixed-rate debt. This allows U S WEST Communications to achieve interest savings over issuing fixed-rate debt directly.

Under an interest rate swap, U S WEST Communications agrees with another party to exchange interest payments at specified intervals over a defined term. Interest payments are calculated by reference to the notional amount based on the fixed- and variable-rate terms of the swap agreements. The net interest received or paid as part of the interest rate swap is accounted for as an adjustment to interest expense.

During 1995 and 1994, U S WEST Communications entered into currency swaps to convert Swiss franc-denominated debt to dollar-denominated debt. This allowed U S WEST Communications to achieve interest savings over issuing fixed-rate, dollar-denominated debt. The currency swap and foreign currency debt are combined and accounted for as if fixed-rate, dollar-denominated debt were issued directly.

The following table summarizes terms of swaps pertaining to U S WEST Communications as of December 31, 1995 and 1994. Variable rates are indexed to two- and ten-year constant maturity Treasury and 30-day commercial paper rates.

	December 31, 1995				December 31, 1994			
	Notional Amount	Maturities	Weighted Average Rate		Notional Amount	Maturities	Weighted Average Rate	
			Receive	Pay			Receive	Pay
Variable to fixed	\$580	1996-1999	5.70	6.56	\$710	1995-1999	6.14	6.19
Currency	204	1999-2001	—	6.55	71	1999	—	6.53

In 1993, U S WEST Communications executed forward contracts to sell U.S. Treasury bonds to lock in the U.S. Treasury rate component of the future debt issue. At December 31, 1995, deferred credits of \$8 and deferred charges of \$51 on closed forward contracts are included as part of the carrying value of the underlying debt. The deferred credits and charges are being recognized as a yield adjustment over the life of the debt, which matures at various dates through 2043. The net deferred charge is directly offset by the lower coupon rate achieved on the debt issuance. At December 31, 1995, there were no open forward contracts.

The counterparties to these interest rate contracts are major financial institutions. U S WEST Communications is exposed to credit loss in the event of nonperformance by these counterparties. U S WEST manages this exposure by monitoring the credit standing of the counterparty and establishing dollar and term limitations which correspond to the respective credit rating of each counterparty. U S WEST Communications does not have significant exposure to an individual counterparty and does not anticipate nonperformance by any counterparty.

NOTE 7: FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair values of cash equivalents, other current amounts receivable and payable, and short-term debt approximate carrying values due to their short-term nature.

The fair values of interest rate swaps are based on estimated amounts U S WEST Communications would receive or pay to terminate such agreements taking into account current interest rates and creditworthiness of the counterparties.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 7: FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The fair values of long-term debt are based on quoted market prices where available or, if not available, are based on discounting future cash flows using current interest rates.

	December 31,			
	1995		1994	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Debt (includes short-term portion)	\$6,754	\$7,050	\$6,124	\$5,600
Interest rate swap agreements — assets	—	(19)	—	(15)
Interest rate swap agreements — liabilities	—	17	—	—
Debt — net	<u>\$6,754</u>	<u>\$7,048</u>	<u>\$6,124</u>	<u>\$5,585</u>

NOTE 8: LEASING ARRANGEMENTS

Certain subsidiaries within the Communications Group have entered into operating leases for office facilities, equipment and real estate. Rent expense under operating leases was \$210, \$235 and \$228 in 1995, 1994 and 1993, respectively. Minimum future lease payments as of December 31, 1995, under noncancelable operating leases, follow:

Year	
1996	\$ 113
1997	112
1998	110
1999	102
2000	101
Thereafter	728
Total	<u>\$1,266</u>

NOTE 9: COMMUNICATIONS GROUP EQUITY

Following are changes in the Communications Group equity for the periods presented:

	December 31,		
	1995	1994	1993
Balance at beginning of period	\$ 3,179	\$2,722	\$ 6,003
Net income (loss)	1,176	1,150	(2,809)
Dividends	(1,010)	(980)	(905)
Equity issuances prior to Recapitalization Plan	79	287	433
Communications Stock issuances	52	—	—
Balance at end of period	<u>\$ 3,476</u>	<u>\$3,179</u>	<u>\$ 2,722</u>

U S WEST has issued 1.7 million shares of Communications Stock since the November 1, 1995 recapitalization and has 473,635,025 shares outstanding at December 31, 1995.

Leveraged Employee Stock Ownership Plan ("LESOP") The Communications Group and the Media Group participate in the defined contribution savings plan sponsored by U S WEST. Substantially all employees of the Communications Group are covered by the plan. U S WEST matches a percentage of eligible employee contributions with shares of Communications Stock and/or Media Stock in accordance with participant elections. Participants may also elect to reallocate past Company contributions between Communications Stock and Media Stock. In 1989, U S WEST established two LESOPs to provide Company stock for matching contributions to the savings plan. Shares in the LESOP are released as principal and

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 9: COMMUNICATIONS GROUP EQUITY (Continued)

interest are paid on the debt. At December 31, 1995, 10,145,485 shares each of Communications Stock and Media Stock had been allocated from the LESOP, while 2,839,435 shares each of Communications Stock and Media Stock remained unallocated.

The borrowings associated with the LESOP, which are unconditionally guaranteed by U S WEST, are reflected in the Media Group Combined Financial Statements. Contributions from the Communications Group and the Media Group, as well as dividends on unallocated shares held by the LESOP (\$8, \$11 and \$14 in 1995, 1994 and 1993, respectively), are used for debt service. Beginning with the dividend paid in fourth-quarter 1995, dividends on allocated shares are being paid annually to participants. Previously, dividends on allocated shares were used for debt service with participants receiving additional shares from the LESOP. Tax benefits related to dividend payments on eligible shares in the savings plan have been allocated to the Communications Group, which paid the dividends.

U S WEST recognizes expense based on the cash payments method. Contributions to the plan related to the Communications Group, excluding dividends, were \$70, \$68 and \$68 in 1995, 1994 and 1993, respectively, of which \$12, \$16 and \$20, respectively, have been classified as interest expense.

NOTE 10: STOCK INCENTIVE PLANS

U S WEST maintains stock incentive plans for executives and key employees, and nonemployees. The Amended 1994 Stock Plan (the "Plan") was approved by shareowners on October 31, 1995 in connection with the Recapitalization Plan. The Plan is a successor plan to the U S WEST, Inc. Stock Incentive Plan and the U S WEST 1991 Stock Incentive Plan (the "Predecessor Plans"). No further grants of options or restricted stock may be made under the Predecessor Plans. The Plan is administered by the Human Resources Committee of the board of directors with respect to officers, executive officers and outside directors and by a special committee with respect to all other eligible employees and eligible nonemployees.

During calendar year 1995, up to 2,200,000 shares of Communications Stock were available for grant. The maximum aggregate number of shares of Communications Stock that may be granted in any other calendar year for all purposes under the Plan is nine-tenths of one percent (0.90 percent) of the shares of such class outstanding (excluding shares held in the Company's treasury) on the first day of such calendar year. In the event that fewer than the full aggregate number of shares of either class available for issuance in any calendar year are issued in any such year, the shares not issued shall be added to the shares of such class available for issuance in any subsequent year or years. Options may be exercised no later than 10 years after the date on which the option was granted.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 10: STOCK INCENTIVE PLANS (Continued)

Data for outstanding options under the Plan is summarized as follows:

	Communications Group		U S WEST, Inc.	
	Number of Shares	Average Option Price	Number of Shares*	Average Option Price
Outstanding January 1, 1993			4,450,150	\$ 35.81
Granted			1,486,106	48.83
Exercised			(412,444)	31.73
Canceled or expired			(222,273)	36.87
Outstanding December 31, 1993			5,301,539	\$ 39.76
Granted			2,438,409	36.15
Exercised			(139,762)	33.72
Canceled or expired			(214,149)	40.71
Outstanding December 31, 1994			7,386,037	\$ 38.66
Granted			3,062,920	43.63
Exercised			(430,631)	34.03
Canceled or expired			(175,147)	39.76
Outstanding October 31, 1995			9,843,179	\$ 40.39
Recapitalization Plan	9,843,179	\$24.11	(9,843,179)	\$(40.39)
Granted	138,309	32.16		
Exercised	(543,037)	21.23		
Canceled or expired	(15,350)	24.91		
Outstanding December 31, 1995	9,423,101	\$24.39	—	—

* Includes options granted in tandem with SARs.

Options to purchase 2,672,666 shares of Communications Stock were exercisable at December 31, 1995. Options to purchase 2,374,394 shares of U S WEST stock were exercisable at December 31, 1994. A total of 2,050,466 shares of Communications Stock were available for grant under the plans in effect at December 31, 1995. A total of 914,816 shares of U S WEST common stock were available for grant under the plans in effect at December 31, 1994. A total of 11,484,792 shares of Communications Stock were reserved for issuance at December 31, 1995.

NOTE 11: EMPLOYEE BENEFITS

Pension Plan

The Communications Group and the Media Group participate in the defined benefit pension plan sponsored by U S WEST. Substantially all management and occupational employees of the Communications Group are covered by the plan. Since plan assets are not segregated into separate accounts or restricted to providing benefits to employees of the Communications Group, assets of the plan may be used to provide benefits to employees of both the Communications Group and the Media Group. In the event the single employer pension plan sponsored by U S WEST would be separated into two or more plans, guidelines in the Internal Revenue Code dictate how assets of the plan must be allocated to the new plans. U S WEST currently has no intention to split the plan. Because of these factors, U S WEST believes there is no reasonable basis to attribute plan assets to the Communications Group as if they had funded separately their actuarially determined obligation.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 11: EMPLOYEE BENEFITS (Continued)

Management benefits are based on a final pay formula while occupational benefits are based on a flat benefit formula. U S WEST uses the projected unit credit method for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. U S WEST's policy is to fund amounts required under the Employee Retirement Income Security Act of 1974 ("ERISA") and no funding was required in 1995, 1994 or 1993. Should funding be required in the future, funding amounts would be allocated to the Communications Group based upon the ratio of service cost of the Communications Group to total service cost of plan participants.

The composition of the net pension cost and the actuarial assumptions of the plan follow:

	Year Ended December 31,		
	1995	1994	1993
Details of pension cost:			
Service cost — benefits earned during the period	\$ 173	\$ 197	\$ 148
Interest cost on projected benefit obligation	558	561	514
Actual return on plan assets	(1,918)	188	(1,320)
Net amortization and deferral	1,185	(946)	578
Net pension cost	<u>\$ (2)</u>	<u>\$ 0</u>	<u>\$ (80)</u>

The expected long-term rate of return on plan assets used in determining net pension cost was 8.50 percent for 1995, 8.50 percent for 1994 and 9.00 percent for 1993.

The funded status of the U S WEST plan follows:

	December 31,	
	1995	1994
Accumulated benefit obligation, including vested benefits of \$5,839 and \$5,044, respectively	<u>\$6,617</u>	<u>\$5,616</u>
Plan assets at fair value, primarily stocks and bonds	<u>\$9,874</u>	<u>\$8,388</u>
Less: Projected benefit obligation	<u>8,450</u>	<u>7,149</u>
Plan assets in excess of projected benefit obligation	1,424	1,239
Unrecognized net (gain) loss	(101)	161
Prior service cost not yet recognized in net periodic pension cost	(62)	(67)
Balance of unrecognized net asset at January 1, 1987	(705)	(785)
Prepaid pension cost	<u>\$ 556</u>	<u>\$ 548</u>

The actuarial assumptions used to calculate the projected benefit obligation follow:

	December 31,	
	1995	1994
Discount rate	7.00%	8.00%
Weighted average rate of compensation increase	5.50%	5.50%

Anticipated future benefit changes have been reflected in the above calculations.

Allocation of Pension Costs U S WEST's allocation policy is to: 1) offset the Company-wide service cost, interest cost and amortization by the return on plan assets; and 2) allocate the remaining net pension cost to the Communications Group based on the ratio of actuarially determined service cost of the Communications Group to total service cost of plan participants. U S WEST believes allocating net pension cost based on service cost is reasonable since service cost is a primary factor in determining pension cost. Net

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 11: EMPLOYEE BENEFITS (Continued)

pension costs allocated to the Communications Group were \$(2), \$0 and \$(71) in 1995, 1994 and 1993, respectively. The service and interest costs for 1995 and the projected benefit obligation at December 31, 1995 attributed to the Communications Group were \$149, \$529 and \$8,021, respectively.

Postretirement Benefits Other Than Pensions

The Communications Group and the Media Group participate in plans sponsored by U S WEST which provide certain health care and life insurance benefits to retired employees. In conjunction with the Company's 1992 adoption of SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," U S WEST elected to immediately recognize the accumulated postretirement benefit obligation for current and future retirees. However, the Federal Communications Commission and certain state jurisdictions permit amortization of the transition obligation over the average remaining service period of active employees for regulatory accounting purposes with most jurisdictions requiring funding as a stipulation for rate recovery.

U S WEST uses the projected unit credit method for the determination of postretirement medical and life costs for financial reporting purposes. The composition of net postretirement benefit costs and actuarial assumptions underlying plan benefits follow:

	Year Ended December 31,								
	1995			1994			1993		
	Medical	Life	Total	Medical	Life	Total	Medical	Life	Total
Service cost — benefits earned during the period	\$ 59	\$ 6	\$ 65	\$ 62	\$ 13	\$ 75	\$ 60	\$ 11	\$ 71
Interest on accumulated benefit obligation	235	32	267	221	39	260	235	36	271
Actual return on plan assets	(319)	(96)	(415)	3	1	4	(73)	(52)	(125)
Net amortization and deferral	228	58	286	(68)	(31)	(99)	27	22	49
Net postretirement benefit costs	<u>\$ 203</u>	<u>\$ 0</u>	<u>\$ 203</u>	<u>\$ 218</u>	<u>\$ 22</u>	<u>\$ 240</u>	<u>\$ 249</u>	<u>\$ 17</u>	<u>\$ 266</u>

The expected long-term rate of return on plan assets used in determining postretirement benefit costs was 8.50 percent for 1995, 8.50 percent in 1994 and 9.00 percent in 1993.

The funded status of the plans follows:

	December 31,					
	1995			1994		
	Medical	Life	Total	Medical	Life	Total
Accumulated postretirement benefit obligation attributable to:						
Retirees	\$ 1,866	\$ 271	\$ 2,137	\$ 1,733	\$ 248	\$ 1,981
Fully eligible plan participants	293	34	327	264	38	302
Other active plan participants	1,059	165	1,224	940	135	1,075
Total accumulated postretirement benefit obligation	3,218	470	3,688	2,937	421	3,358
Unrecognized net gain	378	161	539	243	90	333
Unamortized prior service cost	—	(34)	(34)	—	—	—
Fair value of plan assets, primarily stocks, bonds and life insurance ¹	(1,385)	(460)	(1,845)	(894)	(374)	(1,268)
Accrued postretirement benefit obligation	<u>\$ 2,211</u>	<u>\$ 137</u>	<u>\$ 2,348</u>	<u>\$ 2,286</u>	<u>\$ 137</u>	<u>\$ 2,423</u>

¹ Medical plan assets include Communications Stock of \$210 and Media Stock of \$112 in 1995, and U S WEST common stock of \$164 in 1994.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 11: EMPLOYEE BENEFITS (Continued)

The actuarial assumptions used to calculate the accumulated postretirement benefit obligation follow:

	December 31,	
	1995	1994
Discount rate	7.00%	8.00%
Medical trend*	9.00%	9.70%

* Medical cost trend rate gradually declines to an ultimate rate of 5 percent in 2011.

A one-percent increase in the assumed health care cost trend rate for each future year would have increased the aggregate of the service and interest cost components of 1995 net postretirement benefit cost by approximately \$40 and increased the 1995 accumulated postretirement benefit obligation by approximately \$350.

Anticipated future benefit changes have been reflected in these postretirement benefit calculations.

Plan Assets Assets of the postretirement medical and life plans may be used to provide benefits to employees of both the Communications Group and the Media Group since plan assets are not legally restricted to providing benefits to either Group. In the event that either plan sponsored by U S WEST would be separated into two or more plans, there are no guidelines in the Internal Revenue Code for allocating assets of the plan. U S WEST allocates the assets based on historical contributions for postretirement medical costs, and on the ratio of salaries for life plan participants. U S WEST currently has no intention to split the plans.

Postretirement Medical Costs The service and interest components of net postretirement medical benefit costs are calculated for the Communications Group based on the population characteristics of the Group. Since funding of postretirement medical costs is voluntary, return on assets is attributed to the Communications Group based on historical funding. The Communications Group's annual funding amount is based on its cash requirements with the funding at U S WEST Communications based on regulatory accounting requirements.

Net postretirement medical benefit costs recognized by the Communications Group for 1995, 1994 and 1993 were \$189, \$207 and \$238, respectively. The percentage of postretirement medical assets attributed to the Communications Group at December 31, 1995 and 1994, based on historical voluntary contributions, was 96 and 95 percent, respectively. The accumulated postretirement medical benefit obligation attributed to the Communications Group was \$3,057 at December 31, 1995.

Allocation of Postretirement Life Costs Net postretirement life costs, and funding requirements, if any, are allocated to the Communications Group in the same manner as pensions. U S WEST will generally fund the amount allowed for tax purposes and no funding of postretirement life insurance occurred in 1995, 1994 and 1993. U S WEST believes its method of allocating postretirement life costs is reasonable.

Net postretirement life benefit costs allocated to the Communications Group for 1995, 1994 and 1993 were \$0, \$19 and \$14, respectively. The service and interest costs for 1995 and the accumulated postretirement life benefit obligation at December 31, 1995 attributed to the Communications Group were \$5, \$29, \$425, respectively.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 12: INCOME TAXES

The components of the provision for income taxes follow:

	Year Ended December 31,		
	1995	1994	1993
Federal:			
Current	\$434	\$368	\$350
Deferred	177	233	(115)
Investment tax credits — net	(38)	(47)	(56)
	<u>573</u>	<u>554</u>	<u>179</u>
State and local:			
Current	56	58	48
Deferred	33	41	(19)
	<u>89</u>	<u>99</u>	<u>29</u>
Provision for income taxes	<u>\$662</u>	<u>\$653</u>	<u>\$208</u>

The unamortized balance of investment tax credits at December 31, 1995 and 1994, was \$199 and \$231, respectively.

Amounts for income taxes paid by the Communications Group were \$511, \$491 and \$297 in 1995, 1994 and 1993, respectively.

The effective tax rate differs from the statutory tax rate as follows:

	Year Ended December 31,		
	1995	1994	1993
	In percent		
Federal statutory tax rate	35.0	35.0	35.0
Investment tax credit amortization	(1.3)	(1.7)	(3.5)
State income taxes — net of federal effect	3.1	3.6	3.5
Rate differential on reversing temporary differences	—	—	(2.6)
Depreciation on capitalized overheads — net	—	—	1.6
Tax law change — catch-up adjustment	—	—	3.7
Restructuring charge	—	—	(2.4)
Other	(0.9)	(0.7)	(0.6)
Effective tax rate	<u>35.9</u>	<u>36.2</u>	<u>34.7</u>

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 12: INCOME TAXES (Continued)

The components of the net deferred tax liability follow:

	December 31,	
	1995	1994
Property, plant and equipment	\$1,433	\$1,428
State deferred taxes — net of federal effect	180	221
Other	68	77
Deferred tax liabilities	1,681	1,726
Postemployment benefits, including pension	675	689
Restructuring and other	231	287
Unamortized investment tax credit	70	79
State deferred taxes — net of federal effect	133	194
Other	142	231
Deferred tax assets	1,251	1,480
Net deferred tax liability	\$ 430	\$ 246

The current portion of the deferred tax asset was \$259 and \$300 at December 31, 1995 and 1994, respectively, resulting primarily from restructuring charges and compensation related items.

On August 10, 1993, federal legislation was enacted which increased the corporate tax rate from 34 percent to 35 percent retroactive to January 1, 1993. The cumulative effect on deferred taxes of the 1993 increase in income tax rates was \$54.

NOTE 13: CONTINGENCIES

At U S WEST Communications there are pending regulatory actions in local regulatory jurisdictions that call for price decreases, refunds or both. In one such instance, the Utah Supreme Court has remanded a Utah Public Service Commission ("PSC") order to the PSC for reconsideration, thereby establishing two exceptions to the rule against retroactive ratemaking: 1) unforeseen and extraordinary events, and 2) misconduct. The PSC's initial order denied a refund request from interexchange carriers and other parties related to the Tax Reform Act of 1986. This action is still in the discovery process. If a formal filing - made in accordance with the remand from the Supreme Court - alleges that the exceptions apply, the range of possible risk to U S WEST Communications is \$0 to \$150.

U S WEST COMMUNICATIONS GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 14: QUARTERLY FINANCIAL DATA (UNAUDITED)

	Quarterly Financial Data			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1995				
Operating revenues	\$2,318	\$2,338	\$2,389	\$2,439
Income before income taxes and extraordinary item	500	460	454	432
Income before extraordinary item	315	293	292	284
Net income	315	293	287	281
Pro forma earnings per common share before extraordinary item	0.67	0.62	0.62	0.60
Pro forma earnings per common share	0.67	0.62	0.61	0.59
1994				
Operating revenues	\$2,253	\$2,281	\$2,316	\$2,326
Income before income taxes	467	456	422	458
Net income	295	289	267	299
Pro forma earnings per common share	0.66	0.64	0.59	0.65

Effective November 1, 1995, each share of U S WEST, Inc. common stock was converted into one share each of Communications Stock and Media Stock. Earnings per common share have been presented on a pro forma basis to reflect the two classes of stock as if they had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST, Inc.

1995 first-quarter net income includes \$39 (\$0.08 per share) from a gain on the sales of certain rural telephone exchanges. 1995 second-quarter net income includes \$10 (\$0.02 per share) from a gain on the sales of certain rural telephone exchanges. 1995 third-quarter net income includes \$21 (\$0.04 per share) from a gain on the sales of certain rural telephone exchanges and \$5 (\$0.01 per share) for expenses associated with the Recapitalization Plan. 1995 third-quarter net income also includes a charge of \$5 (\$0.01 per share) for the early extinguishment of debt. 1995 fourth-quarter net income includes \$15 (\$0.03 per share) from a gain on the sales of certain rural telephone exchanges and other charges of \$6 (\$0.01 per share), including an extraordinary charge of \$3 for the early extinguishment of debt and \$3 for expenses associated with the Recapitalization Plan.

1994 net income includes gains on the sales of rural telephone exchanges of \$15 (\$0.03 per share), \$16 (\$0.04 per share) and \$20 (\$0.04 per share) for first quarter, second quarter and fourth quarter, respectively.

1995 Per Share Market and Dividend Data	Market Price			Dividends
	High	Low	Close	
	(Whole dollars)			
November 1, 1995 through December 31, 1995	\$36.375	\$28.375	\$35.625	\$ 0.535

U S WEST MEDIA GROUP FINANCIAL HIGHLIGHTS

	Year Ended December 31,				
	1995	1994	1993	1992	1991
	Dollars in millions (except per share amounts)				
Sales and other revenues:					
Directory and information services	\$ 1,180	\$ 1,075	\$ 956	\$ 949	\$ 891
Wireless communications	941	781	561	407	325
Cable and telecommunications	215	18	—	—	—
Other	38	34	32	28	45
Total sales and other revenues	\$ 2,374	\$ 1,908	\$ 1,549	\$ 1,384	\$ 1,261
EBITDA ¹	\$ 716	\$ 533	\$ 485	\$ 410	\$ 373
Income from continuing operations before extraordinary item ²	145	276	85	146	69
Earnings available for common stock	138	276	85	146	69
Total assets	8,615	7,394	5,446	3,130	3,235
Total debt ³	2,101	1,814	1,526	249	682
Preferred securities ⁴	651	51	—	—	—
Media Group equity	4,472	4,203	3,139	2,265	2,057
Capital expenditures	401	343	215	169	231
Pro forma earnings per common share ⁵	\$ 0.29	\$ 0.61			
Pro forma average common shares outstanding (thousands) ⁵	470,549	453,316			

PROPORTIONATE DATA⁶

	Year Ended December 31,		
	1995	1994	1993
	Dollars in millions		
Sales and other revenues	\$5,115	\$4,213	\$2,157
Operating income	476	401	195
Income from continuing operations before extraordinary item ²	145	276	85
EBITDA ¹ (excludes 1993 restructuring charge)	1,149	902	527
Subscribers/advertisers (thousands)	5,959	4,234	3,086

¹ Earnings before interest, taxes, depreciation, amortization, and other ("EBITDA"). EBITDA also excludes gains on asset sales, equity losses and guaranteed minority interest expense.

² 1995 income from continuing operations before extraordinary item includes a gain of \$95 from the merger of U S WEST's joint venture interest in TeleWest plc with SBC CableComms (UK) and costs of \$9 associated with the November 1, 1995 recapitalization. 1994 income from continuing operations before extraordinary item includes a gain of \$105 on the partial sale of U S WEST's joint venture interest in TeleWest and a gain of \$41 on the sale of U S WEST's paging operation. 1993 and 1991 income from continuing operations before extraordinary item was reduced by restructuring charges of \$76 and \$57, respectively.

³ Excludes debt associated with the capital assets segment, which has been discontinued and is held for sale.

⁴ Includes Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely Company-guaranteed debentures of \$600 in 1995 and preferred stock subject to mandatory redemption of \$51 in 1995 and 1994.

⁵ Effective November 1, 1995, each share of U S WEST, Inc. common stock was converted into one share each of U S WEST Communications Group common stock and U S WEST Media Group common stock. Earnings per common share have been presented on a pro forma basis to reflect the Media stock as if it had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST, Inc.

⁶ Selected proportionate data is not required by generally accepted accounting principles or intended to replace the Combined Financial Statements prepared in accordance with GAAP. It is presented supplementally because the Company believes that proportionate data facilitates the understanding and assessment of its Combined Financial Statements. Proportionate accounting reflects the Media Group's relative ownership interests in operating revenues and expenses for both its consolidated and equity method investments. The table does not reflect financial data of the capital assets segment.

**U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**
(Dollars in millions)

The Recapitalization Plan

On October 31, 1995, the shareholders of U S WEST, Inc., a Colorado corporation ("U S WEST Colorado"), voted to approve a proposal (the "Recapitalization Plan") adopted by the Board of Directors to reincorporate in Delaware and create two classes of common stock. Under the Recapitalization Plan, shareholders approved an agreement and plan of merger between U S WEST Colorado and U S WEST, Inc., a Delaware corporation ("U S WEST" or the "Company"), pursuant to which U S WEST continues as the surviving corporation. In connection with the merger, the Certificate of Incorporation of U S WEST has been amended and restated to designate two classes of common stock of U S WEST, one class of which is authorized as U S WEST Communications Group Common Stock ("Communications Stock") and the other class which is authorized as U S WEST Media Group Common Stock ("Media Stock").

The Communications Stock and Media Stock provide shareholders with two distinct securities that are intended to reflect separately the communications businesses of U S WEST (the "Communications Group") and the multimedia businesses of U S WEST (the "Media Group" and, together with the Communications Group, the "Groups").

The Media Group

The Media Group is comprised of: (i) cable and telecommunications network businesses outside of the Communications Group Region and internationally, (ii) domestic and international wireless communications network businesses and (iii) domestic and international directory and information services businesses.

On February 27, 1996, U S WEST announced a definitive agreement to merge with Continental Cablevision, Inc. ("Continental"). Continental, the nation's third-largest cable operator, serves 4.2 million domestic customers, passes more than seven million domestic homes and holds significant other domestic and international properties. U S WEST will purchase all of Continental's stock for approximately \$5.3 billion and will assume Continental's debt and other obligations, which amount to approximately \$5.5 billion. Consideration for the \$5.3 billion in equity will consist of approximately \$1 billion in U S WEST preferred stock, convertible to Media Stock; and, at U S WEST's option, between \$1 billion and \$1.5 billion in cash, and \$2.8 billion to \$3.3 billion in shares of Media Stock. The transaction, which is expected to close in the fourth quarter of 1996, is subject to a number of conditions and approvals, including approvals from Continental shareholders and local franchising and government authorities.

Continental's 4.2 million domestic customers are highly clustered in five large markets — New England, California, Chicago, Michigan, Ohio and Florida. Upon closing, U S WEST will own or share management of cable systems in 60 of the top 100 American markets and serve nearly one of every three cable households. In addition, Continental has interests in cable properties in Australia, Argentina and Singapore; a 10 percent interest in PRIMESTAR (a direct broadcast satellite service); telephone access businesses in Florida and Virginia; and interests in programming that include Turner Broadcasting System, E! Entertainment Television, the Golf Channel, and the Food Channel.

The Media Group's cable and telecommunications businesses include U S WEST's investment in Time Warner Entertainment Company L.P. ("TWE" or "Time Warner Entertainment"), the second largest provider of cable television services in the United States, its cable systems in the Atlanta, Georgia metropolitan area ("the Atlanta Systems"), and international cable and telecommunications investments, including TeleWest plc ("TeleWest"). In 1995, TeleWest Communications plc merged its cable television and telephony interests with SBC CableComms (UK) to form TeleWest, the largest provider of combined cable and telecommunications services in the United Kingdom. The Media Group also owns interests in cable and/or telecommunications properties in the Netherlands, Sweden, Norway, Hungary, Czech Republic, Malaysia and Indonesia.

U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Media Group provides domestic wireless communications services, including cellular services, in 13 western and midwestern states to a rapidly growing customer base. During 1994, U S WEST signed a definitive agreement with AirTouch Communications to combine their domestic cellular assets. The initial equity ownership of this cellular joint venture will be approximately 70 percent AirTouch and approximately 30 percent Media Group. The combination will take place in two phases. During Phase I, which U S WEST entered effective November 1, 1995, the two companies are operating their cellular properties separately. A Wireless Management Company (the "WMC") has been formed and is providing centralized services to both companies on a contract basis. In Phase II, AirTouch and U S WEST will contribute their domestic cellular assets to the WMC. In this phase, the Media Group will reflect its share of the combined operating results of the WMC using the equity method of accounting. The recent passage of the Telecommunications Act of 1996 has removed significant regulatory barriers to completion of Phase II of the business combination. U S WEST expects that Phase II closing could take place by the end of 1996 or early 1997.

U S WEST partnered with AirTouch Communications, Bell Atlantic and NYNEX to form a strategic national wireless alliance and formed a venture to provide personal communications services ("PCS"). This venture, PCS PrimeCo, purchased 11 licenses in the Federal Communication Commission's (the "FCC") PCS auction, covering 57 million people in Chicago, Dallas, Honolulu, Houston, Jacksonville, Miami, Milwaukee, New Orleans, Richmond, San Antonio and Tampa. The Media Group also provides wireless communications services internationally through its Mercury One 2 One ("One 2 One") joint venture, the world's first PCS service located in the United Kingdom. The Media Group also owns interests in wireless properties in Hungary, the Czech and Slovak Republics, Russia, Malaysia, India and Poland.

The Media Group's directory and information services businesses develop and package content and information services, including telephone directories, database marketing and other interactive services in domestic and international markets. The Media Group publishes more than 300 White and Yellow Pages directories in 14 western and mid-western states and nearly 200 directories in the United Kingdom and Poland. The Media Group also has a 50 percent interest in Listel, Brazil's largest telephone directory publisher.

The Combined Financial Statements of the Media Group include the (i) combined historical balance sheets, results of operations and cash flows of the businesses that comprise the Media Group; and (ii) corporate assets and liabilities of U S WEST and related transactions not identified with the Communications Group; and (iii) an allocated portion of the corporate expense of U S WEST. All significant intra-group financial transactions have been eliminated. Transactions between the Media Group and the Communications Group have not been eliminated. For a more complete discussion of U S WEST's corporate allocation policies, see the U S WEST Media Group Combined Financial Statements — Note 2: Summary of Significant Accounting Policies.

The following discussion is based on the U S WEST Media Group Combined Financial Statements prepared in accordance with GAAP. The discussion should be read in conjunction with the U S WEST, Inc. Consolidated Financial Statements. A discussion of the Media Group's operations on a proportionate basis follows the GAAP presentation in "Selected Proportionate Financial Data."

U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations — 1995 Compared with 1994

Comparative details of income from continuing operations before extraordinary item by industry segment and for significant unconsolidated equity investments follow:

	Percent Ownership	1995 ¹	1994 ²	(Decrease)
Consolidated:				
Directory and information services	100	\$ 240	\$ 247	\$ (7)
Wireless communications	100	62	67	(5)
Cable and telecommunications	100	(7)	(2)	(5)
Unconsolidated equity investments:				
Time Warner Entertainment ³	25.5	(32)	(30)	(2)
TeleWest	26.8	53	76	(23)
One 2 One	50.0	(81)	(58)	(23)
Other ⁴		(90)	(24)	(66)
Income from continuing operations before extraordinary item . . .		<u>\$ 145</u>	<u>\$ 276</u>	<u>\$ (131)</u>
Pro forma earnings per common share before extraordinary item ⁵		<u>\$0.30</u>	<u>\$0.61</u>	<u>(\$0.31)</u>

¹ 1995 income from continuing operations before extraordinary item includes a gain of \$95 from the merger of TeleWest with SBC CableComms (UK) and \$9 for costs associated with the Recapitalization Plan.

² 1994 income from continuing operations before extraordinary item includes a gain of \$105 from the partial sale of U S WEST's joint venture interest in TeleWest and a gain of \$41 from the sale of U S WEST's paging operations.

³ Percent ownership represents pro-rata priority capital and residual equity interests.

⁴ Primarily includes interest expense and divisional expenses associated with equity investments.

⁵ Earnings per common share have been presented on a pro forma basis as if the Media Stock had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST, Inc.

During 1995, income from continuing operations before extraordinary item declined 55 percent, to \$59, excluding the effects of the one-time items described in Notes 1 and 2 to the table above. The decline is due primarily to higher equity losses related to international growth initiatives and increased amortization and interest expense. Interest expense increases relate to debt issued in connection with the Atlanta Systems acquisition and expansion of international investments. The declines were partially offset by improvement in the domestic cellular and Yellow Pages operations.

During 1995, the Media Group incurred an extraordinary loss of \$4, net of a tax benefit of \$2, related to the early retirement of debt by TWE.

Directory and Information Services Income related to Yellow Pages directory advertising increased 10 percent in 1995, to \$307, due to pricing, product enhancements and the effect of improved marketing programs on business volume. Yellow Pages income was partially offset by net operating losses of \$60 related to new products and other growth initiatives, including development of interactive services. The Media Group views new service offerings as an important part of its strategy and expects investments in new products and services in 1996 will continue to partially offset expected income related to the Yellow Pages business.

Income related to directory and information services in 1995 includes \$7 in losses related to expansion of international directory publishing operations. The international publishing operations were not significant to the 1994 results of operations.

**U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

Wireless Communications Income related to wireless communications more than doubled, to \$62 in 1995, excluding the 1994 gain on sale of paging assets of \$41. The increase in wireless communications income is attributable to continued strong growth in cellular subscribers. The cellular subscriber base reached 1,463,000 at December 31, 1995, a 51 percent increase compared with 1994.

Cable and Telecommunications The 1995 loss of \$7 in cable and telecommunications operations is primarily the result of amortization of intangible assets related to the December 1994 acquisition of the Atlanta Systems. The subscriber base of the Atlanta Systems increased 6.7 percent during the last twelve months, to 527,000 at December 31, 1995.

Operating Results of Unconsolidated Equity Investments The net loss related to the Media Group's interests in TWE increased in 1995, due primarily to higher TWE financing costs and depreciation charges, partially offset by increased income related to cable and programming operations. Cable subscribers served by TWE increased almost 6 percent compared with last year, excluding the impact of recent cable transactions.

On September 22, 1995, U S WEST filed a lawsuit in Delaware Chancery Court to enjoin the proposed merger of Time Warner and Turner Broadcasting. U S WEST has alleged breaches of contract and fiduciary duties by Time Warner in connection with this proposed merger. Time Warner filed a countersuit against U S WEST on October 11, 1995, alleging misrepresentation, breach of contract and other misconduct on the part of U S WEST. Time Warner's countersuit seeks a reformation of the Time Warner Entertainment partnership agreement, an order that enjoins U S WEST from breaching the partnership agreement, and unspecified compensatory damages. U S WEST has denied each of the claims in Time Warner's countersuit. The trial for this action concluded on March 22, 1996. A ruling by the Delaware Chancery Court is expected in June 1996.

International businesses are experiencing rapid growth associated with their early development phases. New investments in 1995 include the acquisition of a 50 percent interest in cable television systems in the Netherlands, the acquisition of a 29 percent interest in cable television systems in the Czech Republic and additional capital provided to a 20 percent owned joint venture in Malaysia to provide local wireline and wireless communications. The Czech Republic venture incurred significant start-up losses in 1995, of which the Media Group's share was \$13. The structure of this venture is being renegotiated.

U S WEST ventures have recently been awarded licenses to provide cellular services using digital technology in India and Poland. The Media Group expects losses related to international ventures will be significant in 1996.

In October 1995, TeleWest completed its merger with SBC CableComms (UK). The Media Group recognized an after-tax gain related to the merger of \$95, and has a 26.8 percent interest in the combined company.

Cable television subscribers of TeleWest and its affiliates, based on TeleWest's equity interest in affiliated operations, increased to 457,000 at December 31, 1995, an increase of 44 percent compared with 1994, and telephone access lines increased 93 percent during the last twelve months, to 527,000. Both growth rates exclude the one-time impact of the merger.

Subscribers to U S WEST's international wireless joint venture operations in the United Kingdom, Hungary, the Czech and Slovak Republics, Russia and Malaysia grew to 682,000 at December 31, 1995, which is almost twice the customer base at December 31, 1994. One 2 One served 375,000 customers at December 31, 1995, an 83 percent increase compared with 1994.

Effective January 1, 1995, the capital assets segment is being accounted for in accordance with Staff Accounting Bulletin No. 93, issued by the Securities and Exchange Commission ("SEC"), which requires discontinued operations not disposed of within one year of the measurement date to be accounted for

U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

prospectively in continuing operations as a net investment in assets held for sale. The net realizable value of the assets are reevaluated on an ongoing basis with adjustments to the existing reserve, if any, being charged to continuing operations. No adjustment was required in 1995.

Sales and Other Revenues

	1995	1994	Increase (Decrease)
Directory and information services:			
Domestic	\$1,058	\$ 997	\$ 61
International	122	78	44
	1,180	1,075	105
Wireless communications:			
Cellular service	845	633	212
Cellular equipment	96	120	(24)
Paging sales and service ¹	—	28	(28)
	941	781	160
Cable and telecommunications	215	18	197
Other	38	34	4
Sales and other revenues	<u>\$2,374</u>	<u>\$1,908</u>	<u>\$466</u>

¹ The paging business was sold in June 1994. Results reflect operations for the six months ending June 30, 1994.

Media Group sales and other revenues increased 15 percent, to \$2,374 in 1995, excluding the effects of the 1994 Atlanta Systems acquisition and paging sale. The increase was primarily due to strong growth in cellular service revenue.

Directory and Information Services Revenues related to Yellow Pages directory advertising increased 6.4 percent, to \$1,026 in 1995, due to price increases of 4.5 percent, higher revenue per advertiser and an increase in Yellow Pages advertising volume.

International directory publishing revenues increased \$44 in 1995, primarily due to U S WEST's May 1994 purchase of Thomson Directories. The remaining increase is due to an increase in advertisers and revenue per advertiser.

Wireless Communications Cellular service revenues increased 34 percent, to \$845 in 1995, due to a 51 percent increase in subscribers during the last twelve months (with 20 percent of the additions occurring in December), partially offset by a 13 percent drop in average revenue per subscriber to \$60.00 per month. The increase in subscribers relates to continued growth in demand for wireless services. The Media Group anticipates continued growth in its subscriber base, although at slightly decreased rates.

New distribution programs are being developed which increase availability of cellular products and simplify the cellular service activation process. These programs have contributed to the shift in the customer base from businesses to consumers. This shift, combined with competitive pressures on pricing, will cause the average revenue per subscriber to continue to decline.

Cellular equipment revenues decreased 20 percent, to \$96 in 1995, as a result of lower cellular equipment costs. These lower equipment costs are being passed on to retailers and to new customers. The Media Group expects this trend to continue in 1996 as the cost of equipment continues to decline and as penetration into the consumer market increases.

Revenues related to the paging sales and service operations, which were sold in 1994, approximated \$28 in 1994.

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Cable and Telecommunications Domestic cable and telecommunications revenues increased \$197 in 1995, due to the December 1994 acquisition of the Atlanta Systems.

Operating Income

	1995	1994	Increase (Decrease)
Directory and information services:			
Domestic	\$ 399	\$397	\$ 2
International	(1)	(1)	—
	398	396	2
Wireless communications:			
Cellular	147	82	65
Paging sales and service ¹	—	6	(6)
	147	88	59
Cable and telecommunications	23	—	23
Other ²	(101)	(95)	(6)
Operating income	<u>\$ 467</u>	<u>\$389</u>	<u>\$78</u>

¹ The paging business was sold in June 1994. Results reflect operations for six months ending June 30, 1994.

² Primarily includes divisional expenses associated with equity investments.

During 1995, Media Group operating income increased 13 percent, to \$467, excluding the effects of the 1994 Atlanta Systems acquisition and paging sale. EBITDA increased approximately 16 percent, to \$716, on a comparable basis. The Media Group considers EBITDA an important indicator of the operational strength and performance of its businesses. The increases were primarily due to strong growth in wireless communications operations.

Directory and Information Services During 1995, operating income related to domestic Yellow Pages directory advertising increased \$40. Revenue increases of \$61 and general cost savings of \$15, including \$8 associated with assuming the management of certain data base services from the Communications Group contributed to the increase. The revenue gains and cost savings were partially offset by operating cost increases of \$36, primarily due to an 11 percent increase in paper, printing, delivery and distribution costs. New product development activities reduced domestic directory and information services operating income by \$38 in 1995. The decrease is a result of higher costs associated with the development of new database marketing and interactive services, including a one-time charge of \$8 to exit certain product lines.

On October 15, 1995, U S WEST Direct and the Communications Workers of America ("CWA") reached a tentative agreement on their contract, subject to ratification by the CWA membership. This contract would provide for salary increases of 10.5 percent over three years and provides employees with a lump sum payment of \$850.

EBITDA related to domestic Yellow Pages directory advertising services increased 9 percent, to \$519 in 1995. Expansion of the business combined with cost savings led to an EBITDA margin related to the Yellow Pages operations of 50.6 percent in 1995 compared with 49.4 percent in 1994.

Operating income for international directory publishing operations was unchanged from 1994. The 1995 revenue gains of \$44 were offset by increased operating expenses, primarily associated with the May 1994 acquisition of Thomson Directories and increased costs associated with business volume.

Wireless Communications Cellular operating income increased 79 percent, to \$147 in 1995. The increase in operating income is a result of revenue increases associated with the rapidly expanding subscriber

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base combined with efficiency gains. The 1995 decline in revenue per subscriber of 13 percent has been more than offset by decreases in the cost incurred to acquire a customer ("acquisition costs") and the cost to maintain a customer ("support costs"). Support costs include charges for access and usage of land-line telecommunications networks, subscriber billing, customer service and general support costs, as well as costs associated with roaming, intralata toll calls and fraud. Support costs per subscriber have declined 20 percent in 1995. The decline is generally a result of the efficiencies gained from an expanding customer base without corresponding increases in headcount and infrastructure. The acquisition cost per subscriber added decreased 6 percent in 1995, as a result of the expanding customer base and shifts in the distribution channel resulting in generally less costly subscriber additions.

Cellular EBITDA increased 49 percent during 1995, to \$268. The business is realizing operating scale efficiencies that have resulted in lower costs on a per subscriber basis. The efficiencies have resulted in an increase in 1995 cellular service EBITDA margin to 31.7 percent from 28.4 percent in 1994.

Cable and Telecommunications Cable and telecommunications operating income reflects the December 1994 acquisition of the Atlanta Systems. The Atlanta Systems contributed operating income of \$23 and EBITDA of \$100 in 1995.

Other Other operating income decreased primarily due to costs associated with growth in international operations.

Interest Expense and Other

	1995	1994	Increase (Decrease)
Interest expense	\$100	\$ 66	\$ 34
Equity losses in unconsolidated ventures	207	121	86
Other income	5	46	(41)

Interest expense increased \$34, or 52 percent, primarily as a result of financing costs associated with the December 1994 acquisition of the Atlanta Systems, new domestic and international investments and a reclassification of debt from net investment in assets held for sale.

Equity losses increased \$86 in 1995, primarily due to costs related to the expansion of the network and additional financing costs at TeleWest and additional costs associated with the significant increase in customers at One 2 One. Start-up and other costs associated with new international cable and telecommunications investments primarily located in the Czech Republic and Malaysia contributed to the increase. These increased losses were partially offset by earnings in the European wireless operations. Losses related to domestic investments in TWE and PCS PrimeCo also increased. The Media Group expects the PCS partnership to experience several years of operating losses associated with the start-up phase of the PCS business.

Other income decreased \$41, or 89 percent, primarily as a result of increased minority interest expense associated with the domestic cellular operations, costs associated with the Recapitalization Plan and a 1994 gain on sale of nonstrategic operations.

Provision for Income Taxes

	1995	1994	(Decrease)
Provision for income taxes	\$ 163	\$ 204	(\$41)
Effective tax rate	52.9%	42.5%	—

The increase in the effective tax rate primarily reflects the impact of lower pretax income, the effects of goodwill amortization related to the acquisition of the Atlanta Systems, higher state and foreign income taxes, and expenses associated with the Recapitalization Plan. Additionally, a tax benefit was recorded in 1994 related to the sale of paging assets that contributed to the increase in the effective tax rate.

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Results of Operations — 1994 Compared with 1993

Income from continuing operations by industry segment and for significant unconsolidated equity investments follows:

	Percent Ownership	1994 ¹	1993 ²	Increase (Decrease)
Consolidated:				
Directory and information services	100	\$247	\$220	\$ 27
Wireless communications	100	67	(43)	110
Cable and telecommunications	100	(2)	—	(2)
Unconsolidated equity investments:				
Time Warner Entertainment ³	25.5	(30)	(19)	(11)
TeleWest	37.8	76	(21)	97
One 2 One	50.0	(58)	(22)	(36)
Other ⁴		(24)	(30)	6
Income from continuing operations		<u>\$276</u>	<u>\$ 85</u>	<u>\$191</u>

¹ 1994 income from continuing operations includes a gain of \$105 from the partial sale of U S WEST's joint venture interest in TeleWest, and a gain of \$41 from the sale of U S WEST's paging operations.

² 1993 income from continuing operations was reduced by \$76 for restructuring charges; \$31 pertaining to the directory and information services segment and \$45 pertaining to the wireless segment.

³ Percent ownership represents pro-rata priority capital and residual equity interests.

⁴ Primarily includes interest expense and divisional expenses associated with equity investments.

During 1994, income from continuing operations decreased 19 percent, to \$130, excluding the effects of the one-time items described in Notes 1 and 2 to the table above. The decline in income is primarily a result of increased start-up losses associated with international businesses, partially offset by income growth in domestic wireless operations attributable to rapid growth in customer demand.

During 1993, the Board approved a plan to dispose of the capital assets segment, which includes activities related to financial services, financial guarantee insurance operations and real estate. Until January 1, 1995, the capital assets segment was accounted for as discontinued operations in accordance with Accounting Principles Board Opinion No. 30, which provides for the reporting of the operating results of discontinued operations separately from continuing operations. The Media Group recorded a provision of \$100 (after tax) for the estimated loss on disposal of the discontinued operations and an additional provision of \$20 to reflect the cumulative effect on deferred taxes of the 1993 federally mandated increase in income tax rates. Income from discontinued operations prior to June 1, 1993, was \$38, net of \$15 in income taxes. Income from discontinued operations subsequent to June 1, 1993, is being deferred and was included within the provision for loss on disposal of the capital assets segment.

Directory and Information Services Excluding the effect of the 1993 restructuring charge of \$31, income from directory and information services operations decreased 1.6 percent in 1994, to \$247. Costs related to the development and launching of new products in directory and information services offset income growth from the Yellow Pages publishing operations.

Wireless Communications Excluding the effects of the \$41 gain on the sale of paging operations in 1994 and a \$45 restructuring charge in 1993, cellular income increased \$24 to \$26 in 1994. The increase is due to the addition of 367,000 subscribers in 1994, a 61 percent increase compared with 1993.

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Cable and Telecommunications On December 6, 1994, the Media Group purchased the Atlanta Systems for \$1.2 billion. The results of operations of the Atlanta Systems have been included in the Media Group's results of operations since the date of acquisition which did not have a material impact on 1994 net income.

Operating Results of Unconsolidated Equity Investments TWE partnership losses increased in 1994 primarily due to the full year impact (including financing costs) of the TWE investment compared with three months in 1993. The effects of lower prices for cable services also contributed to the higher loss in 1994.

In 1994, losses related to international equity investments increased as a result of expansion of the customer base at One 2 One and build out of the network at TeleWest.

Sales and Other Revenues

	1994	1993	Increase (Decrease)
Directory and information services:			
Domestic	\$ 997	\$ 949	\$ 48
International	78	7	71
	1,075	956	119
Wireless communications:			
Cellular service	633	443	190
Cellular equipment	120	63	57
Paging sales and service ¹	28	55	(27)
	781	561	220
Cable and telecommunications	18	—	18
Other	34	32	2
Sales and other revenues	<u>\$1,908</u>	<u>\$1,549</u>	<u>\$359</u>

¹ The paging business was sold in June 1994. Results reflect operations for the six months ending June 30, 1994.

During 1994, Media Group sales and other revenues increased 25 percent to \$1,862, excluding the effect of the 1994 Atlanta Systems acquisition and paging sale. The increase was primarily due to strong growth in cellular service revenue.

Directory and Information Services Revenues related to Yellow Pages directory advertising increased approximately \$59, or 6.5 percent, due primarily to pricing. Product enhancements and the effect of improved marketing programs on business volume also contributed to the increase in revenues. Non-Yellow Pages revenues increased \$11, including \$7 related to new products. Partially offsetting these increases was the absence of revenues related to certain publishing, software development and marketing operations that were sold, which reduced revenues by \$22.

The increase in international directory publishing revenues is attributable to U S WEST's May 1994 purchase of Thomson Directories.

Wireless Communications Cellular service revenues increased 43 percent, to \$633 in 1994, due to a 61 percent increase in subscribers (with 24 percent of the additions occurring in December), partially offset by an 8 percent drop in average revenue per subscriber to \$70.00 per month.

Cellular equipment revenues increased 90 percent, to \$120 in 1994, primarily due to an 83 percent increase in gross customer additions, with a higher percentage of those customers purchasing equipment than in 1993. This increase was partially offset by a 13 percent decline in the average selling price of wireless phones.

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Cable and Telecommunications Domestic cable and telecommunications revenues reflect the December 1994 acquisition of the Atlanta Systems.

Operating Income

	1994	1993 ¹	Increase (Decrease)
Directory and information services:			
Domestic	\$397	\$359	\$ 38
International	(1)	(3)	2
	396	356	40
Wireless communications:			
Cellular	82	(29)	111
Paging sales and service ²	6	—	6
	88	(29)	117
Cable and telecommunications	—	—	—
Other ³	(95)	(89)	(6)
Operating income	<u>\$389</u>	<u>\$238</u>	<u>\$151</u>

¹ Includes pretax restructuring charges of \$50 and \$70 for the domestic directory and information services and wireless segments, respectively.

² The paging business was sold in June 1994. Results reflect operations for the six months ending June 30, 1994.

³ Primarily includes divisional expenses associated with equity investments.

Media Group operating income increased 7 percent, to \$383 in 1994, excluding the effects of the one-time items described in Notes 1 and 2 to the table above. Revenue growth, partially offset by higher operating expenses, provided an 10.5 percent increase in 1994 EBITDA, on a comparable basis.

Directory and Information Services Excluding the effect of the 1993 restructuring charge of \$50, operating income from domestic directory and information services operations decreased \$12, or 3 percent, in 1994. Operating income related to the domestic Yellow Pages directory business increased \$20. The increase was driven by strong revenue growth. Non-Yellow Pages operating income decreased \$32, primarily a result of increased costs related to development of new database marketing and interactive services.

The increase in international directory publishing operating income is attributable to U S WEST's May 1994 purchase of Thomson Directories.

Wireless Communications Excluding the effect of the 1993 restructuring charge of \$70, cellular operating income doubled in 1994 to \$41. This is a result of revenue increases associated with the rapidly expanding subscriber base and decreases in the costs incurred to acquire and maintain a customer. Cellular EBITDA increased \$55, or 44 percent in 1994. Cellular service EBITDA margin was 28.4 percent, essentially unchanged compared with 1993.

Other Other operating income decreased primarily due to growth in international operations and the inclusion of administrative costs related to the TWE investment for the full year in 1994, compared with three months in 1993.

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Interest Expense and Other

	1994	1993	Increase
Interest expense	\$ 66	\$27	\$39
Equity losses in unconsolidated ventures	121	74	47
Other income	46	9	37

Interest expense increased \$39, primarily as a result of incremental financing costs associated with the September 1993 TWE investment.

Equity losses in unconsolidated ventures increased \$47, primarily due to start-up costs related to the build out of TeleWest's network and costs related to the expansion of the customer base at One 2 One.

Other income increased \$37, primarily due to an \$18 increase in the TWE management fee. This increase resulted from owning the investment for a full year in 1994, compared with three months in 1993. Other income also includes a \$10 gain on the sale of certain software development and marketing operations in 1994.

Provision for Income Taxes

	1994	1993	Increase
Provision for income taxes	\$ 204	\$ 61	\$143
Effective tax rate	42.5%	41.8%	—

The effective tax rate is significantly impacted by state and foreign taxes on the Media Group Combined Financial Statements.

Liquidity and Capital Resources —Three Years Ended December 31, 1995

Operating Activities

Cash provided by operating activities increased \$89 in 1995, to \$640. During 1995, an income tax payment related to the 1994 partial sale of the Media Group's joint venture interest in TeleWest reduced cash provided by operations by \$60. Adjusted for this one-time income tax payment, operating cash flow of the Media Group increased \$149. Growth in operations from the cellular business and acquisition of the Atlanta Systems contributed to the increase. Growth in operating cash flow from directory and information services operations has been reduced by investments related to its growth initiatives. Operating cash flow from Media Group businesses was partially offset by a significant increase in income taxes paid in 1995, primarily due to lower tax benefits generated from the investment in TWE.

Cash provided by operating activities of the Media Group increased \$28 in 1994 compared with 1993 primarily due to expansion of the cellular business.

The Media Group expects that cash from operations will not be adequate to fund expected cash requirements. Additional financing will come primarily from new debt.

Investing Activities

Total capital expenditures of the Media Group were \$363, \$349 and \$193 in 1995, 1994 and 1993, respectively, the majority was devoted to enhancement and expansion of the cellular network. In 1996, capital expenditures are expected to exceed \$600, of which approximately 50 percent relates to expansion of the cellular network to increase coverage and capacity, and nearly 40 percent relates to enhancement of the Atlanta Systems. The Media Group is in the process of upgrading its Atlanta Systems to 750 megahertz capacity, which will provide more reliability, better signal quality and additional capacity. The upgrade will enable the provision of enhanced cable, data and telecommunications services to its Atlanta customers.

Investing activities of the Media Group also include equity investments in international ventures. In 1995, the Media Group invested \$681 in international ventures, primarily investments in Malaysia, the

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Netherlands, the Czech Republic and the United Kingdom. The Media Group invested approximately \$444 in developing international businesses in 1994, including the acquisition of Thomson Directories. The Media Group anticipates that investments in international ventures will approximate \$400 in 1996. This includes investments for recently awarded licenses to provide cellular service using digital technology in India and Poland. At December 31, 1995, U S WEST guaranteed debt in the principal amount of approximately \$140 related to international ventures.

In March 1995, PCS PrimeCo was awarded PCS licenses in 11 markets. The Media Group's share of the cost of the licenses was approximately \$268, all of which was funded in 1995. Under the PCS PrimeCo partnership agreement, U S WEST is required to fund approximately 24 percent of PCS PrimeCo's operating and capital costs, including licensing costs. U S WEST anticipates that its total funding obligations to PCS PrimeCo during the next three years will be approximately \$400.

In 1994, the Media Group received cash proceeds of \$143 from the sale of its paging operations. In 1993, cash proceeds of \$30 were received from the sale of certain nonstrategic lines of business. The Media Group did not receive cash from the 1994 partial sale of its joint venture interest in TeleWest or from the 1995 merger. All proceeds from the 1994 sale have been used by TeleWest for general business purposes, including financing both construction and operations, and repaying debt.

On February 27, 1996, U S WEST announced a definitive agreement to merge with Continental. Continental, the nation's third-largest cable operator, serves 4.2 million domestic customers, passes more than seven million domestic homes and holds significant other domestic and international properties. U S WEST will purchase all of Continental's stock for approximately \$5.3 billion and will assume Continental's debt and other obligations, which amount to approximately \$5.5 billion. Consideration for the \$5.3 billion in equity will consist of approximately \$1 billion in U S WEST preferred stock, convertible to Media Stock; and, at U S WEST's option, between \$1 billion and \$1.5 billion in cash, and \$2.8 billion to \$3.3 billion in shares of Media Stock. The transaction, which is expected to close in the fourth quarter of 1996, is subject to a number of conditions and approvals, including approvals from Continental shareholders and local franchising and government authorities.

Financing Activities

During 1995, debt increased \$287 primarily due to new investments in international ventures, cash funding of the PCS licenses and a reclassification of debt from net investment in assets held for sale. During fourth-quarter 1995, U S WEST issued \$130 of exchangeable notes, or Debt Exchangeable for Common Stock ("DECS"), due December 15, 1998. Upon maturity, each DECS will be mandatorily exchanged by U S WEST for shares of Enhance Financial Services Group, Inc. ("Enhance") or, at U S WEST's option, redeemed at the cash equivalent. The capital assets segment currently holds approximately 31.5 percent of the outstanding Enhance common stock.

These increases in debt were partially offset by reductions of debt related to the investment in TWE and a refinancing of commercial paper by issuing Company-obligated mandatorily redeemable preferred securities of a subsidiary trust holding solely Company-guaranteed debentures ("Preferred Securities"). U S WEST issued \$600 of Preferred Securities in 1995. The payment of interest and redemption amounts to holders of the securities are fully and unconditionally guaranteed by U S WEST.

Excluding debt associated with the capital assets segment, the Media Group's percentage of debt to total capital at December 31, 1995, was 29.1 percent compared with 29.9 percent at December 31, 1994. Including debt associated with the capital assets segment, Preferred Securities and other preferred stock, the Media Group's percentage of debt to total capital was 44.2 percent at December 31, 1995, and 42.8 percent at December 31, 1994.

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Debt increased \$288 in 1994, primarily due to the December 1994 acquisition of the Atlanta Systems, partially offset by reductions in debt related to the investment in TWE. The cash investment related to the acquisition of the Atlanta Systems was \$745, obtained through short-term borrowing.

U S WEST maintains a commercial paper program to finance short-term cash flow requirements, as well as to maintain a presence in the short-term debt market. U S WEST maintains lines of credit aggregating approximately \$1.3 billion, which is available to both the Media Group and the nonregulated subsidiaries of the Communications Group in accordance with their borrowing needs. Under registration statements filed with the SEC, as of December 31, 1995, U S WEST is permitted to issue up to approximately \$1.2 billion of new debt securities, available to both the Media Group and the nonregulated subsidiaries of the Communications Group.

Debt related to discontinued operations decreased \$487 in 1995 and \$213 in 1994. Cash to the capital assets segment of \$101 in 1994 primarily reflects the payment of debt, net of \$154 in proceeds from the sale of 8.1 million shares of Financial Security Assurance Holdings, Ltd. ("FSA"), an investment of the capital assets segment. For financial reporting purposes debt of the capital assets segment is netted against the related assets. See Media Group Combined Financial Statements — Note 20: Net Investment in Assets Held for Sale.

The Media Group reinvests earnings, if any, for future growth and does not expect to pay dividends on the Media Stock in the foreseeable future.

In connection with U S WEST's announcement on February 27, 1996 of a planned merger with Continental, U S WEST, Inc.'s credit rating is being reviewed by credit rating agencies, which may result in a downgrading.

Financing activities for the nonregulated Communications Group businesses and the Media Group, including the issuance, repayment and repurchase of short-term and long-term debt, and the issuance and repurchase of Preferred Securities, is managed by U S WEST on a centralized basis. Financing activities for U S WEST Communications is separately identified and accounted for in U S WEST's records and U S WEST Communications continues to conduct its own borrowing activities. Debt incurred and investments made by U S WEST and its subsidiaries is specifically allocated to and reflected on the financial statements of the Media Group except that debt incurred and investments made by U S WEST and its subsidiaries on behalf of the nonregulated Communications Group businesses and all debt incurred and investments made by U S WEST Communications is specifically allocated to and reflected on the financial statements of the Communications Group. Debt incurred by U S WEST or a subsidiary on behalf of a Group is charged to such Group at the borrowing rate of U S WEST or such subsidiary.

Risk Management

The Media Group is exposed to market risks arising from changes in interest rates and foreign exchange rates. Derivative financial instruments are used to manage these risks. U S WEST does not use derivative financial instruments for trading purposes.

Interest Rate Risk Management

The objective of the interest rate risk management program is to minimize the total cost of debt. Interest rate swaps are used to adjust the ratio of fixed- to variable-rate debt. The market value of the debt portfolio, including the interest rate swaps, is monitored and compared with predetermined benchmarks to evaluate the effectiveness of the risk management program.

Notional amounts of interest rate swaps outstanding were \$825 and \$850 as of December 31, 1995 and 1994, respectively, with various maturities that extend to 2004. The estimated effect of U S WEST's interest

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rate derivative transactions was to adjust the level of fixed-rate debt of the Media Group from 86 percent to 87 percent at December 31, 1995, and from 68 percent to 71 percent of the total debt portfolio at December 31, 1994 (including debt associated with the capital assets segment).

Foreign Exchange Risk Management

U S WEST has entered into forward and option contracts to manage the market risks associated with fluctuations in foreign exchange rates after consideration of offsetting foreign exposures among international operations. The use of forward and option contracts allow U S WEST to fix or cap the cost of firm foreign investment commitments in countries with freely convertible currencies. The market values of the foreign exchange positions, including the hedging instruments, are continuously monitored and compared with predetermined levels of acceptable risk.

Notional amounts of foreign exchange forward and option contracts outstanding were \$456 and \$170 as of December 31, 1995 and 1994, respectively, with maturities of one year or less. These contracts were primarily for the purchase of Dutch guilders and British pounds in 1995 and British pounds in 1994.

The Media Group had foreign exchange risks associated with a Dutch guilder-denominated payable in the translated principal amount of \$216 at December 31, 1995, and British pound-denominated receivables in the translated principal amounts of \$139 and \$48 at December 31, 1995 and 1994, respectively, of which \$63 and \$48 of these respective balances are with a wholly owned subsidiary. These positions were hedged in 1995.

Disposition of the Capital Assets Segment

U S WEST announced a plan of disposition of the capital assets segment in June 1993. See the Media Group Combined Financial Statements — Note 20: Net Investment in Assets Held for Sale. In December 1993, U S WEST sold \$2.0 billion of finance receivables and the business of U S WEST Financial Services, Inc. to NationsBank Corporation. Proceeds from the sale of \$2.1 billion were used to repay related debt.

During 1994, U S WEST reduced its ownership interest in FSA, a member of the capital assets segment, to 60.9 percent and its voting interest to 49.8 percent through a series of transactions. In May and June 1994, U S WEST sold 8.1 million shares of FSA common stock and received \$154 in net proceeds from the public offering. In December 1995, FSA merged with Capital Guaranty Corporation for shares of FSA and cash of \$51. The transaction was valued at approximately \$203 and reduced U S WEST's ownership interest in FSA to 50.3 percent and its voting interest to 41.7 percent. U S WEST expects to monetize and ultimately reduce its ownership in FSA through the issuance of Debt Exchangeable for Common Stock ("DECS") in 1996. At maturity, each DECS will be mandatorily exchanged by U S WEST for FSA common stock held by U S WEST or, at U S WEST's option, redeemed at the cash equivalent.

On September 2, 1994, U S WEST issued to Fund American Enterprises Holdings Inc. ("FFC") 50,000 shares of cumulative redeemable preferred stock for a total of \$50. The shares are mandatorily redeemable in year ten and, at the option of FFC, the preferred stock also can be redeemed for common shares of FSA.

U S WEST Real Estate, Inc. has sold various properties totaling \$120, \$327 and \$66 in 1995, 1994 and 1993, respectively. The sales proceeds were in line with estimates. Proceeds from building sales were primarily used to repay related debt. U S WEST has completed construction of existing buildings in the commercial real estate portfolio and expects to substantially complete liquidation of this portfolio by 1998. The remaining balance of assets subject to sale is approximately \$490, net of reserves, as of December 31, 1995.

Competitive Strategy

The Media Group's strategy is based on the belief that communication and commerce are migrating from other mediums to electronic networks. Over time, this global phenomenon will result in networks

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replacing traditional distribution channels. To meet the needs of this growing market, the Media Group provides local connections and then integrates market-based service offerings to meet the needs of end users. The Media Group executes this strategy through three lines of business — cable and telecommunications, wireless and directory and information services — in selected high-growth markets worldwide.

Competitive and Regulatory Environment

Cable and Telecommunications The Telecommunications Act of 1996 (the "1996 Act") opens competition by permitting local telephone companies, long-distance carriers and cable television companies to enter each other's businesses. This legislation will enable the Media Group to provide "one-stop shopping" for voice, video and data services, a key objective of the Media Group. The Media Group is currently in the process of negotiating reasonable and non-discriminatory local interconnection rates, terms and conditions with BellSouth and is planning on entering the local exchange market, through the Atlanta Systems, on a competitive basis by the end of 1996.

The Atlanta Systems generally compete for viewer attention with programming from a variety of sources, including the direct reception of broadcast television signals by the viewer's own antenna, satellite master antenna service and direct broadcast satellite services. Cable television systems are also in competition for both viewers and advertising in varying degrees with other communications and entertainment media. Such competition may increase with the development and growth of new technologies.

The 1996 Act has amended certain aspects of the Cable Television Consumer Protection and Competition Act of 1992 ("the 1992 Cable Act"). Under the 1996 Act, cable rates are deregulated effective March 31, 1999, or earlier if competition exists. In addition, the provisions of the 1996 Act simplify the process of filing rate complaints, relax uniform rate requirements and subscriber notice provisions, expand the definition of effective competition and eliminate certain restrictions on the sale of cable systems. Current program access restrictions applying to cable operators are extended to common carriers by the 1996 Act. The 1996 Act also eliminates certain cross-ownership restrictions between cable operators, broadcasters and multichannel, multipoint distribution system operators.

Cable television systems are also subject to local regulation, typically imposed through the franchising process. Local officials may be involved in the initial franchise selection, system design and construction, safety, rate regulation, customer service standards, billing practices, community-related programming and services, franchise renewal and imposition of franchise fees.

In 1995, the Georgia legislature removed the legal prohibition on local telephone competition by authorizing competition in local telephone exchange service. The Media Group has received certification from the Georgia Public Service Commission to provide local switched and nonswitched telephone service in Georgia and, with the passage of the 1996 Act, certain long-distance services.

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Wireless Communications There are two competitive cellular licenses in each market. Competition is based on the price of cellular service, the quality of the service and the size of the geographic area served. The development of PCS services will increase the number of competitors and the level of competition. The Media Group is unable to estimate the impact of the availability of PCS services on its cellular operations, though it could be significant.

The wireless operations are subject to regulation by federal and some state and local authorities. The construction and transfer of cellular systems in the United States are regulated by the FCC pursuant to the Communications Act of 1934. The FCC regulates construction and operation of cellular systems and licensing and technical standards for the provision of cellular telephone service. Pursuant to Congress' 1993 Omnibus Budget Reconciliation Act, the FCC adopted rules preempting state and local governments from regulating wireless entry and most rates.

The passage of the 1996 Act eliminates long-distance restrictions imposed by the Modified Final Judgment ("MFJ"). As a result, the Media Group, including its wireless partners, are now able to offer integrated local and long-distance services. The 1996 Act also permits the Media Group to enter into activities related to the manufacture of telecommunications equipment.

Directory and Information Services The Media Group may face emerging competition in the provision of interactive services from cable and entertainment companies, on-line services and other information providers. Directory listings are beginning to be offered via electronic databases through telephone company and third party networks. As such offerings expand and are enhanced through interactivity and other features, the Media Group may experience heightened competition in its directory publishing businesses. With the passage of the 1996 Act, the Media Group will be able to provide certain information services across LATA boundaries. The Media Group will continue to expand its core products and develop and package new information products to meet its customers' needs.

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FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Selected Proportionate Financial Data

The following table shows the entities included in the Media Group Combined Financial Statements and the percent ownership by industry segment. The proportionate financial and operating data for these entities are summarized in the proportionate data table that follows:

	Cable and Telecommunications		Wireless Communications		Directory and Information Services	
	Domestic	International	Domestic	International	Domestic	International
C O N S O L I D A T E D	Atlanta Systems 100%		U S WEST NewVector 92% (1)		U S WEST Marketing Resources Group 100%	Thomson Directories (UK) 100% U S WEST Polska (Poland) 100%
E Q U I T Y	TWE 25.51%	TeleWest (UK) 26.8% TeleWest Europe (Norway, Sweden, Hungary) Varies A2000 (KTA) (Netherlands) 50% Kabel Plus (Czech Republic) 29% Binariang Communications Sdn Bhd (Malaysia) 20% ARIAWEST (Indonesia) 35%		Mercury One 2 One (UK) 50% Westel Radiotelefon (Hungary) 49% Westel 900 (Hungary) 47% EuroTel (Czech & Slovak Republics) 24.5% Russian Telecommunications Development Corp. (Russia) 67%		Listel (Brazil) 50%

(1) Proportionate information reflects an approximate 8 percent minority interest in NewVector's underlying operations.

U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Selected Proportionate Financial Data (Continued)

The following table and discussion is not required by GAAP or intended to replace the Combined Financial Statements prepared in accordance with GAAP. It is presented supplementally because the Media Group believes that proportionate financial and operating data facilitate the understanding and assessment of its Combined Financial Statements. Proportionate accounting reflects the Media Group's relative ownership interests in operating revenues and expenses for both its consolidated and equity method investments. The financial information included below departs materially from GAAP because it aggregates the revenues and operating income of entities not controlled by the Media Group with those of the consolidated operations of the Media Group. The following table includes allocations of Media Group corporate activity. The table does not reflect financial data of the capital assets segment, which had net assets of \$429, \$302 and \$554 at December 31, 1995, 1994 and 1993, respectively. Previously reported amounts have been reclassified to conform with current year presentation.

	Cable and Telecommunications		Wireless Communications		Directory and Information Services		Total
	Domestic ¹	Intern'l	Domestic	Intern'l	Domestic	Intern'l	
Financial Data:							
Year Ended 1995							
Revenue	\$2,661	\$ 128	\$ 824	\$ 295	\$1,065	\$ 142	\$ 5,115
EBITDA ²	589	(55)	226	(40)	426	3	1,149
Operating income (loss)	181	(117)	116	(92)	398	(10)	476
Income (loss) before extraordinary item	(68)	18	50	(80)	238	(13)	145
Debt							4,417
Year Ended 1994							
Revenue	\$2,196	\$ 85	\$ 662	\$ 186	\$1,005	\$ 79	\$ 4,213
EBITDA ²	436	(42)	161	(68)	413	2	902
Operating income (loss)	120	(73)	76	(103)	389	(8)	401
Income (loss) from continuing operations	(42)	65	74	(68)	251	(4)	276
Debt							3,865
Year Ended 1993							
Revenue	\$ 568	\$ 59	\$ 487	\$ 78	\$ 958	\$ 7	\$ 2,157
EBITDA ²	81	(42)	121	(48)	418	(3)	527
Operating income (loss)	(7)	(64)	(25)	(53)	347	(3)	195
Income (loss) from continuing operations	(31)	(49)	(31)	(22)	221	(3)	85
Debt							3,492

U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Selected Proportionate Financial Data (Continued)

	<u>Cable and Telecommunications</u>		<u>Wireless Communications</u>		<u>Directory and Information Services</u>		<u>Total</u>
	<u>Domestic¹</u>	<u>Intern'l</u>	<u>Domestic</u>	<u>Intern'l</u>	<u>Domestic</u>	<u>Intern'l</u>	
Operating Data (thousands):							
Year Ended 1995							
Subscribers/advertisers	2,945	617	1,339	308	479	271	5,959
Homes passed	4,551	1,172	—	—	—	—	5,723
POPs ³	—	—	33,800	44,300	—	—	78,100
Telephone lines	—	141	—	—	—	—	141
Year Ended 1994							
Subscribers/advertisers	2,407	226	817	169	468	147	4,234
Homes passed	3,952	576	—	—	—	—	4,528
POPs ³	—	—	18,900	38,300	—	—	57,200
Telephone lines	—	69	—	—	—	—	69
Year Ended 1993							
Subscribers/advertisers	1,837	215	509	41	459	25	3,086
Homes passed	3,061	524	—	—	—	—	3,585
POPs ³	—	—	18,200	38,300	—	—	56,500
Telephone lines	—	44	—	—	—	—	44

¹ The proportionate results include the Media Group's 25.51 percent pro-rata priority and residual equity interests in reported TWE results. The reported TWE results are prepared in accordance with GAAP and have not been adjusted to report TWE investments accounted for under the equity method on a proportionate basis.

² Proportionate EBITDA represents the Media Group's equity interest in the entities multiplied by the entities' EBITDA. 1993 EBITDA excludes restructuring charges of \$59 and \$50 related to the domestic wireless and directory and information services segments, respectively.

³ POPs are the estimated market population multiplied by U S WEST's ownership interest in the market.

Proportionate Results of Operations — 1995 Compared with 1994

In 1995, proportionate Media Group revenue increased 17 percent, to \$5.12 billion, and EBITDA increased 17 percent, to \$1.15 billion, excluding the one-time impacts of the 1994 Atlanta Systems acquisition and the sale of paging operations. Strong growth in both domestic cable and telecommunications and wireless communications contributed to the increases.

Cable and Telecommunications During 1995, proportionate revenue for the Media Group domestic cable and telecommunications operations increased 12 percent, to \$2,661, and proportionate EBITDA increased 11 percent, to \$589, excluding the one-time impact of the 1994 acquisition of the Atlanta systems. Proportionate revenue and EBITDA growth is primarily due to the TWE cable, programming and filmed entertainment operations. Cable growth is attributed to subscriber growth of nearly six percent, excluding the impact of 1995 TWE cable transactions, as well as increases in advertising and pay per view revenues.

During 1995, international cable and telecommunications proportionate revenue increased \$43, to \$128, and proportionate EBITDA decreased \$13 to (\$55). Results for new ventures in the Czech Republic, Netherlands and Malaysia, have been included in the proportionate results beginning with the fourth quarter of 1995. The new ventures contributed revenue of \$10 and EBITDA of (\$14), which reflect the start-up nature of the operations.

Wireless Communications During 1995, proportionate revenue for the Media Group domestic wireless operations increased 30 percent, to \$824, and proportionate EBITDA increased 52 percent, to \$226.

U S WEST MEDIA GROUP
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Selected Proportionate Financial Data (Continued)

excluding the effect of the paging business, which was sold in 1994. Proportionate cellular service revenue increased 39 percent, to \$736 in 1995. This increase is due to a 64 percent increase in proportionate subscribers partially offset by a decrease in average revenue per subscriber.

During 1995, international wireless communications proportionate revenue increased \$109, to \$295, and proportionate EBITDA increased \$28, to (\$40). Venture results for Indonesia and Russia have been included in the proportionate results beginning with the fourth quarter of 1995. These ventures contributed revenue of \$9 and EBITDA of (\$4), which reflect the start-up nature of the operations.

Directory and Information Services Proportionate revenue for domestic directory and information services increased 6 percent, to \$1,065 in 1995, and proportionate EBITDA increased 3 percent, to \$426. The proportionate revenue increase is due to price and volume increases. Revenue increases were partially offset by reinvestments in the business, resulting in the 3 percent increase in EBITDA.

Proportionate revenue for international directories businesses increased \$63, to \$142 in 1995, and proportionate EBITDA increased \$1, to \$3. Results for Listel, a Brazilian directories operation, have been included in the Media Group proportionate results beginning with the fourth quarter 1995. Listel contributed proportionate revenue of \$18 and EBITDA of \$2.

Proportionate Debt

Proportionate debt increased \$552 in 1995. The increase is primarily related to the Media Group's international investments. Both TeleWest and One 2 One raised cash through the issuance of debt in 1995, primarily to fund the continued expansion of their businesses.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareowners of U S WEST, Inc.:

We have audited the Combined Balance Sheets of U S WEST Media Group (as described in Note 2 to the Combined Financial Statements) as of December 31, 1995 and 1994, and the related Combined Statements of Operations and Cash Flows for each of the three years in the period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of U S WEST Media Group as of December 31, 1995 and 1994, and the combined results of its operations and its cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

As more fully discussed in Note 2, the Combined Financial Statements of U S WEST Media Group should be read in connection with the audited Consolidated Financial Statements of U S WEST, Inc.

We have also audited the Supplementary Selected Proportionate Results of Operations for the three years in the period ended December 31, 1995, presented on page D-55. The Supplementary Selected Proportionate Results of Operations have been prepared by management to present relevant financial information that is not provided by the Consolidated Financial Statements and is not intended to be a presentation in accordance with generally accepted accounting principles. In our opinion, the Supplementary Selected Proportionate Results of Operations referred to above presents fairly, in all material respects, the information set forth therein on the basis of accounting described on page D-55.

COOPERS & LYBRAND L.L.P.

Denver, Colorado

February 12, 1996, except for note 5, paragraph 3,
as to which the date is February 27, 1996

U S WEST MEDIA GROUP
COMBINED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	1995	1994	1993
	Dollars in millions (except per share amounts)		
Sales and other revenues:			
Directory and information services	\$ 1,180	\$ 1,075	\$ 956
Wireless communications	941	781	561
Cable and telecommunications	215	18	—
Other	38	34	32
Total sales and other revenues	2,374	1,908	1,549
Operating expenses:			
Cost of sales and other revenues	772	612	457
Selling, general and administrative expenses	886	763	607
Depreciation and amortization	249	144	127
Restructuring charge	—	—	120
Total operating expenses	1,907	1,519	1,311
Income from operations	467	389	238
Interest expense	100	66	27
Equity losses in unconsolidated ventures	207	121	74
Gains on merger and partial sale of joint venture interest	157	164	—
Gain on sale of paging assets	—	68	—
Guaranteed minority interest expense	14	—	—
Other income — net	5	46	9
Income from continuing operations before income taxes and extraordinary item	308	480	146
Provision for income taxes	163	204	61
Income from continuing operations before extraordinary item	145	276	85
Discontinued operations	—	—	(82)
Income before extraordinary item	145	276	3
Extraordinary item — early extinguishment of debt, net of tax	(4)	—	—
NET INCOME	\$ 141	\$ 276	\$ 3
Dividends on preferred stock	3	—	—
EARNINGS AVAILABLE FOR COMMON STOCK	\$ 138	\$ 276	\$ 3
Pro forma earnings per common share:			
Income before extraordinary item	\$ 0.30	\$ 0.61	
Extraordinary item — early extinguishment of debt, net of tax	(.01)	—	
PRO FORMA EARNINGS PER COMMON SHARE	\$ 0.29	\$ 0.61	
PRO FORMA AVERAGE COMMON SHARES OUTSTANDING (thousands)	470,549	453,316	

The accompanying notes are an integral part of the Combined Financial Statements

**U S WEST MEDIA GROUP
COMBINED BALANCE SHEETS**

ASSETS

	December 31,	
	1995	1994
	Dollars in millions	
Current assets:		
Cash and cash equivalents	\$ 20	\$ 93
Accounts and notes receivable, less allowance for credit losses of \$58 and \$33, respectively	287	212
Deferred directory costs	247	234
Receivable from Communications Group	106	109
Deferred tax asset	24	52
Other	57	56
Total current assets	<u>741</u>	<u>756</u>
Property, plant and equipment — net	1,148	956
Investment in Time Warner Entertainment	2,483	2,522
Intangible assets — net	1,798	1,858
Investments in international ventures	1,511	881
Net investment in assets held for sale	429	302
Other assets	505	119
Total assets	<u>\$8,615</u>	<u>\$7,394</u>

LIABILITIES AND EQUITY

Current liabilities:		
Short-term debt	\$ 836	\$1,229
Accounts payable	235	170
Deferred revenue and customer deposits	87	76
Other	411	458
Total current liabilities	<u>1,569</u>	<u>1,933</u>
Long-term debt	1,265	585
Deferred income taxes	382	344
Deferred credits and other	276	278
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely Company-guaranteed debentures	600	—
Preferred stock subject to mandatory redemption	51	51
Media Group equity	4,599	4,390
Company LESOP guarantee	(127)	(187)
Total equity	<u>4,472</u>	<u>4,203</u>
Total liabilities and equity	<u>\$8,615</u>	<u>\$7,394</u>
Contingencies (see Note 6 to the Combined Financial Statements)		

The accompanying notes are an integral part of the Combined Financial Statements

U S WEST MEDIA GROUP
COMBINED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1995	1994	1993
	Dollars in millions		
OPERATING ACTIVITIES			
Net income	\$ 141	\$ 276	\$ 3
Adjustments to net income:			
Restructuring charge	—	—	120
Depreciation and amortization	249	144	127
Equity losses in unconsolidated ventures	207	121	74
Gains on merger and partial sale of joint venture interest	(157)	(164)	—
Gain on sale of paging assets	—	(68)	—
Deferred income taxes and amortization of investment tax credits	102	147	(34)
Provision for uncollectibles	55	36	27
Discontinued operations	—	—	82
Changes in operating assets and liabilities:			
Restructuring payments	(19)	(10)	—
Accounts and notes receivable	(103)	(76)	(39)
Deferred directory costs, prepaid and other	(28)	(52)	(33)
Accounts payable and accrued liabilities	36	143	63
Other — net	157	54	133
Cash provided by operating activities	640	551	523
INVESTING ACTIVITIES			
Expenditures for property, plant and equipment	(363)	(349)	(193)
Investment in Time Warner Entertainment	—	—	(1,557)
Investments in international ventures	(681)	(350)	(230)
Investment in PCS licenses	(286)	—	—
Investment in Atlanta Systems	—	(745)	—
Proceeds from sale of paging assets	—	143	—
Other — net	92	(121)	(7)
Cash (used for) investing activities	(1,238)	(1,422)	(1,987)
FINANCING ACTIVITIES			
Net (repayments of) proceeds from short-term debt	(449)	936	—
Repayments of long-term debt	(724)	(316)	(143)
Proceeds from issuance of long-term debt	1,085	—	—
Proceeds from issuance of trust originated preferred securities — net	581	—	—
Proceeds from issuance of common stock	57	323	794
Proceeds from issuance of preferred stock	—	50	—
Repayment of advance from Communications Group	—	—	153
Other — net	(25)	—	—
Cash provided by financing activities	525	993	804
Cash (used for) provided by continuing operations	(73)	122	(660)
Cash (to) from discontinued operations	—	(101)	610
CASH AND CASH EQUIVALENTS			
Increase (decrease)	(73)	21	(50)
Beginning balance	93	72	122
Ending balance	\$ 20	\$ 93	\$ 72

The accompanying notes are an integral part of the Combined Financial Statements

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS
For the Years Ended December 31, 1995, 1994 and 1993
(Dollars in millions)

NOTE 1: RECAPITALIZATION PLAN

On October 31, 1995, the shareholders of U S WEST, Inc., a Colorado corporation ("U S WEST Colorado") voted to approve a proposal (the "Recapitalization Plan") adopted by the Board of Directors of U S WEST, Inc. (the "Board") to reincorporate in Delaware and create two classes of common stock that are intended to reflect separately the performance of the communications and multimedia businesses. Under the Recapitalization Plan, shareholders approved an Agreement and Plan of Merger between U S WEST Colorado and U S WEST, Inc., a Delaware corporation ("U S WEST" or "Company"), pursuant to which U S WEST continues as the surviving corporation. In connection with the merger, the Certificate of Incorporation of U S WEST has been amended and restated to designate two classes of common stock of U S WEST, one class of which is authorized as U S WEST Communications Group Common Stock ("Communications Stock"), and the other class which is authorized as U S WEST Media Group Common Stock ("Media Stock"). Effective November 1, 1995, each share of common stock of U S WEST Colorado was converted into one share each of Communications Stock and Media Stock.

The Communications Stock and Media Stock provide shareholders with two distinct securities that are intended to reflect separately the communications businesses of U S WEST (the "Communications Group") and the multimedia businesses of U S WEST (the "Media Group") and, together with the Communications Group, the "Groups").

The Communications Group is comprised of U S WEST Communications, Inc. ("U S WEST Communications"), U S WEST Communications Services, Inc., U S WEST Federal Services, Inc., U S WEST Advanced Technologies, Inc. and U S WEST Business Resources, Inc. The Communications Group primarily provides regulated communications services to more than 25 million residential and business customers within a 14 state region.

The Media Group is comprised of U S WEST Marketing Resources Group, Inc., which publishes White and Yellow Pages telephone directories, and provides directory and information services, U S WEST NewVector Group, Inc., which provides communications and information products and services over wireless networks, U S WEST Multimedia Communications, Inc., which owns domestic cable television operations and investments, and U S WEST International Holdings, Inc., which primarily owns investments in international cable and telecommunications, wireless communications and directory publishing operations.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The Combined Financial Statements of the Groups comprise all of the accounts included in the corresponding Consolidated Financial Statements of U S WEST. Investments in less than majority-owned ventures are generally accounted for using the equity method. The separate Group Combined Financial Statements have been prepared on a basis that management believes to be reasonable and appropriate and include: (i) the combined historical balance sheets, results of operations and cash flows of the businesses that comprise each of the Groups, with all significant intra-group amounts and transactions eliminated; (ii) in the case of the Communications Group Combined Financial Statements, certain corporate assets and liabilities of U S WEST and related transactions identified with the Communications Group; (iii) in the case of the Media Group Combined Financial Statements, all other corporate assets and liabilities and related transactions of U S WEST; and (iv) an allocated portion of the corporate expense of U S WEST. Transactions between the Communications Group and the Media Group have not been eliminated.

Notwithstanding the allocation of assets and liabilities (including contingent liabilities) and stockholders' equity between the Communications Group and the Media Group for the purpose of preparing the respective financial statements of such Group, holders of Communications Stock and Media Stock are subject to risks associated with an investment in a single company and all of U S WEST's businesses, assets and liabilities. Such allocation of assets and liabilities and change in the equity structure of U S WEST does

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

not result in a distribution or spin-off to shareholders of any assets or liabilities of U S WEST or any of its subsidiaries or otherwise affect responsibility for the liabilities of U S WEST or such subsidiaries. As a result, the rights of the holders of U S WEST's or any of its subsidiaries' debt are not affected. Financial effects arising from either Group that affect U S WEST's results of operations or financial condition could, if significant, affect the results of operations or financial position of the other Group or the market price of the class of common stock relating to the other Group. Any net losses of the Communications Group or the Media Group, and dividends or distributions on, or repurchases of Communications Stock, Media Stock or preferred stock, will reduce the funds of U S WEST legally available for payment of dividends on both the Communications Stock and Media Stock. Accordingly, the Media Group Combined Financial Statements should be read in conjunction with U S WEST's Consolidated Financial Statements and the Communications Group Combined Financial Statements.

The accounting policies described herein applicable to the preparation of the Combined Financial Statements of the Media Group may be modified or rescinded at the sole discretion of the Board without approval of the stockholders, although there is no present intention to do so. The Board may also adopt additional policies depending on the circumstances. Any determination of the Board to modify or rescind such policies, or to add additional policies, including any decision that would have disparate impacts upon holders of Communications Stock and Media Stock, would be made by the Board in good faith and in the honest belief that such decision is in the best interests of all U S WEST stockholders, including the holders of Communications Stock and the holders of Media Stock. In making such determination, the Board may also consider regulatory requirements imposed on U S WEST Communications by the public utility commissions of various states and the Federal Communications Commission. In addition, generally accepted accounting principles require that any change in accounting policy be preferable (in accordance with such principles) to the policy previously established.

Certain reclassifications within the Combined Financial Statements have been made to conform to the current year presentation.

Allocation of Shared Services Certain costs relating to U S WEST's general and administrative services (including certain executive management, legal, accounting and auditing, tax, treasury, strategic planning and public policy services) are directly assigned by U S WEST to each Group, and segment within the Group, based on actual utilization or are allocated based on each Group's operating expenses, number of employees, external revenues, average capital and/or average equity. Beginning in 1996, certain shared services will no longer be allocated to each segment of the Media Group but will be retained at Media Group headquarters. U S WEST charges each Group for such services at fully distributed cost. These direct and indirect allocations were \$55, \$38 and \$43 in 1995, 1994 and 1993, respectively. In 1995, the direct allocations comprised approximately 40 percent of the total shared corporate services allocated to the Media Group. It is not practicable to provide a detailed estimate of the expenses which would be recognized if the Media Group were a separate legal entity. However, U S WEST believes that under the Recapitalization Plan each Group would benefit from synergy's with the other, including lower operating costs than might be incurred if each Group was a separate legal entity.

Allocation of Income Taxes Federal, state and local income taxes, which are determined on a consolidated or combined basis, are allocated to each Group in accordance with tax sharing agreements between U S WEST and the entities within the Groups. The allocations will generally reflect each Group's contribution (positive or negative) to consolidated taxable income and consolidated tax credits. A Group will be compensated only at such time as, and to the extent that, its tax attributes are utilized by U S WEST in a combined or consolidated income tax filing. Federal and state tax refunds and carryforwards or carrybacks of tax attributes will generally be allocated to the Group to which such tax attributes relate.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Media Group includes members which operate in states where U S WEST does not file consolidated or combined state income tax returns. Separate state income tax returns are filed by these members in accordance with the respective states' laws and regulations. The members record a tax provision on a separate company basis in accordance with the requirements of Statement of Financial Accounting Standard ("SFAS") No. 109.

Group Financing Financing activities for the Media Group and the nonregulated Communications Group businesses, including the issuance, repayment and repurchase of short-term and long-term debt, and the issuance and repurchase of preferred securities, are managed by U S WEST on a centralized basis. Financing activities for U S WEST Communications are separately identified and accounted for in U S WEST's records and U S WEST Communications conducts its own borrowing activities. Debt incurred and investments made by U S WEST and its subsidiaries on behalf of the Media Group are specifically allocated to and reflected on the financial statements of the Media Group. Debt incurred and investments made by U S WEST and its subsidiaries on behalf of the nonregulated businesses of the Communications Group and all debt incurred and investments made by U S WEST Communications are specifically allocated to and reflected on the financial statements of the Communications Group. Debt incurred by U S WEST or a subsidiary on behalf of a Group is charged to such Group at the borrowing rate of U S WEST or such subsidiary.

As of November 1, 1995, the effective date of the Recapitalization Plan, U S WEST does not intend to transfer funds between the Groups, except for certain short-term, ordinary course advances of funds at market rates associated with U S WEST's centralized cash management. Such short-term transfers of funds will be accounted for as short-term loans between the Groups bearing interest at the market rate at which management determines the borrowing Group could obtain funds on a short-term basis. If the Board, in its sole discretion, determines that a transfer of funds between the Groups should be accounted for as a long-term loan, the Board would establish the terms on which such loan would be made, including the interest rate, amortization schedule, maturity and redemption terms. Such terms would generally reflect the then prevailing terms upon which management determines such Group could borrow funds on a similar basis. The financial statements of the lending Group will be credited, and the financial statements of the borrowing Group will be charged, with the amount of any such loan, as well as with periodic interest accruing thereon. The Board may determine that a transfer of funds from the Communications Group to the Media Group should be accounted for as an equity contribution, in which case an inter-group interest (determined by the Board based on the then current market value of shares of Media Stock) will either be created or increased, as applicable. Similarly, if an inter-group interest exists, the Board may determine that a transfer of funds from the Media Group to the Communications Group should be accounted for as a reduction in the inter-group interest.

Dividends Under the Recapitalization Plan, U S WEST intends to retain future earnings of the Media Group, if any, for the development of the Media Group's businesses and does not anticipate paying dividends to the Media Group shareholders in the foreseeable future.

Earnings Per Common Share Earnings per common share for 1995 and 1994 have been presented on a pro forma basis to reflect the Media Group's Stock as if it had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST.

Industry Segments The businesses comprising the Media Group operate in four industry segments, as defined in SFAS No. 14, "Financial Reporting for Segments of a Business Enterprise," consisting of directory and information services, wireless communications, cable and telecommunications and the capital assets segment, which is held for sale.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Prior to January 1, 1995, the capital assets segment was accounted for as discontinued operations. Effective January 1, 1995, the capital assets segment has been accounted for as a net investment in assets held for sale, as discussed in Note 20 to the Media Group Combined Financial Statements.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents Cash and cash equivalents include highly liquid investments with original maturities of three months or less that are readily convertible into cash and are not subject to significant risk from fluctuations in interest rates.

Property, Plant and Equipment The investment in property, plant and equipment is carried at cost, less accumulated depreciation. Additions, replacements and substantial betterments are capitalized. All other repairs and maintenance costs are expensed as incurred.

Interest related to qualifying construction projects, including construction projects of equity method investees, is capitalized and reflected as a reduction of interest expense. Amounts capitalized by the Media Group were \$33, \$8 and \$5 in 1995, 1994 and 1993, respectively.

Depreciation is calculated using the straight-line method. When such depreciable property, plant and equipment is retired or sold, the resulting gain or loss is included in income.

Intangible Assets Intangible assets are recorded when the cost of acquired companies exceeds the fair value of their tangible assets. The costs of identified intangible assets and goodwill are amortized by the straight-line method over periods ranging from five to forty years. These assets are evaluated, with other related assets, for impairment using a discounted cash flow methodology.

Foreign Currency Translation Assets and liabilities of international investments are translated at year-end exchange rates, and income statement items are translated at average exchange rates for the year. Resulting translation adjustments are recorded as a separate component of equity. Gains and losses resulting from foreign currency transactions are included in income.

Financial Instruments Net interest received or paid on interest rate swaps is recognized over the life of the swaps as an adjustment to interest expense. Foreign exchange contracts designated as hedges of firm equity investment commitments are carried at market value, with gains and losses recorded in equity until sale of the investment. Forward contracts designated as hedges of foreign denominated loans are recorded at market value, with gains and losses recorded in income.

Investments in Debt Securities Debt securities are classified as available for sale and are carried at fair market value with unrealized gains and losses included in equity.

Revenue Recognition and Deferred Directory Costs Cellular access and cable television revenues are generally billed monthly, in advance, and revenues are recognized the following month when services are provided. Revenues derived from wireless airtime usage are billed and recorded monthly as services are provided.

Directory advertising revenues and related directory costs of selling, composition, printing and distribution are generally deferred and recognized over the period during which directories are used, normally 12 months. For international operations, directory advertising revenues and related directory costs are deferred and recognized upon publication.

Income Taxes The provision for income taxes consists of an amount for taxes currently payable and an amount for tax consequences deferred to future periods in accordance with SFAS No. 109. U S WEST

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

implemented SFAS No. 109, "Accounting for Income Taxes" in 1993. Adoption of the new standard did not have a material effect on the financial position or results of operations, primarily because of U S WEST's earlier adoption of SFAS No. 96.

New Accounting Standards In 1996, U S WEST will adopt SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." SFAS No. 121 requires that long-lived assets and associated intangibles be written down to fair value whenever an impairment review indicates that the carrying value cannot be recovered on an undiscounted cash flow basis. SFAS No. 121 also requires that a company no longer record depreciation expense on assets held for sale. U S WEST expects that the adoption of SFAS No. 121 will not have a material effect on its financial position or results of operations.

In 1996, U S WEST will adopt SFAS No. 123, "Accounting for Stock-Based Compensation." This standard establishes a fair value method for accounting for stock-based compensation plans either through recognition or disclosure. U S WEST will adopt this standard through compliance with the disclosure requirements set forth in SFAS No. 123. Adoption of the standard will have no impact on the financial position or results of operations of U S WEST.

NOTE 3: RELATED PARTY TRANSACTIONS

Customer Lists, Billing and Collection, and Other Services The domestic publishing operations purchase customer lists, billing and collection and other services from the Communications Group. The data and services are purchased at market price. The charges for these services were \$20, \$29 and \$26 in 1995, 1994 and 1993, respectively.

Telecommunications Services The domestic wireless operations purchase telecommunications network access and usage from the Communications Group. The charges for these services were \$40, \$30 and \$24 in 1995, 1994 and 1993, respectively.

NOTE 4: INDUSTRY SEGMENTS

Industry segment data is presented for the combined operations of the Media Group. U S WEST's equity method investments and the capital assets segment, which is held for sale, are included in "Corporate and other." Supplemental Media Group information on a proportionate basis is presented in Management's Discussion and Analysis of Financial Condition and Results of Operations.

The directory and information services segment consists of the publishing of White and Yellow Pages telephone directories, database marketing services and interactive services in domestic and international markets. The wireless communications segment provides information products and services over wireless networks in 13 western and midwestern states. The cable and telecommunications segment was created with the December 6, 1994 acquisition of cable television systems in the Atlanta metropolitan area. (See Note 5 to the Media Group Combined Financial Statements.)

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 4: INDUSTRY SEGMENTS (Continued)

Industry segment financial information follows:

	Directory and Information Services ¹	Wireless Communications	Cable and Telecommunications ²	Corporate and other ³	Combined
1995					
Sales and other revenues	\$1,180	\$ 941	\$ 215	\$ 38	\$2,374
Operating income (loss)	398	147	23	(101)	467
Identifiable assets	58 ⁴	1,439	1,466	5,127	8,615
Depreciation and amortization . .	36	121	77	15	249
Capital expenditures	37	277	64	23	401
1994					
Sales and other revenues	1,075	781	18	34	1,908
Operating income (loss) from continuing operations	396	88	—	(95)	389
Identifiable assets	613	1,286	1,459	4,036	7,394
Depreciation and amortization . .	30	102	6	6	144
Capital expenditures	42	274	2	25	343
1993					
Sales and other revenues	956	561	—	32	1,549
Operating income (loss) from continuing operations ⁴	356	(29)	—	(89)	238
Identifiable assets	450	1,175	—	3,821	5,446
Depreciation and amortization . .	16	104	—	7	127
Capital expenditures	32	175	—	8	215

¹ Includes revenue from directory publishing activities in Europe of \$122, \$78 and \$7, operating losses of \$(1), \$(1) and \$(3), and identifiable assets of \$133, \$124 and \$4 for 1995, 1994 and 1993, respectively.

² Results of operations have been included since the date of acquisition of the Atlanta Systems.

³ Includes U S WEST's equity method investments and the capital assets segment, which has been discontinued and is held for sale.

⁴ Includes pretax restructuring charges of \$50 and \$70 for the directory and information services and wireless communications segments, respectively.

Operating income represents sales and other revenues less operating expenses, and excludes interest expense, equity losses in unconsolidated ventures, other income and income taxes. Identifiable assets are those assets used in each segment's operations. Corporate and other assets consist primarily of cash, debt securities, investments in international ventures, the investment in Time Warner Entertainment, the net investment in assets held for sale and other assets. Corporate and other operating losses include general corporate expenses and administrative costs primarily associated with the Media Group equity investments.

To ensure consistency and quality of service, the wireless segment uses Motorola as its primary vendor for infrastructure equipment and cellular mobile telephone equipment and accessories. In addition, Motorola provides ongoing technological support for the infrastructure equipment. The infrastructure of approximately 75 percent of the Media Group's major cellular markets is comprised of Motorola equipment.

During 1994, U S WEST signed a definitive agreement with AirTouch Communications to combine their domestic cellular assets. The initial equity ownership of this cellular joint venture will be approximately 70 percent AirTouch and approximately 30 percent Media Group. The combination will take place in two phases. During Phase I, which U S WEST entered effective November 1, 1995, the two companies are operating their cellular properties separately. A Wireless Management Company (the "WMC") has been formed and is providing centralized services to both companies on a contract basis. In Phase II, AirTouch

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 4: INDUSTRY SEGMENTS (Continued)

and U S WEST will contribute their domestic cellular assets to the WMC. In this phase, the Media Group will reflect its share of the combined operating results of the WMC using the equity method of accounting. The recent passage of the Telecommunications Act of 1996 has removed significant regulatory barriers to completion of Phase II of the business combination. U S WEST expects that Phase II closing could take place by the end of 1996 or early 1997.

NOTE 5: ACQUISITION OF CABLE SYSTEMS

Atlanta Systems On December 6, 1994, U S WEST acquired the stock of Wometco Cable Corp. and subsidiaries, and the assets of Georgia Cable Partners and Atlanta Cable Partners L.P. (the "Atlanta Systems"), for cash of \$745 and 12,779,206 U S WEST common shares valued at \$459, for a total purchase price of approximately \$1.2 billion. The Atlanta Systems' results of operations have been included in the combined results of operations of the Media Group since the date of acquisition. Had the acquisition occurred as of January 1, 1994, the Media Group revenue and net income for 1994 would have been \$2,098 and \$265, respectively.

The acquisition was accounted for using the purchase method. Accordingly, the purchase price was allocated to assets acquired (primarily identified intangibles) based on their estimated fair values. The identified intangibles and goodwill are being amortized on a straight-line basis over 25 years.

Continental Cablevision, Inc. (Subsequent Event) On February 27, 1996, U S WEST announced a definitive agreement to merge with Continental Cablevision, Inc. ("Continental"). Continental, the nation's third-largest cable operator, serves 4.2 million domestic customers, passes more than seven million domestic homes and holds significant other domestic and international properties. U S WEST will purchase all of Continental's stock for approximately \$5.3 billion and will assume Continental's debt and other obligations, which amount to approximately \$5.5 billion. Consideration for the \$5.3 billion in equity will consist of approximately \$1 billion in U S WEST preferred stock, convertible to Media Stock; and, at U S WEST's option, between \$1 billion and \$1.5 billion in cash, and \$2.8 billion to \$3.3 billion in shares of Media Stock. The transaction, which is expected to close in the fourth quarter of 1996, is subject to a number of conditions and approvals, including approvals from Continental shareholders and local franchising and government authorities.

NOTE 6: INVESTMENT IN TIME WARNER ENTERTAINMENT

On September 15, 1993, U S WEST acquired 25.51 percent pro-rata priority capital and residual equity interests ("equity interests") in Time Warner Entertainment Company L.P. ("TWE" or "Time Warner Entertainment") for an aggregate purchase price of \$2.553 billion. TWE owns and operates substantially all of the entertainment assets previously owned by Time Warner Inc. ("Time Warner"), consisting primarily of its filmed entertainment, programming-HBO and cable businesses.

Upon U S WEST's admission to the partnership, certain wholly-owned subsidiaries of Time Warner ("General Partners") and subsidiaries of Toshiba Corporation and ITOCHU Corporation held pro-rata priority capital and residual equity interests of 63.27, 5.61 and 5.61 percent, respectively. In 1995, Time Warner acquired the limited partnership interests previously held by subsidiaries of each of ITOCHU Corporation and Toshiba Corporation.

U S WEST has an option to increase its pro-rata priority capital and residual equity interests in TWE from 25.51 percent up to 31.84 percent depending upon cable operating performance. The option is exercisable, in whole or part, between January 1, 1999, and May 31, 2005, for an aggregate cash exercise price ranging from \$1.25 billion to \$1.8 billion, depending upon the year of exercise. Either TWE or U S WEST may elect that the exercise price for the option be paid with partnership interests rather than cash.

Pursuant to the TWE Partnership Agreement, there are four levels of capital. From the most to least senior, the capital accounts are: senior preferred (held by the General Partners); pro-rata priority capital (A

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 6: INVESTMENT IN TIME WARNER ENTERTAINMENT (Continued)

preferred - held pro-rata by the general and limited partners); junior priority capital (B preferred - held by the General Partners); and common (residual equity interests held pro-rata by the general and limited partners). Of the \$2.553 billion contributed by U S WEST, \$1.658 billion represents A preferred capital and \$895 represents common capital. The TWE Partnership Agreement provides for special allocations of income and distributions of partnership capital. Partnership income, to the extent earned, is allocated as follows: (1) to the partners so that the economic burden of the income tax consequences of partnership operations is borne as though the partnership was taxed as a corporation ("special tax allocations"); (2) to the partners' preferred capital accounts in order of priority described above, at various rates of return ranging from 8 percent to 13.25 percent; and (3) to the partners' common capital according to their residual partnership interests. To the extent partnership income is insufficient to satisfy all special allocations in a particular accounting period, the unearned portion is carried over until satisfied out of future partnership income. Partnership losses generally are allocated in reverse order, first to eliminate prior allocations of partnership income, except senior preferred and special tax income, next to reduce initial capital amounts, other than senior preferred, then to reduce the senior preferred account and finally, to eliminate special tax allocations.

A summary of the contributed capital and priority capital rates of return follows:

Priority of Contributed Capital	Contributed Capital ^a	Priority Capital Rates of Return ^b (% per annum compounded quarterly)	Time Warner General Partners	Limited Partners	
				Time Warner (ownership %)	U S WEST
Senior preferred	\$1,400 ^c	8.00%	100.00%	—	—
Pro-rata priority capital	5,600	13.00% ^d	63.27%	11.22%	25.51%
Junior priority capital	2,900 ^e	13.25% ^f	100.00%	—	—
Residual equity capital	3,300	—	63.27%	11.22%	25.51%

^a Estimated fair value of net assets contributed excluding partnership income or loss allocated thereto.

^b Income allocations related to priority capital rates of return are based on partnership income after any special tax allocations.

^c The senior preferred is scheduled to be distributed in three annual installments beginning July 1, 1997.

^d 11.00 percent to the extent concurrently distributed.

^e Includes \$300 for the September 1995 reacquisition of assets previously excluded from the partnership (the Time Warner service partnership assets) for regulatory reasons.

^f 11.25 percent to the extent concurrently distributed.

Cash distributions are required to be made to the partners to permit them to pay income taxes at statutory rates based on their allocable taxable income from TWE ("Tax Distributions"). The aggregate amount of such Tax Distributions is computed generally by reference to the taxes that TWE would have been required to pay if it were a corporation. Tax Distributions were previously subject to restrictions until July 1995, and are now paid to the partners on a current basis. For distributions other than those related to taxes or the senior preferred, the TWE Partnership Agreement requires certain cash distribution thresholds be met to the limited partners before the General Partners receive their full share of distributions. No cash distributions have been made to U S WEST.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 6: INVESTMENT IN TIME WARNER ENTERTAINMENT (Continued)

U S WEST accounts for its investment in TWE under the equity method of accounting. The excess of fair market value over the book value of total partnership net assets implied by U S WEST's initial investment was \$5.7 billion. This excess is being amortized on a straight-line basis over 25 years. The Media Group's recorded share of TWE operating results represents allocated TWE net income or loss adjusted for the amortization of the excess of fair market value over the book value of the partnership net assets. As a result of this amortization and the special income allocations described above, the Media Group's recorded pretax share of TWE operating results before extraordinary item was \$(31), \$(18) and \$(20) in 1995, 1994 and 1993, respectively. In addition, TWE recorded an extraordinary loss for the early extinguishment of debt in 1995. The Media Group's share of this extraordinary loss was \$4, net of an income tax benefit of \$2.

As consideration for its expertise and participation in the cable operations of TWE, the Media Group earns a management fee of \$130 over five years, which is payable over a four-year period beginning in 1995. Management fees of \$26, \$26 and \$8 were recorded to other income in 1995, 1994 and 1993, respectively. The Media Group Combined Balance Sheet includes a note payable to TWE of \$169 and \$771 and management fee receivables of \$50 and \$34 at December 31, 1995 and 1994, respectively.

Summarized financial information for TWE is presented below:

Summarized Operating Results	Year Ended December 31,		
	1995	1994	1993
Revenues	\$9,517	\$8,460	\$7,946
Operating expenses ¹	8,557	7,612	7,063
Interest and other expense, net ²	777	647	611
Income before income taxes and extraordinary item	\$ 183	\$ 201	\$ 272
Income before extraordinary item	97	161	208
Net income	\$ 73	\$ 161	\$ 198

¹ Includes depreciation and amortization of \$1,039, \$943 and \$902 in 1995, 1994 and 1993, respectively.

² Includes corporate services of \$64, \$60 and \$60 in 1995, 1994 and 1993, respectively.

Summarized Financial Position	Year Ended December 31,	
	1995	1994
Current assets ³	\$ 2,909	\$ 3,573
Noncurrent assets ⁴	15,996	15,089
Current liabilities	3,214	2,857
Noncurrent liabilities, including minority interest	7,787	7,909
Senior preferred capital	1,426	1,663
Partners' capital ^{5,6}	6,478	6,233

³ Includes cash of \$209 and \$1,071 at December 31, 1995 and 1994, respectively.

⁴ Includes a loan receivable from Time Warner of \$400 at December 31, 1995 and 1994.

⁵ Net of a note receivable from U S WEST of \$169 and \$771 at December 31, 1995 and 1994, respectively.

⁶ Contributed capital is based on the estimated fair value of the net assets that each partner contributed to the partnership. The aggregate of such amounts is significantly higher than TWE's partner's capital as reflected in the Summarized Financial Position, which is based on the historical cost of the contributed net assets.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 6: INVESTMENT IN TIME WARNER ENTERTAINMENT (Continued)

In early 1995, Time Warner announced its intention to simplify its corporate structure by establishing an enterprise that will be responsible for the overall management and financing of the cable and telecommunications properties. Any change in the structure of TWE would require U S WEST's approval in addition to certain creditors' and regulatory approvals.

Contingencies

On September 22, 1995, U S WEST filed a lawsuit in Delaware Chancery Court to enjoin the proposed merger of Time Warner and Turner Broadcasting. U S WEST has alleged breaches of contract and fiduciary duties by Time Warner in connection with this proposed merger. Time Warner filed a countersuit against U S WEST on October 11, 1995, alleging misrepresentation, breach of contract and other misconduct on the part of U S WEST. Time Warner's countersuit seeks a reformation of the Time Warner Entertainment partnership agreement, an order that enjoins U S WEST from breaching the partnership agreement, and unspecified compensatory damages. U S WEST has denied each of the claims in Time Warner's countersuit. The trial for this action concluded on March 22, 1996. A ruling by the Delaware Chancery Court is expected in June 1996.

NOTE 7: INVESTMENTS IN INTERNATIONAL VENTURES

The significant investments in international ventures follows:

Venture	Location	Line of Business	Ownership Percentage	Net Investment at December 31,	
				1995	1994
TeleWest	United Kingdom	C&T	26.8	\$ 540	\$ 456
Binariang Sdn Bhd ...	Malaysia	C&T	20	224	50
A2000 (KTA)	Netherlands	C&T	50	218	—
One 2 One	United Kingdom	W	50	73	123
All other				456	252
Total				<u>\$1,511</u>	<u>\$ 881</u>

CAT Cable and Telecommunications

* Wireless

The following table shows summarized combined financial information for the Media Group's significant equity method investments in international ventures:

Combined Operations	Year Ended December 31,		
	1995	1994	1993
Revenue	\$1,163	\$ 580	\$ 296
Operating expenses	1,264	684	354
Depreciation and amortization	272	140	60
Operating loss	(373)	(244)	(118)
Interest and other, net	(141)	(75)	(40)
Loss before extraordinary item	(514)	(319)	(158)
Extraordinary gain — interest rate swaps	—	11	—
Net loss	<u>\$ (514)</u>	<u>\$ (308)</u>	<u>\$ (158)</u>

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 7: INVESTMENTS IN INTERNATIONAL VENTURES (Continued)

<u>Combined Financial Position</u>	<u>Year Ended December 31,</u>	
	<u>1995</u>	<u>1994</u>
Current assets	\$1,469	\$ 714
Property, plant and equipment — net	3,545	1,462
Other assets	1,644	343
Total assets	<u>\$6,658</u>	<u>\$2,519</u>
Current liabilities	\$1,260	\$ 344
Long-term debt	2,065	463
Other liabilities	58	71
Owners' equity	3,275	1,641
Total liabilities and equity	<u>\$6,658</u>	<u>\$2,519</u>

In November 1994, TeleWest plc ("TeleWest") made an initial public offering of its ordinary shares. Following the offering, in which U S WEST sold part of its 50 percent joint venture interest, U S WEST owned approximately 37.8 percent of TeleWest. Net proceeds of approximately \$650 were used by TeleWest to finance construction and operating costs, invest in affiliated companies and repay debt. It is U S WEST's policy to recognize as income any gains or losses related to the sale of stock to the public. The Media Group recognized a gain of \$105 in 1994, net of \$59 in deferred taxes, for the partial sale of its joint venture interest in TeleWest.

On October 2, 1995, TeleWest and SBC CableComms (UK) completed a merger of their UK cable television and telecommunications interests, creating the largest provider of combined cable and telecommunications services in the United Kingdom. Following completion of the merger, U S WEST and TeleCommunications, Inc., the major shareholders, each own 26.8 percent of the combined company. The Media Group recognized a gain of \$95 in 1995, net of \$62 in deferred income taxes, in conjunction with the merger.

TeleWest, which is the only equity method investment for which a quoted market price is available, had a market value of \$914 at December 31, 1995, and \$1,004 at December 31, 1994.

Foreign Currency Transactions U S WEST enters into forward and zero-cost combination option contracts to manage foreign currency risk. Under a forward contract, U S WEST agrees with another party to exchange a foreign currency and U.S. dollars at a specified price at a future date. Under combination options, U S WEST combines purchased options to cap the foreign exchange rate to be paid at a future date with written options to finance the premium of the purchased options. The commitments, forward contracts and combination options are for periods up to one year.

Forward exchange contracts are carried at market value. Gains or losses on the portion of the contracts designated as hedges of firm equity investment commitments are deferred as a component of Media Group equity and are recognized in income upon sale of the investment. Gains or losses on the portion of the contracts designated to offset translation of investee net income are recorded in income.

Forward contracts are also used to hedge foreign denominated loans. These contracts are carried at market value with gains or losses recorded in income.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 7: INVESTMENTS IN INTERNATIONAL VENTURES (Continued)

Foreign exchange contracts outstanding follow:

	Type	U.S. Equivalent December 31.	
		1995	1994
Forwards:			
Dutch Guilders	Buy	\$225	\$—
British pounds	Buy	130	135
British pounds	Sell	37	—
Japanese yen	Buy	25	—
French francs	Buy	19	—
Combination options:			
British pounds	—	\$—	\$ 35
French francs	—	20	—

Cumulative deferred gains on foreign exchange contracts of \$9 and deferred losses of \$25, including deferred taxes (benefits) of \$4 and (\$10), respectively, are included in Media Group equity at December 31, 1995. Cumulative deferred gains on foreign exchange contracts of \$7 and deferred losses of \$25, including deferred taxes (benefits) of \$3 and (\$10), respectively, are included in Media Group equity at December 31, 1994.

The counterparties to these contracts are major financial institutions. U S WEST is exposed to credit loss in the event of nonperformance by these counterparties. The Company does not have significant exposure to an individual counterparty and does not anticipate nonperformance by any counterparty.

NOTE 8: PROPERTY, PLANT AND EQUIPMENT

The composition of property, plant and equipment follows:

	December 31.	
	1995	1994
Land and buildings	\$ 168	\$ 151
Cellular systems	733	585
Cable distribution systems	167	148
General purpose computers and other	471	412
Construction in progress	167	140
	<u>1,706</u>	<u>1,436</u>
Less accumulated depreciation	558	480
Property, plant and equipment — net	<u>\$1,148</u>	<u>\$ 956</u>

The Media Group depreciates buildings between 15 to 35 years, cellular and cable distribution systems between 5 to 15 years, and general purpose computer and other between 3 to 20 years.

Depreciation expense was \$173, \$121, and \$113 in 1995, 1994 and 1993, respectively.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 9: INTANGIBLE ASSETS

The composition of intangible assets follows:

	December 31,	
	1995	1994
Identified intangibles, primarily franchise value	\$1,183	\$1,166
Goodwill	743	762
	1,926	1,928
Less accumulated amortization	128	70
Total intangible assets — net	<u>\$1,798</u>	<u>\$1,858</u>

Amortization expense was \$76, \$23 and \$14 in 1995, 1994 and 1993, respectively.

NOTE 10: RESTRUCTURING CHARGE

The Media Group's 1993 results reflected a \$120 restructuring charge (pretax) of which \$50 related to the directory and information services segment and \$70 related to the wireless segment. The restructuring charge includes only specific, incremental and direct costs which can be estimated with reasonable accuracy and are clearly identifiable with the restructuring plan.

Following is a schedule of the costs included in the 1993 restructuring charge and amounts remaining at December 31, 1995 and 1994:

	Restructuring Charge	Balance at December 31,	
		1995	1994
Asset write-down and other	\$ 70	\$—	\$—
System development	40	15	30
Employee separation costs and other	10	6	10
Total	<u>\$120</u>	<u>\$ 21</u>	<u>\$ 40</u>

During 1993, the Media Group's wireless subsidiary replaced substantially all of its cellular network equipment, consisting primarily of cell site electronics and switching equipment, in certain of its major market areas.

System development costs includes the replacement of existing, single-purpose systems used in the publishing businesses with new systems designed to provide integrated, end-to-end customer service. Other costs consist primarily of employee separation costs including severance payments, health care coverage and postemployment education benefits and relocation costs. The Media Group expects the restructuring to be substantially completed by the end of 1996. Management does not anticipate any material revisions in total estimated expenditures. However, should expenditures exceed the remaining reserve, additional amounts would be expensed as incurred.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 11: DEBT

Short-term Debt

The components of short-term debt follow:

	December 31,	
	1995	1994
Notes payable:		
Commercial paper	\$ 203	\$ 868
Bank loan	216	—
Current portion of long-term debt	568	561
Allocated to the capital assets segment — net	(151)	(200)
Total	<u>\$ 836</u>	<u>\$1,229</u>

The weighted average interest rate on commercial paper was 5.79 percent and 6.04 at December 31, 1995 and 1994, respectively.

The bank loan, in the translated principal amount of \$216, is denominated in Dutch guilders. The loan was entered into in connection with U S WEST's investment in a cable television venture in the Netherlands and was repaid in February 1996.

U S WEST maintains a commercial paper program to finance short-term cash flow requirements, as well as to maintain a presence in the short-term debt market. Additional lines of credit aggregating approximately \$1.3 billion are available to the Media Group as well as the nonregulated subsidiaries of the Communications Group in accordance with their borrowing needs. The Media Group expects that cash from operations will not be adequate to fund expected cash requirements. Additional financing will come primarily from new debt.

Long-term Debt

Interest rates and maturities of long-term debt at December 31 follow:

Interest rates	Maturities					Total	Total
	1997	1998	1999	2000	Thereafter	1995	1994
Up to 5%	\$—	\$—	\$—	\$—	\$—	\$—	\$ 271
Above 5% to 6%	—	130	—	—	—	130	13
Above 6% to 7%	—	—	55	106	857	1,018	—
Above 7% to 8%	—	—	—	—	737	737	1,057
Above 8% to 9%	—	—	107	—	40	147	194
Above 9% to 10%	29	—	15	25	10	79	79
Above 10%	1	1	—	—	—	2	—
	<u>\$ 30</u>	<u>\$131</u>	<u>\$177</u>	<u>\$131</u>	<u>\$1,644</u>	<u>2,113</u>	<u>1,614</u>
Capital lease obligations and other						2	5
Unamortized discount — net						(494)	(524)
Allocated to the capital assets segment — net						(356)	(510)
Total						<u>\$1,265</u>	<u>\$ 585</u>

Long-term debt consists principally of debentures, medium-term notes, debt associated with U S WEST's Leveraged Employee Stock Ownership Plans ("LESOP"), and zero coupon subordinated notes convertible at any time into equal shares of Communications Stock and Media Stock. The zero coupon notes have a yield to maturity of approximately 7.3 percent and are recorded at a discounted value of \$245 and \$234 at December 31, 1995 and 1994, respectively.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 11: DEBT (Continued)

In 1995, U S WEST issued \$130 of Debt Exchangeable for Common Stock ("DECS"), due December 15, 1998 in the principal amount of \$24.00 per note. The notes bear interest at 7.625 percent, of which 1.775 percent has been included in the assets held for sale reserve. Upon maturity, each DECS will be mandatorily redeemed by U S WEST for shares of Enhance Financial Services Group, Inc. ("Enhance") held by U S WEST or the cash equivalent at U S WEST's option. The number of shares to be delivered at maturity varies based on the per share market price of Enhance. If the market price is \$24.00 per share or less, one share of Enhance will be delivered for each note; if the market price is between \$24.00 and \$28.32 per share, a fractional share equal to \$24.00 is delivered; if the market value is greater than \$28.32 per share, .8475 shares are delivered. The capital assets segment currently owns approximately 31.5 percent of the outstanding Enhance common stock.

At December 31, 1995, U S WEST guaranteed debt in the principal amount of approximately \$140, primarily related to international ventures.

Interest payments, net of amounts capitalized, were \$140, \$167 and \$272 for 1995, 1994 and 1993, respectively, of which \$87, \$134 and \$272, respectively, relate to the capital assets segment.

Interest Rate Risk Management

Interest rate swap agreements are used to effectively convert existing commercial paper to fixed-rate debt. This allows U S WEST to achieve interest savings over issuing fixed-rate debt directly.

Under an interest rate swap, U S WEST agrees with another party to exchange interest payments at specified intervals over a defined term. Interest payments are calculated by reference to the notional amount based on the fixed- and variable-rate terms of the swap agreements. The net interest received or paid as part of the interest rate swap is accounted for as an adjustment to interest expense.

The following table summarizes terms of swaps. Variable rates are indexed to the 30-day commercial paper rate.

December 31.								
1995					1994			
Notional Amount	Maturities	Weighted Average Rate			Notional Amount	Maturities	Weighted Average Rate	
		Receive	Pay				Receive	Pay
Variable to fixed	\$ 55	1997-2004	5.85	9.30	\$ 75	1995-2004	6.06	9.17
Fixed to variable	—	—	—	—	5	1995	6.61	5.87

The counterparties to these interest rate contracts are major financial institutions. The Media Group is exposed to credit loss in the event of nonperformance by these counterparties. U S WEST manages this exposure by monitoring the credit standing of the counterparty and establishing dollar and term limitations which correspond to the respective credit rating of each counterparty. U S WEST does not have significant exposure to an individual counterparty and does not anticipate nonperformance by any counterparty.

NOTE 12: FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair values of cash equivalents, other current amounts receivable and payable, and short-term debt approximate carrying values due to their short-term nature.

The fair values of mandatorily redeemable preferred stock and long-term receivables, based on discounting future cash flows, approximate the carrying values. The fair value of foreign exchange contracts, based on estimated amounts U S WEST would receive or pay to terminate such agreements, approximate the carrying values. It is not practicable to estimate the fair value of financial guarantees associated with international operations because there are no quoted market prices for similar transactions.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 12: FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The fair values of interest rate swaps, including swaps associated with the capital assets segment, are based on estimated amounts U S WEST would receive or pay to terminate such agreements taking into account current interest rates and creditworthiness of the counterparties.

The fair values of long-term debt, including debt associated with the capital assets segment, preferred securities and preferred stock, are based on quoted market prices where available or, if not available, are based on discounting future cash flows using current interest rates.

	December 31,			
	1995		1994	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Debt (includes short-term portion)	\$2,897	\$3,000	\$3,097	\$3,100
Interest rate swap agreements — assets	—	(13)	—	—
Interest rate swap agreements — liabilities	—	34	—	20
Debt — net	<u>\$2,897</u>	<u>\$3,021</u>	<u>\$3,097</u>	<u>\$3,120</u>
Preferred Securities	\$ 600	\$ 636	\$ —	\$ —
Preferred stock	51	55	51	51

Investments in debt securities are classified as available for sale and are carried at market value. These securities have various maturity dates through the year 2001. The market value of these securities is based on quoted market prices where available or, if not available, is based on discounting future cash flows using current interest rates.

The amortized cost and estimated market value of debt securities follow:

Debt Securities	December 31,							
	1995				1994			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate debt	\$20	\$—	\$—	\$20	\$19	\$—	\$—	\$19
Securitized loan	55	—	(5)	50	—	—	—	—
Total	<u>\$75</u>	<u>\$—</u>	<u>\$ (5)</u>	<u>\$70</u>	<u>\$19</u>	<u>\$—</u>	<u>\$—</u>	<u>\$19</u>

The 1995 net unrealized losses of \$3 (net of a deferred tax benefit of \$2) are included in Media Group equity.

NOTE 13: LEASING ARRANGEMENTS

U S WEST has entered into operating leases for office facilities, equipment and real estate. Rent expense under operating leases was \$60, \$63 and \$57 in 1995, 1994 and 1993, respectively. Minimum future lease payments as of December 31, 1995, under noncancelable operating leases, follow:

Year	
1996	\$ 55
1997	49
1998	43
1999	33
2000	24
Thereafter	83
Total	<u>\$287</u>

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

**NOTE 14: COMPANY-OBLIGATED MANDATORILY REDEEMABLE PREFERRED SECURITIES
OF SUBSIDIARY TRUST HOLDING SOLELY COMPANY-GUARANTEED DEBENTURES**

On September 11, 1995, U S WEST Financing I, a wholly owned subsidiary of U S WEST ("Financing I"), issued \$600 million of 7.96 percent Trust Originated Preferred Securities (the "Preferred Securities") and \$19 of common securities. U S WEST holds all of the outstanding common securities of Financing I. Financing I used the proceeds from such issuance to purchase from U S WEST Capital Funding, Inc., a wholly owned subsidiary of U S WEST ("Capital Funding"), \$619 principal amount of Capital Funding's 7.96 percent Subordinated Deferrable Interest Notes due 2025 (the "Subordinated Debt Securities"), the obligations under which are fully and unconditionally guaranteed by U S WEST (the "Debt Guarantee"). The sole assets of Financing I are and will be the Subordinated Debt Securities and the Debt Guarantee.

In addition, U S WEST has guaranteed the payment of interest and redemption amounts to holders of Preferred Securities when Financing I has funds available for such payments (the "Payment Guarantee") as well as Capital Funding's undertaking to pay all of Financing I's costs, expenses and other obligations (the "Expense Undertaking"). The Payment Guarantee and the Expense Undertaking, including U S WEST's guarantee with respect thereto, considered together with Capital Funding's obligations under the indenture and Subordinated Debt Securities and U S WEST's obligations under the indenture, declaration and Debt Guarantee, constitute a full and unconditional guarantee by U S WEST of Financing I's obligations under the Preferred Securities. The interest and other payment dates on the Subordinated Debt Securities correspond to the distribution and other payment dates on the Preferred Securities. Under certain circumstances, the Subordinated Debt Securities may be distributed to the holders of Preferred Securities and common securities in liquidation of Financing I. The Subordinated Debt Securities are redeemable in whole or in part by Capital Funding at any time on or after September 11, 2000, at a redemption price of \$25.00 per Subordinated Debt Security plus accrued and unpaid interest. If Capital Funding redeems the Subordinated Debt Securities, Financing I is required to redeem the Preferred Securities concurrently at \$25.00 per share plus accrued and unpaid distributions. As of December 31, 1995, 24,000,000 Preferred Securities were outstanding.

NOTE 15: PREFERRED STOCK SUBJECT TO MANDATORY REDEMPTION

On September 2, 1994, the Company issued to Fund American Enterprises Holdings Inc. ("FAEC") 50,000 shares of a class of 7 percent Series C Cumulative Redeemable Preferred Stock for a total of \$50. (See Note 20 to the Combined Financial Statements.) The preferred stock was attributed to the Media Group and was recorded at fair market value of \$51 at the issue date. U S WEST has the right, commencing five years from September 2, 1994, to redeem the shares for one thousand dollars per share plus unpaid dividends and a redemption premium. The shares are mandatorily redeemable in year ten at face value plus unpaid dividends. At the option of FAEC, the preferred stock also can be redeemed for common shares of Financial Security Assurance, an investment held by the capital assets segment. The market value of the option was \$20 and \$22 (based on the Black-Scholes Model) at December 31, 1995 and 1994, with no carrying value.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 16: MEDIA GROUP EQUITY

Following are the changes in Media Group equity:

	December 31,		
	1995	1994	1993
Balance at beginning of period	\$4,203	\$3,139	\$2,265
Net income	141	276	3
Equity issuances prior to recapitalization	37	790	786
Media stock issuances	7	—	—
Market value adjustment for debt securities	36	(64)	35
Foreign currency translation	(9)	6	(1)
Company LESOP guarantee	60	56	51
Preferred dividends	(3)	—	—
Balance at end of period	<u>\$4,472</u>	<u>\$4,203</u>	<u>\$3,139</u>

U S WEST has issued 392,000 shares of Media Stock since the November 1, 1995 recapitalization and has 472,314,000 shares outstanding at December 31, 1995.

Included in Media Group equity is the cumulative foreign currency translation adjustment of \$(38), \$(29) and \$(35) at December 31, 1995, 1994 and 1993, respectively, net of income tax benefits of \$24, \$18 and \$9, respectively.

Leveraged Employee Stock Ownership Plan ("LESOP")

The Media Group and the Communications Group participate in the defined contribution savings plan sponsored by U S WEST. Employees of the Media Group are covered by the plan except for Atlanta Systems and foreign national employees. U S WEST matches a percentage of eligible employee contributions with shares of Media Stock and/or Communications Stock in accordance with participant elections. Participants may also elect to reallocate past company contributions between Media Stock and Communications Stock. In 1989, U S WEST established two LESOPs to provide Company stock for matching contributions to the savings plan. Shares in the LESOP are released as principal and interest are paid on the debt. At December 31, 1995, 10,145,485 shares each of Media Stock and Communications Stock had been allocated from the LESOP to participants accounts while 2,839,435 shares each of Media Stock and Communications Stock remained unallocated.

The borrowings associated with the LESOP, which are unconditionally guaranteed by U S WEST, are included in the accompanying Media Group Combined Financial Statements. Contributions from the Communications Group and the Media Group as well as dividends on unallocated shares held by the LESOP (\$8, \$11 and \$14 in 1995, 1994, and 1993, respectively) are used for debt service. Beginning with the dividend paid in fourth-quarter 1995, dividends on allocated shares are being paid annually to participants. Previously, dividends on allocated shares were used for debt service with participants receiving additional shares from the LESOP. Tax benefits related to dividend payments on eligible shares in the savings plan have been allocated to the Communications Group, which paid the dividends.

U S WEST recognizes expense based on the cash payments method. Contributions to the plan related to the Media Group were \$16, \$12, and \$7 in 1995, 1994 and 1993, respectively, of which \$3, \$3 and \$4, respectively, have been classified as interest expense.

NOTE 17: STOCK INCENTIVE PLANS

U S WEST maintains stock incentive plans for executives and key employees, and nonemployees. The Amended 1994 Stock Plan (the "Plan") was approved by shareowners on October 31, 1995 in connection with the Recapitalization Plan. The Plan is a successor plan to the U S WEST, Inc. Stock Incentive Plan and the U S WEST 1991 Stock Incentive Plan (the "Predecessor Plans"). No further grants of options or

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 17: STOCK INCENTIVE PLANS (Continued)

restricted stock may be made under the Predecessor Plans. The Plan is administered by the Human Resources Committee of the board of directors with respect to officers, executive officers and outside directors and by a special committee with respect to all other eligible employees and eligible nonemployees.

During calendar year 1995, up to 1,485,000 shares of Media Stock were available for grant. The maximum aggregate number of shares of Media Stock that may be granted in any other calendar year for all purposes under the Plan is three-quarters of one percent (0.75 percent) of the shares of such class outstanding (excluding shares held in the Company's treasury) on the first day of such calendar year. In the event that fewer than the full aggregate number of shares of either class available for issuance in any calendar year are issued in any such year, the shares not issued shall be added to the shares of such class available for issuance in any subsequent year or years. Options may be exercised no later than 10 years after the date on which the option was granted.

Data for outstanding options under the Plan is summarized as follows:

	Media Group		U S WEST Inc.	
	Number of Shares	Average Option Price	Number of Shares*	Average Option Price
Outstanding January 1, 1993			4,450,150	\$ 35.81
Granted			1,486,106	48.83
Exercised			(412,444)	31.73
Canceled or expired			(222,273)	36.87
Outstanding December 31, 1993			5,301,539	\$ 39.76
Granted			2,438,409	36.15
Exercised			(139,762)	33.72
Canceled or expired			(214,149)	40.71
Outstanding December 31, 1994			7,386,037	\$ 38.66
Granted			3,062,920	43.63
Exercised			(430,631)	34.03
Canceled or expired			(175,147)	39.76
Outstanding October 31, 1995			9,843,179	\$ 40.39
Recapitalization Plan	9,843,179	\$16.28	(9,843,179)	\$(40.39)
Granted	71,580	18.51		
Exercised	(191,243)	14.71		
Canceled or expired	(15,350)	16.82		
Outstanding December 31, 1995	9,708,166	\$16.33	—	—

* Includes options granted in tandem with SARs.

Options to purchase 3,021,166 shares of Media Stock were exercisable at December 31, 1995. Options to purchase 2,374,394 shares of U S WEST stock were exercisable at December 31, 1994. A total of 1,419,795 shares of Media Stock were available for grant under the plans in effect at December 31, 1995. A total of 914,816 shares of U S WEST common stock were available for grant under the plans in effect at December 31, 1994. A total of 11,121,186 shares of Media Stock were reserved for issuance under the Plan at December 31, 1995.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 18: EMPLOYEE BENEFITS

Pension Plan

The Communications Group and the Media Group participate in the defined benefit pension plan sponsored by U S WEST. The employees of the Media Group are covered by the plan except for Atlanta Systems and foreign national employees. Since plan assets are not segregated into separate accounts or restricted to providing benefits to employees of the Media Group, assets of the plan may be used to provide benefits to employees of both the Communications Group and the Media Group. In the event the single employer pension plan sponsored by U S WEST would be separated into two or more plans, guidelines in the Internal Revenue Code dictate how assets of the plan must be allocated to the new plans. U S WEST currently has no intentions to split the plan. Because of these factors, U S WEST believes there is no reasonable basis to attribute plan assets to the Media Group as if they had funded separately their actuarially determined obligation.

Management benefits are based on a final pay formula while occupational benefits are based on a flat benefit formula. U S WEST uses the projected unit credit method for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. The Company's policy is to fund amounts required under the Employee Retirement Income Security Act of 1974 ("ERISA") and no funding was required in 1995, 1994 or 1993. Should funding be required in the future, funding amounts would be allocated to the Media Group based upon the ratio of service cost of the Media Group to total service cost of plan participants.

The composition of the net pension cost and the actuarial assumptions of the plan follow:

	Year Ended December 31,		
	1995	1994	1993
Details of pension cost:			
Service cost — benefits earned during the period	\$ 173	\$ 197	\$ 148
Interest cost on projected benefit obligation	558	561	514
Actual return on plan assets	(1,918)	188	(1,320)
Net amortization and deferral	1,185	(946)	578
Net pension cost	\$ (2)	\$ 0	\$ (80)

The expected long-term rate of return on plan assets used in determining net pension cost was 8.50 percent for 1995, 8.50 percent for 1994 and 9.00 percent for 1993.

The funded status of the U S WEST plan follows:

	December 31,	
	1995	1994
Accumulated benefit obligation, including vested benefits of \$5,839 and \$5,044, respectively	\$ 6,617	\$ 5,616
Plan assets at fair value, primarily stocks and bonds	\$ 9,874	\$ 8,388
Less: Projected benefit obligation	8,450	7,149
Plan assets in excess of projected benefit obligation	1,424	1,239
Unrecognized net (gain) loss	(101)	161
Prior service cost not yet recognized in net periodic pension cost	(62)	(67)
Balance of unrecognized net asset at January 1, 1987	(705)	(785)
Prepaid pension cost	\$ 556	\$ 548

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 18: EMPLOYEE BENEFITS (Continued)

The actuarial assumptions used to calculate the projected benefit obligation follow:

	December 31,	
	1995	1994
Discount rate	7.00%	8.00%
Weighted average rate of compensation increase	5.50%	5.50%

Anticipated future benefit changes have been reflected in the above calculations.

Allocation of Pension Costs U S WEST's allocation policy is to 1) offset the company-wide service cost, interest cost and amortizations by the return on plan assets; and 2) allocate the remaining net pension cost to the Media Group based on the ratio of actuarially determined service cost of the Media Group to total service cost of plan participants. U S WEST believes allocating net pension cost based on service cost is reasonable since service cost is a primary factor in determining pension cost. Net pension costs allocated to the Media Group were \$0, \$0 and \$(9) in 1995, 1994 and 1993, respectively. The service and interest costs for 1995 and the projected benefit obligation at December 31, 1995 attributed to the Media Group were \$24, \$29 and \$429, respectively.

Postretirement Benefits Other Than Pensions

The Communications Group and the Media Group participate in plans sponsored by U S WEST which provide certain health care and life insurance benefits to retired employees. In conjunction with the Company's 1992 adoption of SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," the Company elected to immediately recognize the accumulated postretirement benefit obligation for current and future retirees.

U S WEST uses the projected unit credit method for the determination of postretirement medical and life costs for financial reporting purposes. The composition of net postretirement benefit costs and actuarial assumptions underlying plan benefits follow:

	Year Ended December 31,								
	1995			1994			1993		
	Medical	Life	Total	Medical	Life	Total	Medical	Life	Total
Service cost — benefits earned during the period	\$ 59	\$ 6	\$ 65	\$ 62	\$ 13	\$ 75	\$ 60	\$ 11	\$ 71
Interest on accumulated benefit obligation	235	32	267	221	39	260	235	36	271
Actual return on plan assets ...	(319)	(96)	(415)	3	1	4	(73)	(52)	(125)
Net amortization and deferral ..	228	58	286	(68)	(31)	(99)	27	22	49
Net postretirement benefit costs	<u>\$ 203</u>	<u>\$ 0</u>	<u>\$ 203</u>	<u>\$218</u>	<u>\$ 22</u>	<u>\$240</u>	<u>\$249</u>	<u>\$ 17</u>	<u>\$ 266</u>

The expected long-term rate of return on plan assets used in determining postretirement benefit costs was 8.50 percent for 1995, 8.50 percent in 1994 and 9.00 percent in 1993.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 18: EMPLOYEE BENEFITS (Continued)

The funded status of the plans follow:

	Year Ended December 31,					
	1995			1994		
	Medical	Life	Total	Medical	Life	Total
Accumulated postretirement benefit obligation attributable to:						
Retirees	\$ 1,866	\$ 271	\$ 2,137	\$1,733	\$ 248	\$ 1,981
Fully eligible plan participants	293	34	327	264	38	302
Other active plan participants	1,059	165	1,224	940	135	1,075
Total accumulated postretirement benefit obligation	3,218	470	3,688	2,937	421	3,358
Unrecognized net gain	378	161	539	243	90	333
Unamortized prior service cost	—	(34)	(34)	—	—	—
Fair value of plan assets, primarily stocks, bonds and life insurance ¹	(1,385)	(460)	(1,845)	(894)	(374)	(1,268)
Accrued postretirement benefit obligation	<u>\$ 2,211</u>	<u>\$ 137</u>	<u>\$ 2,348</u>	<u>\$2,286</u>	<u>\$ 137</u>	<u>\$ 2,423</u>

¹ Medical plan assets include Communications Stock of \$210 and Media Stock of \$112 in 1995 and U S WEST common stock of \$164 in 1994.

The actuarial assumptions used to calculate the accumulated postretirement benefit obligation follow:

	December 31,	
	1995	1994
Discount rate	7.00%	8.00%
Medical trend*	9.00%	9.70%

* Medical cost trend rate gradually declines to an ultimate rate of 5 percent in 2011.

A one-percent increase in the assumed health care cost trend rate for each future year would have increased the aggregate of the service and interest cost components of 1995 net postretirement benefit cost by approximately \$40 and increased the 1995 accumulated postretirement benefit obligation by approximately \$350.

Anticipated future benefit changes have been reflected in these postretirement benefit calculations.

Plan Assets Assets of the postretirement medical and life plans may be used to provide benefits to employees of both the Communications Group and the Media Group since plan assets are not legally restricted to providing benefits to either Group. In the event that either plan sponsored by U S WEST would be separated into two or more plans, there are no guidelines in the Internal Revenue Code for allocating assets of the plan. U S WEST allocates the assets based on historical contributions for postretirement medical costs, and on the ratio of salaries for life plan participants. U S WEST currently has no intention to split the plans.

Postretirement Medical Costs The service and interest components of net postretirement medical benefit costs are calculated for the Media Group based upon the population characteristics of the Group. Since funding of postretirement medical costs is voluntary, return on assets is attributed to the Media Group based upon historical funding. The Media Group has historically funded the maximum annual tax deductible contribution for management employees and the amount of annual expense for occupational employees. The Media Group periodically reviews its funding strategy and future funding amounts, if any, will be based upon the cash requirements of the Group.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 18: EMPLOYEE BENEFITS (Continued)

Net postretirement medical benefit costs recognized by the Media Group for 1995, 1994 and 1993 were \$14, \$11 and \$11, respectively. The percentage of postretirement medical assets attributed to the Media Group at December 31, 1995 and 1994, based upon historical voluntary contributions, was 4 and 5 percent, respectively. The accumulated postretirement medical benefit obligation attributed to the Media Group was \$161 at December 31, 1995.

Allocation of Postretirement Life Costs Net postretirement life costs, and funding requirements, if any, are allocated to the Media Group in the same manner as pensions. U S WEST will generally fund the amount allowed for tax purposes and no funding of postretirement life insurance occurred in 1995, 1994 and 1993. U S WEST believes its method of allocating postretirement life costs is reasonable.

Net postretirement life benefit costs allocated to the Media Group for 1995, 1994 and 1993 were \$0, \$3, and \$3, respectively. The service and interest costs for 1995 and the accumulated postretirement life benefit obligation at December 31, 1995 attributed to the Media Group were \$1, \$3 and \$45, respectively.

NOTE 19: INCOME TAXES

The components of the provision for income taxes follow:

	Year Ended December 31,		
	1995	1994	1993
Federal:			
Current	\$ 47	\$ 50	\$ 72
Deferred	48	104	(32)
	95	154	40
Foreign:			
Current	6	—	—
Deferred	33	14	2
	39	14	2
State and local:			
Current	8	(6)	23
Deferred	21	42	(4)
	29	36	19
Provision for income taxes	<u>\$163</u>	<u>\$204</u>	<u>\$ 61</u>

Amounts U S WEST paid for income taxes were \$566, \$313 and \$391 in 1995, 1994 and 1993, respectively, inclusive of the capital assets segment, of which \$55, (\$178) and \$94 related to the Media Group. The Media Group, including the capital assets segment, had taxes payable of \$90 and \$88 as of December 31, 1995 and 1994, respectively.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 19: INCOME TAXES (Continued)

The effective tax rate differs from the statutory tax rate as follows:

	Year Ended December 31,		
	1995	1994	1993
	In percent		
Federal statutory tax rate	35.0	35.0	35.0
Foreign taxes — net of federal effect	8.3	1.9	.6
State income taxes — net of federal effect	6.1	4.9	6.6
Amortization	2.5	—	.2
Restructuring charge	—	—	1.1
Other	1.1	.7	(1.7)
Effective tax rate	<u>53.0</u>	<u>42.5</u>	<u>41.8</u>

The components of the net deferred tax liability follow:

	December 31,	
	1995	1994
Property, plant and equipment	\$ 107	\$ 76
Leases	662	684
State deferred taxes — net of federal effect	178	174
Intangible assets	112	164
Investments in partnerships	213	142
Other	12	13
Deferred tax liabilities	<u>1,284</u>	<u>1,253</u>
Postemployment benefits, including pension	22	29
Restructuring, assets held for sale and other	98	130
Currency translation	15	16
Start-up expenditures	17	9
State deferred taxes — net of federal effect	33	38
Other	55	61
Deferred tax assets	<u>240</u>	<u>283</u>
Net deferred tax liability	<u>\$1,044</u>	<u>\$ 970</u>

The current portion of the deferred tax asset was \$24 and \$52 at December 31, 1995 and 1994, respectively, resulting primarily from restructuring charges and compensation-related items.

The net deferred tax liability includes \$686 in 1995 and \$678 in 1994 related to the capital assets segment.

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE

The Combined Financial Statements of the Media Group include the discontinued operations of the capital assets segment. During the second quarter of 1993, the U S WEST Board of Directors approved a plan to dispose of the capital assets segment through the sale of segment assets and businesses. Accordingly, the Media Group recorded an after-tax charge of \$100 for the estimated loss on disposition. An additional provision of \$20 is related to the effect of the 1993 increase in federal income tax rates. The capital assets segment includes activities related to financial services and financial guarantee insurance operations. Also included in the segment is U S WEST Real Estate, Inc., for which disposition was announced in 1991 and a \$500 valuation allowance was established to cover both carrying costs and losses on disposal of related properties.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE (Continued)

Effective January 1, 1995, the capital assets segment has been accounted for in accordance with Staff Accounting Bulletin No. 93, issued by the Securities Exchange Commission, which requires discontinued operations not disposed of within one year of the measurement date to be accounted for prospectively in continuing operations as a "net investment in assets held for sale." The net realizable value of the assets is reevaluated on an ongoing basis with adjustments to the existing reserve, if any, charged to continuing operations. No such adjustment was required in 1995. Prior to January 1, 1995, the entire capital assets segment was accounted for as discontinued operations in accordance with Accounting Principles Board Opinion No. 30.

During 1994, U S WEST reduced its ownership interest in Financial Security Assurance Holdings, Ltd. ("FSA"), a member of the capital assets segment, to 60.9 percent, and its voting interest to 49.8 percent through a series of transactions. In May and June 1994, U S WEST sold 8.1 million shares of FSA, including 2 million shares sold to Fund American Enterprises Holdings Inc. ("FEC"), in an initial public offering of FSA common stock. U S WEST received \$154 in net proceeds from the offering. The Media Group retained certain risks in asset-backed obligations related to the commercial real estate portfolio. On September 2, 1994, U S WEST issued to FEC 50,000 shares of cumulative redeemable preferred stock for a total of \$50. (See Note 15 to the Combined Financial Statements.) In December 1995, FSA merged with Capital Guaranty Corporation for shares of FSA and cash of \$51. The transaction was valued at approximately \$203 and reduced U S WEST's ownership interest in FSA to 50.3 percent and its voting interest to 41.7 percent. U S WEST expects to monetize and ultimately reduce its ownership in FSA through the issuance of Debt Exchangeable for Common Stock ("DECS") in 1996. At maturity, each DECS will be mandatorily exchanged by U S WEST for shares of FSA common stock held by U S WEST or, at U S WEST's option, redeemed at the cash equivalent.

U S WEST entered into a transaction to reduce its investment in Enhance Financial Services Group, Inc. ("Enhance") during fourth-quarter 1995. U S WEST issued DECS due December 15, 1998. Upon maturity, each DECS will be mandatorily exchanged by U S WEST for shares of Enhance Common Stock or, at U S WEST's option, redeemed at the cash equivalent. The capital assets segment currently owns approximately 31.5 percent of the outstanding Enhance common stock. (See Note 11 to the Combined Financial Statements.)

U S WEST Real Estate, Inc. has sold various properties totaling \$120, \$327 and \$66 in each of the three years ended December 31, 1995, respectively. The sales proceeds were in line with estimates. Proceeds from building sales were primarily used to repay related debt. U S WEST has completed construction of existing buildings in the commercial real estate portfolio and expects to substantially complete the liquidation of this portfolio by 1998. The remaining balance of assets subject to sale is approximately \$490, net of reserves, as of December 31, 1995.

In December 1993, U S WEST sold \$2.0 billion of finance receivables and the business of U S WEST Financial Services, Inc. to NationsBank Corporation. Sales proceeds of \$2.1 billion were used primarily to repay related debt. The pretax gain on the sale of approximately \$100, net of selling expenses, was in line with management's estimate and was included in the Media Group's estimate of provision for loss on disposal. The management team that previously operated the entire capital assets segment transferred to NationsBank.

Building sales and operating revenues of the capital assets segment were \$237, \$553 and \$710 in 1995, 1994 and 1993, respectively. Income from discontinued operations for 1993 (to June 1) totaled \$38. Income (loss) from the capital assets segment subsequent to June 1, 1993 is being deferred and is included within the reserve for assets held for sale.

The assets and liabilities of the capital assets segment have been separately classified on the Combined Balance Sheets as net investment in assets held for sale.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE (Continued)

The components of net investment in assets held for sale follow:

	December 31,	
	1995	1994
	Dollars in millions	
ASSETS		
Cash and cash equivalents	\$ 38	\$ 7
Finance receivables — net	953	1,073
Investment in real estate — net of valuation allowance	368	465
Bonds, at market value	149	155
Investment in FSA	384	329
Other assets	177	347
Total assets	<u>\$2,069</u>	<u>\$2,376</u>
LIABILITIES		
Debt	\$ 796	\$1,283
Deferred income taxes	686	678
Accounts payable, accrued liabilities and other	148	103
Minority interests	10	10
Total liabilities	<u>1,640</u>	<u>2,074</u>
Net investment in assets held for sale	<u>\$ 429</u>	<u>\$ 302</u>

Finance receivables primarily consist of contractual obligations under long-term leases that U S WEST intends to run off. These long-term leases consist mostly of leveraged leases related to aircraft and power plants. For leveraged leases, the cost of the assets leased is financed primarily through nonrecourse debt which is netted against the related lease receivable.

The components of finance receivables follow:

	December 31,	
	1995	1994
Receivables	\$ 921	\$1,095
Unguaranteed estimated residual values	447	467
	1,368	1,562
Less: Unearned income	390	459
Credit loss and other allowances	25	30
Finance receivables — net	<u>\$ 953</u>	<u>\$1,073</u>

Investments in debt securities are classified as available for sale and are carried at market value. Any resulting unrealized holding gains or losses, net of applicable deferred income taxes, are reflected as a component of Media Group equity.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE (Continued)

The amortized cost and estimated market value of investments in debt securities are as follows:

Debt Securities	December 31,							
	1995				1994			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal	\$ 91	\$1	\$1	\$ 91	\$113	\$—	\$13	\$100
Other	58	—	—	58	65	—	10	55
Total	<u>\$149</u>	<u>\$1</u>	<u>\$1</u>	<u>\$149</u>	<u>\$178</u>	<u>\$—</u>	<u>\$23</u>	<u>\$155</u>

Note: Also included in Media Group equity are unrealized gains and losses on debt securities associated with the Media Group's equity investment in FSA. 1995 includes unrealized gains of \$24, net of deferred taxes of \$13, and 1994 includes unrealized losses of \$49, net of deferred tax benefits of \$26.

The 1995 net unrealized gains of \$39 (net of deferred taxes of \$21) and the 1994 net unrealized losses of \$64 (net of deferred tax benefits of \$34), are included in Media Group equity.

Debt

Interest rates and maturities of debt associated with the capital assets segment at December 31 follow:

Interest rates	Maturities				Total	Total
	1997	1998	1999	2000	1995	1994
Up to 5%	\$—	\$—	\$—	\$—	\$—	\$ 55
Above 5% to 6%	10	—	—	—	10	15
Above 6% to 7%	54	—	—	—	54	154
Above 7% to 8%	5	—	—	—	5	17
Above 8% to 9%	—	—	134	4	138	189
Above 9% to 10%	48	5	—	—	53	114
Above 10% to 11%	—	29	—	—	29	29
	<u>\$117</u>	<u>\$ 34</u>	<u>\$134</u>	<u>\$ 4</u>	<u>289</u>	<u>573</u>
Allocated to the capital assets segment — net ..					507	710
Total					<u>\$796</u>	<u>\$1,283</u>

Debt of \$71 and \$119 at December 31, 1995 and 1994, respectively, was collateralized by first deeds of trust on associated real estate and assignment of rents from leases.

The following table summarizes terms of swaps associated with the capital assets segment. Variable rates are indexed to three- and six-month LIBOR.

	December 31, 1995 and 1994					
	Notional Amount	Maturities	Weighted Average Receive Rate		Weighted Average Pay Rate	
			1995	1994	1995	1994
Variable to fixed ¹	\$380	1996-1997	5.96	5.69	9.03	9.03
Fixed to variable ¹	380	1996-1997	7.29	7.29	5.87	5.80
Variable rate basis adjustment ²	10	1997	5.92	5.89	5.85	7.04

¹ The fixed to variable swaps have the same terms as the variable to fixed swaps and were entered into to terminate the variable to fixed swaps. The net loss on the swaps is deferred and amortized over the remaining life of the swaps and is included in the reserve for assets held for sale.

² Variable rate debt based on Treasuries is swapped to a LIBOR-based interest rate.

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 20: NET INVESTMENT IN ASSETS HELD FOR SALE (Continued)

Financial Instruments with Off-Balance Sheet Credit Risk — Financial Guarantees

The Media Group retained certain risks in asset-backed obligations related to the commercial real estate portfolio. The principal amounts insured on the asset-backed obligations follow:

<u>Terms to Maturity</u>	<u>December 31,</u>	
	<u>1995</u>	<u>1994</u>
0 to 5 Years	\$ 639	\$ 540
5 to 10 Years	450	537
10 to 15 Years	10	391
Total	<u>\$1,099</u>	<u>\$1,468</u>

Concentrations of collateral associated with insured asset-backed obligations follow:

<u>Type of Collateral</u>	<u>December 31,</u>	
	<u>1995</u>	<u>1994</u>
Commercial mortgages:		
Commercial real estate	\$ 442	\$ 530
Corporate secured	657	888
Other asset-backed	—	50
Total	<u>\$1,099</u>	<u>\$1,468</u>

Additional Financial Information

Information for U S WEST Financial Services, Inc., a member of the capital assets segment, follows:

<u>Summarized Financial Information</u>	<u>Year Ended December 31,</u>		
	<u>1995</u>	<u>1994</u>	<u>1993</u>
Revenue	\$ 44	\$ 54	\$ 410
Net finance receivables	931	981	1,020
Total assets	1,085	1,331	1,797
Total debt	274	533	957
Total liabilities	1,024	1,282	1,748
Equity	61	49	49

U S WEST MEDIA GROUP
NOTES TO COMBINED FINANCIAL STATEMENTS (Continued)

NOTE 21: QUARTERLY FINANCIAL DATA (UNAUDITED)

	Quarterly Financial Data			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1995				
Sales and other revenues	\$ 536	\$ 585	\$ 604	\$ 641
Income before income taxes and extraordinary item	38	54	84	131
Income before extraordinary item	15	25	33	71
Net income	15	25	29	71
Pro forma earnings per common share before extraordinary item	0.03	0.05	0.07	0.15
Pro forma earnings per common share	0.03	0.05	0.06	0.15
1994				
Sales and other revenues	\$ 418	\$ 459	\$ 482	\$ 549
Income from continuing operations before income taxes	55	153	92	180
Income from continuing operations and net income	29	86	51	110
Pro forma earnings per common share	0.07	0.19	0.11	0.24

Effective November 1, 1995, each share of U S WEST, Inc. common stock was converted into one share each of Communications Stock and Media Stock. Earnings per common share have been presented on a pro forma basis to reflect the two classes of stock as if they had been outstanding since January 1, 1994. For periods prior to the recapitalization, the average common shares outstanding are assumed to be equal to the average common shares outstanding for U S WEST, Inc.

1995 third-quarter net income includes costs of \$5 (\$0.01 per share) associated with the Recapitalization Plan and costs of \$4 (\$0.01 per share) for the early extinguishment of debt. 1995 fourth-quarter net income includes a gain of \$95 (\$0.20 per share) from the merger of U S WEST's joint venture interest in TeleWest. 1995 fourth-quarter net income also includes costs of \$4 (\$0.01 per share) associated with the Recapitalization Plan.

1994 second-quarter net income includes a gain of \$41 (\$0.09 per share) on the sale of paging operations. 1994 fourth-quarter net income includes a gain of \$105 (\$0.23 per share) from the partial sale of U S WEST's joint venture interest in TeleWest.

1995 Per Share Market Data

	Market Price		
	High	Low	Close
	(Whole dollars)		
November 1, 1995 through December 31, 1995	\$20.000	\$17.375	\$19.000

U S WEST MEDIA GROUP

SUPPLEMENTARY SELECTED PROPORTIONATE RESULTS OF OPERATIONS

The Media Group believes that proportionate financial data facilitates the understanding and assessment of its Combined Financial Statements. The following proportionate accounting table reflects the relative weight of the Media Group's ownership interest in its domestic and international investments in cable and telecommunications, wireless and directory and information services operations. The financial information included below departs materially from generally accepted accounting principles ("GAAP") because it aggregates the revenues and operating income of entities not controlled by the Media Group with those of the consolidated operations of the Media Group. This table is not intended to replace the Combined Financial Statements prepared in accordance with GAAP. Supplemental Media Group information on a proportionate basis is presented in Management's Discussion and Analysis.

	Year Ended December 31,		
	1995	1994	1993
Sales and other revenues	\$5,115	\$4,213	\$2,157
Operating expenses	3,966	3,311	1,630
EBITDA ¹	1,149	902	527
Restructuring charge	—	—	109
Depreciation and amortization	673	501	223
Operating income	476	401	195
Income from continuing operations before extraordinary item	145	276	85
Net income	\$ 141	\$ 276	\$ 3

Note: Certain reclassifications within the Selected Proportionate Results of Operations have been made to conform to the current year presentation.

¹ Earnings before interest, taxes, depreciation and amortization ("EBITDA").

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