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### FLORIDA PUBLIC SERVICE COMMISSION CAPITAL CIRCLE OFFICE CONTER - 2540 SERVICE ON BOULEWARD TALLAURSSEE, FLORIDA 32309-8060

### APPLICATION FOR

### ANTHURITY TO PROVIDE ALTERNATIVE LOCAL EXCHANGE SERVICE WITHIN THE STATE OF FLORIDA

### **MISTRUCTICUS**

- 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, assignment or transferom.
- 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 ensuer which will not fit the allotted space.
- 4. If you have questions about completing the form, contact:

Florida Public Service Commission
Division of Communications, Cortification & Compliance Section
2540 Shamerd Oak Boulevard
Tallahassoo, Florida 22399-0066
(904) 413-6000

 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 (now 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 noncertificated 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
    cortificated company. The Commission must
    approve the new controlling entity.
- 2. Home of applicant: U.S. Long Distance, Inc.
- 3. A. Metional mailing address including street name, number, post office box, city , state, zip code, and phone number.

  9311 San Pedro, Suite 100
  San Antonio, Texas 78216
  (210) 525-9009
  - 8. Florida mailing address including street name, number, post office box, city , state, zip code, and phone number.

    NRAI Services Inc.

    o/b/o U.S. Long Distance, Inc.

    526 E. Park Avenue
    Tallahassae, FL 32301 (800) 460-1110
  - C. Physical address of alternative local exchange service in Florida including street name, number, post office box, city, zip code and phone number.

n/a

4.	Structure of organization:
	Individual   Corporation   Foreign Corporation   Foreign Partnership   Limited Partnership   Limited Partnership   Other, Please explain
<b>5.</b>	If incorporated, please provide proof from the Florida Secretary of State that the applicant has authority to operate in Florida.  Corporate charter number: P20921
6.	Name under which the applicant will do business (d/b/s): U.S. Long Distance, Inc.
7.	If applicable, please provide proof of fictitious name (d/b/a) registration.  Fictitious name registration number:n/a
٥.	If applicant is an individual, pertnership, or joint venture, please give name, title and address of each legal entity.
9.	State whether any of the officers, directors, or any of the ten 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 officer, director, or stockholder meets these conditions.
10.	
11.	Kenneth F. Melley, Jr.  Vice President - Regulatory Affairs (800) 460-1110  Please list other states in which the applicant is currently providing or has applied to provide local exchange or alternative local exchange service, USLD is authorized to provide local service in Texas, California, Oklahoma and Kansas. USLD is pending approval for such authorization in Oregon, Missouri, Arkansas and Georgia.

FORM PSC/CRU 8 (07/95) Required by Chapter 364.337 F.S. 12. Was 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.

See Attached Footnote.

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

  See Attachment 1.
  - A. Financial capability.

Regarding the showing of financial capability, the following applies:

The application should contain the applicant's financial statements for the most recent 3 years, including:

- 1. the balance sheet
- 2. income statement
- 3. statement of retained earnings.

Further, a written explanation, which can include supporting documentation, regarding the following should be provided to show financial capability.

- 1. Please provide documentation that the applicant has sufficient financial capability to provide the requested service in the geographic area proposed to be served.
- 2. Please provide documentation that the applicant has sufficient financial capability to maintain the requested service.
- 3. Please provide documentation that the applicant has sufficient financial capability to meet its lease or ownership obligations.

MMTE: This documentation may include, but is not limited to, financial statements, a projected profit and loss statement, credit references, credit bureau reports, and descriptions of business relationships with financial institutions.

FORM PSC/CRU 8 (07/95)
Required by Chapter 364.337 F.S.

If available, the financial statements should be audited financial statements.

If the applicant does not have audited financial statements, it shall be so stated. The unaudited financial statements should then be signed by the applicant's chief executive officer and chief financial officer. The signatures should attest that the financial statements are true and correct.

- 8. Managerial capability.
- C. Technical capability.

### **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 asser that pursuant to Chapter 837.06, Florida Statutes, "Missour insuringly 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 misdemeaner of the second degree, punishable as provided in s. 775.082 and s. 775.083".

Official: Signature

2/25/47 Date

Title:

Kenneth F. Melley, Jr.

(210) 525-9009 Telephone Number

Vice President - Regulatory Affairs

Address:

U.S. Long Distance, Inc. 9311 San Pedro, Suite 100

San Antonio, TX 78216

### **APPLICATION FOR AUTHORITY**

### TO PROVIDE ALTERNATIVE LOCAL EXCHANGE SERVICE WITHIN THE STATE OF FLORIDA

### **FOOTNOTE**

Service complaints can be registered by dialing USLD's customer service number, which
appears on all correspondence to customers, or by writing to U.S. Long Distance, Inc.,
Attention: Customer Service, 9311 San Pedro, Suite 100, San Antonio, Texas 78216.

### ATTACHMENT I

### SECURITIES AND EXCHANGE COMMISSION Workinston, D.C. 20549

### Form 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 or 15(4) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 1994 Off

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from

to

Commission file number 6-18195

U.S. Long Distance Corp.

(Fract Name of Registrant as Specified in its Charter)

(State of Secreporation)

74-2522103 (LR.S. Employer Identification No.)

9311 San Pedro, Suite 300, San Antonio, Texas (Address of Principal Facution (Olice) 78286 (719 Code)

(210) 525-9809 (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: Common Stock, Par Value \$0.01 Per Share (Title of Class)

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 🖂

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.

The aggregate market value of the Registrant's outstanding Common Stock held by non-affiliates of the Registrant at December 14, 1994, was \$150,354,611. There were 12,933,730 shares of Common Stock outstanding at December 14, 1994, and the closing sales price on the Nasdaq Stock Market's National Market ("Nasdaq National Market") for the Company's Common Stock was \$11% per share on such date.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement for the 1995 Annual Meeting of Stockholders to be held on March 1, 1995, are incorporated by reference in Part III hereof.

### U.S. LONG DISTANCE CORP.

### ANNUAL REPORT ON FORM 10-K For The Fiscal Year Ended September 30, 1994

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### PART I

### Item 1. Business

U.S. Long Distance Corp. (the "Company") is a fully-integrated long distance telecommunications and information management services company. From fiscal 1989 through fiscal 1994, the Company's revenues increased at a compounded annual rate of 84%, totaling \$181.8 million for fiscal 1994. The Company has three primary areas of business: billing clearinghouse and information management services for other operator services and direct dial long distance companies; operator services for the hospitality and private pay telephone industries; and direct dial long distance telecommunications services in most states, but focused on the West Coast, Southwest and Pacific Northwest, primarily serving small and medium-sized commercial customers.

The long distance telephone industry has changed significantly since the mandated divestiture by American Telephone and Telegraph Co. ("AT&T") of its 22 local telephone companies in 1984. Regulations mandating equal access to the existing telecommunications network led to the creation of hundreds of new long distance companies. Competition now pervades across all categories of long distance telephone services, including both domestic and international direct dial long distance telephone services, operator assisted and calling card services, and 800 and specialized in-bound long distance telephone services. While AT&T, and to a lesser extent MCI Telecommunications Corporation ("MCI") and Sprint Incorporated ("Sprint"), together dominate the estimated \$70 billion long distance telecommunications industry, management believes that a growing share of the market is serviced by smaller long distance companies such as the Company. It is estimated by management that approximately 70% of the long distance market is shared among AT&T, MCI and Sprint, while the other approximate 30% is serviced by smaller companies such as the Company.

### Billing Clearinghouse and Information Services

The Company, through its subsidiary Zero Plus Dialing, Inc., is a major third party billing clearinghouse for call records resulting from telephone calls carried by its customers. These customers are operator services providers and direct dial long distance telephone companies. Call records are generated when consumers place calls from telephones presubscribed to a customer's network or customer telephones that require operator assistance and/or alternative billing options, such as collect and person-to-person calls, third party billing, and calling card billing. Through its contractual billing arrangements with over 900 local telephone companies, the Company has the ability to collect long distance charges from all but a small portion of United States and Canadian households and businesses. Without access to the billing and collection services of the local telephone companies, operator services providers would not have a practical means of billing and collecting the revenues generated from their services since these carriers know only the billing telephone number and not the name or address of the party to be billed. However, due to up-front financial fees, significant investments in systems and infrastructure and volume requirements, most operator services providers and local and regional direct dial long distance carriers do not find it practical or cost effective to establish direct billing and collection relationships with local telephone companies similar to the relationships the Company has established. The Company achieves discounted billing costs due to its aggregated volumes and passes these discounted costs on to its billing services customers.

At September 30, 1994, the Company provided billing and information services to 167 customers, consisting of operator services providers, direct dial long distance telephone companies and store-and-forward pay telephone owners. Revenues from the Company's largest billing services customer represented approximately 8% of the Company's billing services revenues (approximately 2% of total consolidated operating revenues) in fiscal 1994, although the Company's five largest billing services customers represented approximately 29% of billing services revenues (8% of total revenues) in fiscal 1994. The Company billed 102.6 million, 149.8 million and 238.6 million third-party calls during the 1992, 1993 and 1994 fiscal years, respectively (excluding call records that the Company processed for its own operator services and direct dial long distance services businesses). Billing services revenues were \$31.0 million, \$42.0 million and \$52.4 million in fiscal 1992, 1993 and 1994, respectively.

### Industry Overview

The Company believes that there are four major billing clearinghouses in the telephone industry in the United States, the largest of which are the Company and OAN Services, Inc., a wholly owned subsidiary of Electronic Data Systems, Inc., itself a subsidiary of General Motors Corporation. AT&T, MCI and Sprint as well as certain other long distance companies have established their own billing arrangements with local telephone companies, but they do not offer these services to other operator services providers and direct dial long distance carriers. Management estimates that there are presently approximately 23 million operator services calls and approximately 20 million direct dial long distance calls being billed each month through the four clearinghouses. The Company processed a monthly average of approximately 12.4 million operator assisted calls and 13.5 million direct dial calls during the fiscal quarter ended September 30, 1994 (excluding 1.8 million monthly call records processed for the Company's operator services and direct dial long distance services businesses). Competition among the clearinghouses is based on the quality of information reporting, collection bistory, the speed of collections and the price of services.

### Sales and Marketing

The Company markets its billing, reporting systems and information management services to its customers through a direct sales and marketing effort based at its headquarters in San Antonio, Texas. Most of the Company's sales activity is through active participation in industry trade shows and educational seminars and workshops. The Company advertises to a limited extent in trade journals and other industry publications.

### Operations

The Company uses the billing and collection facilities of the local telephone companies to bill and collect long distance telephone charges (call records) on behalf of its long distance company customers. Upon receipt of the customers' revenues from the local telephone companies, the Company reconciles its customer accounts, provides informational reporting and distributes the collected funds to the appropriate customers. The Company also performs the screening, editing and information management functions required to track the call records throughout the billing and collection process, to inform its customers about the quality and quantity of their call records and to handle rate adjustments and refunds on behalf of its customers. In addition, the Company provides accounting reconciliation and reporting and payment systems necessary to provide accountability and auditability for the revenues billed for each customer by each local telephone company. The Company also aggregates and pays state and local telecommunications and sales taxes on behalf of its customers and in most cases handles billing inquiries from consumers. The Company introduced a billing management product in 1993 whereby the Company assists operator services and direct dial long distance companies in obtaining their own billing and collection agreements with the local telephone companies and provides a range of administrative and management services to these customers.

The Company operates two independent computer systems to ensure continual "up time" for its billing clearinghouse and information management processes. One such system is dedicated to the daily billing and information management processing activities. The other serves as a back-up to the primary system and is used to store six months of billing detail. This detail is immediately accessible to the Company's customer service representatives who handle billing inquiries. The collection period from the time the Company submits call records to the local telephone companies until the local telephone companies return the collected funds to the Company generally ranges from 35 to 90 days. Since timely submission of call records to the local telephone companies is critical to prompt collections and high collection rates, the Company has made the necessary investment in computer systems to ensure that its customers' call records are processed and submitted to the local telephone companies, generally within 24 hours of receipt by the Company.

The Company has a revolving line of credit with Greybound Financial Corporation (GFC), formerly Bell Atlantic Capital Corp., secured by accounts receivable and other unencumbered assets of the Company, in order to offer an advanced funding program to its billing customers. The Company borrows funds under this credit facility to purchase certain eligible billing customers' accounts receivable. An eligible customer can receive cash for 50% to 80% of its accounts receivable within five business days of submitting its call records to

the Company for processing, generally 30 to 85 days earlier than the normal local telephone company payment cycle. The Company advances funds nearly every business day under this program. Almost half of the Company's billing services customers are using the Company's advanced funding program. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Advanced Funding Program and Receivable Financing Facility."

### Competitive Advantages

Commencing in 1990, the Company designed, developed and implemented an innovative billing clearinghouse and information management system. Management believes that this system, due to its unique design, affords the Company a competitive advantage in the following areas: effective customer accounting and reporting; expedited payment on customers' accounts receivable; improved collectibility; and monitoring of local telephone company billing and collection efforts.

The Company provides its customers with detailed information that can be used to manage their accounts receivable, improve the quality of their services and, ultimately, enhance their profitability. To ensure that each customer is responsible only for its own uncollectible call records and customer service rebates, the Company developed systems and procedures enabling it to accurately attribute uncollectible call records to specific customers.

When the local telephone company responds to inquiries from the billed party, its primary motivation is frequently to accommodate this party rather than to pursue collection. Recognizing this fact, the Company negotiated with certain local telephone companies for the right to respond directly to such inquiries. As a result of handling such inquiries, the Company has realized an improvement in its collection rates.

Billing and collection are dependent upon state-of-the-art systems and procedures. However, many of the local telephone companies are still using billing and collection systems that were developed prior to the AT&T divestiture and are not capable of providing the quality of billing and collection services that the Company's customers desire. The Company's Quality Assurance Department and Telco Relations Department continually monitor the performance of the local telephone companies' billing systems in order to detect billing errors. Since the inception of this business in 1990, the Company has discovered and collected for its customers significant amounts attributable to billing errors made by local telephone companies.

### Strategy and Growth Opportunities

The Company intends to continue to pursue opportunities in billing clearinghouse services and information management services for companies in the operator services market. In addition, in fiscal 1992 the Company began billing calls for direct dial long distance telephone companies. The Company believes that its billing services should be attractive to long distance telephone companies who serve or desire to serve small businesses and residential consumers on a more cost-effective basis. Billing through the Company's contractual arrangements with the local telephone companies is less expensive for smaller accounts and provides higher collection rates than if the customer were billed directly by the long distance telephone company. The direct dial long distance market is over five times larger than the operator services market; therefore, management expects that direct dial long distance calls will represent a growing portion of the Company's billing volumes and associated revenues over the next two years.

During fiscal 1994, the Company experienced significant growth in its billing management business. Under billing management agreements, the Company provides data processing, accounting, tax processing and reporting, and end user customer service for customers who desire to possess their own billing agreements with the local telephone companies. The number of call records processed by the Company related to such billing management services grew from approximately 700,000 in fiscal 1993 to 11.4 million in fiscal 1994. Management expects this growth trend to continue.

### Operator Services

The Company provides operator assisted services for private pay telephones, hotels, university dormitories and hospitals through its long distance telecommunications subsidiary, U.S. Long Distance, Inc. The Company's operator services are accessed when calls requiring operator assistance and/or alternate billing options are placed from customer locations. Such services involve the use of live and automated operators to receive, validate and complete the calls. The Company processes collect, third-party, person-to-person and calling card calls, bills these calls through its billing subsidiary and generally shares a percentage of call revenues with its customers.

At September 30, 1994, the Company provided operator services to approximately 122,000 hotel, motel, hospital and dormitory rooms. In addition, at September 30, 1994, the Company had service contracts with private pay telephone owners covering approximately 52,000 pay telephones. The Company carried 46.2 million, 86.5 million and 104.7 million minutes of operator services traffic during fiscal 1992, 1993 and 1994, respectively. The Company carried 9.1 million average monthly minutes of operator services traffic during the fourth quarter of fiscal 1994, as company's operator services revenues amounted to \$34.8 million, \$63.5 million and \$67.9 million in fiscal 1992, 1993 and 1994, respectively.

### Industry Overview

Management believes that there are now approximately 125 operator services providers competing within the long distance telecommunications industry. AT&T continues to dominate the operator services market, supplying operator services for more than 90% of the traffic originating from the hospitality industry and over 70% of the traffic carried from the pay telephone industry. Additionally, MCI and Sprint provide operator services and are considered by management to be major competitors. Excluding AT&T, MCI, Sprint, GTE and Regional Bell Operating Companies, management believes the Company is one of the five largest providers of operator services.

Many operator services providers, including the Company, initially focused on the hospitality industry. More recently, as the private pay telephone industry has grown and taken market share from the public pay telephone market generally served by AT&T, many operator services providers gained increasing market share by providing service to the owners of private and public pay telephones. Competition between the Company and other operator services providers is based upon commission programs, quality of service, reporting and customer service.

### Sales and Marketing

The Company markets its operator services nationally through the combined effort of direct sales representatives based in Illinois, Minnesota, Texas, and California and a network of agents. The Company's corporate sales force focuses on larger accounts, such as hotel management companies, multi-unit franchises, hospital chains, large private pay telephone companies and universities. The Company's agents market the Company's operator services on a nationwide basis and typically receive a commission based upon the volume of business generated. The Company also participates in various industry trade shows and promotes its operator services through advertisements in trade magazines. The Company customizes its telecommunication services to provide, among other things, individualized reports and specialized call branding to customers.

### Operations

The Company owns and operates its own operator center in San Antonio, Texas, which employed 309 operators and support staff at September 30, 1994. The Company provides live and automated operator services 24 hours per day, 365 days per year, and features multi-lingual operators versed in Spanish, French, German, Japanese and a variety of other languages. The Company maintains a sophisticated emergency call handling system that enables its operators to access police, fire and other emergency agencies within the jurisdiction of the telephone from which the call is placed. The Company utilizes its own transmission facilities when possible or contracts to use facilities of other long distance network providers as necessary.

operator assistance and to access the Company's network by dialing the Company's access number, then passing the call record information to one of the switching centers. The Company validates the calling card or telephone number to be billed and then completes the call, while recording the date, distance, duration and time of day for subsequent billing purposes. As of September 30, 1994, the Company was authorized to The Company switches the majority of its operator assisted calls at its main switching centers located in Houston and Waco, Texas, Seattle, Washington and Los Angeles, California. Many operator assisted calls are transmitted to the Company's switching centers via dialing equipment installed at customers' locations or in customer pay telephone equipment. This dialing equipment is programmed to recognize calls requiring within 43 states. lete international and interstate calls placed throughout the United States, as well as intrastate calls

## Competitive Advantages

own facilities and maintaining its own operator center, the Company is able to provide high quality transmission on an economic basis. Additionally, because it is the source of commission payments to its operator services customers, the Company believes that its financial stability and history of timely payments allow it to company's flexible rate options allow it to offer customized operator services providers. Moreover, the Company's flexible rate options allow it to offer customized commission programs to its customers as compared to larger operator services providers. Management believes that the Company enjoys several competitive advantages over many others in the operator services industry. By virtue of the Company's large call volumes relative to many other operator services providers and the cost efficiencies it realizes by routing a portion of its operator services traffic over its

reporting also allows its customers to reconcile the accuracy or integrity of their commissions. The Company calling patterns and volumes for each customer location or pay telephone. This advanced reporting system its customers to access the system from remote locations and obtain customized and sophisticated reporting of 24 hours per day, 365 days per year. flows the Company's operator services customers to analyze their traffic on a daily basis and maximize In September 1994, the Company began implementing a computerized bulletin board service that allows toys a highly skilled professional staff of customer service employees and technicians, who provide service

## Strategy and Growth Opportunities

Company intends to pursue geographic expansion on a nationwide basis. Through its direct sales force and its participation in state, regional and national trade associations, the The Company has developed a strong presence in operator services throughout the United States

While the Company's hospitality business represents an increasing percentage of the Company's operator services revenues. The Company recently signed a new agreement with Interstate Hotels Corporation, the nation's largest independent hotel management company, to extend and expand its existing telecommunications contract through September 1998. Under the original agreement, the Company provided automated operator services to approximately 50 hospitality properties. The new agreement has been broadened to include live operator and direct dial long distance telecommunications services. The Company anticipates that Company will continue to develop and present new products and services for this market, such as prepaid calling cards and conference calling he majority of its growth in the operator services business will be within the hispitality industry, and the

# Direct Digit Long Distance Services

authorized to provide direct dial long distance services to customers in 42 states as of September 30, 1994, but sized commercial customers and, to a lesser extent, residential customers. U.S. Long Distance, Inc. was full-service long distance carrier currently providing direct dial long distance services to small and medium-The Company, through its long distance telecommunications subsidiary, U.S. Long Distance, Inc. is a focuses its direct sales efforts in Texas, Louisiana, Oklahoma, New Mexico, California, Oregon and Washington to take advantage of network efficiencies. In addition to its basic "one-plus" service, the Company provides inbound 800 service, travel and debit card services, private line services, data transmission services, wholesale carrier services and other customer-specific products.

The Company began offering direct dial long distance services following its entry into the direct dial long distance business in July 1991 through the acquisition of three related direct dial long distance companies in Texas. As of September 30, 1994, the Company serviced approximately 35,000 commercial and residential customers. The Company carried an average of 44.7 million minutes per month of long distance traffic during the fiscal quarter ended September 30, 1994, as compared to 17.2 million and 10.3 million during the fiscal quarters ended September 30, 1993 and 1992, respectively. In fiscal 1992, 1993 and 1994, the Company had \$19.2 million, \$28.6 million and \$61.4 million, respectively, in direct dial long distance revenues, comprising 23%, 21% and 34% of total operating revenues in each period, respectively.

### Industry Overview

Direct dial long distance revenues industrywide are estimated to have been approximately \$70 billion in 1993, up from approximately \$50 billion in 1992. AT&T and, to a lesser extent, MCI and Sprint, dominate the long distance industry and control a combined market share of approximately 70%. These large national companies offer comprehensive telecommunications services in a wider array of products than other long distance companies and typically target national, multi-state business customers and millions of residential long distance users through national television and media advertising. The Company believes that over 600 smaller long distance companies account for the remaining 30% of the market. These companies typically concentrate on smaller regional, local business and residential customers. Management estimates that the Company's share of direct dial long distance revenues is less than 5% of the market. Competition in the direct dial long distance industry is based upon price and, to a lesser extent, upon customer service, product design and innovation, customized billing capabilities, transmission quality and availability of service.

### Sales and Marketing

At September 30, 1994, the Company employed 121 direct dial long distance sales personnel. These personnel are located throughout the Company's service area and are responsible for marketing to commercial accounts. The Company supervises sales and marketing efforts from its corporate headquarters and utilizes various advertising media to enhance its commercial marketing efforts and to attract and retain residential customers. The Company examines the calling profiles of target markets and designs long distance services that specifically fill certain demands. For example, the Company issues long distance calling cards customized to include the customer's corporate logo and has also customized debit cards to be used as promotional marketing tools. In addition to its own sales force, the Company also markets its direct dial long distance services through authorized agents, other carriers and affinity organizations (strategic partnerships).

The Company currently has an exclusive marketing agreement with Nolan Ryan, formerly a player with the Texas Rangers\* professional baseball team and a potential hall of fame candidate, who acts as the Company's spokesman for its direct dial long distance services and whose picture appears in the Company's advertisements and product literature, including debit cards.

### Operations

The Company completes calls that are originated when the customer dials "1" plus the area code and number to reach any domestic or international destination. All long distance calls placed over the Company's network are directed to call destination points by computerized switching equipment operating at one of the Company's switching centers. The switching equipment receives a subscriber's direct dial call, verifies the caller's billing status, routes the call to the dialed destination, monitors the call's duration and collects other information for billing purposes. The Company's switching equipment selects the most cost-efficient transmission circuit or path available prior to switching and completing each call. The Company employs digital, state-of-the-art switching equipment at the Company's switching centers in Houston and Waco, Texas.

Seattle, Washington and, beginning in September 1994, Los Angeles, California. The Los Angeles switching equipment, along with the acquisition of two separate direct dial long distance companies located in Southern California during fiscal 1994, allowed the Company to expand its direct dial long distance target market for commercial and residential customers into California.

To satisfy increasing or anticipated usage of its long distance network, the Company, from time to time, adds circuit capacity at each existing switching center by increasing the number of telecommunications ports. In June 1992, the Company began upgrading its network with the addition of Common Channel Signaling System 7. The Company's Common Channel Signaling System 7 capabilities are currently operational for virtually all originating traffic within the Company's markets. This network protocol significantly reduces connect time delays and provides additional technical capabilities and efficiencies for the routing of calls.

### Competitive Advantages

The Company competes with AT&T, MCI and Sprint and numerous local and regional carriers primarily on the basis of price and, to a lesser extent, on the basis of its services and its local identity. The Company generally prices its services up to 25% below AT&T, MCI and Sprint comparable service offerings. In addition, by designing long distance products and services that fill specific market needs, the Company enhances its ability to compete with AT&T, MCI and Sprint.

The Company believes that its emphasis on customer service distinguishes itself from many of its regional and local competitors. The Company maintains a responsive customer service center, staffed with 61 trained professionals at September 30, 1994. Moreover, in competing with certain regional and local long distance carriers, the Company holds a competitive advantage within its regional territory because the Company's regional concentration of traffic over its network facilities allows for the cost efficiencies of a national carrier. In addition, the Company believes that its local identity in the markets it serves provides an advantage in marketing its services and competing with long distance carriers based outside of the target region. Management believes that, through its experience in billing services, the Company has developed the expertise in information systems necessary to meet the needs of its direct dial long distance customers. For instance, the Company provides an invoice indicating call detail in a form that assists customers in controlling and monitoring telecommunications costs for various projects or departments.

The Company employs digital switching equipment utilizing a network comprised largely of high quality fiber-optic circuitry to maximize communications quality and has continually expanded transmission capacity in anticipation of increased traffic volume and to ensure that its network is optimally accessible when network demand is heavy. The Company believes that its use of a digital fiber-optic network is particularly advantageous in marketing its data transmission services.

### Strategy and Growth Opportunities

The Company's strategic focus in the direct dial long distance industry is to compete with AT&T, MCI and Sprint, primarily on the basis of price, while maintaining a comparable or higher level of service. Moreover, the Company intends to continue to focus on small and medium-sized commercial customers and will continue its efforts to develop innovative and cost-efficient services that meet the needs of its customers. In this regard, the Company has developed new products to take advantage of recent FCC regulations allowing subscribers to 800 services to change long distance carriers without changing 800 numbers. Another product that the Company has recently begun marketing is the debit card. These prepaid long distance calling cards are a growing trend in telecommunications and are being wholesaled by the Company as specialty services, promotional items and even as collectors' items. The Company also continues to market to residential customers. Due to the difficulty of billing residential accounts cost-effectively, this market has traditionally not been a focus of regional and local long distance companies. The Company believes that its billing services operation can cost effectively bill these accounts through its agreements with local telephone companies.

The Company espects to look for opportunities to expand its long distance business, both by internal growth and through acquisitions. The Company has continued its acquisition activities, the primary focus of which is to make additional acquisitions in the direct dial long distance industry. The Company believes its

operator services business affords it the opportunity to expand its direct dial long distance business on a more cost-effective basis than many of its competitors. By having a concentration of operator services call traffic in a particular geographic region, the Company can utilize any long distance facilities it installs or acquires to service a ready base of call traffic, thereby louering the marginal transmission costs for any direct dial long distance traffic that the Company acquires or develops in that region. The Company believes this cost advantage not only improves the potential profitability of both the Company's operator services and direct dial long distance services businesses in such region, but also expands the number of direct dial long distance companies that would be attractive acquisition candidates in that region. Pursuant to its acquisition strategy, the Company acquired five separate, privately owned direct dial long distance companies located in Oregon. Texas, and California during fiscal 1994. These acquired companies generated \$18.1 million in revenue for fiscal year 1994 and accounted for approximately 55% of the increase in direct dial long distance revenues from fiscal 1993.

In addition, effective October 1, 1994, the Company completed the acquisition of L.D. Network, Inc., a direct dial long distance telephone company headquartered in Los Angeles, California and serving the greater occounting purposes. L.D. Network, Inc. had revenues of approximately \$2.5 to \$3.0 million for the readed September 30, 1994, and served approximately 400 direct dial long distance customers at September 30, 1994.

The success of the Company's acquisition program will depend, among other things, on the availability of general candidates, the availability of funds to finance acquisitions and the availability of management resources to oversee the operation of acquired businesses. While the Company has, from time to time, had discussions with direct dial long distance companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report.

### Corporate Synergy

Management believes that the Company has certain operating advantages and cost efficiencies through the integration of its three businesses. The combined traffic volumes of the Company's operator services and direct dial long distance businesses operate to lower the Company's transmission costs for both these businesses in geographic regions where the Company operates long distance switching equipment. In addition, within its direct dial regions, the Company's sales force now can provide integrated long distance solutions to the hospitality industry by offering both operator services and direct dial long distance telephone services. The volume of call records from the Company's operator services business also assists in lowering the marginal costs for the Company's billing services due to increased economies of scale. Furthermore, lower billing only permit the Company to cost effectively provide direct dial long distance services to residential and small business consumers.

Management also believes that the Company's participation and experience in the direct dial long distance and operator services businesses position the Company to better understand the needs of customers for its billing clearinghouse and information management services, assist the Company in designing billing and information management services that effectively meet the needs of its billing customers, and enable the Company to react more quickly to market changes.

### Government Regulation

General

The Company competes in an industry that, to a large degree, continues to be regulated by government agencies. At approximately the same time as the required divestiture of the Bell telephone companies by AT&T in 1984, the Federal Communications Commission (the "FCC") announced rules that were created to foster a self regulating interstate telecommunications industry, relying upon competitive forces to keep rates and services in check. Management believes that the current direct dual marketplace demonstrates substantial progress toward the fulfillment of these objectives. For example, the cost of a long distance call has

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significantly declined while the number of long distance companies has multiplied. Competition has encouraged these direct dial long distance companies to find ever more efficient methods of carrying calls.

### Billing Services

Billing on behalf of independent long distance providers using local telephone company monthly bills also emerged as a consequence of the AT&T divestiture. Bell and GTE telephone companies are required by antitrust consent decrees to offer billing services for all long distance companies if they provide billing and collection (including disconnection of service to the consumer for nonpayment of long distance charges) for any long distance company. Subsequent to that decision, the FCC determined that interstate billing and collection services were to be provided by the local telephone companies on an unregulated basis. The Company, therefore, contracted with local telephone companies for billing and collection services free from the regulatory control of the FCC.

In some states, billing and collection of intrastate telecommunications records are subject to regulatory jurisdiction. For example, a state regulatory commission may require that the local telephone company provide billing and collection services to any entity that desires to obtain such services, and these services must be offered at the same rates and terms to any such entity. These rates and terms, which are "tariffed," are incorporated by reference into the billing and collection agreements between the Company and the local telephone companies and are subject to any change that is approved by the applicable state regulatory agency. Because intrastate billing volume is outweighed by interstate billing volume, the state regulation of billing and collection is not anticipated to pose significant consequences to the overall operations of the Company.

### Operator Services

On October 15, 1990, President Bush signed into law the Telephone Operator Consumer Service Improvement Act of 1990 ("TOCSIA"). Congress directed the FCC to impose upon the interstate operator services provider carrying the call, the information the caller can request of the operator and the alternative available to the consumer for reaching other long distance carriers. Operator services providers were required to file with the FCC informational traffs that describe the rules and regulations poverning the provision of interstate operator assisted relecommunications and to include all rates that may apply to an interstate call. Furthermore, operator services providers were required to submit, on a Congressionally prescribed timetable, certain reports relating to rate changes, complaints and costs. Based on these reports, on November 16, 1922, the FCC submitted to Congress its "Final Report Pursuant to the Telephone Operator Consumer Services Improvement Act of 1990." The purpose of this report was to identify whether increased regulatory scrutiny was required by the FCC to satisfy Congressional objectives. The FCC determined that "... market forces are securing rates and charges that are just and reasonable ... " and therefore stated "... we conclude that no further action is necessary ... " on behalf of the FCC at this time.

As of Sentember 30, 1994 the Commany was authorized to carry intrastate operator assisted traffic in

As of September 30, 1994, the Company was authorized to carry intrastate operator assisted traffic in 43 states. Authorization is pending approval in one other state. State regulatory agencies have the authority to impose their own rules and regulations governing the provision of intrastate operator services, including regulation of rates. Many states have rules similar if not identical to those imposed by the FCC on interstate operator assisted calls. The Company remains in material compliance with the requirements of each of the individual state regulatory agencies and continues to pursue authorization to provide intrastate operator services in other targeted states. Certain states are expected to introduce or revise their rules governing operator services providers within the next year. The Company does not anticipate significant difficulty in complying with the new or revised rules.

### Direct Dial Long Distance Services

The FCC has regulatory jurisdiction over interstate and international telecommunications common carriers, like the Company. Under Section 214 of the Federal Communications Act, the FCC must certify a communications common carrier before it may provide international services. The Company has obtained

Section 214 authorization to provide international switched services by means of resale. The FCC has ruled that "non-dominant" common carriers, like the Company, need not apply for Section 214 authorization for the provision of domestic U.S. interstate services.

As of September 30, 1994, the Company was authorized to provide intrastate long distance service within 42 states and had applications pending in two others. Regulations within each of these states, as they pertain to completing direct dial long distance calls for the Company's customers within the state, are virtually static and pone no foreseeable concern. As the Company expands the geographic scope of its direct dial long distance business, it will obtain state regulatory approvals as necessary to provide intrastate long distance service.

### Interstate Access Transport Proceeding

Recently, in an effort to encourage competition in the provision of interstate access services, the ICC granted increased pricing flexibility to local telephone companies for "access transport" services. Access transport refers to the connection provided by local telephone companies between long distance carriers' long distance facilities and the telephone companies' central offices. These rate structures previously were designed such that local telephone companies assessed an equal charge per unit of access to all long distance carriers, regardless of the volume of local access that these long distance carriers independently purchased. Under the newly adopted pricing plan, beginning in December 1993, local telephone companies were able to offer more cost effective access to those long distance carriers with very high access volumes in a particular local market Accordingly, long distance carriers with lesser access requirements would experience increases in their overall average access cost. Although all carriers will be affected differently, the FCC initially projected that the smallest long distance carrier in terms of access requirements would experience no more than a 1% increase in total cost and that the largest long distance carriers may experience up to a 0.8% decrease in total cost However, information filed with the FCC by the local telephone companies in September 1993 shows the impact differentials between large and small long distance carriers to be much greater in certain cases. If such differential is substantial with respect to the Company, the differential could significantly impact the Company. Several parties have asked the FCC to suspend and investigate these local telephone tariffs and to order that they be revised to reduce the impact on smaller long distance carriers.

The pricing plan was implemented on December 30, 1993 and is to be in effect until November 1, 1995. During the interim period, the FCC is expected to consider whether to make this pricing plan permanent or to make further revisions. Under this process, the FCC could grant local telephone companies further flexibility and could potentially impose a greater burden upon the operations of the Company's direct dial long distance services. The FCC believes that, by November 1995, the proliferation of competitive access providers and increased long distance carrier network efficiencies should offset any inequities caused by volume-sensitive access pricing. Management is unable to predict the course and effect of the FCC's actions on this issue at this time.

In a related matter, the FCC has authorized local telephone companies to offer volume discounts on access transport services, once certain threshold conditions are met. The offering of such discounts could produce cost advantages for long distance carriers with large volumes of transport traffic. This FCC action is subject to pending petitions for reconsideration.

### CHD Calling Card Proceeding

The AT&T proprietary calling card, often called a Card-Issuer Identifier ("CIID") card, carries an account number that operator services providers such as the Company are unable to validate or accept for billing. Tremendous problems arose regarding this CIID card when it was introduced because the accompanying dialing instructions direct the cardholder to attempt to place calls by first accessing the presubscribed operator services provider's network, notwithstanding the inability of non-AT&T providers to complete the call. On October 8, 1992, the FCC adopted an order declining to require AT&T to allow all long distance companies to validate and bill calls using the AT&T CIID card.

The FCC did require AT&T to engage in a vigorous customer re-education campaign to correct the mininformation that AT&T had distributed to consumers about the CHD card. Furthermore, the FCC

ordered AT&T to simplify customer access via 1-800 dialing. In addition, the FCC invited comments from interested parties on establishing mechanisms by which operator services providers could receive compensation from AT&T for transferring such CIID card calls to AT&T.

In December 1992, the FCC held a public meeting regarding compensation to be paid by AT&T to operator services providers. The FCC encouraged the parties to reach a negotiated proposal to define the terms and conditions of such compensation. The Competitive Telecommunications Association subsequently negotiated with AT&T on behalf of the Company, and on April 13, 1993, the Company signed an agreement with AT&T stipulating the terms of such compensation. According to the terms of this agreement, the Company will provide recorded redialing instructions for each CHD card call attempted over the Company's operator service network and AT&T will compensate the Company for each such call. This agreement is scheduled to expire in February 1995.

### Billed Party Preference

Another issue under consideration by the FCC currently is termed "Billed Party Preference," or BPP. This term refers to a concept in which any long distance call outside the local telephone company's calling area carried from a publicly available telephone would be completed over the long distance carrier network of the billed party's previously expressed preference. This would be accomplished through a local telephone company database system that would match every calling card and telephone number to a preferred long distance company and direct all calls accordingly. In April 1992, the FCC tentatively proposed adopting BPP. During the summer of 1992, comments from local telephone companies, long distance carriers and other industry participants revealed that the cost of imposing BPP could be in excess of \$1 billion and could require hundreds of millions of dollars each year to support its operation. The majority of these commenters were in opposition to the implementation of BPP. Commenters made clear that many technical impediments remain to full deployment of BPP. Several local telephone companies indicated that equipment vendors could not support implementation of BPP prior to 1996. Other commenters claimed that no technology exists that could implement BPP without making call processing significantly less convenient for many operator services calls, particularly those requiring a live operator.

In August 1994, industry members responded to a Commission Further Notice of Proposed Rulemaking. The Commission had tentatively concluded, based upon their calculation of related cost information previously submitted by industry members, that the potential benefits of a BPP system appeared to outweigh its costs, although the Commission admitted the financial data it used in its study could be outdated. Once again, industry participants were resoundingly opposed to the Commission's proposal, including AT&T and most of the Regional Bell Operating Companies (the "RBOCs"). The FCC has taken no further action since receiving these comments.

If such a system were implemented successfully, the unique market niche of operator services provider presubscription, such as that of the Company, would be rendered ineffectual, as an owner of publicly available telephones would be unable to direct operator assisted calls over the network of such owner's desired carrier. It is difficult to assess the industry support for BPP given the inherent problems described above, and the FCC continues to consider implementation of the proposal. In any event, local telephone companies have indicated that, if so directed, approximately two to four years would be required to reconfigure their networks to BPP's specifications. Thus, while BPP remains viable, the Company believes that it is not likely to be implemented in the near term.

### 800 Service Competition

On May 1, 1993, "number portability" for interstate 800 services became available. Under the new system, which was mandated by the FCC, subscribers to 800 service may change their usage from one long distance carrier to another without the need to change 800 numbers. Previously, 800 numbers were divided among the long distance carriers, a system that prevented customers from changing 800 service carriers without also abandoning their 800 numbers. The new system of number portability ends the restraint on the

ability of competing long distance carriers to sell services to customers with unique or heavily advertised numbers.

### FCC Forbearance Policy

On November 13, 1992, the U.S. Court of Appeals for the D.C. Circuit found the FCC's "forbearance" policy to be unlawful. Under this policy, "non-dominant" interstate long distance carriers (almost all but AT&T) had been excused from filing tariffs to govern their service offerings, and instead were permitted to enter into individual contracts with customers. As a result of the court ruling, all long distance carriers now are required to file tariffs with the FCC for their long distance services. The Company is in compliance with this requirement. The U.S. Supreme Court has agreed to review the Court of Appeals' invalidation of the forbearance policy during the Supreme Court's upcoming term.

In response to the Court of Appeals' decision, AT&T filed actions in the U.S. district courts against MCI and other carriers seeking damages for their failure to comply with the requirements of the Communications Act. Shortly thereafter, the FCC adopted revised rules governing non-dominant carrier tariff filings. As a result, the district court dismissed AT&T's action against MCI, but AT&T has asked the court for a rehearing of the dismissal. Several proceedings regarding the issue of damages for non-compliance with tariff filing requirements are also pending at the FCC. If the court or FCC ultimately finds in AT&T's favor, it is possible that entities could seek damages from other competitive carriers, such as the Company, who failed to file or comply with tariff rates. The outcome or timing of any such proceeding is impossible to predict, nor is it possible to predict the timing or outcome of the pending court review.

### Other Regulatory Matters

Legislation was introduced in the 103rd Congress which would have codified many of the requirements of the AT&T Consent Decree of 1983. H.R. 3626, "The Anti-Trust Reform Act of 1993," sponsored by Congressmen Brooks and Dingell, proposed to incrementally eliminate the long distance restrictions imposed on the RBOCs over a period of five years, pending review and approval of the FCC and the Department of Justice. The bill also would have allowed the RBOCs to provide cable programming services and cable signals over their network, while at the same time permitting cable companies to carry telecommunications signals over their existing network.

S.B. 1822, a Bill introduced in early February 1994 by Senator Hollings, Chairman of the Senate Commerce Committee, would have allowed RBOC entry into long distance upon obtaining FCC approval after demonstrating some level of actual competition in their local service area, and that their entry into long distance would not unfairly harm existing competition. While the 103rd Congress ended before a telecommunications bill reached Conference Committee, certain legislators have indicated their interest in sponsoring telecommunications legislation in the 104th Congress, which convenes in January 1995. The Company would face formidable new competition in the event the RBOCs are permitted to enter the long distance business. Competition would be more formidable if such entry is not predicated on certain RBOC concessions over their control of long distance access services. The Company is unable to determine the time frame or outcome of such consolidation or negotiations.

In September 1993, AT&T petitioned the FCC to reclassify it as a "non-dominant" carrier. The FCC has asked for public comment on the AT&T proposal. If the petition is granted, AT&T would be given additional flexibility in its service offering and pricing. Such flexibility could make AT&T an even more formidable competitor than it is today. The Company cannot predict the timing or outcome of FCC action on this petition.

### fimployees

At September 30, 1994, the Company had 737 full-time employees, including 23 officers, 175 sales and marketing personnel, 72 network, technical and operations personnel, 182 accounting, administrative and support personnel, and 285 telephone operators and customer service representatives and related support personnel. At September 30, 1994, the Company also employed 286 part-time telephone operators and

Company believes that its employee relations are good. customer service representatives. None of the Company's employees are represented by a union. The

## New 2. Properties

At September 30, 1994, the Company occupied approximately 76,000 square feet of space for its corporate offices at 9311 San Padro, San Antonio, Texas, substantially all of which is leased pursuant to a lease agreement that expires in January 1999. The Company currently pays a yearly rental of approximately \$965,000 for this facility (plus a pro rata charge for cleaning services, real estate tax escalations and electricity), which represents its maximum annual liability through the lease termination date. Additionally, at September 30, 1994, the Company leased approximately 17,000 square feet of space for its operator services center at 2200 Danbury, San Antonio, Texas, and approximately 73,000 square feet in the aggregate for 32 sales and operations offices throughout Texas, Oblahoma, New Menico, Louisiana, California, Oregon and Washington for which the Company is puying an aggregate of approximately \$727,000 annually in rental expense. At such date, the Company also occupied an additional 30,000 square feet located in North San Antonio for a customer service facility at a cost of approximately \$240,000 per year. Total rental obligations under leases in effect on September 30, 1994, for the fiscal years 1995, 1996 and 1997 were \$1,696,000, \$1,651,000 and \$1,525,000, respectively. The Company believes that its facilities are adequate to meet its current needs.

Subsequent to September 30, 1994, the Company incurred an additional lease obligation through its acquisition of L.D. Network, Inc. consisting of a location in California totaling 1,450 square feet with an naual restal of \$17,000.

## how 3. Legal Proceedings

results of operations, assets and liabilities, revenues and revenue recognition and agreements and transactions. The Company has and will continue to cooperate fully with the SEC. Although the Company cannot predict when the SEC's private investigation will be concluded, based upon its review of facts and circumstances, management does not believe that the SEC's review in this matter will result in any adjustment to the instituted an informal inquiry relating to certain of the Company's accounting practices, including revenue recognition and accounting related to the Company's accounts receivable, purchased receivables and other assets, and related disclosures. When the Company's Board of Directors learned of the SEC's informal inquiry, Arthur Andersen LLP, the Company's independent public accountants, was engaged to conduct a special review of the Company's accounting policies and procedures. This review was managed by a senior purtner of Arthur Andersen LLP who was not involved in the annual audit process. This special review On May 5, 1994, the Company was informed that the SEC had instituted a formal order of private investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934, as amended (In The Matter of U.S. Long Dissauce (IIO-2852)), relating to, among other things, the Company's financial condition, provided strong additional assurance that the financial statements of the Company were fairly stated and in conformity with generally accepted accounting principles. Representatives of the Company and Arthur Andersen LLP have met with the Enforcement Division of the SEC to discuss the issues raised by the inquiry. Company's previously reported financial statements In December 1993, the Securities and Exchange Commission (the "SEC"), Division of Enforcement,

The SEC's Division of Enforcement instituted a formal order of private investigation pursuant to Section 21(a) of the Securities Enchange Act of 1934, as amended (In the Matter of Trading in the Securities of Value-Added Communications, Inc. (HO-2765)) on August 25, 1993. The investigation relates to the trading in the securities of both the Company and Value-Added Communications, Inc. ("VAC"), an operator service provider based in Dallas, Texas. A proposed merger between the Company and VAC was terminated in February 1993. Specifically, the SEC has alleged, among other things, that certain individuals may have employed devices, schemes or artifices to defraud others in connection with the purchase or sale of the securities of either the Company. VAC or both. The SEC may impose a variety of civil, crimical and administrative remedies and/or sanctions against any individual or entity found to have violated the federal

securities laws. The Company is unaware of any activity by the Company or its management that might have violated the insider trading provisions of the federal securities laws.

On December 15, 1993, the Company, its Board of Directors, a former director and Arthur Andersen LLP were named as defendants in a stockholder class action lawsuit filed in the United States District Court for the Western District of Texas (Colby L. Collier v. U.S. Long Distance Corp., et al., Civil Action No. SA93CA1066). The Complaint, filed by an individual who claimed to own shares of the Company's Common Stock, was brought on behalf of purchasers of the Company's Common Stock during the period from December 22, 1992 through December 10, 1993. The Complaint alleged, among other things, violations of federal securities laws, including antifraud provisions, common law fraud and negligent misrepresentation in connection with the Company's filings with the SEC, the preparation of the Company's financial statements and the Company's public statements and press releases. The lawsuit requested, among other things, compensatory damages in an unspecified amount, prejudgement interest, costs and reasonable attorness' fees On April 4, 1994, the plaintiffs in the above pending class action lawsuit voluntarily moved for the dismissal of their complaints without prejudice. No settlement amounts were paid by the Company or Arthur Andersen LLP.

On December 21, 1993, the Company, its Board of Directors and a former director were named as defendants in a separate class action lawsuit (Lipput v. U.S. Long Distance Corp., et al., Civil Action No. SA93CA1000). This action, also filed in the United States District Court for the Western District of Texas, was brought by an individual who claimed to own shares of the Company's Common Stock on behalf of purchasers of the Common Stock during the period November 20, 1992 through December 9, 1993. The Complaint alleged, among other things, violations of federal securities laws, including antifraud provisions, common law fraud, deceit and negligent misrepresentation in connection with the Company's filings with the SEC, the preparation of the Company's financial statements and the Company's public reports, statements and press releases. The lawsuit sought, among other things, compensatory and punitive damages in an unspecified amount, pre-judgment interest, costs and attorneys' fees. On April 4, 1994, the plaintiffs in the above pending class action lawsuit voluntarily moved for the dismissal of their complaints without prejudice. No settlement amounts were paid by the Company.

The Company is involved in various claims and legal actions arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations; however, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have an adverse effect on the Company's results of operations for the fiscal period in which such resolution occurred.

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

During the fourth quarter of the fiscal year, no matter was submitted by the Company to a vote of its stockholders through the solicitation of proxies or otherwise.

## PART II

# hem S. Market for the Company's Common Equity and Related Stockholder Matters

## Market Information

mark-down or commission, and may not necessarily represent actual transactions. Since June 18, 1991, the Company's common stock, par value \$0.01 per share (the "Common Stock"), has been quoted on the Nasdaq National Market under the symbol "USLD." The table below sets forth the high and low bid prices for the Common Stock from October 1, 1992, through December 14, 1994, as reported by the Nasdaq National Market. These price quotations reflect inter-dealer prices, without retail mark-up.

3 92	\$124	Fiscal Year Ended September 30, 1995:
3 376	\$11%	4th quarter
	SI4W	3rd quarter
5	\$14%	2nd quarter
\$12%	\$13	Fiscal Year Ended September 30, 1994:
\$18	830	4th quarter
5 9%	\$15%	3rd quarter
\$10%	\$19%	2nd quality
<b>\$</b>	<b>K618</b>	Fiscal Year Ended September 30, 1993:
1	ŧ	

### Stochholders

At December 14, 1994, there were 12,933,730 shares of Common Stock outstanding, held by 705 holders of record. The last reported sales price of the Common Stock on December 14, 1994, was \$11% per share.

## Dividend Pulley

covenants in various credit agreements of the Company prohibit the payment of dividends on the Common presently intends to retain all earnings for the operation and development of its business and does not anticipate paying any cash dividends on the Common Stock in the foreseeable future. Furthermore, certain The Company has never declared or paid any cash dividends on the Common Stock. The Company

### been 6. Selected Financial Data

The selected financial data presented below are derived from the audited Consolidated Financial Statements of the Company. The data presented below for the fiscal years ended September 30, 1992, 1993 and 1994 should be read in conjunction with the Consolidated Financial Statements, the Notes thereto and the other financial information included in this report.

		Fincal Ves	I aded Siego	ember 30,		
	1000	1001(1)	1992	1993	1994	
		(In therease	is, escapt per	sherr data)		
Consultigated Security Statement Date:						
Operating revenues			decrees	and the second	and the last	
Dilling services	\$ 7,435	\$16,327	\$31,028	\$ 41,966	\$ 52,438	
Operator services	11,910	17,245	34,809	63,529	67,907	
Direct dial long distance services	0	3,133	19,214	28,631	61,407	
Total operating revenues	19,345	36,705	85,051	134,126	181,752	
Operating expenses						
Cost of services	12,585	25,07R	58,956	93,544	126,724	
Selling, general and administrative	5,443	N,320	16,986	25,095	36,234	
Depreciation and amortization	1,384	2,022	3,542	5,937	9,378	
Income (loss) from operations (2)	(67)	1,285	5,567	9,550	9,415	
Other Income (capenie)	(476)	12	(1,393)	(1,071)	955	
Income (loss) before income taxes, extraordinary items and						
discontinued operations	(543)	1,297	4,174	8,479	10,370	
Provision for income tases	0	(590)	(1,735)	(3,303)	(4,290	
facome (lass) before extraordinary items and discontinued						
operations	(543)	707	2,439	5,176	6,090	
Extraordinary items and discontinued operations	0	518 (3)	1,533 (3)	(316)(4)	0	
Net incume (kms)	\$ (543)	\$ 1,225	\$ 3,972	\$ 4,860	\$ 6,090	
Per share information (5):	Tank and					
Income (loss) before extraordinary items and discontinued						
operations	\$ (0.10)(6)	\$ 0.06 (6)	\$ 0.21	\$ 0.43	\$ 0.43	
Net income (loss)	\$ (0.10)(6)	\$ 012 (6)	\$ 0.35	\$ 0.40	\$ 043	
Weighted average common shares outstanding	6,458	8,848	11,509	12,117	14,069	
	Keptenher M.					
	1990	1001	1992	1993	1004	
	THE RESERVE	- 1	la thomash)		STURED	
Constituted Belower Short Date:						
Working capital (deficit)	\$(1,825)	\$(1,573)	\$ 1,557	\$ 9,114	\$ 12,864	
Current assets	18,734	42,718	72,519	94.67K	110,148	
Total anch	24,137	61.962	99,669	137,657	164,093	
Long-term obligations, less current portion	861	12,213	18,209	13,956	17,591	
Total stockholders' equity	2.717	5,458	10,498	38,137	49,216	
		September 30,				
	1900	1001	1992	1003	1994	
	THE RESERVE OF THE PARTY OF THE	The second secon	billing clear	leghapur custo	mm)	
Operating States						
Hilling call records processed per month (7)(8)	2,700	6,500	10,800	15,100	25,500	
Billing cleaninghouse customers (9)	35	71	115	142	167	
Operator services minutes per month (7)	2,300	3,100	4,800	10,600	9,100	
Pas selephones services (9)	69	5.9	15.9	44.8	52.0	
Resents serviced (9)	61.2	62.6	90.7	106.0	122.0	
Direct dial long distance minutes per month(7)	0	7,960	10,100	17,200	44,700	

Includes the results of operations of the Company's direct dial long distance business after July 25, 1991.
 the date of acquisition.

(Footnotes continued on following page)

<sup>(2)</sup> Income (loss) from operations does not include the net contribution (interest income less interest expense) relating to the Company's advanced funding program for its billing services customers during

- fiscal 1991, 1992, 1993 and 1994. This net contribution, along with other interest expense and interest income, is included in other income (expense).
- (3) Reflects the utilization of net operating loss carryforwards.
- (4) Reflects the utilization of a net operating loss carryforward and an extraordinary loss attributable to a \$547,000 (\$0.05 per share) write-off, net of income taxes, of unamortized discount and capitalized financing costs resulting from the prepayment of indebtedness in the fiscal quarter ended June 30, 1993.
- (5) The Company has never declared cash dividends on its Common Stock, nor does it anticipate doing so in the foreseeable future.
- (6) Preferred stock dividends of \$77,000 and \$199,000 for the fiscal years ended September 30, 1990 and 1991, respectively, were deducted from income (loss) before extraordinary items and discontinued operations and net income (loss) in arriving at income (loss) applicable to common stockholders for purposes of determining per share amounts.
- (7) Calculated based upon a monthly average over the fiscal quarter ended on the date indicated.
- (8) Does not include call records that the Company processed for its operator services and direct dial long distance services businesses.
- (9) At end of the period.

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

The following is a discussion of the consolidated financial condition and results of operations of the Company for fiscal 1992, 1993 and 1994. It should be read in conjunction with the Consolidated Financial Statements of the Company, the Notes thereto and the other financial information included elsewhere in this report. For purposes of the following discussion, references to year periods refer to the Company's fiscal year ended September 30 and references to quarterly periods refer to the Company's fiscal quarters ended December 31, March 31, June 30 and September 30.

### Chemien

Revenues grew to \$181.8 million in 1994 from \$134.1 million in 1993 and \$85.1 million in 1992. During the five-year period ended September 30, 1994, revenues grew at an 84% compounded rate. The Company's gross profit margin decreased from 30.7% in 1992 to 30.3% in both 1993 and 1994. The decrease in gross margin from 1992 to 1993 was largely due to the growth of lower gross margin operator services revenues as a percentage of total revenues. Gross margin has remained flat from 1993 to 1994 primarily due to higher network costs as a percentage of revenue, which were offset by the growth of higher gross margin direct dial long distance services revenues as a percentage of total revenues. Although there was no year-to-year improvement, gross profit margins improved in each successive quarter of 1994, with 33.5% being reported for the fourth quarter, the highest level reported for the Company during the past three fiscal years.

The Company's selling, general and administrative ("SG&A") expenses as a percentage of revenues were 19.9%, 18.7% and 20.0% in 1994, 1993 and 1992, respectively. The increase from 1993 to 1994 is primarily the result of the increased percentage of Company revenues derived from the direct dial long distance business, which incurs higher SG&A expenses as a percentage of revenues than the Company as a whole, and legal and accounting costs that were incurred in connection with two Securities and Exchange Commission (SEC) investigations and two class action lawsuits (see Note 10 to the Consolidated Financial Statements). Depreciation and amortization expenses as a percentage of revenues were 5.2%, 4.4% and 4.2% in 1994, 1993 and 1992, respectively.

Income from operations of \$9.4 million, \$9.6 million, and \$5.6 million was reported for 1994, 1993 and 1992, respectively. Net income has grown each year from 1992 to 1994, with net income reported by the Company increasing to \$6.1 million, or \$0.43 per share, for 1994 from \$4.0 million, or \$0.35 per share, for 1992.

### Results of Operations

The following table presents certain items in the Consolidated Statements of Income as a percentage of total operating revenues for the years ended September 30, 1992, 1993 and 1994:

	1992	1993	1994
Operating revenues:			
Billing services	36.5%	31.3%	28.8%
Operator services	40.9	47.4	37.4
Direct dial long distance services	22.6	21.3	33.8
Total operating revenues	100.0	100.0	100,0
Operating expenses:			
Cost of services	69.1	69.7	69.7
Selling, general and administrative	20.0	18.7	19.9
Depreciation and amortization	4.2	44	_5.2
Income from operations	6.5%	7.1%	5.2%

### Year Ended September 30, 1994 Compared to Year Ended September 30, 1993

Operating Revenues

Revenues in 1994 increased by 36% to \$181.8 million from \$134.1 million in 1993. Growth in direct dial long distance services, billing services and operator services accounted for \$32.8 million, \$10.5 million and \$4.4 million, respectively, of the increase in revenues.

Billing Services. Billing services revenue increased by 25% to \$52.4 million in 1994, compared to \$42.0 million in 1993. The increase in revenue was due to an increase in the number of billing call records processed. An average of 19.9 million billing call records were processed per month during 1994, compared to an average of 12.5 million per month during 1993 (in both years, excluding call records that the Company processed for its own operator services and direct dial long distance services businesses). This volume increase was the result of new business from customers that signed billing agreements with the Company during the past year, as well as expanded business from existing customers. Direct dial long distance billing call records represented 8.9 million and 2.6 million of the average number of records processed per month in 1994 and 1993, respectively. The Company believes that billing services for the direct dial long distance carrier market will continue to represent an increasing percentage of its billing services revenue.

Operator Services. Operator services revenue grew by 7% to \$67.9 million in 1994, compared to \$63.5 million in 1993. The growth was primarily the result of the changes in the Company's operator services billing practices as discussed below and, to a lesser extent, the increased number of pay telephones serviced by the Company. The Company serviced an average of 48,200 pay telephones per month for 1994, compared to an average of 30,900 per month for 1993. Although the Company has experienced significant growth in the number of pay telephones serviced, this growth has not resulted in a corresponding increase in revenue. This has been caused by several factors, including an increase in the percentage of pay telephones serviced by the Company located in states that impose regulations on operator services providers, an increasing awareness on the part of the consumer of the ability to select a carrier of choice by dialing access codes of other carriers ("80) dial-around"), and an increase in the number of jurisdictions that have imposed rate tariff regulations on operator services providers. In addition to the above factors, future growth in operator services revenues will be hindered by changes in the Company's billing practices which occurred in June and July of 1994 to the extent these changes are not offset by other pricing modifications.

The Company made several changes in its operator services billing practices beginning in February 1993. Such changes increased the amount of time charged to consumers for the use of the Company's operator services. These changes increased operator services revenue by \$509,000 and \$1,631,000 for the third and fourth quarters of fiscal 1993, respectively, and increased first, second and third quarter fiscal 1994 operator services revenue by \$1,673,000, \$1,818,000 and \$2,106,000, respectively. These amounts were collected from consumers over a 17-month period, were not in compliance with certain regulatory requirements and may be subject to refund in various regulatory jurisdictions. It is not possible to estimate the ultimate earnings impact, if any, of potential refunds and other related claims. However, based upon its review of current facts and circumstances, management does not believe that any such refunds or claims will have a material adverse impact on the financial condition or results of operations of the Company. Any potential claims paid to consumers or regulatory agencies will be partially offset by refunds of commissions that were paid to the Company's agents and pay telephone owners. The Company further modified its operator services billing practices in June and July of 1996 to comply with all regulatory requirements in those areas in which it provides services. Where appropriate, the Company has refiled tariffs to provide an enhanced description of the Company's operator services billing practices.

Direct Dial Long Distance Services. Direct dial long distance services revenue increased by 114% to \$61.4 million in 1994, compared to \$28.6 million in 1993. Approximately 55% of this increase is attributable to the acquisition of five direct dial long distance companies and customer bases during the year ended September 30, 1994 (See Note 3 to the Consolidated Financial Statements). The remaining portion of the increase is attributable to internal growth achieved through the efforts of an expanded wholesale carrier services sales force and 800 portability, as well as a higher quality sales force which has been more effective in securing business from larger customers. The Company believes that there are opportunities for continued

expansion, both internally and externally through acquisitions, in all three of its primary businesses. However, because direct dial long distance services represent the largest market in which the Company is active, management believes that this business presents the Company with its greatest revenue growth opportunity. The Company believes that its base of operator services business affords it the opportunity to expand its direct dial long distance business on a more cost effective basis than many of its direct dial long distance competitors. Accordingly, the Company continues to consider potential acquisitions. This activity is focused primarily on small to medium-sized direct dial long distance telephone companies. While the Company has, from time to time, had discussions with direct dial long distance companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report.

### Operating Expenses

Cost of Services. Cost of services (transmission costs, operator costs, commissions and billing costs) increased to \$126.7 million in 1994, from \$93.5 million in 1993. The gross profit margin for both 1994 and 1993 was 30.3%, even though the gross profit margin declined for both the operator services and direct dial long distance services businesses in 1994. These declines did not impact the consolidated gross profit margin because of the significant increase in the Company's higher gross margin direct dial long distance services revenues as a percentage of total revenues. These revenues accounted for 34% of the Company's total consolidated revenues for 1994 compared to 21% for 1993. Although there was no year-to-year improvement, gross profit margins improved in each successive quarter of 1994, with 33.5% being reported for the fourth quarter, the highest quarterly level reported by the Company during the past three fiscal years.

The gross profit margin declines for both operator services and direct dial long distance services in 1994 were primarily due to higher fixed networking costs, both as a percentage of revenues and dollar level, during the first six months of 1994. These higher costs were partly the result of expansion of networking capacity in the Pacific Northwest and on the West Cosst. Specifically, because of certain regulatory developments in the State of California (see Note 11 to the Consolidated Financial Statements), the Company did not begin to provide its operator services to certain pay telephones under contract as soon as it had expected. Thus, the Company incurred network costs without gaining the full benefit of the associated revenues. The Company provided certain operator services to substantially all pay telephones currently subject to this contract by the end of the second quarter of 1994. During the third quarter of 1994, networking costs began to decrease to a level consistent with the previous year's results and continued to do so throughout the remainder of 1994. The increase in the percentage of networking costs to direct dial long distance revenues was also caused by the significant growth in the Company's wholesale carrier services revenues, which have a lower gross margin than other direct dial long distance revenues. Although management continues to undertake measures to improve gross profit margins, the impact of regulatory issues (see Note 11 to the Consolidated Financial Statements) and the changes in billing practices discussed above could pressure future gross profit margins.

Selling, General and Administrative. SG&A expenses in 1994 were \$36.2 million, representing 19.9% of revenues, compared to \$25.1 million in 1993, or 18.7% of revenues. SG&A expenses as a percentage of revenues increased from the prior year primarily as a result of a higher percentage of Company revenues being derived from the direct dial business. A higher level of SG&A expense is incurred in connection with direct dial long distance revenues than with other revenues earned by the Company. SG&A expenses were also higher from year to year as a result of the direct dial long distance companies acquired during the first six months of 1994 having higher SG&A expenses as a percentage of revenues than the Company as a whole and due to higher legal and accounting costs incurred in connection with the SEC's investigations and stockholder class action lawsuits. As a result of a strong focus on cost control and cost efficiencies to be gained from integrating the companies acquired in 1994, management anticipates that SG&A expenses as a percentage of revenue will decline slightly in 1995.

Depreciation and Amortization. Depreciation and amortization expense was \$9.4 million in 1994, compared with \$5.9 million in 1993. Depreciation and amortization expense as a percentage of revenues increased to 5.2% in 1994 from 4.4% in 1993. This increase is primarily attributable to additional depreciation expense associated with capital equipment acquired to facilitate the growth of the Company's direct dial long

distance and operator services businesses and the amortization of the cost of customer bases and contracts acquired and goodwill related to acquired companies.

### Income from Operations

Income from operations in 1994 decreased to \$9.4 million, representing 5.2% of revenues, compared to \$9.6 million, or 7.1% of revenues, in 1993. Higher SG&A and depreciation and amortization expenses were virtually offset by higher gross profit.

### Other Income (Expense)

Net other income (expense) improved to net other income of \$955,000 in 1994 from net other expense of \$1.1 million in 1993. The improvement was primarily attributable to the retirement of the Company's Senior Subordinated Notes and reduced interest expense as a result of renegotiating the Company's revolving credit facility. These increases in net interest income were partially offset by increased interest costs associated with financing a higher level of capital expenditures.

### Income Taxes

The Company's effective tax rate increased to 41.3% in 1994, from 39.0% in 1993. The Company's effective tax rate is higher than the federal statutory rate due to state income taxes and certain deductions taken for financial reporting purposes which are not deductible for federal income tax purposes. The increase in the effective rate is primarily due to (1) higher state income taxes, (2) an increase in nondeductible amortization expenses related to acquisitions, and (3) an increase in nondeductible expenses caused by the tax law changes contained in the Omnibus Budget Reconciliation Act of 1993.

### Extraordinary Items

The Company reported no extraordinary items in 1994. The extraordinary loss of \$316,000 in 1993 related to a \$547,000 write-off, net of income taxes, of unamortized financing costs and unamortized discount associated with the Company's Senior Subordinated Notes, which were retired prior to their maturity date in connection with the Company's underwritten public offering in June 1993. This loss was partially offset by utilization of \$231,000 of the Company's net operating loss carryforward ("NOL").

### Net Income

The Company continued to experience earnings growth during 1994, with net income of \$6.1 million in 1994, compared to \$4.9 million in 1993, an increase of 25%. Net income for 1994 reflected continued growth of billing and operator services revenues and expansion of the Company's direct dial long distance services business through both internal growth and acquisitions.

### Year Ended September 30, 1993 Compared to Year Ended September 30, 1992

### Operating Revenues

Revenues in 1993 increased by 58% to \$134.1 million from \$85.1 million in 1992. Significant growth in operator services, billing services and direct dial long distance services accounted for \$28.7 million, \$10.9 million and \$9.4 million, respectively, of the increase in revenues.

Billing Services. Billing services revenues increased by 35% to \$42.0 million in 1993, compared to \$31.0 million in 1992. The rise in billing services revenues was principally due to the addition of new operator services companies as customers, as well as an increase in the number of direct dial long distance carriers that have contracted to bill their long distance call records through the Company. An average of 12.5 million billing call records were processed per month during 1993, compared with 8.6 million during 1992 (in both years, excluding call records that the Company processed for its operator services and direct dial long distance services businesses). Direct dial long distance billing call records represented 2.6 million and 800,000 of the average number of records processed per month in 1993 and 1992, respectively.

Operator Services. Operator services revenues grew by 83% to \$63.5 million in 1993, compared to \$34.8 million in 1992. The growth was the result of the continued expansion of the Company's customer base, primarily in the private pay telephone arena. The Company serviced approximately 44,800 pay telephones at September 30, 1993, compared to approximately 15,900 at September 30, 1992. Pay telephone operator services revenues accounted for approximately 77% of operator services revenues during 1993, increasing from 66% during 1992. A significant portion of this increase is attributable to the execution of five pay telephone operator services agreements from the fourth quarter of 1992 through the second quarter 1993, representing approximately 22,500 pay telephones. In 1993, these five contracts accounted for approximately \$15.0 million in operator services revenues.

Direct Dial Long Distance Services. Direct dial long distance services revenues increased by 49% to \$28.6 million in 1993, compared to \$19.2 million in 1992. The higher level of revenues was attributable to the efforts of an expanded sales force, the acquisition of direct dial long distance customer bases, increased emphasis on customer service, and radio and television advertising. Also contributing to the increase was a restructuring of marketing and sales programs and products to target higher volume, higher revenue customers. During 1993, the Company introduced several new residential and commercial products and adjusted selected pricing structures to improve its position in the highly competitive direct dial long distance business.

### Operating Expenses

Cost of Services. Cost of services (transmission costs, operator costs, commissions and billing costs) increased to \$93.5 million in 1993, from \$59.0 million in 1992. Gross profit margin percentage was 30.3% during 1993, compared to 30.7% for 1992. This decrease is attributable to the increase in the percentage of lower margin operator services revenues to total revenues in 1993 compared to 1992.

Selling, General and Administrative. SG&A expenses in 1993 were \$25.1 million, representing 18.7% of revenues, compared to \$17.0 million in 1992, or 20.0% of revenues. Despite higher spending related to the expansion of the Company's sales and related support groups, technical support operations and management information services department, the Company has continued to reduce SG&A expenses as a percentage of revenues.

Depreciation and Amortization. Depreciation and amortization expense was \$5.9 million in 1993, compared with \$3.5 million in 1992. Depreciation and amortization expense as a percentage of revenues remained relatively constant at 4.4% and 4.2% during 1993 and 1992, respectively.

### Income from Operations

Income from operations in 1993 increased to \$9.6 million, representing 7.1% of revenues, compared to \$5.6 million, or 6.5% of revenues, in 1992. This increase was attributable to the decrease in SCi&A expenses as a percentage of revenues offset by the increase in cost of services as a percentage of revenues discussed above.

### Other Income (Expense)

Net other expense decreased to \$1.1 million in 1993 from \$1.4 million in 1992. The decrease was primarily attributable to the retirement of the Company's Senior Subordinated Notes and increased net interest income realized from the Company's advanced funding program (see "Advanced Funding Program and Receivable Financing Facility" below) for billing services customers. The decrease in net other expense is also attributable to increased interest income earned from the Company's advances to certain of its private pay telephone customers. However, increases in interest income in 1993 were partially offset by increased interest costs associated with financing a higher level of capital expenditures.

### Income Taxes

The Company's effective tax rate decreased to 39.0% in 1993, from 41.6% in 1992. The Company's effective tax rate is higher than the federal statutory rate due to the addition of state income taxes and certain

expenses taken for financial reporting purposes which are not deductible for federal income tax purposes. The decline in the effective tax rate in 1993 was the result of a reduction in the percentage of non-tax deductible spenses relative to pretas book income. This reduction was caused by the significant year to year increase in retax book income in 1993.

## Extraordinary livrus

The extraordinary loss of \$316,000 in 1993 related to a \$547,000 write-off, net of income taxes, of unamortized financing costs and mannortized discount associated with the Company's Senior Subordinated Notes, which were related prior to their maturity date in connection with the Company's underwritten public offering in June 1993. This loss was partially offset by utilization of \$231,000 of the Company's NOL. The extraordinary item of \$1.5 million in 1992 related to the utilization of the Company's NOL.

### Net lacome

The Company continued to experience earnings growth during 1993, with net income of \$4.9 million in 1992, an increase of 22%. Net income for 1993 reflected continued growth in operating revenues from all of the Company's businesses and a decrease in SG&A expenses as a percentage of revenues companyed to the prior year. The increase in net income was partially offset by an extraordinary loss of \$316,000 in 1993. This less related to a \$547,000 write-off, net of income taxes, of unamortized financing costs and unamortized discount associated with the early repayment of debt, as partially offset by the utilization of \$231,000 of the Company's net operating loss carryforward.

## Liquidity and Capital Beasurers

The Company's cash balance increased to \$16.8 million at September 30, 1994 from \$15.4 million at September 30, 1993. As an additional source of cash availability, the Company has a revolving credit receivable financing facility with Greybound Financial Corporation (GFC), formerly Bell Atlantic Capital Corp., that allows the Company to borrow against its own operator services and direct dial long distance services accounts receivable. At September 30, 1994, the Company had approximately \$18.7 million available for borrowing and no amounts borrowed against its own eligible receivables under this revolving credit receivable financing facility. See "Advanced Funding Program and Receivable Financing Facility" below. Working capital was \$12.9 million at September 30, 1994, companed to \$9.1 million at September 30, 1993. The Company's current ratio was 1.1:1 at both dates. Additionally, the Company's cash flow provided by operations was \$16.2 million for 1994, increasing from \$4.8 million for 1993.

Accounts accelerable increased to \$35.2 million at September 30, 1994 from \$28.5 million at September 30, 1993. This increase was primarily attributable to a higher level of direct dial long distance services revenues in the fourth quarter of 1994 compared to the fourth quarter of 1993. Purchased receivables from hilling customers increased to \$53.3 million at September 30, 1994 from \$47.3 million at September 30, 1993. This increase is attributable to the growth in the volume of records billed. Trade accounts payable and accrued highlities increased to \$17.4 million and \$11.2 million, respectively, at September 30, 1994 from \$11.7 million and \$90.0 million at September 30, 1993. The increases in accounts payable and accrued liabilities are due to significantly higher facal 1994 costs and the overall expansion of the Company's business. Prepaids and other current assets and other assets increased to \$4.8 million and \$8.3 million, respectively, at September 30, 1994 from \$3.6 million and \$8.1 million, respectively, at September 30, 1993. The increase in prepaids and other current assets is primarily the result of the Company's advances to certain of its private pay telephone customers. The increase in other assets is primarily due to the purchase of a \$1.5 million certificate of deposit eld as security for an equipment financing facility, as discussed below

primarily related to the purchase of telecommunications equipment and office furniture and equipment. During 1994, the Company financed, through long-term borrowings, approximately \$9.8 million of equipment purchased during 1994 and the fourth quarter of 1993. Approximately \$5.0 million of these borrowings were through an equipment financing facility with BOT Financial Corporation, a subsidiary of the Bank of Tokyo. Capital expenditures amounted to approximately \$10.4 million during 1994. These expenditures were An additional \$3.0 million was borrowed through an equipment financing facility with General Electric Capital Corporation and is secured by a \$1.5 million certificate of deposit which has been recorded as a long-term asset on the balance sheet at September 30, 1994. This certificate of deposit will be released upon evidence of the resolution of the SEC investigations. See "Item 3. Legal Proceedings." The remaining \$1.5 million of borrowings were with various other institutions. During 1995, the Company anticipates investing \$10 to \$15 million in additional equipment to service the Company's projected growth. Approximately \$6 to \$8 million of these capital expenditures are expected to be purchases of telecommunications equipment, approximately \$3 to \$5 million are expected to be purchases of computer hardware and software to develop systems to support the anticipated continued growth of the Company's business and the remainder is expected to be for purchases of office furniture and equipment and payments for leasehold improvements. The Company anticipates financing these capital expenditures primarily through term notes or capital leases with various lending institutions. The Company also has an agreement with Frost National Bank to finance up to \$5.0 million of equipment for up to 180 days at the prime rate plus 1%. At September 30, 1994, the Company had no amounts outstanding under this facility, which expires on December 31, 1994.

The Company's operations and expansion into new geographic markets will continue to require substantial capital investment for the development and procurement of transmission facilities and telecommunications and office equipment. In addition, any acquisitions that the Company may consummate may require substantial capital investment. The Company believes that it has the ability to continue to secure long-term equipment financing and that this ability, combined with cash flow generated from operations and available borrowing capacity under its existing credit facilities, will be sufficient to fund capital expenditures, working capital needs and debt repayment requirements for the foreseeable future.

The Company's credit facilities and equipment loans contain various restrictions and financial ratio maintenance requirements. Under the most restrictive terms of its credit facilities, the Company is required to maintain a quarterly ratio of consolidated operating income, as defined in the agreements, to consolidated fixed charges of at least 1.5 to 1.0 and is prohibited from paying dividends on its common stock. The Company may also be subject to certain limitations on its annual capital expenditures and on the issuance of additional secured debt, but can issue subordinated unsecured debt provided the ratio of total consolidated debt to total capitalization does not exceed 85%. Further, the Company may not issue debt if its ratio of funded debt (as defined in the applicable loan agreement) to total capitalization would exceed 60%. The agreements further limit the ability of certain of the Company's subsidiaries to remit dividends to the Company. Cross default provisions of the Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other loan agreements. Under the Company's most significant credit facilities, the Company has guaranteed the obligations of its subsidiaries. The Company was in compliance with all required covenants at September 30, 1994 and 1993.

The Company continually evaluates business opportunities, including potential acquisitions. The primary focus of the Company's acquisition activities is to make additional acquisitions in the direct dial long distance industry. One or more of such acquisitions could result in a substantial change in the Company's operations and financial condition. The success of the Company's acquisition activities will depend, among other things, on the availability of acquisition candidates, the availability of funds to finance acquisitions and the availability of management resources to oversee the operation of acquired businesses. While the Company has, from time to time, had discussions with direct dial long distance companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report.

As consideration for any acquisitions, the Company may issue common stock, preferred stock, convertible debt or other accurities, in addition to or in lieu of the payment of cash, that could result in dilution of the percentage ownership of public stockholders. The Company does not intend to seek stockholder approval for any such acquisitions or accurity insuances unless required by applicable law or regulations. The Company issued an aggregate of \$20,000 shares of its common stock during fiscal 1994 for the acquisitions of four direct dial long distance companies (see Note 3 to the Consolidated Financial Statements). The Company has granted the holders of these shares certain registration rights, the cost of which will be borne by the Company. Subsequent to the acquisition of one of these companies, the Company amended the terms of its purchase agreement with the former stockholders of the company, agreeing, among other things, to issue additional

difference in cash within five days to the Company. Assuming the closing bid price of the Company's common stock on November 18, 1994, of \$11.75 is the same as the closing bid price of the Company's common stock on the First Available Sale Date, the Company would be required to pay approximately \$211,000 in cash to the former stockholders. Subsequent to September 30, 1994, the Company issued 175,000 shares of its Shares on the date they become available for sale through a registration statement declared effective with the SEC (the "First Available Sale Date") and \$1,386,064. The value of the Additional Shares on the First specified acquisition price. On November 2, 1994, pursuant to the terms of the amended agreement, the Company paid an aggregate of \$41,360 in cash and issued 100,000 shares of its common stock to the former stockholders (see Note 3 to the Consolidated Financial Statements). In addition, the Company agreed to pay in cash within five days to such former stockholders the difference, if any, between the value of the Additional common stock in the acquisition of L.D. Network, Inc. See "Item 1. Business - Direct Dial Long Distance Available Sale Date will be determined by reference to the bid price of the Company's common stock as quoted on the Nasdaq National Market at the close of business on such date. If the value of the Additional Shares on the First Available Sale Date is greater than \$1,386,064, the former stockholders shall yay such Services - Strategy and Growth Opportunities." shares of its common stock and pay a cash sum to these former stockholders, if accessary, to guarantee a

Company's financial position. The shares will be purchased using available Company funds from time to time on the open market over the course of the 12 months beginning June 1, 1994, as market and other relevant conditions warrant. As of September 30, 1994, the Company had purchased 160,000 shares under this program at an average market price of \$9.74 per share, and as of December 13, 1994, the Company had purchased an additional 107,500 shares at an average market price of \$10.00 per share. Shares purchased management and board members believed that the Company's common stock was undervalued relative to the shares of its outstanding common stock. The Company instituted this stock purchase program because ader this program will be used for general corporate purposes, including as possible consideration for any On June 1, 1994, the Company was authorized by its board of directors to putchase up to 1,000,000

On November 4, 1993, the Company filed a registration statement with the SEC relating to an offering of up to 1,840,000 shares of common stock by the Company and certain selling stockholders. The Company postponed this offering in December 1993 after being informed by the SEC that the Company was the subject of an informal inquiry. See "Item 3. Legal Proceedings." In January 1994, the Company announced that it would not proceed with a primary offering of its stock. However, the Company's existing registration statement was assended to relate to a shelf offering of an aggregate of approximately 1.7 million shares to be offered and receive any of the proceeds of the shares being offered under the registration statement other than minimal proceeds upon the exercise of stock purchase warrants. On June 29, 1994, the Company filed a shelf receive any of the proceeds of the shares being offered under the registration statement. rights. This shelf registration statement has not yet been declared effective by the SEC. The Company will not proceeds of the shares being offered under this registration statement. On November 3, 1994, the Company filed an additional shelf registration statement with the SEC relating to a shelf offering of an aggregate of 308,000 shares to be offered and sold, from time to time, by certain stockholders with certain registration statement was declared effective by the SEC on September 28, 1994. The Company will not receive any of the registration statement with the SEC relating to a shelf offering of an aggregate of 234,991 shares to be offered and sold, from time to time, by certain stockholders with certain registration rights. This shelf registration sold, from time to time, by certain warrantholders and other stockholders with certain registration rights. This shelf registration statement was declared effective by the SEC on May 27, 1994. The Company will not

# Advanced Funding Program and Secritable Financing Facility

customers prior to collection of the funds by the Company's billing services business from the local telephone companies (see Note 2 to the Consolidated Financial Statements). On December 7, 1993, the Company and GFC executed an amendment to the Company's revolving line of credit facility. The new terms are more favorable to the Company and include, among other things, the following: greater loan availability; a reduction The Company has a revolving line of credit facility with GFC to draw upon to advance funds to its billing in the Company's interest rate and loan fees; the right to repay and reborrow funds within the availability formula; elimination of certain financial covenants; and a maturity of December 31, 1996. The revolving line of credit is \$45,000,000 for the first and second years of the agreement and, at the option of the Company, \$60,000,000 for the third year.

Because it generally takes 35 to 90 days to collect receivables from the local telephone companies, customers can significantly accelerate cash receipts by utilizing the Company's receivable financing program. The Company offers participation in this program to qualifying customers through its Advanced Payment Agreement. Under the terms of this agreement, the Company purchases the customer's accounts receivable on the date ("Purchase Date") the call records are transmitted to the local telephone companies. The purchase price, which is determined after all cash has been collected, is equal to the face amount of the billing seconds submitted to the local telephone companies by the Company for billing and collection less certain deductions, including: all local telephone company charges, rejects, unbillables and bad debt deductions; all credits and adjustments granted to end users; sales taxes, processing and financing service fees charged by the Company; and any other coats incurred by the Company in processing or collecting customer billing records.

Within five days from the Purchase Date, an initial payment is made to the customer based on a percentage of the value of the customer's call records submitted to the local telephone companies. This percentage is established by the Advanced Payment Agreement and generally ranges between 50% and 80%, but typically averages approximately 75%. The Company pays the remaining balance of the purchase price upon collection of funds from the local telephone companies. The funds used to make the initial payments are generally horrowed under the Company's revolving line of credit facility with GFC. Since the facility was amended in December 1993, the Company has from time to time paid down a portion of the line with excess funds prior to collection of the related receivables from the local telephone companies. The Company had paid down \$13.5 million of the credit facility at September 30, 1994, and consequently, the outstanding balance of the line of credit represented approximately 47% of purchased receivables at September 30, 1994, rather than the more historically typical 75%. The amount borrowed by the Company under this credit facility to finance the advanced funding program was \$25.2 million and \$36.1 million at September 30, 1994 and 1993, respectively.

Financing service fees charged to customers by the Company are recorded as interest income and are computed at a rate above the prime rate on the amount of advances (initial payments) outstanding to a customer during the period commencing from the date the initial payment is made until the Company recoups the full amount of the initial payment from receipts from local telephone companies. The interest rate charged to the customer by the Company is higher than the interest rate charged to the Company by GFC, in part to cover the administrative expenses incurred in providing this service. Borrowing costs are computed at a rate above the prime interest rate, but less than the rate charged by the Company on advances, and are based on the amount of borrowings outstanding during the period commencing from the date the funds are borrowed until the loan is repaid by the Company. Borrowing costs are recorded as interest expense. The result of these financing activities is the generation of a net amount of interest income that contributes to the net income of the Company.

As part of the Advanced Payment Agreement, the customer grants the Company a first lien security interest in, and right of offset with respect to, all the customer accounts, generally including those not acquired by the Company, and agrees to take other action as may be required to perfect the Company's first lien security interest in such customer accounts. Under the terms of the agreement with GFC, the Company is obligated to repay amounts borrowed from GFC and advanced to its billing customers whether or not the purchased accounts receivable are actually collected.

### Segonnality

Approximately 95% of the Company's direct dial long distance revenues are generated by commercial customers, and accordingly, the Company experiences general decreases in long distance revenues around national holidays when commercial traffic is reduced. The Company typically experiences decreases in operator services revenues in the fall and winter months as pay telephone usage declines due to cold and

inclement weather in many parts of the United States. The Company believes the portion of revenues generated from its operator services billing customers may be similarly affected. As a result of the seasonal variations discussed above, revenue reported in the Company's first fiscal quarter ending December 31 (which includes the Thanksgiving, Christmas and New Year's Eve holidays) historically has been the lowest level of any quarter of the year. Conversely, due to increased traffic from pay telephones during the spring and summer months and a lower concentration of national holidays, the Company has historically experienced its highest revenue levels in the third and fourth quarters of the fiscal year. Since the Company's fixed operating expenses do not decrease during the first quarter, the Company's profitability is also, generally, at its lowest level for any quarter of the year.

### Effect of Indiation

Inflation is not a material factor affecting the Company's business. Prices charged to the Company for switching equipment and transmission costs have not materially changed during the year. General operating expenses such as salaries, employee benefits and occupancy costs are, however, subject to normal inflationary pressures.

### New Accounting Standards

The Company is not currently, nor does it expect to be, materially affected by any new standards recently issued by the Financial Accounting Standards Board.

### Bem B. Financial Statements and Supplementary Data

The consolidated financial statements of the Company and the related report of the Company's independent public accountants thereon are included in this report at the page indicated.

	Page
Report of Independent Public Accountants	30
Consolidated Balance Sheets at September 30, 1993 and 1994	31
Consolidated Statements of Income for the Years Ended September 30, 1992, 1993 and	32
Consolidated Statements of Stockholders' Equity for the Years Ended September 30, 1992, 1993 and 1994	33
Consolidated Statements of Cash Flows for the Years Ended September 30, 1992, 1993 and	34
Notes to Consolidated Financial Statements	35

### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of U.S. Long Distance Corp.:

We have audited the accompanying consolidated balance sheets of U.S. Long Distance Corp. (a Delaware corporation) and subsidiaries as of September 30, 1993 and 1994, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended September 30, 1994. 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 financial position of U.S. Long Distance Corp. and subsidiaries as of September 30, 1993 and 1994, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1994, in conformity with generally accepted accounting principles.

As explained in Note 2 to the Consolidated Financial Statements, effective October 1, 1993, the Company changed its method of accounting for income taxes.

ARTHUR ANDERSEN LLP

San Antonio, Texas November 18, 1994

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

### ASSETS

	Negtra	ber M.	
	[00]	1994	
	(le the	encode)	
Current assets:			
Cash and cash equivalents	\$ 15,357 28,481	\$ 16,765 35,223	
Accounts receivable, net of allowances of \$816 (1993) and \$621 (1994)	47,269	53,347	
Purchased receivables from billing customers		4,813	
Prepaids and other	3,571	( management)	
Total current assets	94,678	110,148	
Property and configurate	29,983	41,750	
Less accumulated depreciation and amortization	(7,718)	(13,487)	
Net property and equipment	22,265	28,263	
Equipment held under capital leases, net of accumulated amortization of \$1,298	A		
(1993) and \$1,777 (1994)	4,111	2,458	
Other assets:			
Excess of cost over net assets acquired, net of accumulated amortization of			
\$484 (1993) and \$925 (1994)	8,469	14,943	
Other assets, net of accumulated amortization of \$2,760 (1993) and \$5,027			
(1994)	8,134	8,281	
Total assets	\$137,657	\$164,093	
Total assets	-	-	
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable:			
Trade	\$ 11,738	\$ 17,358	
Third party billing customers	23,949	36,995	
Account liabilities	9,023	11,201	
Revolving line of credit for purchased receivables	36,061	25,235	
Current parties of long-term debt	3,635	5,381	
Current portion of obligations under capital leases	1,158	1,114	
Total current liabilities	85,564	97,284	
Other liabilities.	1,918	3,091	
I one-term debt less current portion	9,219	13,385	
Obligations under capital leases, less current portion	2,819	1,117	
Total liabilities	99,520	114,877	
Commitments and contingencies (See Note 10)			
Stockholders' equity:			
Preferred shares, \$.01 par value, 10,000,000 shares authorized, no shares issued			
or outstanding in 1993 or 1994	0	0	
Common shares, \$.01 par value, 50,000,000 shares authorized, 11,913,176			
shares issued and 11,869,843 shares outstanding in 1993; 12,931,545 shares			
issued and 12,751,813 shares outstanding in 1994	119	129	
Additional mad-in capital	36,113	42,540	
Retained carnings	1,998	8,211	
Treasury stock	(93)	(1,664)	
Total stockholders' equity	38,137	49,216	
Total liabilities and stockholders' equity	\$137,657	\$164,093	
Total liabilities and stockholders equity		SERVICE SERVIC	

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME

	For the Year Ended September M.		
	1992	1993	1994
	escep	-uetv)	
Operating revenues:	£31 030		\$ 52,438
Billing services	\$31,028	\$ 41,966 63,529	67,907
Operator services	19,214	28,631	61,407
Direct dial long distance services	-	-	100000000000000000000000000000000000000
Total operating revenues	85,051	134,126	181,752
Operating expenses:	58,956	93,544	126,725
Cost of services	16,986	25,095	36,234
Selling, general and administrative	3,542	5,937	9,378
Depreciation and amortization	79,484	124,576	172,337
Income from operations	5,567	9,550	9,415
Other income (expense):			
Interest income	2,782	3,953	4,287
Interest expense	(4,156)	(4,773)	(3,381)
Other, net	(19)	(251)	49
Total other income (expense)	(1,393)	(1,071)	955
Income before provision for income taxes and extraordinary items	4,174	8,479	10,370
Provision for income taxes	(1,735)	(3,303)	(4,280
Net income before extraordinary items	2,439	5,176	6,090
Extraordinary items:	2012		
Utilization of net operating loss carryforwards	1,533	231	0
\$349 (1993)	0	(547)	0
Net income applicable to common stock	\$ 3,972	\$ 4,860	5 6,090
Net income per common share:			
Net income before extraordinary items	\$ 0.21	\$ 0.43	\$ 0.43
Extraordinary items	0.14	(0.03)	0.00
Net income per share applicable to common stock	\$ 0.35	\$ 0.40	\$ 0.43

### CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY For the Years Ended September 30, 1992, 1993 and 1994

	Course	a Neet	Perfect	nd Stooch	Additional Paid-in	Metaland	Tresum
	Nhore	Active	Share	Amount (In thousa	('apital	Farnings	Stock
Balances at September 30, 1991	8,930	\$ 89	0	\$0	\$12,296	\$(6,834)	\$ (93)
Exercise of stock options	386	4	0	0	1,064	0	0
Net income	0	_0	0	_0	0	3,972	0
Balances at September 30, 1992	9,316	93	0	0	13,360	(2,862)	(93)
Exercise of stock options and warrants	740	7	0	0	2,426	0	0
Issuance of common stock	1,857	19	0	0	20,327	0	0
Net income	0	0	0	_0	0	4,860	0
Balances at September 30, 1993	11,913	119	0	0	36,113	1,998	(93)
Pooling with Telecom West Inc	270	3	0	0	5	123	0
Exercise of stock options and warrants	113		0	0	827	0	0
Issuance of common stock	636	6	0	0	5,358	0	0
Issuance of treasury stock	0	0	0	0	237	0	66
Purchase of treasury stock	0	0	0	0	0	0	(1,637)
Net income	0	_0	0	_0	0	6,090	0
Balances at September 30, 1994	12,932	\$129	0	\$0	\$42,540	\$ 8,211	\$(1,664)

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended September 30,			
	1992	las)	1994	
		(In thousands)		
Cash flows from operating activities:				
Net income before extraordinary items	5 2,439	\$ 5,176	5 6,090	
Adjustments to reconcile net income before extraordinary items to				
not cash provided by operating activities:				
Utilization of net operating loss carryforwards	1,533	231	0	
Depreciation and amortization	3,542	5,937	9,378	
Provision for losses on accounts receivable	429	448	1,254	
Deferred compensation	213	216	244	
Amortization of debt discount	219	144	0	
Loss (gain) on disposition of property and equipment	28	(21)	48	
Changes in current assets and liabilities, net of effects from				
- the of direct diel have distance community				
Increase in accounts receivable	(6.816)	(12,050)	(6,078)	
Increase in prepaids and other	(862)	(2,709)	(1.868)	
Increase in accounts payable	3,202	2,334	3,982	
Increase in accrued liabilities	2,425	3,210	1,663	
Increase in other liabilities	0	1,712	1,454	
T. T. T. T. T. T. T. M. A. A. G. C. C. M. A. S. C. C. A. S. C.	-	4,628	16,167	
Net cash provided by operating activities	6,352	4,028	10,10	
Cash flows from investing activities:			. 7 730	
Purchase of property and equipment	(4,599)	(16,115)	(7,720)	
Acquisition of direct dial long distance companies, net of cash			1450	
acquired	0	0	(565)	
Payments for purchased receivables from billing customers, net	(16,232)	(6,384)	(6,078)	
Collection of proceeds due to third party customers, net	8,304	2,203	13,046	
Payments received on note	0	0	686	
Proceeds from sale of equipment	0	160	179	
Purchase of other assets	(132)	(4,760)	(2.139)	
Net cash used in investing activities	(12,659)	(24,896)	(2.591)	
Cash flows from financing activities:				
Draws (payments) on revolving line of credit for purchased				
receivables, net	11.882	4,637	(10,826)	
Proceeds from issuance of debt	2,139	11,531	7,704	
Proceeds from issuance of ocot	(1,028)	(14,243)	(4,919)	
Payments on debt	(1.045)	(1,190)	(2,771)	
Payments on capital leases	0	(184)	(267)	
Financing costs	679	21,181	470	
Proceeds from issuance of common stock, net of issuance costs	100.00	21,181	(1,559)	
Purchase of treasury stock	0	-	AND THE PERSONS NO.	
Net cash provided by (used in) financing activities	12,627	21,732	(12,168)	
Net increase in cash and cash equivalents	6,320	1,464	1,408	
Cash and cash equivalents, beginning of year	7,573	13,893	15,357	
Can and case equivalents, regiming to year	\$ 13,893	\$ 15,357	\$ 16,765	
Cash and cash equivalents, end of year	-	Marie Marie Marie	DOMESTICAL PROPERTY.	

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Sentember 30, 1992, 1993 and 1994

### Note 1. Business Activity

U.S. Long Distance Corp. (USLD) was organized under the laws of the Province of British Columbia, Canada, in 1983 and was domesticated and reincorporated under the Delaware Corporation Act in the State of Delaware, United States of America, in 1987, USLD and its subsidiaries (collectively, the Company) currently provide operator services (calling card, collect, person-to-person, and third-party billing calls requiring operator assistance) to hotels, motels, hospitals, university dormitories and private pay telephone owners throughout the continental United States. The Company also operates as a full-service switch-based long distance carrier currently providing direct dial long distance services to small and medium-sized commercial customers and, to a lesser extent, residential customers and was authorized to provide direct dial long distance services to businesses and residents of 42 states as of September 30, 1994. Additionally, the Company provides billing clearinghouse and information management services to unaffiliated operator services providers and direct dial long distance companies.

### Note 2. Summery of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The accompanying consolidated financial statements include the accounts of USLD and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified for comparative purposes.

### Revenue Recognition Policies

The Company recognizes revenue from its operator and direct dial long distance services as such services are performed, net of an estimate for uncollectible revenue, based on historical experience. The Company recognizes revenue from its billing services upon transmission of billable calls to the local telephone companies, which calls are to be billed and collected by the Company.

### Third Party Billing Services

Zero Plus Dialing, Inc. (ZPDI), a subsidiary of USLD, provides billing services to operator services providers and direct dial long distance companies through billing agreements with the local telephone companies, which maintain the critical database of end-user names and addresses of the billed parties. Bills are generated by the local telephone companies and the collected funds are remitted to ZPDI, which in turn remits these funds, net of certain fees, to its billing customers. ZPDI records a trade accounts receivable and revenue for fees charged for its billing services. When the customer's receivables are collected by ZPDI from the local telephone companies, ZPDI's trade receivables are reduced by the amount corresponding to ZPDI's processing fees and the remaining funds are recorded as an accounts payable to third-party billing customers.

ZPDI offers participation in a receivable financing program to qualifying customers through its Advanced Payment Agreement. Under the terms of this agreement, ZPDI generally draws down on its revolving credit facility for purchased receivables and purchases the customer's accounts receivable for an amount equal to the face amount of the billing records submitted to the local telephone companies by ZPDI for billing and collection less:

- all local telephone company charges, rejects, unbillables and bad debt deductions;
- all credits and adjustments granted to end users;
- · all ZPDI processing fees and sales taxes, if appropriate;
- · all financing service charges assessed by ZPDI; and

 any and all losses, costs or expenses incurred by ZPDI in processing or collecting the customer accounts from all previously billed call records

The purchase price is remitted by ZPDI to its customers in two payments. Within five days from receiving a customer's records, an initial payment is made to the customer based on a percentage of the face amount of the customer's call records submitted by ZPDI to the local telephone companies. ZPDI pays the remaining balance of the purchase price to the customer upon collection of funds from the local telephone customers. The purchase date is the date the initial payment is made.

Any third-party accounts receivable purchased by ZPDI are recorded as purchased receivables from billing customers in an amount equal to the face amount of the billing records submitted to the local telephone companies by ZPDI for billing and collection. Concurrently, an equal amount is recorded as accounts payable to third-party billing customers. The amount of the initial payment made to the customer reduces accounts payable to third-party billing customers. The balance, reported as an accounts payable to third-party billing customers (\$23,949,000 and \$36,995,000 at September 30, 1993 and 1994, respectively) consists of:

- an amount equal to the face value of all purchased receivables, reduced for any amounts paid as initial payments under Advanced Payment Agreements, and
- an amount equal to collections from local telephone companies that have not yet been remitted to customers

The purchased receivables balance is relieved at the time the customer receivables are collected from the local telephone companies. Any differences between the amount initially recorded as a purchased receivable and the amount ultimately collected from the local telephone companies, resulting from the fees and deductions detailed above, are recorded as a reduction of the purchased receivable and accounts payable—third-party billing customer accounts in an equal amount. The funds are remitted to the customer after ZPDI deducts finance service charges earned under the agreement.

Finance service charges are assessed to customers and are computed at a rate above the prime interest rate based on the amounts funded to customers. Finance service charges are recorded as interest income during the period from the date of initial payment until ZPDI recoups the full amount of the initial payment from receipts from local telephone companies. No other revenues or income are recorded in connection with the Advance Payment Agreement.

The following third-party receivables purchased and financed by ZPDI were outstanding at:

	Neptember 30,	
	1003	1004
	(in the	mends)
Purchased receivables from billing customers	\$47,269	\$53,347
Purchase money borrowings under revolving credit facility for purchased receivables	\$36,061	\$25,235

The Company has virtually no collection risk related to its purchased accounts receivable and thus does not record an allowance for doubtful accounts related to such receivables. While the Company does not have the legal right of recourse against its billing customers with respect to purchased receivables, the Company does have the right of offset against all funds held for the account of such customers and a first lien security interest in all of such billing customers' accounts, generally including those not acquired by the Company.

# NOTES TO CUNSOLIDATED FINANCIAL STATEMENTS — (Continued)

### Property and Equipment

estimated useful lives of the related assets, which range from three to seven years. Upon disposition, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in other income for that period. Expenditures for maintenance and repairs are charged to expense as incurred Direct installation costs and major improvements are capitalized. Property and equipment are stated at cost. Depreciation is computed on a straight-line hasis over the

## Excess of Cost Over Net Assets Acquired

Excess of cost over net assets acquired represents the excess of the consideration paid over the fair value of the net assets acquired and is being amortized using the straight-line method over forty years for the excess related to the initial acquisition of a direct dial long distance business and twenty years for the excess related to appropriateness of the asset valuations and the amortization periods. all subsequent acquisitions of direct dial long distance businesses. Periodically, the Company assesses the

### Other Assets

held as security for an equipment financing facility, a minority investment in a professional basketball team which is carried at cost, long-term deposits and the long-term portion of notes receivable have been included each respective agreement, the acquisition costs of direct dial long distance customer bases, which are amortized over the expected life of the customer bases, and costs incurred to acquire operator service agreements, which are amortized over the life of each respective contract. In addition, a certificate of deposit billing and collection services and certain customer service and other agreements. Such costs are being amortized over three to eight-year periods. During fiscal 1992, the estimated useful lives of certain of these billing and collection agreements were revised from five years to eight years, resulting in decreased amortization of approximately \$200,000 and a corresponding increase in net income before extraordinary terms and net income of the same amount (\$.02 per share) during fiscal 1992. Other assets also include inancing costs related to the issuance of debt, which have been deferred and are amortized over the life of Other assets include costs incurred to acquire billing agreements with local telephone companies for

### Income Taxes

effects of such adjustments shall be included in income in the period in which the tax laws or rates are changed. The adoption of SFAS No. 109 did not have a material impact on the Company's financial position or results of operations. Prior to October 1, 1993, the Company accounted for income taxes in accordance with the provisions of Accounting Principles Board Opinion No. 11 "Accounting for Income Taxes." Standards No. 109 "Accounting for Income Taxes," which the Company adopted effective October 1, 1993. Under SFAS No. 109, deferred tax liabilities and assets are recorded based on enacted income tax rates which are expected to be in effect in the period in which the deferred tax liability or asset is expected to be settled or realized. A change in the tax laws or rates results in adjustments to the deferred tax liabilities or assets. The In February 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting

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## Net Income Per Common Share

weighted average number of common shares and common share equivalents outstanding during the applicable period. The weighted average number of shares outstanding during each fiscal year differs from the number of shares outstanding during each fiscal year differs from the number of shares outstanding at each year-end due to assumed conversions of options and warrants that were outstanding ng the respective periods and for the assumed issuance of common stock contingently issuable as discussed Net income per common share was computed by dividing net income applicable to common stock by the

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

stock offering, discussed in Note 6, occurred at the beginning of fiscal 1993, net income per common share would have been \$0.49. The supplemental pro forms net income per share amount was calculated including adjustments for discount and capitalized financing cost amortization, debt management fees and interest prepayment of the Senior Subordinated Notes. equivalents relates to the reduction in shares covered by the lender's stock purchase warrants as a result of the Subordinated Notes and a 336,902 reduction in common share equivalents. The reduction in common share expense. In addition, the number of common shares used to compute the per share amount has been adjusted include the addition of 913,000 shares of common stock whose proceeds were used to retire the Senior Had the prepayment of the Senior Subordinated Notes, discussed more fully in Note 4, and the common

1992, 1993 and 1994, was 11,509,000, 12,117,000 and 14,069,000, respectively. The approximate weighted average number of shares used in computing net income per share for fiscal

### Statements of Cash Flows

Cash payments and non-cash activities during the periods indicated were as follows:

Tax benefit recognized in connection with stock option energies	Capital lease and debt obligations incurred  Contingent obligations incurred	Common stock issued in connection with acquisitions	Liabilities assumed in connection with acquisitions	Non-cash investing and financing activities:  Assets accusined in connection with acquisitions.	Cash payments for interest		
ack option		cquisitions	esitions				
1	1 9	1	1	ı	\$ <u>=</u>	132	í
1,363	1,918	1	1	3,018	\$4.98.2 2.88.2	1	Faded Neptron
<b>35</b>	1,637	496	4,273	11,560	3 1455	1	T p

For purposes of determining cash flows, the Company considers all temporary cash investments purchased with an original maturity of three months or less to be cash equivalents.

### Nets 3. Acquisitions

corporation. Effective September 30, 1992, U.S. Long Distance, Inc. (USLDI) and National Telephone Exchange, Inc. (NTX), subsidiaries of USLD, were combined in a statutory merger, with USLDI being the surviving

listance services to small and medium-sized businesses in the San Antonio, Texas and West Texas areas. ( West Texas, Inc.) for cash and notes payable. Nueces Marketing Partners, Ltd. provided direct dial long se of Nueces Marketing Partners, Ltd. (formerly Travis Telecom of San Autonio, Inc. and Travis Telecom On March 4, 1993, the Company consummated its acquisition of the direct dial long distance customer

On July 1, 1993, the Company acquired the direct dial long distance customer base of U.S. Long Distance of Louisiana, Inc., a Louisiana corporation located in Lake Charles, Louisiana, for cash. The Company had no prior ownership interest in this entity nor was it an affiliate of the Company. In addition, the assistance provided to the Company in obtaining a particular telephone contract, the Company issued 7,500 purchase agreement contained an earnout provision whereby the Company would be required to issue to the seller 10,000 shares of the Company's common stock if a specified revenue level was attained by this operation in the 12-month period following the acquisition. In connection with the acquisition, and in consideration for

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

shares to an affiliate of the seller and granted the seller the right to earn and receive up to an aggregate of 120,000 shares of the Company's common stock upon the attainment of certain revenue levels under such telephone contract in the first three years following the acquisition and a warrant to acquire up to an aggregate of 80,000 shares of the Company's common stock at an exercise price of \$11.50 per share upon the attainment of certain revenue levels under the telephone contract in the fourth and fifth years following the acquisition. The Company initially valued the customer base of U.S. Long Distance of Louisiana, Inc. and the telephone contract at the value of the consideration given by the Company, including cash, common stock issued, and the 130,000 contingently issuable shares.

In May 1994, the Company renegotiated the terms of this telephone agreement to reduce both the term and rates charged for long distance services after the Company notified its customer that certain of the customer's former employees may have improperly directed the Company with respect to the payment of certain commissions relating to the provision of the Company's services. The Company is cooperating with its customer in the customer's civil lawsuit against the customer's former employees. As a result of the foregoing, on May 9, 1994, the Company amended the terms of the purchase agreement, agreeing, among other things, to issue 60,000 shares of its common stock to the seller to fully satisfy all contingent consideration requirements of the agreement and to grant certain registration rights with respect to these shares. The carrying values of the customer base and contract, as well as the corresponding liability which was previously recorded, were reduced by approximately \$630,000 in the third quarter of fiscal 1994 to reflect final issuance of the 60,000 shares, which occurred during May 1994. At September 30, 1994, the Company did not have any remaining liability related to this telephone agreement.

On October 1, 1993, the Company acquired Telecom West Inc. (TW1), a direct dial long distance company, for 270,000 shares of its common stock, 27,000 of which were deposited in an escrow account to satisfy certain indemnification obligations. All of the shares held in escrow related to this acquisition have been included in the weighted average shares outstanding for purposes of the earnings per share calculations. These shares were released from escrow on October 1, 1994. The business combination has been accounted for as a pooling-of-interests combination. The accompanying consolidated financial statements include the operating results of TWI since the effective date of the business combination. The consolidated financial statements for periods prior to the combination have not been restated to include the accounts and results of operations of TWI due to the transaction not having a significant impact on the Company's prior period financial position or results of operations.

During fiscal 1994, the Company acquired four other separate, privately-owned direct dial long distance companies located in Texas and California. These acquisitions have been accounted for as purchases, and accordingly, the results of operations of each company have been included in the Company's consolidated financial statements since the respective dates of acquisition. No pro forma financial information with regard to these acquisitions has been presented as the acquisations do not have a significant impact, either individually or in the aggregate, on the Company's prior or current period financial position or results of operations. An aggregate of \$948,000 cash and 550,000 shares of the Company's common stock were issued in connection with these purchase transactions. Of these shares, 6,000 were deposited in an escrow account to satisfy certain indemnification obligations. All of the shares held in escrow related to these acquisitions have been included in the weighted average shates outstanding for purposes of the earnings per share calculations. These shares were released from escrow on November 1, 1994. Total assets acquired and liabilities assumed for these acquired companies were approximately \$2.8 million and \$3.3 million, respectively. The excess of the aggregate purchase price over the fair value of aggregate net tangible assets acquired is approximately \$8.0 million, of which approximately \$6.9 million has been recorded as goodwill and is being amortized on a straight-line basis over 20 years. The remaining balance has been recorded as the purchase price for customer lists and is being amortized on a straight-line basis over five years.

Subsequent to the acquisition of one of these companies, the Company amended the terms of its purchase agreement with the former stockholders of the company, agreeing, among other things, to issue additional shares of its common stock and pay a cash sum to these former stockholders, if necessary, to guarantee a specified acquisition price. These additional shares have been included in the weighted average common shares outstanding for purposes of the carnings per share calculations. On November 2, 1994, pursuant to the terms of the amended agreement, the Company paid an aggregate of \$41,360 in cash and issued an additional 100,000 shares (the "Additional Shares") to the former stockholders. In addition, the Company agreed to pay in cash within five days to such former stockholders the difference, if any, between the value of the Additional Shares on the date they become available for sale through a registration statement declared effective with the SEC (the "First Available Sale Date") and \$1,386,064. The value of the Additional Shares on the First Available Sale Date will be determined by reference to the bid price of the Company's common stock as quoted on the Nasdaq National Market at the close of business on such date. If the value of the Additional Shares on the First Available Sale Date is greater than \$1,386,064, the former stockholders shall pay such difference in cash within five days to the Company. Assuming the closing bid price of the Company's common stock on November 18, 1994, of \$11.75 is the same as the closing bid price of the Company's common stock on the First Available Sale Date, the Company would be required to pay approximately \$211,000 in cash to the former stockholders.

The Company granted certain registration rights to the persons receiving its common stock in the acquisitions and caused its subsidiaries to enter into employment agreements with certain principals of the acquired companies.

### Note 4. Debt

Long-term debt is comprised of the following:

	Septem	aber 30,
	1993	1994
	(in the	usands)
Revolving line of credit for purchased receivables, with a company, 8.25% at September 30, 1994 (prime rate (7.75%) plus .5%), due in varying		
amounts through December 1996	\$36,061	\$25,235
Variable interest rate term notes	1,949	1,191
Fixed interest rate term notes	10,905	17,575
Total debt	48,915	44,001
Less — Current portion	39,696	30,616
Less — Current Jonison	5 9,219	\$13,385

The Company has a revolving line of credit with a company to finance the purchase of certain eligible accounts receivable. Any amounts borrowed to purchase receivables under this revolving credit facility are due upon the Company's collection of the related receivables. In December 1993, the Company and lender executed an amendment to the Company's revolving line of credit facility. The new terms are more favorable to the Company and include, among other things, the following: greater loan availability, a reduction in the Company's interest rate and loan fees, the right to repay and reborrow funds within the availability formula, elimination of certain financial covenants, and a maturity of December 31, 1996. The revolving line of credit is \$45,000,000 for the first and second years of the agreement and, at the option of the Company, \$60,000,000 for the third year. The revolving credit receivable financing facility also allows the Company to borrow against its own operator services and direct dial long distance services accounts receivable. At September 30, 1994, the Company had approximately \$18.7 million available for borrowing and no amounts borrowed against its own receivables under this facility. Any borrowings under this facility bear interest at the prime rate plus. 5%. This

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

facility is collateralized by the related accounts receivable and by virtually all of the assets of the Company not otherwise pledged as security under other debt agreements. Performance under the revolving credit facility has been guaranteed by the Company.

The Company also has an agreement with Frost National Bank to finance up to \$5.0 million of equipment for up to 180 days at the prime rate plus 1%. At September 30, 1994, the Company had no amounts outstanding under this facility, which expires on December 31, 1994.

To finance the acquisition of three related direct dial long distance companies in July 1991, the Company placed \$10,000,000 of its 13% Senior Subordinated Notes due 1995 (Senior Subordinated Notes) with certain investment funds on August 5, 1991. In June 1993, the Senior Subordinated Notes were retired using a portion of the net proceeds received from the Company's June 1993 underwritten common stock offering. The early retirement of the Senior Subordinated Notes resulted in an extraordinary loss of approximately \$547,000, net of approximately \$349,000 of income tax benefits, from the write-off of the related unamortized original issue discount and unamortized financing costs.

The Company has various variable rate term notes at rates ranging from prime plus 2% to prime plus 2.5%, due in varying amounts through February 1998. The Company also has various fixed rate notes with rates ranging from 6.75% to 15.75%, due in varying amounts through June 1999. The proceeds from the issuance of these notes were used to acquire certain computer and telecommunications equipment and office furniture. The loans are guaranteed by the Company and are secured by the assets acquired with the proceeds of such notes.

The credit facilities discussed above contain various restrictions and financial ratio maintenance requirements. Under the most restrictive terms of its credit facilities, the Company is required to maintain a quarterly ratio of consolidated operating income, as defined in the agreements, to consolidated fixed charges of at least 1.5 to 1.0 and is prohibited from paying dividends on its common stock. The Company may also be subject to certain limitations on its annual capital expenditures and on the issuance of additional secured debt, but can issue subordinated unsecured debt provided the ratio of total consolidated debt to total capitalization does not exceed 85%. Further, the Company is required to maintain a ratio of funded debt, as defined in the applicable loan agreement, to total capitalization not greater than 60%. The agreements further limit the ability of certain of the Company's subsidiaries to remit dividends to the Company. Cross-default provisions of the Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other loan agreements. Under the Company's most significant credit facilities, the Company has guaranteed the obligations of its subsidiaries. The Company was in compliance with all required covenants at September 30, 1993 and 1994.

Scheduled maturities for the years ending September 30, 1995 through 1999 are as follows (in thousands):

1995		\$30,610
1996		4,67
1997		4,32
1998		3,39
1999	.,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	99
		\$44.00

### Note 5. Legers

The Company leases equipment and office space under non-cancelable operating leases. Rental expense for fiscal 1992, 1993 and 1994, was \$895,000, \$1,744,000 and \$2,886,000, respectively. Future minimum lease payments under these leases at September 30, 1994, are as follows (in thousands):

Year Ending September 30,	** ***
1995	\$2,486
1996	2,205
1997	2,006
1998	1,493
1999	100000
Thereafter	313
Total minimum lease payments	\$8,882

The Company also leases various computer and telecommunications equipment under capital lease arrangements. Future minimum lease payments under these capital leases together with the present value of the net minimum lease payments at September 30, 1994, are as follows (in thousands):

Year Ending September 30,	
1772	\$1,300
1996	649
1997	398
1998	154
1999	
Total minimum lease payments	2,562
Less: Amount representing interest	(331
Present value of net minimum lease payments	\$2,231

### Note 6. Share Capital

During fiscal 1993, the Company sold, through an underwritten common stock offering, 1,850,000 shares of common stock, receiving net proceeds of approximately \$20,269,000 after expenses of approximately \$755,000. Additionally, warrants to purchase 450,000 shares of common stock were exercised by certain selling stockholders at \$0.01 per share in connection with the underwritten common stock offering.

On June 1, 1994, the Company was authorized by its board of directors to purchase up to one million shares of its outstanding common stock. The shares acquired pursuant to this stock purchase program will be purchased using available Company funds from time to time on the open market over the course of the twelve months beginning June 1, 1994 as market and other relevant conditions warrant. Accordingly, the Company purchased 160,000 shares under this program at an average market price of \$9.74 per share (see Note 12). All of these shares were purchased subsequent to July 1, 1994. At September 30, 1994, the Company had 179,732 shares of treasury stock, carried at cost.

No dividends were paid on the Company's common stock during fiscal 1992, 1993 and 1994.

### Note 7. Stock Options and Stock Purchase Warrants

The Company has granted stock options to directors and employees as follows:

	Number of Shares	Price Range of Shares Under Option
Outstanding, September 30, 1993	1,252,689	
Canceled	(141,054)	\$ 4.62 - \$13.88
Granted	657,850	\$ 9.38 - \$13.88
Exercised	(112,386)	\$ 1.50 - \$ 9.75
Outstanding, September 30, 1994	1,657,099	
Exercisable, September 30, 1994	610,792	

A total of 76,665 stock options outstanding at September 30, 1994, are exercisable at prices ranging from \$2.75 to \$4.62 at varying dates through July 25, 1996. A total of 55,000 stock options outstanding at September 30, 1994, were granted under the provisions of the Company's Non-Employee Director Stock Option Plan and are exercisable at prices ranging from \$2.25 to \$9.88 per share. These options, which are subject to certain vesting requirements, expire at varying dates through Lebruary 23, 1999. As of September 30, 1994, there were 140,000 shares remaining to be issued under this plan. The remaining 1,525,434 options outstanding at September 30, 1994, were granted under the provisions of the 1990 Employee Stock Option Plan and are exercisable at prices ranging from \$1.50 per share to \$12.13 per share. These options, which are subject to certain vesting requirements, expire at varying dates through September 26, 1999. This plan provides for the granting of incentive stock options and nonqualified stock options. As of September 30, 1994, there were 568,307 shares remaining to be issued under this plan. During fiscal 1992 and 1993, options to purchase 386,306 and 289,705 shares of common stock were exercised, respectively.

The excess of the market value of the common stock on the date granted over the exercise price of such options results in compensation expense to the Company on the date the options vest. Approximately \$213,000, \$216,000 and \$244,000 of compensation expense was recognized by the Company during fiscal 1992, 1993 and 1994, respectively. Deferred compensation costs amounting to \$374,000 and \$427,000 at September 30, 1993 and 1994, respectively, have been netted against paid-in capital in the accompanying consolidated financial statements.

Stock purchase warrants to purchase 1,078,200 shares of common stock were outstanding at September 30, 1993 and 1994 which were issued in connection with the sale of the Senior Subordinated Notes described in Note 4 and are exercisable at \$.01 per share until August 5, 1999. The Company attributed \$750,000 of the proceeds from the Senior Subordinated Notes to these warrants in the accompanying consolidated financial statements. During fiscal 1993, warrants to purchase 450,000 shares of common stock were exercised and the remaining warrants were reduced by 336,902 due to the early retirement of the Senior Subordinated Notes. There were no stock purchase warrants exercised in fiscal 1992 or 1994.

In October 1992, the Company agreed to grant a non-transferable warrant to purchase 125,000 shares of common stock at an exercise price of \$12.38, pursuant to a telecommunications service agreement. The exercise price of the warrant was equal to the market value of the Company's common stock on the date of grant. The exercise of the warrant is contingent upon the attainment of a certain operator service call volume billed by the Company pursuant to the telecommunications service agreement.

In July 1993, the Company agreed to grant a warrant evidencing the right to purchase up to 80,000 shares of common stock at an exercise price of \$11.50 per share and issue up to an additional 130,000 shares of common stock to the seller of U.S. Long Distance of Louisiana, Inc. Under this agreement, the exercise of the warrant and the issuance of the common stock was contingent upon the attainment of certain revenue levels

under a telephone contract and from a particular customer base. In May 1994, the Company issued 60,000 shares of its common stock to the seller to fully satisfy all contingent consideration requirements of the agreement.

### Note & Income Taxes

The provision for income taxes is comprised of the following (in thousands):

	Veer I	Year Faded September M.		
	1992	100)	1994	
Current	\$1,183	\$1,189	\$3,069	
Deferred	552	2,114	1,211	
	\$1,735	\$3,303	\$4,280	

The provision for income taxes for fiscal 1992, 1993 and 1994 differs from the amount computed by applying the statutory federal income tax rate of 34% to income before taxes. The reasons for these differences were as follows (in thousands):

	Veer Finded September 30,		
	1643	140)	1004
Computed income tax provision at statutory rate	\$1,419	\$2,883	\$3,526
Increases (reductions) in taxes resulting from: State income taxes	209	391	567
Amortization of asset valuations in excess of tax	58	40	146
Other, net	49	_(11)	41
Provision for income taxes	\$1,735	\$3,303	\$4,210)

The tax effect of significant temporary differences, which comprise the deferred tax assets and liabilities, are as follows (in thousands):

	Neptem	L. M.
	1003	1994
Deferred tax assets:  Expense provisions	\$ 147 850 1,014	\$ 102 796 0
Total gross deferred tax assets	2,011 (396)	898
Net deferred tax assets	(1,385)	898 (1,640)
Tax depreciation and amortization in excess of book  Prepaid expenses	(230)	(260) (396)
Total gross deferred tax liabilities	(1,615)	(2,296)
Net deferred tax liability		\$(1,398)

The valuation allowance at September 30, 1993 represents the tax benefits of certain future net operating loss carryforward amounts which were not expected to be realizable as of that date. During the year ended

September 30, 1994, the Company generated sufficient taxable income to utilize all the net operating loss carryforwards existing at September 30, 1993. As such, no valuation allowance was required at September 30, 1994.

During fiscal 1992 and 1993, the Company recognized, as an extraordinary item, a tax benefit of approximately \$1,533,000 and \$231,000, respectively, resulting from the utilization in such years of the Company's net operating loss carryforwards generated in fiscal years prior to fiscal 1992. No such tax benefit was recognized during fiscal 1994.

For the year ended September 30, 1994, the Company had fully utilized its federal income tax net operating loss carryforwards available to reduce future income tax liabilities. The Company has an alternative minimum tax carryforward of approximately \$2.3 million available to reduce future federal taxable income. The Company has recognized the benefits of such tax carryforward for financial reporting purposes.

### Note 9. Benefit Plans

The Company adopted the U.S. Long Distance Corp. 401(k) Retirement Plan (Retirement Plan) effective January 1, 1992. Participation in the Retirement Plan is offered to eligible employees of the Company or its subsidiaries. Generally, all employees of the Company or its subsidiaries who are 21 years of age and who have completed one year of service during which they worked at least 1,000 hours are eligible for participation in the Retirement Plan.

The Retirement Plan is a defined contribution plan which provides that participants generally may make voluntary salary deferral contributions, on a pretax basis, of between 2% and 15% of their compensation in the form of voluntary payroll deductions up to a maximum amount as indexed for cost-of-living adjustments. The Company makes matching contributions at a percentage determined annually of the first 6% of a participant's compensation contributed as salary deferral. The Company may from time to time make additional discretionary contributions. During fiscal 1994, a discretionary contribution in the amount of approximately \$51,000 was made. No discretionary contributions were made in fiscal 1992 or 1993. During fiscal 1992, 1993 and 1994, the Company's contributions totaled approximately \$34,000, \$79,000 and \$198,000, respectively.

The Company adopted the U.S. Long Distance Corp. Executive Compensation Deferral Plan (Executive Plan) and the U.S. Long Distance Corp. Director Compensation Deferral Plan (Director Plan) effective January 1, 1994. Participation in the Executive Plan is offered to selected employees occupying management positions who are determined by the Company's board of directors from time to time to be eligible to participate in the Executive Plan. Participation in the Director Plan is offered to individuals occupying a position as an outside director. The Executive and Director Plans are defined contribution plans which provide that participants may make voluntary salary deferral contributions, on a pretax basis, of between 1% and 100% of their eligible compensation. Under the Executive Plan, the Company makes matching contributions equal to the lesser of 100% of a participant's contributions or an amount determined based on a formula established by the plan. Matching contributions under the Director Plan are 33% of the participant's contributions. The Company has the right to make matching contributions of a different amount or no contributions under both plans. During fiscal 1994, the Company contributed \$60,000 and \$6,000 to the Executive Plan and Director Plan, respectively.

Additionally, the Company adopted the U.S. Long Distance Corp. Executive Qualified Disability Plan effective January 1, 1994. The Disability Plan provides long-term disability benefits for certain employees occupying management positions through disability insurance coverage purchased by the Company and Company funded payments. Benefits under the Disability Plan are provided directly by the Company based on definitions contained in the insurance policies.

In December 1990, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Post-Retirement Benefits Other Than Pensions"

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

and in November 1992, the FASB issued Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Post-Employment Benefits." The Company does not currently offer any retirement benefits covered by Statement No. 106 or Statement No. 112 and thus is not affected by these standards.

## Note 10. Commitments and Contingencies

Company is a party would have a material adverse effect on the Company's financial position or results of operations; however, due to the inherent uncertainty of intention, there can be no assurance that the resolution The Company is involved in various claims and legal actions arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the of any particular claim or proceeding would not have an adverse effect on the Company's results of operations for the fiscal period in which such resolution occurred.

policies and procedures. This review was managed by a senior partner of Arthur Andersen LLP who was not involved in the annual audit process. This special review provided satuag additional assurance that the financial statements of the Company were fairly stated and in conformity with generally accepted accounting principles. Representatives of the Company and Arthur Andersen LLP have met with the Enforcement Division of the SEC to discuss the issues raised by the inquiry. On May 5, 1994, the Company was informed that the SEC had instituted a formal order of private investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934, as amended (In The Matter of U.S. Long Distance (HO-2852)), relating to, among other things, the of the Company's accounting practices, including revenue recognition and accounting related to the Company's accounts rectivable, purchased receivables and other assets, and related disclosures. When the Company's financial condition, results of operations, assets and liabilities, revenues and revenue recognition and agreements and transactions. The Company has and will continue to cooperate fully with the SEC. Although the Company cannot predict when the SEC's private investigation will be concluded, based upon its review of facts and circumstances, management does not believe that the SEC's review in this matter will independent public accountants, was engaged to conduct a special review of the Company's accounting Company's Board of Directors learned of the SEC's informal inquity, Arthur Andersen LLP, the Company's result in any adjustment to the Company's previously reported financial statements. In December 1993, the SEC's Division of Enforcement instituted an informal inquiry relating to certain

Section 21(a) of the Securities Euchange Act of 1934, as amended (In the Matter of Trading in the Securities of Value-Added Communications, Inc. (IIO-2765)) on August 25, 1993. The investigation relates to the trading in the securities of both the Company and Value-Added Communications, Inc. ("VAC"), an operator service provider based in Dallas, Texas. A proposed merger between the Company and VAC was terminated in February 1993. Specifically, the SEC has alleged, among other things, that certain individuals may have securities of either the Company, VAC or both. The SEC may impose a variety of civil, criminal and administrative remedies and/or sanctions against any individual or entity found to have violated the federal securities laws. The Company is unaware of any activity by the Company or its management that might have violated the insider trading provisions of the federal securities laws. employed devices, schemes or artifices to defraud others in connection with the purchase or sale of the The SEC's Division of Enforcement instituted a formal order of private investigation pursuant to

On December 15, 1993, the Company, its Board of Directors, a former director, and Arthur Andersen LLP were named as defendants in a stockholder class action lawsuit filed in the United States District Court for the Western District of Texas (Colby L. Collier v. U.S. Long Distance Corp., et al., Civil Action No. SA93CA1066). The Complaint, filed by an individual who claimed to own shares of the Company's Common Stock during the period from December 22, 1992 through December 10, 1993. The Company's Common Stock during the period of federal accurities laws, including antifrand provisions, common law fraud and negligent misrepresentation in connection with the Company's filings with the SEC, the preparation of the Company's financial statements

# U.S. LONG DISTANCE CORP. AND SHESHMARKS

# NOTES TO CONSULDATED FINANCIAL STATEMENTS — (Continued)

and the Company's public statements and press releases. The lawsuit requested, among other things, compensatory damages in an unspecified amount, prejudgement interest, costs and reasonable attorneys' fees. On April 4, 1994, the plaintiffs in the above pending class action lawsuit voluntarily moved for the dismissal of their complaints without prejudice. No settlement amounts were paid by the Company or Arthur

unspecified amount, pre-judgment interest, conts and attorneys' fees. On April 4, 1994, the plaintiffs in the above pending class action lawsait voluntarily moved for the dismissal of their complaints without prejudice. No aettlement amounts were paid by the Company. Complaint alleged, among other things, violations of federal securities laws, including antifraud provisions, common law fraud, deceit and negligent misrepresentation in connection with the Company's filings with the SEC, the preparation of the Company's financial statements and the Company's public reports, statements and press releases. The lawsest sought, among other things, compensatory and punitive damages in an Texas, was brought by an individual who claimed to own shares of the Company's Common Stock on behalf of purchasers of the Common Stock during the period November 20, 1992 through December 9, 1993. The defendants in a separate class action lawsuit (Ligpist v. U.S. Long Distance Cosp. et al., Civil Action No. SA93CA1088). This action, also filed in the United States District Court for the Western District of On December 21, 1993, the Company, its Board of Directors and a former director were named as

The Company is obligated to pay a total of approximately \$3,909,000 during fiscal 1995 for minimum usage charges under hilling and collection agreements with certain local telephone companies. The Company anticipates exceeding the minimum usage volumes with these local telephone companies during fiscal 1995. The Company is also obligated to pay a minimum of approximately \$8,700,000 through April 1996 for usage charges under service agreements with certain long distance carriers

### Note 31. Regulatory Mattern

Grand

regulations govern the manner in which those services are provided, such as the provision of written and verbal identification of the operator services provider on each call. At the date of this report, the Company was in material compliance with the regulations set forth by the FCC, and by those state regulatory agencies who have exercised similar authority over intrastate calls. The FCC issued a report to Congress in November 1992 Federal Communications Commission (FCC) that describe the rules and regulations governing the provision of their interstate operator assisted services, including any rates and charges that may be applied. Additional ndustry and that no additional regulations were necessary. Operator services providers such as the Company are required to the informational tariffs with the that the current regulatory and competitive forces are effectively regulating the operator services

impact on the financial condition or results of operations of the Company. Any potential claims paid to consumers or regulatory agencies will be partially offset by refunds of commissions that were paid to the Company's agents and pay telephone owners. The Company further modified its operator services billing practices in June and July of 1994 to comply with all regulatory requirements in those areas in which it circumstances, management does not believe that any such refunds or claims will have a material adverse subject to refund in various regulatory jurisdictions. It is not possible to estimate the ultimate carnings impact, if any, of potential refunds and other related claims, However, based upon its review of current facts and consumers over a 17-month period, were not in compliance with certain regulatory requirements and may be services. These changes increased operator services revenue by \$509,000 and \$1,631,000 for the third and fourth quarters of fiscal 1993, respectively, and increased first, second and third quarter fiscal 1994 operator services revenue by \$1,673,000, \$1,818,000 and \$2,106,000, respectively. These amounts were collected from The Company made several changes in its operator services billing practices beginning in February 1993. Such changes increased the amount of time charged to consumers for the use of the Company's operator

provides services. Where appropriate, the Company has refiled tariffs to provide an enhanced description of the Company's operator services billing practices.

Under the FCC's policy of forbearance, "non-dominant" interstate "1+" long distance carriers were excused from the tariff filing requirement imposed upon long distance companies through the Communications Act of 1934, as amended (the Act). On November 13, 1992, the U.S. Court of Appeals for the D.C. Circuit found this policy to be unlawful. The U.S. Supreme Court upheld the Circuit Court decision on June 17, 1994. All long distance providers, including the Company, are now required to file tariffs which contain a "reasonable range of rates" with the FCC for their direct dial long distance services. The Company is in compliance with this requirement.

In response to the Circuit Court's original action, however, American Telephone and Telegraph Co. (AT&T) filed actions in the United States District Court against MCI Telecommunications Corporation (MCI) and two other carriers seeking damages for their failure to comply with the Act during the period prior to November 13, 1992. If the Court ultimately finds in AT&T's favor, it is possible that AT&T could also seek damages from other competitive carriers, such as the Company, who did not file tariffs while complying with the FCC's forbearance policy. The likelihood, timing or outcome of any such proceeding is impossible to predict.

### Interstate Access Transport Proceeding

In January 1994, the FCC granted increased pricing flexibility to local telephone companies for "access transport" services. These services refer to the connection provided by the local telephone companies between long distance telephone companies and their customers' telephones. Local telephone companies formerly assessed an equal charge per unit of access to all long distance telephone companies, regardless of the volume of access each long distance telephone company purchased. After implementation of the FCC's new plan, local telephone companies now may discount access transport rates to the long distance telephone companies with the highest access volumes, and increase access transport rates to long distance telephone companies with relatively lower access volume. The FCC originally projected the variance in these discounted and increased prices should not exceed 1.8%.

The pricing plan is scheduled to expire in November 1995. During this interim, the FCC is expected to consider whether to make this pricing plan permanent or to enact further revisions. Under this process, the FCC could grant local telephone companies further flexibility and could potentially impose a greater burden upon the Company's direct dial long distance services. The FCC is forecasting that, by November 1995, the proliferation of competitive access providers and increased long distance telephone company network efficiencies should offset any pricing inequities caused by volume-sensitive access pricing. Management is unable to predict either the course and effect of the FCC's actions on this issue at this time, or the timing or outcome of the pending court review.

### CHD Calling Card Proceeding

The proprietary calling card of AT&T, often called a card issuer-identifier (CIID) card, carries an account number that operator services providers such as the Company are unable to accept for billing. The dialing instructions that accompanied these cards once directed the cardholder to attempt to place calls by first accessing the presubscribed operator services provider's network, notwithstanding the inability of non-AT&T providers to complete the call. On October 8, 1992, the FCC adopted an Order requiring AT&T to engage in a vigorous customer re-education campaign to correct this consumer misinformation. In addition, AT&T established a mechanism by which operator services providers could receive compensation for referring such CIID card calls to AT&T. This direct compensation for errant access by CIID cardholders, which is scheduled to continue until 1995, converts previously unrecoverable network expenses into billable revenue.

### **Billed Party Preference**

Billed Party Preference (BPP) is an issue under consideration currently by the ECC and refers to a concept in which any long distance call outside the local telephone company's calling area carried from a publicly available telephone would be automatically routed over the long distance telephone company network of the billed party's preference. This would be accomplished through a local telephone company data-base system that would match every calling card and telephone number to a preferred long distance telephone company and route all calls accordingly.

In April 1992, the FCC tentatively proposed adopting BPP. During the summer of 1992, comments from local telephone companies, long distance telephone companies and other industry representatives revealed that the costs of imposing BPP could be in excess of \$1 billion and could require hundreds of millions of dollars each year to operate. Commentors made clear that many ancillary technical impediments would necessarily accompany deployment of BPP, as contemplated. Furthermore, equipment manufacturers could not support implementation of BPP until three years after such decision. Most commentors appeared to oppose the BPP proposal.

On June 6, 1994 the FCC released a "Further Notice of Proposed Rulemaking" in the BPP proceeding. Once again, the FCC expressed a clear interest in examining further the relative costs associated with BPP implementation. The FCC also requested that the industry provide suggestions for a more cost efficient alternative which might similarly meet the objectives of BPP, which are the facilitation of access to operator service networks, increased competition and lower end user rates. The FCC received industry members' comments on August 1, 1994, which again were heavily against the adoption of this system. The FCC has taken no further action to date, and it is impossible to predict when and if any final ruling might be issued.

If such a system were implemented, the unique market niche of operator services providers, such as the Company, would be severely impaired, since operator services providers depend upon public telephone presubscription, and BPP takes the call routing decision away from the public telephone owner. It is difficult to assess the industry support for BPP, given the inherent technical problems it involves. AT&T is on record as opposing this proposal, and the Regional Bell Operating Companies agree that they would not support it unless they were not held accountable for the costs of its implementation. The FCC has been investigating this proposal now for six years, and the record in this proceeding shows that network reconfiguration would take two to four years beyond any positive FCC action. Thus, while BPP remains arguably viable, as demonstrated by the FCC's recent Notice, it is not probable that it would be technically implemented in the near term.

### MFJ Legislation

Legislation was introduced in the 103rd Congress which would have codified many of the requirements of the AT&T Consent Decree of 1983. H.R. 3626, "The Anti-Trust Reform Act of 1993," sponsored by Congressmen Brooks and Dingell, proposed to incrementally climinate the long distance restrictions imposed on the RBOCs over a period of five years, pending review and approval of the FCC and the Department of Justice. The bill also would have allowed the RBOCs to provide cable programming services and cable signals over their network, while at the same time permitting cable companies to carry telecommunications signals over their existing network.

S.B. 1822, a Bill introduced in early February 1994 by Senator Hollings, Chairman of the Senate Commerce Committee, would allow RBOC entry into long distance upon obtaining FCC approval after demonstrating nome level of actual competition in their local service area, and that their entry into long distance would not unfairly harm existing competition. While the 103rd Congress ended before a telecommunications bill reached Conference Committee, certain legislators have indicated their interest in sponsoring telecommunications legislation in the 106th Congress, which convenes in January 1995. The Company would face formidable new competition in the event the RBOCs are permitted to enter the long distance business.

Competition would be more formidable if such entry is not predicated on certain RBOC concessions over their control of long distance access services. The Company is unable to determine the time frame or outcome of such consolidation or negotiations.

In September 1993, AT&T petitioned the FCC to reclassify it as a "non-dominant" carrier. The FCC has asked for public comment on the AT&T proposal. If the petition is granted, AT&T would be given additional flexibility in its service offering and pricing. Such flexibility could make AT&T an even more formidable competitor than it is today. The Company cannot predict the timing or outcome of FCC action on this petition.

### California

On September 17, 1993, the California Public Utilities Commission adopted an Order which would have allowed the Company to begin providing certain intral.ATA telecommunications services within the state beginning January 1, 1994. Subsequently on October 6, 1993, the Commission rescinded the September 17, 1993 Order, citing certain improprieties within the Commission review process, pertaining specifically to certain California local exchange company employees and their improper access to decision makers during the final compilation of the Order. The Commission issued a report of its investigation into the alleged improprieties on October 13, 1993, and the California Legislature held a hearing on October 21, 1993 regarding the events leading up to September's release of the Ordering document. In July 1994, the Commission released a proposed "Implementation Rate Design" decision for public comment. On September 15, 1994, the Commission adopted this decision, which authorizes certain intral.ATA competition beginning on January 1, 1995.

### Texas PIU Issue

In a Final Order released in Docket 10127 on April 12, 1993 (Final Order), the Texas Public Utility Commission (PUC) adopted new regulations governing the method by which interexchange carriers (IXCs) such as the Company calculate intrastate access charges paid to local exchange companies (LECs). These new rules required an independent auditor's review and approval of an IXC's methodology of determining its own intrastate access usage. The auditors' reports were to be submitted to the LECs for review and implementation beginning on June 15, 1994.

However, on June 13, 1994, Travis County Judge Hume Coler found in Allcomm Long Distance. Inc. v. PUC and Southwestern Bell, Cause No. 94-06509, that Allcomm was entitled to an injunction against enforcement by the PUC and Southwestern Bell of the Final Order because it improperly delegated regulatory authority outside the PUC. Permanent injunctive relief was granted to Allcomm in this Cause on June 17, 1994. The decision has been appealed by PUC and Southwestern Bell.

On June 15, 1994, the Company, along with several other IXCs (Intervenors) sought intervention and similar injunctive relief in a new cause filed with Judge Cofer, Cause No. 94-06509-A, American Telco. Inc. et al. v. PUC and Southwestern Bell. The Intervenors reached an agreement in accordance with Rule 11, Texas Rules of Civil Procedures, with the PUC and Southwestern Bell which provided that, in lieu of submitting audit reports, Intervenors would have such reports held under seal by a designated third party until a final nonappealable judgment is rendered in the Allcomm case. In the interim, Intervenors such as the Company are not prohibited from continuing to establish access charge levels based upon their own respective methodologies.

In the event Judge Cofer's decision is overturned on appeal, it is possible that the Company may be required by further PUC action to adopt modified methodologies which could subsequently obligate it to compensate the LECs for any resulting differences in calculated access charges. The Company cannot predict the timing nor outcome of the appeal nor the actions which may be undertaken by the LLCs either before or

after the appeal is finalized. Based on the advice of legal counsel, management believes there is no retroactive liability for periods prior to September 30, 1994. However, management estimates that under the most extreme application of the independent auditors' proposed methodologies, the difference between applying the methodologies would result in increased intrastate access charges of between \$3 million and \$4 million annually.

### Note 12. Subarquent Events

Effective October 1, 1994, the Company acquired L.D. Network, Inc., a direct dial long distance company headquartered in Los Angeles, California, for 175,000 shares of the Company's common stock, 17,500 of which were deposited in an escrow account to satisfy certain indemnification obligations. L.D. Network, Inc. had revenues of approximately \$2.5 to \$3.0 million for the year ended September 30, 1994 and had 400 customers at September 30, 1994. The acquisition of L.D. Network, Inc. will be accounted for as a pooling-of-interests combination. The Company granted certain registration rights to the persons receiving its common stock in the acquisition and caused its subsidiary to enter into an employment agreement with a principal of the acquired company.

Subsequent to September 30, 1994, the Company purchased 107,500 shares of its common stock at an average market price of \$10.00 per share in accordance with the stock purchase plan authorized by its board of directors (see Note 6).

Note 13. Selected Quarterly Financial Data (Unaudited)

		Three Mos	nto Ended	
	December 31, 1993	March 31,	Jose M.	Neptrader M. 1984
	(le the	mach, map	per share a	manpair)
	\$38,792	\$42,181	\$48,387	\$52,392
) from operations	(1,124)	817	3,803	5,919
loss) before extraordinary item	(679)	563	2,385	3,821
s)	(679)	563	2,385	3,821
loss) per share of common stock				
raordinary item	\$ (0.05)	5 0.04	\$ 0.17	\$ 0.27
loss) per share of common stock	(0.05)	0.04	0.17	0.27
		Three Mer	the Faded	
	December 34, 1982	March 31, (90)	June 10, 1993	Neptomber M. (40)
	(le the	wards, excep	-	messic)
	\$26,126	\$30,700	\$35,435	\$41,865
m operations	1,321	1,761	2,990	3,478
e before extraordinary item	548	794	1,563	2,271
<b>6</b>	779	794	1,016	2,271
per share of common stock before				
linary item	\$ 0.05	\$ 0.07	\$ 0.13	\$ 0.17
per share of common stock	0.07	0.07	0.09	0.17

### Stem 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure None.

### PART III

### Item 10. Directors and Executive Officers of the Company

The information called for by this item is incorporated herein by reference from the information under the captions "Election of Directors" (Item 1 on proxy), "Management — Directors and Executive Officers," and "Section 16(a) Reporting" of the Company's definitive proxy statement to be filed pursuant to Regulation 14A with the Securities and Exchange Commission relating to its Annual Meeting of Stockholders to be held on March 1, 1995 (the "Definitive Proxy Statement").

### Stem 11. Executive Compensation

The information called for by this item is incorporated herein by reference from the information under the caption "Management — Committees, Meetings and Compensation of the Board of Directors — Directors' Fees" and from the information under the caption "Executive Compensation" of the Company's Definitive Proxy Statement.

### Item 12. Security Ownership of Certain Beneficial Owners and Management

The information called for by this item is incorporated herein by reference from the information under the caption "Voting Securities and Principal Stockholders" of the Company's Definitive Proxy Statement.

### Item 13. Certain Relationships and Related Transactions

The information called for by this item is incorporated herein by reference from the information under the caption "Certain Transactions" of the Company's Definitive Proxy Statement.

### PART IV

### btem 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

### (a) Documents Filed as Part of Report

### 1. Financial Statements:

The consolidated financial statements of the Company and the related report of the Company's independent public accountants thereon have been filed under Item 8 hereof.

### 2. Financial Statement Schedules:

The following financial statement schedules and the report of independent public accountants thereon are included in this report at the page indicated. All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted because such schedules are not required under the related instructions or are inapplicable or because the information required is included in the Consolidated Financial Statements or notes thereto.

	Pap
Report of Independent Public Accountants	54
Schedule 11 - Amounts Receivable from Related Parties and Underwriters, Promoters, and	
Employees Other than Related Parties	55
Schedule III - U.S. Long Distance Corp. Condensed Financial Information	56
Schedule VIII Valuation and Qualifying Accounts	60
Schedule IX — Short-Term Borrowings	61
Schedule X — Supplementary Income Statement Information	62

### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of U.S. Long Distance Corp.:

We have audited, in accordance with generally accepted auditing standards, the consolidated financial statements of U.S. Long Distance Corp. and subsidiaries and have issued our report thereon dated November 18, 1934. Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedules II, III, VIII, IX and X are the responsibility of the Company's management and are presented for purposes of complying with the Securities and Exchange Commission's rules and are not part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly state in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

San Antonio, Texas November 18, 1994

### AMOUNTS RECEIVABLE FROM RELATED PARTIES AND UNDERWRITERS, PROMOTERS, AND ENGLOYEES OTHER THAN RELATED PARTIES (In thousands)

					entines		
Floor Year	Name of Debter	***	Additions	Adminis	Amounts Visites off	Current	Fed of Period Not Convert
1992		\$0	\$ 0	\$0	\$0	5 0	\$0
1993		\$0	\$ 0	\$0	\$0	5 0	50
1994	Dave Clem	\$0	\$100	\$0	\$0	\$100	\$0

### U.S. LONG DISTANCE CORP.

### CONDENSED FINANCIAL INFORMATION (Not Consolidated)

### CONDENSED BALANCE SHEETS (In thousands)

### ASSETS

	Septem	her Mi,
	100)	1994
Current assets:		
Accounts receivable	\$ 495 379	\$ 396 1,433
Total current assets	874	1,829
	18,472	11,488
Investment in subsidiaries (equity method)	19,931	33,309
Net property and equipment	2,882	3,644
Other assets	916	2,392
Total assets	\$43,075	\$52,663
Current liabilities: Accounts payable	\$ 816 1,238 326	\$ 692 ( 212 904
Total current liabilities	2,380	1.655
Other Nabilities	485	783
Long-term debt, less current portion	155	94
Common stock	119	129
Additional paid-in capital	36,113	42,540
Retained earnings	1,998	8,211
	(93)	(1,664
Treasury slock		-
Total stockholders' equity	38,137	49,216

See notes to condensed financial statements

### U.S. LONG DISTANCE CORP.

### CONDENSED FINANCIAL INFORMATION (Not Complifated)

### CONDENSED STATEMENTS OF INCOME (In thousands)

	I or the be	or Federal Nag	tember M.
	1465	(100)	1000
Cost and expenses:			
Operating and general expenses	5 329	\$ 549	\$ 859
Interest expense	1,594	1,198	105
Other	(1,923)	(2,294)	(964)
	. 0	547	0
Equity in earnings of subsidiaries	3,972	4,860	6,090
Net income before extraordinary items	3,972	5,407	6,090
Extraordinary loss on early extinguishment of debt	0	(547)	0
Net income applicable to common stock	\$3,972	\$4,860	\$6,090

See notes to condensed financial statements.

### U.S. LONG DISTANCE CORP.

### CONDENSED FINANCIAL INFORMATION (Not Consolidated)

### CONDENSED STATEMENTS OF CASH FLOWS (in thousands)

	I or the Vo	or Laded Septe	ember 34,
	1445	120	194
Cash flows from operating activities:			\$ 6,090
Net income before extraordinary item	\$ 3,972	\$ 5,407	3 0.00
Adjustments to reconcile net income before extraordinary item to net			
each provided by (used in) operating activities:	(3,972)	(4,860)	(6,090)
Equity in earnings from continuing operations of subsidiaries	329	549	859
Depreciation and amortization expense	213	216	244
Deferred compensation	219	144	0
Amortization of dcht discount			
Changes in operating assets and liabilities:	0	(865)	(1,300
Increase in current assets	1.160	876	(764
Increase (decrease) in current liabilities	0	3,630	22
Increase in other liabilities	(1,998)	(13,669)	5,409
Net cash provided by (used in) operating activities	(77)	(8,572)	4,470
Cash flows from investing activities:			
Developed of property and equipment	(353)	(2,274)	(1,327
Acquisition of direct dial long distance companies, net of cash acquired	0	0	(565
Purchase of other assets	(213)	(476)	(1,508
Net cash used in investing activities	(566)	(2,750)	(3,400
and a second contraction of the second contr	125	528	569
Proceeds from issuance of debt	(141)	(10,240)	(518
Marine and an debt	(21)	(147)	(32
Financing costs	679	21,181	470
Proceeds from issuance of common shares	The Marie	0	(1,559
Purchase of treasury shares	-	11,322	(1,070
Net cash provided by (used in) financing activities		STREET, SQUARE, SQUARE	0
Net decrease in cash and cash equivalents	(1)	0	
Cash and cash equivalents, beginning of year			
Cash and cash equivalents, end of year	5 0	5 0	2

See notes to condensed financial statements

### NOTES TO CONDENSED FINANCIAL STATEMENTS

### Note I. Debt:

See Note 4 to the Consolidated Financial Statements of the Company for disclosure of long-term obligations and guarantees.

### Nate 2. Dividends From Subsidiaries:

No cash dividends were paid to U.S. Long Distance Corp. by its subsidiaries during the years ended September 30, 1992, 1993 and 1994.

### Note 3. Contingencies:

See Note 10 to the Consolidated Financial Statements of the Company for disclosure of material contingencies.

### Note 4. Nubsequent Events:

See Note 12 to the Consolidated Financial Statements of the Company for disclosure of subsequent events.

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES VALUATION AND QUALIFYING ACCOUNTS (In themsels)

			Addition		Wette-affe		
Finest Year	Description .	#	Changed to Coats and Express	Charge to	( bappel to Allemane	-	
	Allowance for doubtful accounts	\$590	\$ 429 \$ 448	\$0 \$0	\$ (588)	(1) \$431 \$816	
	Allowance for doubtful accounts Allowance for doubtful accounts	\$431 \$816	\$1,254	\$60	\$(1,449)		

<sup>(1)</sup> Accounts determined to be uncollectible upon purchase of direct dial long distance subsidiary.

### SHORT-TERM BORROWINGS(1) (In thousands, except percentage amounts)

Phos Noor	inies.	******	Weighted Admir East	Mexicon Amount (hardending thering the Period	Average Amount Outstanding During she Period(2)	Weighted Average Interest Bate During the Perind(3)
1992	Payable to a company	\$31,424	7.13%	\$31,424	\$21,565	7.79%
1993	Payable to a company	\$36,061	7.38%	\$38,080	\$30,917	7.31%
1994	Payable to a company	\$25,235	8.25%	\$36,061	\$27,499	7.33%

See Note 4 of Notes to Consolidated Financial Statements for a discussion of the terms and provisions of the Company's short-term borrowings.

<sup>(2)</sup> Average amount outstanding during the period was determined on an average daily basis.

<sup>(3)</sup> Weighted average interest rate during the period determined on a daily rate basis.

### U.S. LONG DESTANCE CORP. AND SUBSEDIARIES SUPPLEMENTARY INCOME STATEMENT INFORMATION (In thousands)

lincal Year		Charged In Contract and Expenses
1992	Amortization of intangible assets	\$ 506
1993	Amortization of intangible assets	\$1,048
1994	Amortization of intangible assets	\$2,235

### 3. Exhibits:

The exhibits listed below are filed as part of or incorporated by reference in this report. Where such filing is made by incorporation by reference to a previously filed document, such document is identified in parentheses. See the Index of Exhibits included with the exhibits filed as part of this report.

Fabilit Number	Description
3.1	<ul> <li>Certificate of Incorporation, as amended (Exhibit 3(a) to General Form for Registration of Securities on Form 10, dated December 21, 1989)</li> </ul>
3.2	- Certificate of Amendment dated October 27, 1989 (Exhibit 4 to December 31, 1989, Form 10-Q)
3.3	- Certificate of Amendment dated June 19, 1990 (Exhibit 4 to June 30, 1990, Form 10-Q)
3.4	<ul> <li>Certificate of Designation, Powers, Preferences, and Rights of the Series A</li> <li>Preferred Stock (Exhibit 3.4 to September 30, 1990, Form 10-K)</li> </ul>
3.5	- Certificate of Amendment dated February 14, 1991 (Exhibit 4.5 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)
3.6	<ul> <li>Certificate of Amendment to Certificate of Designation, Powers, Preferences and Rights of Series A Preferred Stock (Exhibit 4.6 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)</li> </ul>
3.7	- Certificate of Amendment dated March 23, 1993 (Exhibit 3.7 to September 30, 1993, Form 10-K)
3.8	- Certificate of Elimination of Series A Preferred Stock dated May 21, 1993 (Exhibit 3.8 to September 30, 1993, Form 10-K)
3.9	- Bylaws of the Company (Exhibit 3.7 to September 30, 1992, Form 10-K)
4.1	<ul> <li>Form of Certificate Evidencing Common Stock (Exhibit 4(a) to General Form for Registration of Securities on Form 10, dated December 21, 1989)</li> </ul>
4.2	— Securities Purchase Agreement dated August 5, 1991, by and between the Company and Electra Investment Trust P.L.C., Scimitar Development Capital Fund, Scimitar Development Capital "B" Fund, and Electra Holdings, Inc. (collectively, the "Purchasers"), Senior Subordinated Notes due 1995, dated August 5, 1991 made by the Company and payable to the Purchasers, Warrant Certificates, dated August 5, 1991, executed by the Company to the Purchasers, and the Guaranty, dated August 5, 1991, executed by U.S. Long Distance, Inc., Buyer Acquisition Corporation, Mega Plus Dialing, Inc., Zero Plus Dialing, Inc. and U.S. Billing Services, Inc. in favor of the Purchasers (Exhibit 4.1 to Report on Form 8-K, dated August 7, 1991)
4.3	<ul> <li>Amendment of August 5, 1991, Securities Purchase Agreement and Amendment of Warrant Certificates dated December 16, 1991 (Exhibit 4.3 to September 30, 1991, Form 10-K)</li> </ul>
44	<ul> <li>Second Amendment of August 5, 1991, Securities Purchase Agreement dated May 13, 1993 (Exhibit 4.4 to Amendment No. 2 on Form S-3 to Form S-1 Registration Statement, SEC File No. 33-54448, dated May 17, 1993)</li> </ul>
4.5	- Form of Warrant Certificate (Exhibit 4.5 to Amendment No. 2 on Form S-3 to Form S-1 Registration Statement, SEC File No. 33-54448, dated May 17, 1993)
46	— Asset Purchase Agreement by and between U.S. Long Distance, Inc., R. J. Bono and U.S. Long Distance of Louisiana, Inc., dated July 1, 1993 (Exhibit 4.6 to Amendment No. 1 to Registration Statement on Form S-3, SEC File No. 33-71228, dated November 23, 1993)

Exhibit Number	<u>(Description</u>
47	Letter Agreement dated October 6, 1992, by and between Communications Central, Inc., U.S. Long Distance Corp. and U.S. Long Distance, Inc. (Exhibit 4.7 to Amendment No. 1 to Registration Statement on Form S-3, SEC File No. 33-71228, dated November 23, 1993)
10.1	<ul> <li>Transmission Agreement dated April 25, 1991, by and between the Company and MCI Telecommunications Corporation (Exhibit 10.1 to September 30, 1991, Form 10-K)</li> </ul>
10.2	<ul> <li>Amended and Restated Employment Agreement dated November 1, 1993, by and between the Company and Parris H. Holmes, Jr. (Exhibit 10.2 to September 30, 1993, Form 10-K)</li> </ul>
10.3	<ul> <li>Form of Amended and Restated Employment Agreement dated November 1, 1993, by and between the Company and its named executive officers (Exhibit 10.3 to September 30, 1993, Form 10-K)</li> </ul>
10.4	-Form of Employment Agreement by and between the Company and its Vice Presidents (Exhibit 10.4 to September 30, 1993, Form 10-K)
10.5	— 1990 Employee Stock Option Plan, as amended (Exhibit 4.11 to Registration Statement on Form S-8, SEC File No. 33-51604, dated September 1, 1992)
10.6	<ul> <li>Form of Option Agreement by and between the Company and its Employees, Under the Employee Stock Option Plan (Exhibit 10.8 to September 30, 1992, Form 10-K)</li> </ul>
10.7	— Form of Stock Option Agreement for Directors, Key Employees and Advisors of the U.S. Long Distance Corp. (Exhibit 4.14 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)
10.8	— Form of Stock Option Agreement for Key Employees of U.S. Long Distance Corp. (Exhibit 4.15 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)
10.9	Form of Stock Option Agreement for Non-Employee Directors of U.S. Long Distance Corp. (Exhibit 4.13 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)
10.10	— Amended and Restated Loan and Security Agreement dated May 22, 1991, by and hetween Zero Plus Dialing. Inc., U.S. Long Distance Corp. and U.S. Long Distance, Inc. and Bell Atlantic TriCon Leasing Corporation ("Bell Atlantic") (currently Greyhound Financial Corporation) (Exhibit 10.10 to September 30, 1991, Form 10-K) and related Revolving Credit Note dated May 24, 1991, Term Note dated June 1992, Corporate Guaranties dated May 24, 1991, and First Amendment and Joinder to Amended and Restated Loan and Security Agreement dated December 17, 1992 (Exhibit 10.9 to September 30, 1992, Form 10-K)
10.11	— Second Amendment to Amended and Restated Loan and Security Agreement dated April 2, 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently Greyhound Financial Corporation) (Exhibit 10.11 to September 30, 1993, Form 10-K)
10.12	— Third Amendment to Amended and Restated Loan and Security Agreement dated October 1, 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently Greyhound Financial Corporation) (Exhibit 10.12 to September 30, 1993, Form 10-K)

Number Number	- Complete
10.13	— Fourth Amendment and Joinder to Amended and Restated Loan and Security Agreement dated October 1, 1993 by and between Zero Plus Dialing, Inc. U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently Greyhound Financial Corporation) (Exhibit 10.13 to September 30, 1993, Form 10-K)
10.14	— Fifth Amendment and Joinder to Amended and Restated Loan and Security Agreement dated November 16, 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp. d/b/a Telecom West, Inc., STS Telecommunications, Inc. and Bell Atlantic (currently Greyhound Financial Corporation) (Exhibit 10.14 to September 30, 1993, Form 10-K)
10.15	<ul> <li>Letter Agreement dated December 2, 1993 by and between Bell Atlantic (currently Greyhound Financial and U.S. Long Distance Corp. (Exhibit 10.15 to September 30, 1993, Form 10-K)</li> </ul>
10.16	<ul> <li>Data Processing Service Agreement dated December 1, 1989, as amended, by and between Affiliated Computer Services, Inc. and U.S. Long Distance Corp., Zero Plus Dialing, Inc. and U.S. Billing, Inc. (Exhibit 10.16 to September 30, 1993, Form 10-K)</li> </ul>
10.17	<ul> <li>Office Lease Agreement dated September 29, 1988, by and between U.S. Long Distance, Inc. and Nowlin Building Partnership, Ltd., as amended (Exhibit 10.10 to September 30, 1992, Form 10-K)</li> </ul>
10.18	<ul> <li>Agreement of Lease dated April 26, 1991, by and between Zero Plus Dialing, Inc. and HBH Properties, as amended (Exhibit 10.11 to September 30, 1992, Form 10-K)</li> </ul>
10.19	<ul> <li>Agreement of Lease dated October 20, 1992, by and between Zero Plus Dialing, Inc. and Northpoint Atrium Building, Ltd. (Exhibit 10.12 to September 30, 1992, Form 10-K)</li> </ul>
10.20	<ul> <li>Agreement of Lease dated September 1, 1992, by and between U.S. Long Distance, Inc. and Multi-Employer Property Trust (Exhibit 10.13 to September 30, 1992, Form 10-K)</li> </ul>
10.21	— Loan and Security Agreement dated July 25, 1991, by and between Buyer Acquisition Corporation (NTX) and Bell Atlantic (currently Greyhound Financial Corporation) (Exhibit 10.13 to September 30, 1991, Form 10-K) and related Revolving Credit Note, Term Note, Subordination Agreement and Corporate Guaranties dated July 25, 1991 (Exhibit 10.14 to September 30, 1992, Form 10-K)
10.22	<ul> <li>Adoption Agreement for Professional and Businessmen's Association, Inc., Non-Standardized 401(k) Profit Sharing Plan and Trust (Exhibit 4.11 to Registration Statement on Form S-8, SEC File No. 33-46567, dated March 19, 1992)</li> </ul>
10.23	<ul> <li>Professional and Businessmen's Association, Inc., Regional prototype Defined Contribution Plan and Trust (Exhibit 4.12 to Registration Statement on Form S-8, SEC File No. 33-46567, dated March 19, 1992)</li> </ul>
10.24	— Loan Agreement, Promissory Note, Security Agreement and Guaranty dated August 8, 1991, by and between National Telephone Exchange, Inc. and First City, Texas — San Antonio, N.A., as amended, and Loan Assumption and Consent Agreement dated September 30, 1992, by and between U.S. Long Distance, Inc., U.S. Long Distance Corp., National Telephone Exchange, Inc. and First City, Texas — San Antonio, N.A. (Exhibit 10.17 to September 30, 1992, Form 10-K)

Pabilit Number	Enceloise Control of the Control of
10.25	<ul> <li>Asset Purchase Agreement dated February 21, 1991, by and between Buyer Acquisition Corporation and National Telephone Exchange, Inc. (Exhibit 2.1 to Report on Form 8-K, dated August 7, 1991)</li> </ul>
10.26	<ul> <li>Asset Purchase Agreement dated February 21, 1991, by and between Buyer Acquisition Corporation and Valu-Line of Wichita Falls, Inc. (Exhibit 2.2 to Report on Form 8-K, dated August 7, 1991)</li> </ul>
10.27	<ul> <li>Asset Purchase Agreement dated February 21, 1991, by and between Buyer Acquisition Corporation and Central Texas Long Distance, Inc. (Exhibit 2.3 to Report on Form 8-K, dated August 7, 1991)</li> </ul>
10.28	— Promissory Note, Security Agreement, as amended, and Corporate Guaranty dated October 30, 1990, by and between U.S. Long Distance Corp., U.S. Long Distance, Inc. and Elico Leasing Corporation (Exhibit 10.21 to September 30, 1992, Form 10-K)
10.29	— Loan Agreement, as amended, Promissory Note, and Security Agreement dated March 27, 1992, by and between National Telephone Exchange, Inc. and First City, Texas — San Antonio, N.A. and Loan Assumption and Coment Agreement dated September 30, 1992, by and between U.S. Long Distance, Inc., U.S. Long Distance Corp., National Telephone Exchange, Inc. and First City, Texas — San Antonio, N.A. (Exhibit 10.22 to September 30, 1992, Form 10-K)
10.30	— Purchase Money Security Agreements dated September 17, 1992, and October 27, 1992, by and between U.S. Long Distance Corp. and Charter Financial, Inc. (Exhibit 10.23 to September 30, 1992, Form 10-K)
10.31	<ul> <li>Agreement and Plan of Merger by and between U.S. Long Distance Corp. and USLD Acquisition Corp. and Telecom West, Inc. and Ed Lassman, John Kalita and Larry Ostlic, dated September 30, 1993 (Exhibit 10.31 to September 30, 1993, Form 10-K)</li> </ul>
10.32	— Stock Purchase Agreement by and between U.S. Long Distance Corp., STS Telecommunications, Inc. and J. T. Poorman, Lou Poorman, Brad Poorman, Tony Poorman and NTS Communications, Inc., dated November 2, 1993 (Exhibit 10.32 to September 30, 1993, Form 10-K)
10.33	<ul> <li>Operator Services Agreement by and between the Company and G-Five Corp., dated September 16, 1993 (Exhibit 10.33 to September 30, 1993, Form 10-K)</li> </ul>
10.34	— 1993 Stock Option Plan for Non-Employee Directors (Exhibit 10.34 to September 30, 1993, Form 10-K)
10.35	<ul> <li>Form of Director Option Agreement by and between the Company and Non- Employee Directors, subject to stockholder approval (Exhibit 10.35 to September 30, 1993, Form 10-K)</li> </ul>
10.36	— Sixth Amendment to Amended and Restated Loan and Security Agreement dated December 7, 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance, Inc., U.S. Long Distance Corp., U.S. Billing, Inc., USLD Acquisition Corp., STS Telecommunications, Inc. and Bell Atlantic (currently Greyhound Financial Corporation) (Filed herewith)
10.37	— Seventh Amendment to Amended and Restated Loan and Security Agreement dated March 17, 1994 by and between Zero Plus Dialing, Inc., U.S. Long Distance, Inc., U.S. Long Distance Corp., U.S. Billing, Inc., USLD Acquisition Corp., California Acquisition Corp., Telecom Acquisition Corp., STS Telecommunications, Inc., Enhanced Services Billing, Inc. and Bell Atlantic (currently Greybound Financial Corporation) (Filed herewith)

Franks:	<u>Decelotion</u>
10.38	<ul> <li>Agreement and Plan of Merger by and between U.S. Long Distance Corp., Telecom Acquisition Corp., Inland Call America, Inc. and the individual stockholders of Inland Call America, Inc., dated March 1, 1994 (Filed herewith)</li> </ul>
10.39	— Agreement and Plan of Merger by and between U.S. Long Distance Corp., California Acquisition Corp., Donyda, Inc., d/b/a Call America of Palm Desert and Call America of San Diego, and Donald C. Clem, Nancy C. Clem and David M. Clem, dated March 14, 1994 and effective March 15, 1994 (Filed herewith)
10.40	— Agreement and Plan of Merger by and between U.S. Long Distance Corp., U.S. Long Distance, Inc., L.D. Network, Inc. and Luana Yost and David Yost, dated October 6, 1994 and effective October 1, 1994 (Filed herewith)
10.41	- U.S. Long Distance Corp. Executive Compensation Deferral Plan (Filed herewith)
10.42	- U.S. Long Distance Corp. Executive Qualified Disability Plan (Filed herewith)
10.43	- U.S. Long Distance Corp. Director Compensation Deferral Plan (Filed herewith)
11.1	- Statement regarding computation of per share earnings (Filed herewith)
21.1	- Subsidiaries of the Company (Filed herewith)
23.1	- Consent of Arthur Andersen LLP (Filed herewith)

### (b) Reports on Form 8-K

The Company filed its report on Form 8-K on September 22, 1994.

### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

U.S. LONG DISTANCE CORP.

By: /s/ PARRIS H. HOLMES, JR.

Partis H. Holmes, Jr.

Chairman of the Board and
Chief Executive Officer

Date: December 22, 1994

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 22nd day of December, 1994.

	<u>110</u>	
/s/ PARRIS H. HOLMES, JR. Farris H. Holmes, Jr.	Chairman of the Board and Chief Executive Officer	
/s/ LARRY M. JAMES Larry M. James	Chief Operating Officer, President and Director	
/s/ MICHAEL E. HIGGINS Michael E. Higgins	Senior Vice President and Chief Financial Officer	
/s/ CHARLES E. AMATO Charles E. Amato	Director	
/s/ GARY D. BECKER  Gary D. Becker	Director	
/s/ LEE COOKE	Director	

### CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports included in this Form 10-K for the year ended September 30, 1994, into the Company's previously filed Registration Statements (SEC File No. 33-41039, 33-46567, 33-51604, 33-71228, 33-77404, 33-77612, 33-80866, 33-81686 and 33-85912).

ARTHUR ANDERSEN LLP

San Antonio, Texas December 21, 1994 mod come

## SECURITIES AND EXCHANGE COMMISSION SECURITIES AND EXCHANGE COMMISSION

### WOLM HOW

Annial repurt pursiant to section 13 or 19(4) of the For the Fiscal Year Ended September 30, 1996 SECURITIES EXCHANGE ACT OF 1934

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Commission File Number: 0-18195

U.S. LONG DISTANCE CORP.

(Exact Name of Registrant as Specified in its Charter)

Defamare (State of Incorporation)

(LR.S. Employer Identification No.)

9311 San Pudra, Saile 188, San Antonia, Tean (Address of Principal Executive Office)

(Zip Code)

(2)0) 525-9009

(Registrant's Telephone Number, Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act. Name

Securities Registered Pursuant to Section 12(g) of the Act Common Starth, Par Value \$8.01 For Share (Title of Class)

reports) and (2) has been subject to such filing requirements for the past 90 days. Yes III No II 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

of this form 10-K or any amendment to this Form 10-K. (II) and be comtained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III indicate by check mark if dischoure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will

The aggregate market value of the Registrant's outstanding Common Stock held by non-affiliates of the Registrant at December 13, 1996 was \$129,312,069. There were 15,076,381 shares of the Registrant's Common Stock outstanding at December 13,

# DOCUMENTS INCUMPORATED BY REFERENCE.

on February 25, 1997, are incorporated by reference in Part III hereof Portions of the Registrant's Definitive Proxy Statement to be filed in connection with the 1997 Annual Meeting of Stockholders to be held

### U.S. LONG DISTANCE CORP.

### Annual Report on Form 10-K For The Fiscal Year Ended September 30, 1996

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### ITEM L. BUSINESS

Other than historical and factual statements, the matters and items discussed in this Annual Report on Form 10-K are forward-looking statements that involves risks and invertainties. Actual results of U.S. Long-Distance Corp. and its subsidiaries (collectively, the "Company") may differ materially from the results discussed in the forward-looking statements. Certain factors that could contribute to such differences are discussed with the forward-looking statements throughout this report and are summarized in "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements-Cautionary Language."

The Company is a fully-integrated long distance communications company. From fiscal 1991 through fiscal 1996, the Company's revenues increased at a compounded annual rate of 60%, totaling \$180.3 million for fiscal 1996. The Company offers an integrated group of communication services including direct dial long distance, prepaid calling cards, travel cards, data transmission and calling center services.

The long distance telephone industry has changed significantly since the mandated divestiture by American Telephone and Telegraph Co. ("AT&T") of its 22 local telephone companies in 1984. Regulations mandating equal access to the existing telecommunications network led to the creation of hundreds of new long distance companies. Competition now pervades across all categories of long distance telephone services, including both domestic and international direct dial long distance telephone services, operator assisted and calling card services, and 800/888 specialized in-bound long distance telephone services. While AT&T and, to a lesser extent, MCI Telecommunications Corporation ("MCI") and Sprint Corporation ("Sprint"), together dominate the estimated \$78 billion long distance telecommunications industry, management believes that a growing share of the market is serviced by smaller long distance companies such as the Company, Industry sources estimate that approximately 80% of the long distance market is shared among AT&T, MCI and Sprint.

The Telecommunications Act of 1996, which was signed into law on February 8, 1996, is the first major overhaul of the telecommunications law since the diventiture of AT&T. This act allows telecommunications providers such as the Company to provide local telephone services. The local telephone service industry is estimated to be a \$95 billion industry and is dominated by the Regional Bell Operating Companies (RBOCs). The Company is actively pursuing its entrance into the local service industry. The Company is currently certified to offer local service in three states and has certification pending in four other states. The Company has signed an interconnection agreement with Southwestern Bell enabling the Company to provide local telephone service to business and residential customers in Southwestern Bell's five-state service area. Additionally, the Telecommunications Act of 1996 allows the RBOCs to compete in the long distance industry. However, the applicant RBOC must first satisfy a legislative "checklist" that outlines the steps required for an RBOC to open its network to competition on a local basis.

On July 10, 1996, the Company's Board of Directors approved a plan to spin-off the Company's commercial billing clearinghouse and information management services business ("Billing Group Business") as a separate public company the "Distribution"). To effect the spin-off, the Board approved the distribution of the outstanding shares of common stock of its wholly owned subsidiary that owned and operated the Billing Group Business, Billing Information Concepts Corp. ("Billing"), to its stockholders. The Distribution was tax-free for federal income tax purposes to the stockholders of the Company, and the Company will not recognize income, gain or loss as a result of the Distribution, except for direct spin-off costs. The Distribution was completed on August 2, 1996.

### Direct Dial Long Distance Services

The Company is a full-service long distance carrier currently providing direct dial long distance services to small and mediumsized commercial customers and, to a lesser extent, residential customer accounts. The Company was authorized to provide direct dial long distance services to customers in 47 states at September 30, 1996. However, the Company focuses its direct sales efforts in the West Coast, Pacific Northwest, Southwest and Southeast regions of the United States to take advantage of network efficiencies. In addition to its basic "one-plus" services, the Company provides inbound 800 service, travel and prepaid calling card services, private line services, data transmission services, wholesale carrier services and other customer-specific products.

The Company began offering direct dial long distance services following its entry into the direct dial long distance business in August 1991 through the acquisition of three related direct dial long distance companies in Texas. At September 30, 1996, the Company serviced approximately 47,000 commercial and residential customer accounts. The Company carried an average of 106.5 million minutes per month of long distance traffic during the fiscal quarter ended September 30, 1996, as compared to 62.6 million and 44.7 million during the fiscal quarters ended September 30, 1995 and 1994, respectively. In fiscal 1996, 1995 and 1994, the Company had \$119.4 million, \$84.5 million and \$62.8 million, respectively, in direct dial long distance revenues, comprising 66%, 59% and 53% of total operating revenues in each period, respectively.

### Industry Overview

Direct dial long distance revenues industrywide are estimated to be approximately \$78 billion in 1996, up from approximately \$73 billion in 1995. AT&T, MCI and Sprint dominate the long distance industry. Industry sources estimate that these companies control a combined market share of approximately \$0%. These companies offer comprehensive communications services in a wider array of products than other long distance companies and typically target national, multi-state business customers and millions of residential long distance users through national television and media advertising. The Company believes that over 500 smaller long distance companies account for the remaining 20% of the market. These companies typically concentrate on smaller regional and local business customers. Competition in the direct dial long distance industry has historically been based upon price. More recently, the focus has been moving towards customer service, product design and innovation, customized billing capabilities, transmission quality and availability of service.

### Sales and Marketing

The Company's direct dial long distance sales personnel are located throughout the Company's service area and are responsible for marketing to commercial accounts. The Company supervises sales and marketing efforts from its corporate headquarters and utilizes various advertising media to enhance its commercial marketing efforts and to attract and retain residential customers. The Company examines the calling profiles of target markets and designs long distance services that specifically fill certain demands. For example, the Company issues long distance calling cards customized to include a customer's corporate logo and has also customized prepaid calling cards to be used as promotional marketing tools. The Company also directly markets to employees of commercial customers for their residential service. In addition to its own sales force, the Company markets its direct dial long distance services through authorized agents, other carriers and affinity organizations (strategic partnerships).

The Company currently has an exclusive marketing agreement with Nolan Ryan, formerly a player with the Texas Rangers's professional baseball team and a potential hall of fame candidate, who acts as the Company's spokesman for its direct dial long distance services and whose picture appears in the Company's advertisements and product literature, including prepaid calling cards.

### Operations

The Company completes calls that are originated when a pre-subscribed customer dials "1" plus the area code and number or when a customer selects the Company's network through dial-up access to reach any domestic or international destination. All long distance calls placed over the Company's network are directed to call destination points by computerized digital network switching equipment operating at one of the Company's switching centers. The switching equipment receives a customer's direct dial call, verifies the caller's billing status and authorization codes, routes the call to the dialed destination, monitors the call's duration and collects other information for billing purposes. The Company's switching equipment selects the most cost-efficient transmission circuit or path available prior to switching and completing each call. The Company employs state-of-the-art digital switching equipment at the Company's switching centers in Houston, Texas, Waco, Texas, Seattle, Washington; and Los Angeles, California. The Company has also purchased a digital switch in Atlanta, Georgia, and will take possession of it in January 1997.

To satisfy increasing or anticipated usage of its long distance network and to ensure that its network is optimally accessible when network demand is heavy, the Company, from time to time, adds circuit capacity at each existing switching center by increasing the number of telecommunications ports and access lines. The Company utilizes state of the art Common Channel Signaling System 7, which is currently operational for virtually all originating and terminating traffic within the Company's markets. This network protocol significantly reduces connect time delays and provides additional technical capabilities and efficiencies for the routing of calls.

### Competitive Advantages

The Company competes with AT&T, MCI and Sprint and numerous local, regional and national carriers on the basis of its products and services, competitive pricing and local identity. The Company, generally, prices its services up to 20% below AT&T, MCI and Sprint comparable service offerings. In addition, by designing long distance products and services that fill specific market needs, the Company enhances its ability to compete with AT&T, MCI and Sprint and others.

The Company believes that its emphasis on customer service distinguishes itself from many of its competitors. The Company has taken an integrated team approach to sales and service by increasing the number of sales support representatives in its field offices to maintain responsive service after the sale. The Company recently deployed notebook computers to the sales force to enhance marketing presentations and automate the customer order entry function. Additionally, the Company implemented a computerized bulletin board service called Advantage Direct, which is similar to the remote access service offered to its operator services customers. This service allows customers to monitor and evaluate calling patterns and volume by department or location. Moreover, in competing with certain regional and local long distance carriers, the Company believes it holds a competitive advantage within its territory because the Company's regional concentration of traffic over its network facilities allows for certain cost efficiencies of a national carrier. In addition, the Company believes that its local identity in the markets it serves provides an advantage in marketing its services and competing with

long distance carriers based outside of the target regions. A tasagement believes that the Company has developed the expertise in information systems necessary to meet the needs of its direct dial long distance customers. For instance, the Company provides an invoice indicating call detail in a form that assists customers in costrolling and monitoring communications costs for various projects or departments.

The Company employs digital switching equipment utilizing a network comprised largely of high quality fiber-optic circuitry to maximize communications quality. The Company believes that its use of a digital fiber-optic network is particularly advantageous in marketing both its voice and data transmission services. The Company also designs redundant and diverse routes to each major service area to ensure service availability.

The communications industry is ever-changing, and the recently passed Telecommunications Act of 1996 is expected to have a major impact on the industry's competitive environment. In essence, the RBOCs will be competing with long distance curriers for both domestic and international long distance customers. The Company believes it is prepared to meet this challenge by capitalizing on its experienced management team and sales force, personalized customer service, quality products and services and competitive pricing structures.

### Strategy and Growth Opportunities

The Company's strategic focus in the direct dial long distance industry is to compete with AT&T. MCI and Sprint primarily on the basis of competitive pricing, while offering a comparable or higher level of service. Moreover, the Company intends to remain focused on small and medium-sized commercial customers and will continue its efforts to develop innovative and cost-efficient services that meet the needs of its customers. The Company intends to introduce new communications products, such as local service, Internet access, paging, frame relay/ISDN and cellular service, over the next 12 to 18 months. The introduction of the local service product provides the Company the largest opportunity for growth. The local services industry is estimated to be a \$95 billion market. Each of the Company's existing 47,000 customer accounts are already utilizing this service from the local exchange carrier in each locality. The Company believes that it has the potential to capitalize on its relationship with existing customers to bundle the local product with its existing products and services. The bundling of these services with long distance service will enhance the Company's product offerings and provide new and existing customers with the integrated communication services they desire. To a lesser extent, the Company also continues to market to residential customers.

The Company expects to look for opportunities to expand its long distance business, both by internal growth and through acquisitions. The primary focus of the Company's acquisition activities is to make additional acquisitions that will grow the Company's direct dial long distance business. The Company believes its operator services business affords it the opportunity to expand its direct dial long distance business on a more cost-effective basis than many of its competitors. By leaving a concentration of operator services call traffic in a particular geographic region, the Company can utilize any long distance facilities it installs or acquires to service a ready base of call traffic, thereby lowering the marginal transmission costs for any direct dial long distance traffic that the Company acquires or develops in that region. The Company believes this cost advantage not only improves the potential profitability of both the Company's operator services and direct dial long distance services businesses in such region, but also expands the number of companies that would be attractive acquisition candidates in that region.

The Company continually evaluates business opportunities, including potential acquisitions. One or more of such acquisitions could result in a substantial change in the Company's operations and financial condition. The success of the Company's acquisition activities will depend, among other things, on the availability of acquisition candidates, the availability of funds to finance acquisitions and the availability of management resources to oversee the operation of acquired businesses. While the Company has, from time to time, had discussions with communications companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report that would have a material impact on the Company's financial position or results of operations. There is no assurance that any acquisitions will be completed.

### Operator Services

The Company provides operator assisted services for private pay telephones, hotels, motels, university dormitories and hospitals. The Company's operator services are accessed when calls requiring operator assistance and/or alternate billing options are placed from customer locations. Such services involve the use of live and automated operators to receive, validate and complete the calls. The Company processes collect, third-party, person-to-person and calling card calls and, generally, shares a percentage of call revenues with its customers.

tooms. In addition, at September 30, 1996, the Company provided operator services to approximately 135,900 hotel, motel, hospital and domitton from a finishment of paytelephone. The Company carried 7.6 million average monthly minutes of operator services traffic during the fourth quarter of fiscal 1996, as compared to 8.3 million and 9.1 million average monthly minutes during the fourth quarters of fiscal 1995 and 1994, respectively. The Company's operator services revenues amounted to \$60.9 million, \$59.6 million, \$54.7 million in fiscal 1996, 1995 and 1994, respectively.

### Industry Overview

Management believes that there are approximately 125 operator services providers competing within the long distance communications industry. AT&T continues to dominate the operator services market, supplying operator services for traffic originating from both the hospitality and pay telephone industries. Additionally, MCI and Sprint provide operator services and are considered by management to be major competitors. Excluding AT&T, MCI, Sprint, General Telephone Operating Companies (GTE) and the RBOCs, management believes the Company is one of the five largest providers of operator services.

Many operator services providers, including the Company, initially focused on the hospitality industry. More recently, as the private pay telephone industry has grown and taken market share from the public pay telephone market traditionally served by AT&T, many operator services providers gained increased market share by providing service to the owners of private and public pay telephones. Competition between the Company and other operator services providers is based upon commission programs, quality of service, reporting and customer service.

### Sales and Marketing

The Company markets its operator services nationally through the combined effort of regional sales representatives based in Illinois, Texas, Florida and California and a network of agents. The Company's corporate sales force focuses on larger accounts, such as hotel management companies, multi-unit franchises, hospital chains, large private pay telephone companies and universities. The Company's agents market the Company's operator services on a nationwide basis and typically receive a commission based upon the volume of business generated. The Company also participates in various industry trade shows and promotes its operator services through advertisements in trade magazines. The Company customizes its communications services to provide, among other things, individualized reports and specialized call branding to customers.

### Operations

The Company owns and operates its own operator center in San Antonio, Texas, which employed 311 operators and support staff at September 30, 1996. The Company provides live and automated operator services 24 hours per day, 365 days per year, and features multi-lingual operators versed in Spanish, French, German, Japanese and a variety of other languages. The Company maintains a sophisticated emergency call handling system that enables its operators to access police, fire and other emergency agencies within the jurisdiction of the telephone from which the call is placed. The Company utilizes its own transmission facilities when possible or contracts to use facilities of other long distance network providers as necessary.

The Company switches the majority of its operator assisted calls at its four main switching centers. Many operator assisted calls are transmitted to the Company's switching centers via call processing equipment installed at customer locations or in customer pay telephone equipment. This call processing equipment is programmed to recognize calls requiring operator assistance and to access the Company's network by dialing the Company's access number, then passing the call record information to one of the switching centers. The Company validates the authorization code or telephone number to be billed and then completes the call, while recording the date, destination, duration and time of day for subsequent billing purposes. At September 30, 1996, the Company was authorized to complete international and interstate calls placed throughout the United States, as well as intrastate calls within 46 states.

### Competitive Advantages

Management believes that the Company enjoys several competitive advantages over many others in the operator services industry. By virtue of the Company's large call volumes relative to many other operator services providers and the cost efficiencies it realizes by routing a large portion of its operator services traffic over its own facilities and maintaining its own operator center, the Company is able to provide high quality transmission on an efficient and economical basis. Additionally, because it is the source of commission payments to its operator services customers, the Company believes that its financial stability and history of tancity payments allow it to compete effectively against many smaller, under-capitalized operator services providers. Moreover, the Company's flexible rate options allow it to offer customized commission programs to its customers as compared to larger operator services providers.

In 1994, the Company implemented a computerized bulletin board service called Stealth that allows its customers to access the system from remote locations and obtain customized and sophisticated reporting of calling patterns and volumes for each customer location or pay telephone. This advanced reporting system allows the Company's operator services customers to analyze their traffic on a daily basis and maximize telecommunications revenues by, for example, relocating underutilized telephones. The Company's detailed reporting also allows its customers to reconcile the accuracy or integrity of their commissions. The Company employs a skilled, professional staff of customer service employees and technicians, who provide service 24 hours per day, 365 days per year.

### Strategy and Growth Opportunities

The Company has developed a strong presence in operator services throughout the United States. Through its direct sales force and agents and its participation in state, regional and national trade associations, the Company intends to pursue geographic expansion on a nationwide basis. The Company will continue to market its operator services business to both the private pay telephone and hospitality industries and present new products and services for these markets.

The Company's existing relationship with operator service customers, who typically own or manage numerous private pay telephones or hotels, provides a unique opportunity for the Company. The Company will have the potential to provide local access to a large volume of phone lines, yet limited number of customers. These characteristics will allow the Company to quickly and efficiently enter the local services market in targeted areas.

### Corporate Synergy

Management believes that the Company has certain operating advantages and cost efficiencies through the integration of its two businesses. The combined traffic volumes of the Company's operator services and direct dial long distance businesses operate to lower the Company's transmission costs for both of these businesses in geographic regions where the Company operates long distance switching equipment. In addition, the Company's sales force can provide integrated long distance solutions by offering both operator services and direct dial long distance telephone services and, in the near future, local services. The opportunity to bundle products and services strengthens customer relationships and, thus, customer retention.

### Covernment Regulation

### General

The Company competes in an industry that, to a large degree, continues to be regulated by government agencies. At approximately the same time as the required divestiture of the Bell telephone companies by AT&T in 1984, the Federal Communications Commission (the "FCC") announced rules that were created to foster a self-regulating, interstate telecommunications industry, relying upon competitive forces to keep rates and services in check. Management believes that the current direct dial marketplace demonstra, substantial progress toward the fulfillment of these objectives. For example, the cost of a long distance call has significantly declined while the number of long distance companies has multiplied. Competition has encouraged these direct dial long distance companies to find ever more efficient methods of carrying calls.

### Operator Services

On October 15, 1990, President Bush signed into law the Telephone Operator Consumer Service Improvement Act of 1990. Congress directed the FCC to impose upon the interstate operator services market certain rules and regulations designed to increase consumer awareness concerning the operator services provider carrying the call, the information the caller can request of the operator, and the alternatives available to the consumer for reaching other long distance carriers. Operator services providers were required to file with the FCC informational tariffs that describe the rules and regulations governing the provision of interstate operator assisted telecommunications and to include all rates that may apply to an interstate call. Furthermore, operator services providers were required to submit, on a Congressionally prescribed timetable, certain reports relating to rate changes, complaints and costs. Based on these reports, on November 16, 1992, the FCC submitted to Congress its "Final Report Pursuant to the Telephone Operator Consumer Services Improvement Act of 1990." The purpose of this report was to identify whether increased regulatory scrutiny by the FCC was required to satisfy Congressional objectives. The FCC determined that "...market forces are securing rates and charges that are just and reasonable." and therefore stated "...we conclude that no further action is necessary..."

At September 30, 1996, the Company was authorized to carry intrastate operator assisted traffic in 46 states. Authorization is pending approval in one other state. State regulatory agencies have the authority to impose their own rules and regulations governing the provision of intrastate operator services, including regulation of rates. Many states have rules similar if not identical to those imposed by the ECC on interstate operator assisted calls. At the date of this report, the Company was in material compliance with the requirements of each of the individual state regulatory agencies and continues to pursue authorization to provide intrastate operator services in other

space sees not auto-put to include a server their rules governing operator services providers within the next year space sees not auto-puts significant difficulty in complying with the new or revised rules.

### Direct Dial Long Distance Services

ATTEST OF

provision of domestic U.S. interstate services. The FCC has regulatory jurisdiction over interstate and international telecommunications common carriers, like the Company Under Section 214 of the Federal Communications Act, the FCC must certify a communications common carrier before it may provide international services. The Company has obtained Section 214 authorization to provide international switched services by means of reside. FCC has ruled that "non-dominant" common carriers, like the Company, need not apply for Section 214 authorization for the

will seek state regulatory approvats as necessary to provide intrastate long distance service. within each of these states, as they pertain to completing direct dial long distance calls for the Company's customers within the state, are within static and pose no forescenable concern. As the Company expands the geographic scope of its direct dial long distance business, it At September 30, 1996, the Company was authorized to provide intrastate long distance service within 47 states. Regulations

### Balled Party Professor

concept in which any long distance call outside the local telephone company's calling area carried from a publicly available telephone would be completed over the long distance carrier network of the billed party's previously expressed preference. This would be accomplished through a local telephone company database system that would make every calling card and telephone number to a preferred long distance company and then direct all calls accordingly. In April 1992, the ECC tentatively proposed adopting BPP During the summer of 1992, comments from local telephone companies, long distance carriers and other industry participants revealed that the cost of imposing BPP could be in excess of \$1.0 billion and could require hundreds of millions of dollars each year to support its operation. The majority of these commentors were in opposition to the implementation of BIP. Certain commentors made clear that many technical impediments remain to full deployment of BIP. Other commentors claimed that no technology exists that could implement BITP without making call processing significantly less convenient for many operator services calls, particularly those requiring Another issue under consideration by the FCC currently is termed "Billed Party Preference," or BPP. This term refers to a

In August 1994, inclusivy members responded to a Commission Further Notice of Proposed Rulemaking. The Commission had tentatively concluded, based upon their calculation of related cost information previously submitted by inclusivy members, that the potential benefits of a BFP system appeared to outweigh its costs, although the Commission admitted the financial data it used in its study could be outslated. Once again, inclusivy participants were resoundingly opposed to the Commission's proposal, including AT&T and most of the RHOCs. To date, the FCC has taken no further action.

If such a system were implemented successfully, the unique market niche of operator services provider presubscription, such as that of the Company, would be rendered virtually ineffectual, as an owner of publicly available telephones would be unable to direct operator assisted calls over the network of such owner's desired carrier, it is difficult to assess the industry support for BPP given the companies have indicated that, if so directed, approximately two to four years would be required to reconfigure their networks to HPP's specifications. Thus, while BPP remains viable, the Company believes that it is not lakely to be implemented in the near term herest problems described above, and the FCC continues to consider implementation of the proposal. In any event, local telephone

("APCC") and the Competitive Telecommunications Association ("CompTel"), recommended that the FCC impose certain rate thresholds for interstate operator assisted services, which the FCC would presume to be reasonable, and any OSP electing to charge rates higher than such threshold would be required to first prove to the FCC that such rates are justified based upon the underlying costs of the service (the "APCC Rate Cap Proposal"). The NAAG Petition was proposed to remain in effect until such time that HPP is adopted and fully implemented. The APCC Rate Cap Proposal was proposed to obvisite the need to consider any further action On March 9, 1995, the FCC requested industry comment on two proposals it had recently received relative to the BPP proceeding. In an ex-parte petition, the National Association of Attorney's General ("NAAG") suggested that the FCC modify its current branding requirement such that operator service providers ("OSPs") would be required to announce at the beginning of each call more specific information for obtaining access to alternate carriers (the "NAAG Petition"). Another petition filed by a coalition of industry members, including most of the RHOC's two competitive access providers, the American Public Communications Counsel Chargest Hale

In June 1996, the FCC issued a Second Further Notice of Proposed Rulemaking (SFNPRM) in this proceeding. In it, the FCC proposed adopting a rule which would require OSPs to announce the rates for certain calls to the billed party prior to connecting the call, thereby allowing the billed party to disconnect such call without incurring any unwanted charges. In September, the FCC released its Second request for Comment in the SFNPRM soliciting technical and other administrative details to support the proposed

announcement requirement. Most commentors objected to the discriminatory nature of the proposal, which would have some carriers announcing rates while others would not.

If adopted, the NAAG Petition or any form of modified call branding could have a negative effect upon the number of calls completed over OSP networks such as the Company's, if end users elect to act upon the additional branding announcement regarding rates or access to other carriers. Furthermore, additional network time would be consumed without a corresponding increase in revenue. If the APCC Rate Cap Proposal is adopted, OSPs such as the company may be immediately required to lower their interstate rates until such time as the FCC rules upon an attempt to justify higher, existing rates. OSPs may be required to adjust the amount of commission payments made to their subscriber customers as a result of implementation of such a proposal, or effect other operational changes to offset any reduction in interstate operator services revenue. The Company cannot predict when and if any final ruling on either proposal might be issued.

### MFJ Legislation

On February 8, 1996, President Clinton signed the Telecommunications Act of 1996 into law. The new law allows the RBOCs to petition their respective "in-region" state regulatory agencies to seek authority from the FCC to allow the applicant RBOC to provide long distance services. To obtain this authority, each state agency is required to certify to the FCC that the applicant RBOC has satisfied a legislative "checklist" that outlines the steps required for an RBOC to open its network to competition on a local basis. These steps include the provision of competitive network interconnection, unbundled access to network elements and other necessary access to poles, ducts, conduits and rights-of-way. Furthermore, applicant RBOCs must provide non-discriminatory access to white pages listings and telephone number assignments. Applicant RBOCs must provide local number portability, toll dialing parity and local service resale. The FCC is required to consult with the Department of Justice ("DOJ") to assist in determining if an applicant RBOC's entry into the long distance business violates any anti-trust standards the DOJ considers appropriate. Ninety days after receiving such an application, the FCC is required to render its decision. RBOC's may provide out-of-region long distance services subject to existing laws and regulations governing long distance communications.

To date, no RBOC has requested authority for in-region interLATA authority, because the provisions set forth above have not been satisfied by any RBOC. However, many entities have reached interconnection agreements with RBOCs to date, including the Company, and many states are impending rules governing local competition. It is reasonable to expect that the conditions for RBOC entry will be met in the near future, and carriers in the interLATA long distance business today, such as the Company, will encounter new, formidable competition.

### Texas PIU Issue

In a Final Order released in Docket 10127 on April 12, 1993, the Texas Public Utility Commission ("PUC") adopted new regulations governing the method by which interexchange carriers ("IXCs") such as the Company calculate intrastate access charges paid to local telephone companies. These new rules required an independent auditor's review and approval of an IXC's methodology of determining its own intrastate access usage. An independent audit by an accounting firm verified that the Company's process of calculating PIU is reasonable and statistically valid and, as such, no additional PIU or billing adjustments are required.

### Regulatory Rate Proceedings

During the course of normal operations, a regulated company may, at any time, come under specific scrutiny with regard to any of its rates, terms or conditions by which such service is rendered by the state or federal regulatory agency charged with such oversight responsibility, or by an attorney general or other jurisdictional consumer officials. In such cases, a regulated company can be required to, among other things, provide cost justification for the charges it imposes on some or all of its services, or to address perceived consumer inequities. After review of such justification, the regulatory agency generally has the authority to require a carrier to modify the process by which such services are rendered or to effect changes to its applicable rate structure. Consumer officials and attorneys general can pursue civil action if their concerns are not adequately addressed by the carrier. The Company operates in several jurisdictions in which its tariffs or services may, from time to time, fall under such scrutiny at the discretion of the governing regulatory agency or other officials. The Company could therefore be required, as a result of such an investigation and subsequent proceeding, to implement changes in its rate structure, which could ultimately affect its revenues. The Company cannot predict whether or not any such requirement may be imposed in any particular jurisdiction.

### Employees

At September 30, 1996, the Company had 602 full-time employees, including 15 officers, 224 sales and marketing personnel, 68 network, technical and operations personnel, 111 accounting, administrative and support personnel and 184 telephone operators and customer service representatives and related support personnel. At September 30, 1996, the Company also employed 181 part-time

telephone operators and customer service representative. None of the Company's employees are represented by a union. The Company believes that its employee relations are good.

### STEM 2. PROPERTIES

At September 30, 1996, the Company occupied approximately 93,500 square feet of space for its corporate offices at 9311 San Pedro, San Antonio, Texas, and Billing has assumed the liability for and occupies approximately 18,000 square feet of space at the same location until April 1, 1997, at which time the space reverts back to the Company. The approximate 111,500 square feet is leased pursuant to a lease agreement that expires in January 1999. Additionally, at September 30, 1996, the Company leased approximately 17,000 square feet of space for its operator services center at 2200 Dunbury, San Antonio, Texas, and approximately 56,000 square feet in the aggregate for 26 sales and operations offices throughout Texas, Oklahoma, New Mexico, Louisiana, California, Oregon and Washington. The Company believes that its facilities are adequate to meet its current needs.

### **PIEM 3.** LEGAL PROCEEDINGS

On December 18, 1996, the Securities and Exchange Commission filed a civil injunctive action in the Federal District Court for the District of Columbia alleging that Mr. Parris H. Holmes, Jr., Chairman of the Board of the Company, failed to file timely twelve reports regarding certain 1991 and 1992 transactions in the stock of the Company as required by Section 16(a) of the Securities Exchange Act of 1934, as amended. Section 16(a) requires officers and directors of reporting companies to file monthly reports with the Commission regarding their personal transactions in the securities of their company. Mr. Holmes settled this action on December 18, 1996, without admitting or denying the allegations of the complaint, by consenting to the to the entry of an injunction barring future violations with respect to these requirements and paying a civil penalty of \$50,000.

The Commission has conducted an investigation relating to trading in the securities of Value-Added Communications, Inc ("VAC"), an operator services provider based in Dullas, Texas, and of the Company (In the Matter of Trading in the Securities of Value-Added Communications, Inc. (HO-2765)). A proposed merger between the Company and VAC was terminated in February 1993. The investigation concerned whether certain persons may have purchased securities while in possession of material non-public information or disclosed this information to others. The Commission Staff has notified Mr. Holmes of its decision to terminate this investigation.

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations, however, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on the Company's results of operations for the fiscal period in which such resolution occurred.

### PTEM A. SURMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of the fiscal year, no matter was submitted by the Company to a vote of its stockholders through the solicitation of proxies or otherwise.

### ITEM S. MARKET FOR THE COMPANY SCOMMON EQUITY AND RELATED STOCKHOLDER MATTERS

### Market Information

The Company's common stock, par value \$0.01 per share (the "Common Stock"), is quoted on the Nasdaq National Market System under the symbol "USLD." The table below sets forth the high and low bid prices for the Common Stock from October 1, 1994, through December 13, 1996, as reported by the Nasdaq National Market System. These price quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

	High	Lon
Fiscal Year Ended September 30, 1995:		c 91/2
1st quarter	\$ 12 1/4	
2nd quarter	\$ 16	\$ 11 1/2
3rd quarter	\$ 17 %	\$ 14%
4th quarter	\$ 17 %	\$ 141/2
Fiscal Year Ended September 30, 1996:	a set	
Isl quarter	\$ 15 %	5 10 /4
2nd quarter	5 20 %	\$ 13
3rd quarter ""	5 41 % "	5 19 4
310 quarter	5 39 % (1)	5 25 1, 111
4th quarter (Pre-Distribution)	\$ 10	h) (0)
4th quarter (Post-Distribution) (1)		
Fiscal Year Ended September 30, 1997:		
1st quarter (through December 13, 1996)	\$ 10 1/4	3 //5

On May 14, 1996, the Company's Board of Directors approved the spin-off of Billing. On August 2, 1996, the Company completed the Distribution of all of the capital stock of Billing. The average stock price for the first 10 business days after the distribution date was \$6.77 for the Company and \$19.36 for Billing.

### Stockholders

At December 13, 1996, there were 15,076,381 shares of Common Stock outstanding, held by 641 holders of record. The last reported sales price of the Common Stock on December 13, 1996, was \$8.00 per share.

### Dividend Policy

The Company has never declared or paid any cash dividends on the Common Stock. The Company presently intends to retain all carnings for the operation and development of its business and does not anticipate paying any cash dividends on the Common Stock in the foreseeable future. Furthermore, certain covenants in various credit agreements of the Company prohibit the payment of cash dividends on the Common Stock.

## ITEM & SELECTED FINANCIAL DATA

The selected financial data presented below are derived from the audited Consolidated Financial Statements of the Company. The data presented below for the fiscal years ended September 30, 1996, 1995 and 1994 should be read in conjunction with the Consolidated Financial Statements, the Notes thereto and the other financial information included elsewhere in this report. All periods presented reflect the spin-off of Billing as discontinued operations as of September 30, 1991. See Note 3 to the Consolidated Financial Statements for further discussion of the spin-off. The Company has never declared cash dividends on its Common Stock, nor does it anticipate doing so in the foresceable future

Operating Date (manufated): Operator services minutes per month (2) Pay telephones serviced (2) Rooms serviced (2) Privet dial long distance minutes per month (2)		Total assets (1) Long-term obligations, less current portion		Net loss from continuing operations per common share	
7,600 61.3 135.9 105,400	į	\$10,244 \$10,241	þ	\$180,346 \$(13,754) \$ (0.89)	þ
8,300 60.9 136.9 62,600	1	\$86,027 \$16,168	į	\$ (2,083) \$ (0,14)	
9,100 52.0 122.0 44,700	Spinster A	\$79,413 \$16,684	Spicetri A	\$180,346 \$144,050 \$117,541 \$(13,754) \$ (2,083) \$ (2,475) \$ (0.89) \$ (0.14) \$ (0.18)	Facel Year Ended September 1995 1994 1
10,400 44.8 106.0 17,200	1	\$11.2% \$1.000	1	\$(1.265) \$ (0.10)	Fixed Year Ended September M. 1995 1994 1993 a thomsonds, except per shore data)
4,800 15.9 90.7	195	\$36,573 \$17,603	þ	\$ (0.10) \$ (58.050 \$13.050	

- (1) Excludes net assets of discontinued operations.
- (2) Calculated based upon a monthly average over the fiscal quarter ended on the date indicated
- (3) At end of the period.

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

### Forward Looking Statements - Cautionary Statements

This Annual Report on Form 10-K contains certain "forward-looking statements" within the meaning of Section 27A of tile Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Specifically, all statements other than statements of historical facts included in this report regarding the Company's financial position, business strategy and plans and objectives of management of the Company for future operations are forward-looking statements. These forward-looking statements are based on the beliefs of the Compeny's management, as well as assumptions made by and information currently available to the Company's management. When used in this report, the words "anticipate," "believe." "estimate," "expect" and "intend" and words or phrases of similar import, as they relate to the Company or Company management, are intended to identify forward-looking statements. Such statements reflect the current view of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions related to certain factors including without limitations, competitive factors. general economic conditions, customer relations, relationships with vendors, the interest rate environment, governmental regulation and supervision, seasonality, the operation of the Company's networks, transmission costs, product introductions and acceptance, seclinological change, changes in industry practices, one-time events and other factors described herein ("cautionary statements") Although the Company believes that the expectations are reasonable, it can give no assurance that such expectations will prove to be correct. Based upon changing conditions, should any one or more of these risks or uncertainties materialize, or should any underlying assumptions princ incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the applicable cautionary statements.

### General

The following is a discussion of the consolidated financial condition and results of operations of the Company for fiscal 1996, 1995 and 1994. It should be read in conjunction with the Consolidated Financial Statements of the Company, the Notes thereto and the other financial information included elsewhere in this report. For purposes of the following discussion, references to year periods refer to the Company's fiscal years ended September 30 and references to quarterly periods refer to the Company's fiscal quarters ended December 31, March 31, June 30 and September 30.

On July 10, 1996, the Company's Board of Directors approved a plan to spin-off the Company's Billing Group Business as a separate public company. To effect the spin-off, the Board approved the distribution of the outstanding shares of common stock of its wholly owned subsidiary that owned and operated the Billing Group Business, Billing, to the Company's stockholders. The Distribution was tax-free for federal income tax purposes to the Company's stockholders, and the Company did not recognize income, gain or loss as a result of the Distribution except for direct spin-off costs. The Distribution was completed on August 2, 1996.

The accompanying Consolidated Statements of Income reflect the operating results of Billing as discontinued operations in accordance with Accounting Principles Board Opinion No. 30. Prior period operating results have been restated to reflect continuing operations. The Consolidated Pro Forma Statements of Income are also included and discussed in a separate section below.

### Overview

Revenues grew to \$180.3 million in 1996 from \$144.1 million in 1995 and \$117.5 million in 1994. During the five-year period ended September 30, 1996, revenues grew at a 60% annual compounded rate. The Company's gross profit margin was 34.3% in 1996, 34.7% in 1995 and 37.9% in 1994. The decrease in gross margin from 1994 to 1996 was largely due to the growth of lower gross margin direct dial long distance revenues as a percentage of total revenues.

The Company's selling, general and administrative ("SG&A") expenses as a percentage of revenues were 28.1%, 28.9% and 32.8% in 1996, 1995 and 1994, respectively. The decrease from 1994 to 1996 was primarily the result of tighter expense controls and increased efficiencies. Depreciation and amortization expenses as a percentage of revenues were 6.5%, 7.0% and 7.2% in 1996, 1995 and 1994, respectively.

Net loss from continuing operations of \$13.8 million, \$2.1 million and \$2.5 million was reported for 1996, 1995 and 1994, respectively. The Company reported net income of \$1.4 million, or \$0.09 per share, for 1996, \$12.0 million, or \$0.83 per share, for 1995; and \$6.1 million, or \$0.43 per share, for 1994. Fiscal 1996 results were down compared to 1995 and 1994 due to \$13.0 million of direct spin-off costs and \$2.8 million in restructuring charges incurred in fiscal 1996. As further discussed in the Outlook, the Company believes that it has the competitive product offerings, personnel and financial resources for continued business success.

### Results of Operations

The following table presents certain items in the Consolidated Statements of Income as a percentage of total operating revenues for the years ended September 30, 1996, 1995 and 1994:

	1996	1995	1994
Operating revenues:			
Direct dial long distance services	66.2%	58.6%	53.5%
Operator Services	33.8	41.4	46.5
Total operating revenues	100.0%	100.0%	100.0%
Operating expenses:			
Cost of services	65.7%	65.3%	62.1%
Selling, general and administrative	28.1	28.9	32.8
Spin-off costs	72	0.0	0.0
Restructuring charges	1.6	0.0	0.0
Depreciation and amortization	6.5	7.0	7.2
Loss from operations	.0.15	0.25-	C.Ir.

### Operating Revenues

Revenues in 1996 increased by 25% to \$180.3 million from \$144.1 million in 1995 and by 53% from \$117.5 million in 1994. Growth in direct dial long distance services revenues accounted for \$34.9 million of the total increase in revenues from 1995 to 1996.

Direct Dial Long Distance Services. Direct dial long distance services revenue increased 41% to \$119.4 million in 1996 compared to \$84.5 million in 1995 and 90% compared to \$62.8 million in 1994. The increase in revenue is primarily attributable to growth in the number of customers serviced. The Company believes that there are opportunities for continued expansion, both internally and externally through acquisitions, in both of its primary businesses. However, because direct dial long distance services represent the largest market in which the Company is active, management believes that this business presents the Company with its greatest revenue growth opportunity. The Company believes that its base of operator services business affords it the opportunity to expand its direct dial long distance business on a more cost effective basis than many of its direct dial long distance competitors. Accordingly, the Company continues to consider potential acquisitions. Acquisition activity is focused primarily on small to medium-sized companies that will grow the Company's direct dial long distance business. While the Company has, from time to time, had discussions with such companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report that would have a material impact on the Company's financial position or results of operations.

Operator Services: Operator services revenue was \$60.9 million in 1996 compared to \$59.6 million in 1995 and \$54.7 million in 1994. The Company processed 17.5 million operator services calls in 1996 compared to 17.4 million in 1995 and 17.2 million in 1994. The Company serviced an average of approximately 66,100 pay telephones and 128,300 hospitality rooms per month for 1996, compared to an average of approximately 55,200 pay telephones and 130,300 hospitality rooms per month for 1995 and 48,200 pay telephones and 103,000 hospitality rooms per month for 1994. Although the volume of operator services calls has increased, the related increase in revenues have been, and will continue to be, offset by several factors, including an increase in the percentage of pay telephones serviced by the Company located in states that impose rate fariff regulations on operator services providers and an increasing awareness on the part of the consumer of the ability to select a carrier of choice by dialing access codes of other carriers ("dial-around"). Additionally, changes in federal or state regulations could negatively impact revenues of the Company (see Note 15 to the Consolidated Financial Statements).

### Operating Expenses

Cost of Services. The gross profit margin was 34.3%, 34.7% and 37.9% during 1996, 1995 and 1994, respectively. The decline in gross profit margins from 1994 to 1996 is primarily due to the change in the Company's revenue mix. The Company's direct dial long distance services gross margins have increased, however, the improvement was offset by an increase in the direct dial long distance services revenue as a percentage of total revenue. Such revenues have a lower gross margin than the operator services revenue and accounted for 66%, 59% and 53% of revenue during 1996, 1995 and 1994, respectively. The direct dial long distance services margin has increased primarily as a result of continued improvements in networking efficiencies and reductions in transmission costs.

Selling, General and Administrative. SG&A expenses for 1996 were \$50.7 million, representing 28.1% of revenues, compared to \$41.6 million in 1995, or 28.9% of revenues, and \$38.5 million in 1994, or 32.8% of revenues. SG&A expenses as a percentage of revenues have continued to decrease as a result of tighter expense controls and efforts to streamline the Company's operations.

Direct Spin-off Costs. Direct spin-off costs represent cost incurred in connection with the Distribution of Billing. The \$13.0 million amount represents certain professional and filing fees payments required for terminating or restructuring employment contracts, tax payments triggered by the spin-off and non , set expenses associated with the vesting of stock grants.

Restructuring Charges. The \$2.8 million in restructure charges for 1996 includes costs associated with consolidating customer service, credit and collection and other support functions, vacating certain office facilities, terminating certain marketing contracts, writing down excess assets and providing severance payments.

Depreciation and Amortization Depreciation and amortization expense was \$11.8 million, \$10.0 million and \$8.4 million in 1996, 1995 and 1994, respectively. Depreciation and amortization expense as a percentage of revenues decreased to 6.5% in 1996 from 7.0% in 1995 and 7.2% in 1994. This decrease as a percentage of revenue is primarily attributable to the increase in revenues and was achieved despite a charge of \$727,000 related to asset write-offs in the fourth quarter of fiscal 1996.

Loss from Continuing Operations

Loss from continuing operations in 1996 increased to \$16.5 million from \$1.6 million in 1995 and \$2.4 million in 1992 Excluding direct spin-off costs and restructuring charges, the Company would have reported a loss from continuing operations of \$667,000 in 1996. The continued improvement in operations is primarily attributable to the decrease in SG&A expenses as a percentage of revenues, as discussed above, and the increase in revenues.

Other Expense, net

Net other expense decreased to \$628,000 in 1996 from \$999,000 and \$865,000 in 1995 and 1994, respectively. The decrease is primarily attributable to a lower level of indebtedness over the past year.

Income Taxes

The Company's effective tax rate is higher than the federal statutory rate due to the addition of state income taxes and certain deductions taken for financial reporting purposes which are not deductible for federal income tax purposes.

Net Income

The Company reported net income of \$1.4 million, \$12.0 million and \$6.1 million in 1996, 1995 and 1994, respectively. The decrease in 1996 is attributable to the direct spin-off costs and restructuring charges incurred.

### Effects of Spin-off of Milling Group Business

The Consolidated Statements of Income included in this report reflect the continuing and discontinued operations of the Company for the years ended September 30, 1996, 1995 and 1994. Included below is supplemental unaudited pro forma financial information that management believes is important to provide an understanding of the results of the Company on a stand-alone basis Consolidated Pro Forma Statements of Income are presented below for each of the last four fiscal years as well as for each quarter of fiscal 1996 and 1995. These unaudited Consolidated Pro Forma Statements of Income are based on the historical statements of the periods presented adjusted to reflect the items discussed in the accompanying Notes to the unaudited Consolidated Pro Forma Financial Statements. The unaudited Consolidated Pro Forma Statements of Income give effect to the spin-off as if it had occurred on September 30, 1992. The pro-forma adjustments reflect the terms of the spin-off agreements, which are expected to have a continuing impact on the Company.

The unaudited consolidated pro forma financial information is presented for informational purposes only and should be read in conjunction with the accompanying notes and with the Company's historical Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" set forth herein. The pro-forma financial statements should not be considered indicative of the operating results which the Company will achieve in the future if it were operated on an independent, stand-alone basis because, among other things, these statements are based on historical rather than prospective information and upon certain assumptions which are subject to change

The unaudited Consolidated Pro Forma Statements of Income of the Company reflect, in management's opinion, all adjustments necessary to fairly state the pro forma results of operations for the periods presented and to make the unaudited pro forma statements not misleading.

### U.S. LAING INSTANCE CORP. and SUBSIDIARIES COPPRELIMATED PRO FORMA STATEMENTS OF INCOME

### (in thousands, except per share amounts) (Unaudited)

Fincal Year Ended			
1996	1995	1994	1993
		12/1/201/201	
CONTRACTOR AND			\$ 29,673
_60,945		The state of the s	_50,446
180,346	144,050	117,541	80,119
_118,493	94,038	_72.944	47,403
61,853	50,012	44,597	32,716
50,722	41,580	38,541	27,804
_11.798	_10.032	_8,424	5,060
(667)	(1,600)	(2,358)	(148
	The second secon	(865)	(1.561
1.000	The second second	(3.233)	(1,709
11,000	Committee of the commit		718
The second secon	Committee of the Commit		(991
ATTICAL DAY	0	0	_ (316
\$ (751)	\$ (1.507)	\$ (1.875)	\$ (1,307
\$(0.05)	\$(0.10)	\$(0.13)	\$(0.11
	G0000000000000000000000000000000000000		Sept. 30,
1995	1996	1996	1996
636.031	\$10.016	\$11 106	\$34,015
A CONTRACTOR OF THE SECOND	5-3-5-010 com cm	THE DANGE OF THE PARTY OF THE P	16.28
700 3 2000			50,29
	A STATE OF THE REAL PROPERTY.	207.75	32.73
		A LOS OFFICE AND A	
The state of the s		The state of the s	17,56
			13,27
_2.771	2.938	_2.702	3,38
(831)	(1.087)	345	90
(186)	(215)	(159)	
(1,017)	(1,302)	186	83
428	547	(79)	(35.
		6 107	
\$ (589)	\$ (755)	\$ 107	5 48
\$_(589) \$(0.04)	\$(0.05)	<u>5 107</u> 50 01	\$ 484 \$0.0
	118.493 61.853 50,722 11.798 (667) (668) (1.295) 544 (751) 0 \$_(751) \$(0.05)  15,398  Unc. 31, 1995  \$25,034 14,674 39,708 26,386 13,322 11,382 2,771 (831) (186) (1,017)	September   1996   1995   1995   1995   1995   1995   180,346   144,050   118,493   94,038   61,853   50,012   50,722   41,580   11,798   10,032   (667)   (1,600)   (628)   (9999)   (1,295)   (2,599)   544   1,092   (751)   (1,507)   0   0   0   (751)   \$(1,507)   0   0   (1,507)   \$(0.05)   \$(0.10)   15,398   14,587   14,587   14,674   14,609   39,708   43,655   26,386   28,875   13,322   14,780   11,382   12,929   2,771   2,938   (831)   (1,087)   (136)   (215)   (1,017)   (1,302)   (1,017)   (1,0	September 30.   1996   1995   1994     1995   1994     1995   1994     1995   1994     1995   1994     1995   1996     1995   1996   1995   1996   1999   1995   1995   1996   1999   1995   1995   1996   1999   1995   1996   1999   1996   1999   1996   1999   1996   1999   1996   1999   1996   1999   1996   1999   1996   1999   1996   1999   1996   1999   1996   1999   1996

### CONSOLIDATED PRO FORMA STATEMENTS OF INCOMES

### (f) showsands, except per share amounts) (f) naudited)

Weighted average common shares and common share equivalents  14,208  14,49	701,41	657,41	14.886
get income (loss) per common share \$(0.04) \$(0.04)	(10.0)\$	(50'0)5	20.05
Net meanic (loss) \$ (15) \$	GEST S	GILD \$	187 5
	(910)	615	(902)
Office expense, net (275) (24)	(340)	(676)	(523)
26.5 32.5.5 sensor and amortization as a sensor of a s	824.2 9,624	10261	965.2
	SEII	11611	15,121
	170,55	159'9E	025,14
	219,896	THEST	011.81
control of the seconds	904 013	012,152	011 1CS
SEET PEET		\$661	\$661
	old midt.	babail call	10° 10°

special of consolidated problems formed by the form of solutions and statements

((1)

- (A) The long distance and 800 services provided by the Company to Helling have, historically, been channeled in consolidation. The print forms statements of income reflect an adjustment for these long distance and 800 services revenues to achieve ann's length pricing consistent with the Telecommunications Agreement that has been executed between the Company and Hilling.
- (B) The billing clearinghouse and information management services provided by Billing to the Company have, historically, been eliminated in consolidation. The pro-form statements of income reflect an adjustment for these billing elearinghouse and information management costs to achieve aim's length pricing consistent with the Zero Plus-Nero Minus Billing and Information Management Services Agreement and the Company executed between Billing and the Company.
- (C) In order to reflect the operating results of the Company on normalized basis, these unaudited Consolidated Pro Forma Statements of Income exclude direct spin-off costs and restructuring charges. Direct spin-off costs were \$13.0 million and \$6.3 million for the year and quarter ended September 30, 1996, respectively. Restructuring charges were \$2.8 million for the year and quarter ended September 30, 1996.
- On the unaudried Corsolidated Fro Forma Statements of Income, the Company reflects a pro-forma benefit (provision) for their and fourth quarters of fiscal 1996 due to nondeductibility of certain nonrecurring expenses associated with the spin-off and testing the quarters of fiscal 1996 due to nondeductibility of certain nonrecurring expenses associated with the spin-off and restricturing.

### Outlook

The statements contained in this Outlook are based on current expectations. These statements are forward looking, and actual results may differ materially

The industry in which the Company operates is very competitive and is characterized by rapid change. In addition, the Company has faced, and continues to face, regulatory issues which have affected or which may affect operating revenues and operating profit. The continued success of the Company is dependent on its ability to adapt to these competitive and regulatory changes. In developing strategies to achieve continued growth in operating revenues and operating profits, the Company anticipates continuing geographic expansion, expanding its product offerings and controlling costs to improve gross margins and reduce SG&A expense as a percentage of revenue.

The Company continues to evaluate and take actions to improve the profitability of its existing products, to identify new products to fully utilize the Company's existing sales distribution channels and to evaluate programs that are expected to increase revenues through partnerships with independent sales agents. The Company has implemented, among other things, a regionalized approach to pricing, which is expected to improve price competitiveness. Furthermore, management is in the process of expanding product offerings to include local access and Internet services, as well as frame relay and paging services in selected markets. The expansion of products should increase revenues, as well as strengthen customer relationships and increase customer retention. The Company also plans to expand its direct dial long distance services residential customer base in selected markets through direct marketing efforts, as well as by offering long distance services to employees of commercial customers. To expand its footprint nationally over the next several years, management is considering and will continue to consider new investments in switching and related networking equipment. The Company has purchased a digital switch in Atlanta, Georgia, and will take possession of it in January 1997. In addition, the Company continues to evaluate acquisition candidates in strategic geographic areas to expand its market. However, the Company has no agreement or pending negotiations with respect to any acquisition at the date of this report that would have a material impact on the Company's financial position or results of operations.

The Company has implemented a number of actions designed to improve overall profitability and reduce the Company's cost structure. With regard to improving the Company's gross margins, management is focused on maximizing network efficiencies by implementing technological improvements and reducing unit costs. In November 1995, the Company joined the Associated Communication Companies of America ("ACCA") which provides members with opportunities to pool purchasing power to acquire lower transmission rates from interexchange carriers through volume discounts and to work in partnership with other members to capitalize on resource sharing arrangements such as switch partitioning and network sharing. The Company already has realized, from this arrangement, certain benefits during the last half of fiscal 1996 and expects continued benefits as the arrangement continues to be phased in Lastly, management has streamlined and reorganized certain corporate, administrative and overhead functions to better align its infrastructure with the smaller operation that resulted from the spin-off.

Over the past several years, the Company has undertaken a program of developing new products and expanding its existing service offerings, geographic focus and network. In connection with these new products and services, the Company has made significant investments in telecommunications circuits, switches, equipment and software. These investments, generally, are timed to coincide closely with anticipated revenue growth. In addition, the Company continues to increase its sales and marketing, customer support, network operations and field services commitments in anticipation of the expansion of its customer base in targeted geographic markets. The Company expects to continue to expand the breadth and scale of its network and related sales and marketing, customer support and operations activities. The Company attempts to carefully plan these expansion efforts to minimize the effect to profitability, however, they can cause the Company to incur significant increases in expenses from time to time in anticipation of potential future growth in the Company's customer base and targeted geographic markets.

The Company's future results of operations and the other forward looking statements contained in this Outlook, in particular the statements regarding revenue growth and reducing cost structure, involve a number of risks and uncertainties. In addition to the factors discussed above, other factors that could cause actual results to differ materially are the following: business conditions and the general economy, competitive factors, acceptance of new products and pricing pressures, availability of leased network facilities, risk of collection of accounts receivable, technological advancements, regulatory factors, litigation and other factors as discussed in the cautionary statements.

The Company believes that it has the competitive product offerings, personnel and financial resources for continued business success; however, future revenues, costs and profits all are influenced by a number of factors and are subject to certain risks and incertainties, as discussed above.

### Liquidity and Capital Resources

The Company's cash balance increased to \$8.8 million at September 30, 1996, from \$0 at September 30, 1995. This increase is attributable to the transfer of cash from Billing to the Company pursuant to the spin-off of Billing. Cash has, historically, been managed by a centralized cash management department in Billing. Consequently, cash was not allocated among the Company's subsidiaries and was recorded on the balance sheet of Billing. Total consolidated cash was \$22.9 million at September 30, 1995, none of which is reflected on the Company's balance sheet for financial reporting purposes. Working capital was \$20.1 million at September 30, 1996, compared to \$11.7 million at September 30, 1995. The Company's current ratio was 1.7.1 at September 30, 1996, versus 1.5.1 at September 30, 1995. Additionally, the Company's cash flow provided by operations was \$1.6 million for fiscal 1996 and \$1.8 million for 1995. Cash flow provided by operating activities would have been \$5.8 million had the Company not incurred direct spin-off costs and restructuring charges.

Accounts receivable increased to \$35.9 million at September 30, 1996 from \$30.5 million at September 30, 1995. This increase is attributable primarily to a higher level of direct dial long distance services revenues in the fourth quarter of 1996 compared to the fourth quarter of 1995. Trade accounts payable and accrued liabilities increased to \$10.9 million and \$13.6 million, respectively, at September 30, 1996 from \$10.7 million and \$6.7 million at September 30, 1995. The increases in accounts payable and accrued liabilities are due to the overall expansion of the Company's business. Prepaids and other current assets increased to \$6.0 million at September 30, 1996 from \$4.1 million at September 30, 1995. This increase is attributable to an increase in a receivable from Billing for equipment loans under the Company's financing facility pursuant to the spin-off. The decrease in other assets to \$4.9 million at September 30, 1996 from \$6.5 million at September 30, 1995 is due to the normal amortization of these assets and a \$727,000 write-down of customer lists associated with certain acquisitions.

Capital expenditures amounted to approximately \$11.0 million during 1996. These expenditures were related primarily to the purchase of telecommunications equipment, computer equipment and software, and office furniture. During 1996, the Company financed approximately \$3.5 million of equipment through long-term borrowings. During 1997, the Company anticipates capital expenditures of \$18.0 million to \$22.0 million to service the Company's projected growth. Approximately \$10.0 million to \$12.0 million of these capital expenditures are expected to be purchases of telecommunications equipment, approximately \$5.0 million to \$7.0 million are expected to be purchases of computer hardware and software to develop systems to support the anticipated growth of the Company's business and the remainder is expected to be for purchases of office furniture and equipment. The Company anticipates financing these capital expenditures primarily through term notes with various lending institutions. Although line of credit commitments have been made by various lenders for equipment purchases, there is no assurance that the Company will be able to obtain satisfactory financing for these capital expenditures.

The Company's operations and expansion into new geographic markets will continue to require substantial capital investment for the development and procurement of transmission facilities and telecommunications and office equipment. In addition, any acquisitions that the Company may consummate may require substantial capital investment. The Company believes that it has the ability to continue to secure long-term equipment financing and that this ability, combined with cash flow generated from operations and available borrowing capacity under its existing credit facilities, will be sufficient to fund capital expenditures, working capital needs and debt repayment requirements for the foreseeable future.

The Company has a revolving credit receivable financing facility which allows the Company to borrow against its own direct dial long distance services and operator services accounts receivable. At September 30, 1996, the Company had approximately \$14.0 million available for borrowing and did not have any amounts borrowed under this facility. Any borrowings under this facility will bear interest at the prime rate plus .5%. This facility is collateralized by the related accounts receivable and by virtually all of the assets of the Company not otherwise pledged as security under other debt agreements.

The Company is a guarantor on a \$45.0 million credit receivable financing facility for Billing. Under the terms of the Transitional Services and Sublease Agreement entered into pursuant to the spin-off, the Company's potential liability as guarantor is compensated at the rate of 1% of the average annual outstanding balance. At September 30, 1996, Billing had \$19.0 million outstanding under this facility. Both the revolving credit financing facility and the guarantee arrangement terminate on December 31, 1996. The Company anticipates executing agreements in the near future which would provide the Company with receivable financing facilities executing \$10.0 million.

In fiscal 1996, the Company entered into a \$10.0 million equipment financing facility with an interest rate float at the 30-day commercial paper rate plus 2.70%. No amounts were outstanding under this facility at September 30, 1996. The agreement provides for a one-year period during which the Company may finance up to \$10.0 million in equipment on an interest payment only basis. Upon completion of this period in September 1997, the note amount will convert to a series of term notes with 20% of the total amount borrowed due in each of the next five years. Any amounts not due in a given year may be prepaid and reborrowed at the Company's discretion.

The Company has various fixed rate notes with interest rates ranging from 6.75% to 11.0%, due in varying amounts through August 2001. The proceeds from the issuance of these notes were used to acquire certain computer and telecommunications equipment and office furniture. The loans are secured by the assets acquired with the proceeds of such notes. Certain of these notes are also guaranteed by Billing.

Historically, the Company has obtained financing for capital expenditures through term debt agreements and capital lease agreements that were guaranteed and cross-collateralized by the Company and Billing. These debt agreements were negotiated based on the strength of the consolidated financial statements, earnings and cash flow of the consolidated group. Most of these debt agreements were secured by the assets of all the subsidiaries within the consolidated group. The Company has received from certain lenders loan agreement amendments or separate loan agreements whereby the subject indebtedness will be secured by only the Company's assets. In other cases, the existing cross guarantees and security arrangements between the Company and Billing will remain in place for the duration of the facility. In this regard, the Company and Billing have agreed to pay each other a credit support fee.

The credit facilities discussed above contain various restrictions and financial ratio maintenance requirements. Under one of its credit facilities, the Company is required to maintain a quarterly ratio of consolidated operating income, as defined in the agreements, to consolidated fixed charges of 1.5 to 1.0. Further, the Company is required to maintain a ratio of funded debt, as defined in the agreement, to total capitalization of not greater than 60% and total debt to total capitalization of not greater than 85%. Other agreements require the Company to maintain cash flow coverage ratios, as defined in the agreements, ranging between 1.25 and 1.40 and a minimum tangible net worth ranging between \$30.0 million and \$35.0 million. Under one agreement, the Company is prohibited from paying a cash dividend on its common stock. Cross-default provisions of the Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other loan agreements. Under the Company's most significant credit facilities, USLD has guaranteed the obligations of its subsidiaries. The Company was in compliance with all required covenants at September 30, 1996 and 1995.

The Company continually evaluates business opportunities, including potential acquisitions. The primary focus of the Company's acquisition activities is to make additional acquisitions that will grow the Company's direct dial long distance business. One or more of such acquisitions could result in a substantial change in the Company's operations and financial condition. The success of the Company's acquisition activities will depend, among other things, on the availability of acquisition candidates, the availability of funds to finance acquisitions and the availability of management resources to oversee the operation of acquired businesses. While the Company has, from time to time, had discussions with other telecommunications companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report that would have a material impact on the Company's financial position or results of operations.

As consideration for any acquisitions, the Company may issue common stock, preferred stock, convertible debt or other securities, in addition to or in lieu of the payment of cash, that could result in dilution of the percentage ownership of public stockholders. The Company does not intend to seek stockholder approval for any such acquisitions or security issuances unless required by applicable law or regulations.

### Nessenality

Approximately 95% of the Company's direct dial long distance revenues is generated by commercial customers and, accordingly, the Company experiences general decreases in long distance revenues around national holidays when commercial traffic is reduced. The Company typically experiences decreases in operator services revenues in the fall and winter months as pay telephone usage declines due to cold and inclement weather in many parts of the United States. As a result of the seasonal variations discussed above, revenue reported in the Company's first fiscal quarter ending December 31 (which includes the Thanksgiving, Christmas and New Year's Eve holidays), historically, has been the lowest level of any quarter of the year. Conversely, due to increased traffic from pay telephones during the spring and summer months and a lower concentration of national holidays, the Company has historically experienced its highest revenue levels in the third and fourth quarters of the fiscal year. Because the Company's fixed operating expenses do not decrease during the first fiscal quarter, the Company's profitability is also, generally, at its lowest level for any quarter of the year.

### Effect of Inflation

Inflation is not a material factor affecting the Company's business. Prices charged to the Company for switching equipment and transmission costs have not materially changed during the year. General operating expenses such as salaries, employee benefits and occupancy costs are, however, subject to normal inflationary pressures.

### New Accounting Standards

The Company is not currently, nor does it expect to be, materially affected by any new standards recently issued by the Financial Accounting Standards Board.

### TTEM IL FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements of the Company and the related report of the Company's independent are accountants thereon are included in this report at the page indicated.

	Page
Report of Independent Public Accountants	22
Consolidated Balance Sheets at September 30, 1996 and 1995	33
Consolidated Statements of Income for the Years Linded September 30, 1996, 1995 and 1994	35
Consolidated Statements of Stockholders' Equity for the Years Ended September 30, 1996, 1995 and 1994	2.6
Consolidated Statements of Cash Flows for the Years Ended September 30, 1996, 1995 and 1994	
Notes to Consolidated Financial Statements	2.

### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Hoard of Directors and Stockholders of U.S. Long Distance Corp.:

We have audited the accompanying consolidated balance sheets of U.S. Long Distance Corp. (a Delaware corporation) and subsidiaries as of September 30, 1996 and 1995, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended September 30, 1996. 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 financial position of U.S. Long Distance Corp. and subsidiaries as of September 30, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1996, in conformity with generally accepted accounting principles.

As explained in Note 2 to the Consolidated Financial Statements, effective October 1, 1993, the Company changed its method of accounting for income taxes.

ARTHUR ANDERSEN LLP

San Antonio, Texas November 14, 1996

### U.S. LONG BINTANCE CORP. AND SUBSIBILABLES

### CONSOLIDATED BALANCE SHEETS (In thousands)

### ASSETS

	September 30.	
	_1996_	1995
Current assets:		
Cash and cash equivalents	\$ 8,842	\$ 0
Accounts receivable, net of allowances for doubtful accounts of \$2,519 (1996) and \$1,938 (1995)	35,867	30,548
Prepaids and other	_6.002	4.077
Total current assets	50,711	34,625
Property and equipment.	58,370	47,800
Less accumulated depreciation and amortization	(28,793)	_(19,196)
Not reportly and complicits	29,577	28,694
Equipment held under capital leases, net of accumulated depreciation of \$1,458 (1996) and \$1,958 (1995)	282	1,540
Other assets:		
Excess of cost over net assets acquired, net of accumulated amortization of \$2,065 (1996)		ESTE CHANGE
and \$1.502 (1995)	13,804	14,685
Other assets, net of accumulated amortization of \$4,892 (1996) and \$4,443 (1995)	4,870	6,483
Net assets of discontinued operations (see Note 3)	0	39.083
Total assets	\$99,244	\$125,110
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Trade accounts payable	\$10,909	\$ 10,748
Accrued liabilities	13,581	6,684
Current portion of long-term debt.	5,854	5,147
Current portion of obligations under capital leases	294	372
Total current liabilities	30,638	22,951
Other liabilities	52	3,318
Long-term debt, less current portion	10,146	12,327
Obligations under capital leases, less current portion	143	523
Payable to Billing Information Concepts Corp., net	0	17,860
Commitments and contingencies (See Note 6, 10 and 14)		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, no shares issued or		
outstanding at September 30, 1996 or 1995	0	0
Common stock, \$0.01 par value, \$0,000,000 shares authorized; 15,255,977 and 14,281,866 shares		
issued and 15,051,876 and 14,094,634 shares outstanding at September 30, 1996 and 1995.	153	143
respectively	54,554	49.304
Additional paid-in capital	5,465	20,473
Retained earnings Treasury stock	_(1,997)	(1.789)
	58.265	68.131
Total stockholders' equity	THE RESERVE OF THE PARTY OF THE	\$125,110
Total liabilities and stockholders' equity	\$99,244	\$122,110

The accompanying notes are an integral part of these consolidated financial statements

### U.S. LONG DESTANCE COMP. AND SUBSEDIARIES

### CONSOLIDATED STATEMENTS OF INCOME. (In thousands, except per share amounts)

	For the Year		
		ded Septemb	1994
	_1996_	1772_	
Operating revenues	\$ 119,401	\$ 84.484	\$ 62.834
Operator services	60,945	59,566	54,797
Operator services	180,346	144.050	117,541
Total operating revenues	118,493	94,038	72,944
Cost of services		50,012	44 597
Gross profit	61,853		THE PROPERTY OF
Selling, general and administrative expense	50,722	41,580	38,541
Direct spin-off costs	12,969	0	0
Restructuring charges	2,840	0	0
Depreciation and amortization expense	_11.798	_10,032	_8.424
Loss from continuing operations	(16,476)	(1,600)	(2,368)
Other income (expense):			473
Interest income	#94	682	(1,609)
Interest expense	(1,356)	(1,643)	270
Other, net	(166)	(38)	(866)
Total other income (expense)	(628)	(999)	(3,233)
Loss from continuing operations before income tax benefit	(17,104)	(2,599)	758
Income tax benefit	3,350	516	Control of the Contro
Net loss from continuing operations	(13,754)	(2,083)	(2,475)
Discontinued operations (Note 3):			
Income from discontinued operations, net of income taxes of \$9,292 (1996).	15,161	14,118	8,565
\$8.661 (1995) and \$5,038 (1994)		\$ 12,035	\$ 6,090
Net income	\$ 1,407	3.14.022	2 0.070
Net income (loss) per common share			
Continuing operations	\$ (0.89)	\$ (0.14)	\$ (0.18)
Discontinued operations	0.98	0.97	0.61
Net income per common share	\$ 0.09	5 0.83	\$ 0.43
Weighted average common shares and common share equivalents outstanding	15,398	14,587	14,069

The accompanying notes are an integral part of these consolidated financial statements

### U.S. LONG DISTANCE COMP. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

### For the Years Ended September 30, 1994, 1995 and 1996 (In thousands)

					Additional		
	_Common Stock_		SCHOOL SECTION SERVICES	Preferred Stock	Paid-in	Retained	Treasury
	Shares	Amount	Shares	Amount	Capital	Earnings	Stock
Balances at September 30, 1993	11,913	\$119	0	\$0	\$36,113	\$ 1,998	5 (93)
Pooling with Telecom West Inc	270	3	0	0	5	123	0
Exercise of stock options and							
warrants	113	1	0	0	827	0	0
Issuance of common stock	636	6	0	0	5,358	0	0
Issuance of treasury stock	0	0	0	0	237	-0	66
Purchase of treasury stock	0	0	0	0	0	0	(1,637)
Net income	0	0	0	0	0	6,090	0
Balances at September 30, 1994	12,932	129	0	0	42,540	8,211	(1,664)
Pooling with L.D. Network, Inc.	175	2	0	0	1	227	0
Exercise of stock options and							
warrants	1,080	11	0	0	4,805	0	0
Issuance of common stock	195	2	0	0	2,422	0	0
Retirement of treasury stock	(100)	(1)	0	0	(949)	0	950
Purchase of treasury stock	0	0	0	0	0	0	(1,075)
Other capital contribution	0	0	0	0	485	0	0
Net income	0	0	0	0	0	12.035	0
Balances at September 30, 1995	14,282	143	0	0	49,304	20,473	(1,789)
Issuance of common stock	223	2	0	0	1,210	0	0
Return of escrowed shares	0	0	0	0	0	0	(118)
Exercise of stock options and warrants	751		0	0	3,913	0	0
Other capital contribution	0	0	0	0	127	0	0
Spin-off of Billing Information							
Concepts Corp.	0	0	0	0	0	(16,415)	0
Net income	0	0	0	0	. 0	_1,407_	0
Balances at September 30, 1996	15,256	\$153	0	\$0	\$54,554	\$ 5.465	\$(1,907)

The accompanying notes are an integral part of these consolidated financial statements

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES

### CONSOLIBATED STATEMENTS OF CASH FLOWS (In thousands)

		For the Vent Ended September 3:		
		1995	444	
Cash flows from operating activities:				
Net loss from continuing operations	\$(13,754)	\$ (2,083)	\$ (2.175)	
Adjustments to reconcile net loss from continuing operations to net cash				
provided by operating activities:		10,032	8,424	
Depreciation and amortization	11,798	6,231	5.095	
Provision for losses on accounts receivable		255	220	
Deferred compensation	4,078	171	48	
Loss on write-down of property and equipment	1,084			
Changes in current assets and liabilities, net of effects from purchase of				
direct dial long distance companies:			(6.535)	
Increase in accounts receivable	(13,001)	(12,882)	(1.997)	
(Increase) decrease in prepaids and other	(766)	600	4.851	
Increase (decrease) in accounts payable	161	(4,222)	(300)	
Increase (decrease) in accrued liabilities	0,897	1,869	1,398	
Increase (decrease) in other liabilities	(3,266)	1.843_	The State of the S	
Net cash provided by operating activities	1,619	1,814	<b>x</b> ,731	
Net cash provided by discontinued operations	16,661	6,549	1,007	
Cash flows from investing activities:		10.7611	(7,036)	
Purchases of property and equipment	(11,007)	(9,761)	(565)	
Acquisition of direct dial long distance companies, net of cash acquired		(175)	179	
Proceeds from sale of assets	******	632	(880)	
Other investing activities	(335)	(24)	The second secon	
Net cash used in investing activities		(9,358)	(8,302)	
Cash flows from financing activities:			7,119	
Proceeds from issuance of debt	3,500	4,784	(4,875)	
Payments on debt	and the state of	(5,512)	(2.544	
Payments on capital leases	(438)	(1,267)	(267	
en ander ander	ment .		470	
Proceeds from issuance of common stock, net of issuance costs	4,339	4,065		
Purchase of treasury stock		_(1,075)	_11.559	
Net cash provided by (used in) financing activities	1,859	995	11.430	
Net increase in cash and cash equivalents	8,842	0	0	
Cash and cash equivalents, beginning of year	0	0	0	
Cash and cash equivalents, end of year	5 8.842	5 0	5 0	
Cash and cash equivalents, eva so year				

The accompanying notes are an integral part of these consolidated financial statements.

### U.S. LONG BINTANCE CORP. AND SUBSIDIARIES NOTES TO COMMILIDATED FINANCIAL STATEMENTS Neglember 30, 1996, 1995 and 1994

### Note 1. Duniness Activity

U.S. Long Distance Corp. ("USLD") was redomesticated from Canada and reincorporated under the Delaware Corporation Law Act in the State of Delaware, United States of America, in 1987. USLD and its subsidiaries (collectively, the "Company") offer an integrated group of communications services including direct dial long distance, prepaid calling cards, travel cards, data transmission and calling center services. The Company's network consists of a highly advanced, digital switching system which provides nationwide, largely fiber-optic, access throughout the United States.

The Company is a full-service long distance carrier currently providing direct deal long distance services to small and mediumsized commercial customers and, to a lesser extent, residential customers. In addition, the Company provides operator assisted services for private pay telephones, hotels, motels, university dormitories and hospitals. In fiscal 1996, direct dial long distance services represented approximately two-thirds of the Company's revenues, while operator services represented approximately one-third of revenues.

### Note 2. Nummary of Nignificant Accounting Policies

### Principles of Consolidation and Basis of Presentation

The accompanying consolidated financial statements include the accounts of USLD and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain current period and prior period amounts have been reclassified for comparative purposes.

On August 2, 1996, the Company completed the spin-off of its billing clearinghouse and information management services business. Billing Information Concepts Corp. ("Billing"). The spin-off has been accounted for as a discontinued operation and, accordingly, the Company restated its consolidated financial statements for all periods presented prior to that date in accordance vish Accounting Principles Board ("APB") Opinion No. 30. Financial disclosures for all periods presented reflect that restatement.

Cash was historically managed by a centralized cash management department in Billing. Consequently, cash was not allocated among USLD's subsidiaries and was recorded on the balance sheet of Billing. Total consolidated cash was \$22.9 million at September 30, 1995, none of which is reflected on the Company's balance sheet for financial reporting purposes.

The intercompany payable to Billing has been reported as a separate line item in the restated balance sheet under the caption "Payable to Billing, net" between the liability and stockholders' equity sections of the balance sheet. See further discussion of discontinued operations in Note 3.

### Estimates in the Financial Statements

The preparation of 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 the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Revenue Recognition Policies

The Company recognizes revenue from its direct dual long distance and operator services as such services are performed.

### Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the related assets, which range from three to ten years. Upon disposition, the cost and related accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss is reflected in other income for that period. Expenditures for maintenance and repairs are charged to expense as incurred. Direct installation costs and major improvements are capitalized.

### Excess of Cost Over Net Assets Acquired

Excess of cost over net assets acquired represents the excess of the consideration paid over the fair value of the net assets acquired. The initial acquisition of the direct dial long distance business is being amortized using the straight-line method over 40 years, all subsequent acquisitions of direct dial long distance businesses are being amortized over 20 years. The Company annually assesses the appropriateness of the asset valuations and the amortization periods.

### Other Assets

Other assets include financing costs related to the issuance of long-term debt, which have been deferred and are amortized over the life of each respective agreement, acquisition costs of direct dial long distance customer bases, which are amortized over the expected useful life of the customer bases, and costs incurred to acquire operator services agreements, which are amortized over the life of each respective contract. In addition, a certificate of deposit held as security for an equipment financing facility, long-term deposits and the long-term portion of notes receivable have been included in other assets.

### Fair Value of Financial Instruments

The estimated fair value amounts of the Company's financial instruments have been determined by the Company using appropriate valuation methodologies and approximate their recorded book values at September 30, 1996 and 1995. The carrying values of the Company's cash, receivables, accounts payable, debt and all other financial instruments approximate their fair market values.

### Advertising Expense

The Company charges advertising costs to expense as the costs are incurred. Total advertising expense was \$1.1 million, \$543,000 and \$796,000 for the years ended September 30, 1996, 1995 and 1994, respectively.

### Income Taxes

In February 1992, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," which the Company adopted effective October 1, 1993. Under SFAS No. 109, deferred tax liabilities and assets are recorded based on enacted income tax rates that are expected to be in effect in the period in which the deferred tax liability or asset is expected to be settled or realized. A change in the tax laws or rates results in adjustments to the deferred tax liabilities or assets. The effects of such adjustments are required to be included in income in the period in which the tax laws or rates are changed. The adoption of SFAS No. 109 did not have a material impact on the Company's financial position or results of operations. Prior to October 1, 1993, the Company accounted for income taxes in accordance with the provisions of APB Opinion No. 11, "Accounting for Income Taxes."

### Net Income (Loss) Per Common Share

Net income (loss) per common share was computed by dividing net income (loss) applicable to common stock by the weighted average number of common shares and common share equivalents outstanding during the applicable period. The weighted average number of shares outstanding during each fiscal year differs from the number of shares outstanding at each year end due to assumed conversions of options and warrants that were outstanding during the respective periods.

Cash payments and non-cash activities during the periods indicated were as follows:

	Year Ended September 30.		
	1226	1995 in thomand	1994
Cash payments for interest	\$1,393	\$1,685	\$ 1.641
Cash payments for income taxes	187	414	0
Noncash investing and financing activities:			
Assets acquired in connection with acquisitions	0	939	11,560
Liabilities assumed in connection with acquisitions	0	351	4,273
Common stock issued in connection with acquisitions	0	896	4,962
Capital lease and debt obligations incurred	1,159	470	295
Contingent obligations incurred	. 0	0	1,637
Tax benefit recognized in connection with stock			
option exercises	1,421	1,236	392
Return of escrowed treasury stock	118	0	0
Reimbursable spin-off costs due from Billing	704	0	0
Dividend pursuant to spin-off of Billing	34,345	0	0

For purposes of determining cash flows, the Company considers all temporary cash investments purchased with an original maturity of three months or less to be cash equivalents.

### Recent Accounting Pronouncements

In March 1995, FASB issued 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 be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In fiscal 1996, the Company determined that certain computer equipment, customer lists and goodwill were impaired and, accordingly, wrote down these assets by \$1.8 million, of which \$1.1 million is included in restructuring charges and \$727,000 is included in depreciation and amortization expense.

In October 1995, FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 defines a fair value based method of accounting for employee stock options or similar equity instruments. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period of the award, which is usually the vesting period. However, SFAS No. 123 also allows entities to continue to measure compensation costs using the intrinsic value method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees." Entities electing to remain with the accounting prescribed by APB Opinion No. 25 must make pro forma disclosures of net income and earnings per share as if the fair value based method of SFAS No. 123 had been applied. The accounting and disclosure requirements of SFAS No. 123 are effective for transactions entered into in fiscal years that begin after December 15, 1995. The Company intends to measure compensation costs in accordance with APB Opinion No. 25 and to provide pro-forma disclosures of net income and earnings per share as if the fair value based method of accounting under SFAS No. 123 had been applied. Therefore, management of the Company does not anticipate SFAS No. 123 will have a material impact on the Company's financial position or results of operations.

In June 1996, FASB issued SFAS No. 125 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 125 provides accounting and reporting standards for, among other things, the transfer and servicing of financial assets, such as factoring receivables with recourse. SFAS No. 125 is effective for transfers and servicing of financial assets occurring after December 31, 1996, and is to be applied prospectively. Earlier or retroactive application is not permitted. Management of the Company does not anticipate the adoption of SFAS No. 125 will have a material impact on the Company's financial position or results of operations.

### Note 3. Discontinued Operations

On August 2, 1996, the Company completed the spin-off of Billing, its billing clearinghouse and information management services business. The spin-off has been accounted for as a discontinued operation and, accordingly, the Company restated its Consolidated Financial Statements for all periods presented prior to that date. The spin-off was a tax-free distribution of 100% of the common stock of Billing to the Company's stockholders. Revenue of the discontinued operations of Billing was \$85.8 million, \$80.8 million and \$57.7 million in fiscal 1996, 1995 and 1994, respectively. Net income of the discontinued operations of Billing was \$15.2 million, \$14.1 million and \$8.6 million in fiscal 1996, 1995 and 1994, respectively. In connection with the spin-off, the

Company entered into an agreement with Billing under which the intercompany payable/receivable balances were forgiven. Additionally, Billing agreed to reimburse the Company for direct out-of-pocket expenses associated with the spin-off and to transfer cash to the Company to provide the Company a working capital balance of \$21.5 million at the spin-off date. The net effect of this agreement resulted in the Company recording the distribution as a dividend in the amount of \$16.4 million for financial statement purposes. Direct spin-off costs recorded as operating expenses in the year ended September 30, 1996 were approximately \$13.0 million and include professional fees, tax payments triggered by the spin-off, payments called for under employment agreements and costs associated with accelerated stock grants.

The summarized components of net assets of discontinued operations at September 30, 1995 were as follows (in thousands)

	\$100,735
Current assets	
Property and equipment, net	1.785
Other	1.375
Total assets	106,895
Accounts payables, accruals and debt	640,405
Revolving line of credit	23,030
Other liabilities and obligations	2,237
Total liabilities	85,672
Receivable from the Company	(17.860)
Net assets of discontinued operations	\$ 39,083

### Note 4. Acquisitions

On October 1, 1993, the Company acquired Telecom West Inc. ("TWT"), a direct dial long distance company, in exchange for 270,000 shares of its common stock. The business combination has been accounted for as a pooling-of-interests combination. The accompanying consolidated financial statements include the operating results of TWI since the effective date of the business combination. The consolidated financial statements for periods prior to the combination have not been restated to include the accounts and results of operations of TWI due to the transaction not having a significant impact on the Company's prior period financial position or results of operations.

During fiscal 1994, the Company acquired four other separate, privately-owned direct dial long distance companies located in Texas and California. These acquisitions have been accounted for as purchases and, accordingly, the results of operations of each company have been included in the Company's consolidated financial statements since the respective dates of acquisition. An aggregate of \$1.0 million cash and 650,000 shares of the Company's common stock were issued in connection with these purchase transactions. Total assets acquired and liabilities assumed for these acquired companies were approximately \$2.8 million and \$3.3 million, respectively. The excess of the aggregate purchase price over the fair value of aggregate net tangible assets acquired is approximately \$8.0 million, of which approximately \$6.9 million has been recorded as goodwill and is being amortized on a straight-line basis over 20 years. The remaining balance has been recorded as the purchase price for customer lists and is being amortized on a straight-line basis over five years.

On October 6, 1994, the Company acquired L.D. Network, Inc. ("LDN"), a direct dial long distance company, in exchange for 175,000 shares of its common stock. The business combination has been accounted for as a pooling-of-interests combination. The accompanying consolidated financial statements include the operating results of LDN since October 1, 1994. The consolidated financial statements for periods prior to the combination have not been restated to include the accounts and results of operations of LDN due to the transaction not having a significant impact on the Company's prior period financial position or results of operations.

In March 1995, the Company acquired the long distance commercial customer base of a company and certain assets of another company. These acquisitions have been accounted for as purchases and, accordingly, the results of operations of each acquisition have been included in the Company's consolidated financial statements since the respective effective dates of acquisition. Cash of \$175,000 and 78,000 shares of the Company's common stock were issued in connection with these purchase transactions. Total assets acquired and liabilities assumed for these acquisitions were approximately \$1.1 million and \$280,000, respectively. The excess of the purchase price over the fair value of aggregate net tangible assets acquired is approximately \$1.0 million, of which approximately \$316,000 has been recorded as goodwill and is being amortized on a straight-line basis over 20 years. The remaining balance has been recorded as the purchase price for customer lists and is being amortized on a straight-line basis over 10 years.

No pro forma financial information with regard to any acquisitions has been presented as the acquisitions do not have a significant impact, either individually or in the aggregate, on the Company's prior or current period financial position or results of operations. The Company granted certain registration rights to the persons receiving its common stock in the acquisitions and caused its subsidiaries to enter into employment agreements with certain principals of the acquired companies.

### Note 5. Property and Equipment

Property and equipment consist of the following:

	1996 (in the	1995 ousands)
Communications equipment	\$40,573	\$33,652
Furniture, fixtures and equipment	15,618	11.437
Leasehold improvements	_2,779_	2.711
Less accumulated depreciation	(26.793)	(19,100)
Net property and equipment	\$29,577	\$28,694

### Note 6. Debt

Long-term debt is comprised of the following:	September 30.
	[996 1995 (in thousands)
Fixed interest rate term notes Less - Current portion	\$16,000 \$17,474 _5,854 _5,147
Longsterm debt less current portion	\$10,146 \$12,327

The Company has a revolving credit receivable financing facility which allows the Company to borrow against its own operator services accounts receivable and certain direct dial long distance services accounts receivable. At September 30, 1996, the Company had approximately \$14.0 million available for borrowing and did not have any amounts borrowed under this facility. At September 30, 1995, the Company did not have any amounts borrowed under this facility. Any borrowings under this facility will bear interest at the prime rate plus 5%. This facility is collateralized by the related accounts receivable and by virtually all of the assets of the Company not otherwise pledged as security under other debt agreements. This financing facility terminates on December 31, 1996.

The Company is a guaranter on a \$45.0 million credit receivable financing facility for Billing. Under the terms of the Transitional Services and Sublease Agreement discussed further in Note 13, the Company's potential liability as guaranter is compensated by Billing at the rate of 1% of the average annual outstanding balance. At September 30, 1996, Billing had \$19.0 million outstanding under this facility. The guarantee arrangement terminates on December 31, 1996.

In fiscal 1996, the Company entered into a \$10.0 million equipment financing facility with an interest rate at the 30-day commercial paper rate, as defined in the agreement, plus 2.70%. No amounts were outstanding under this facility at September 10, 1996. The agreement provides for a one-year period during which the Company may finance up to \$10.0 million in equipment on an interest payment only basis. Upon completion of this period in September 1997, the outstanding borrowings will convert to a series of term note with 20% of the total amount borrowed due in each of the next five years. Any amounts not due in a given year may be prepaid and reborrowed at the Company's discretion. A commitment fee of \$75,000 was paid in connection with this facility. It is being amortized over five years.

The Company has various fixed rate notes with interest rates ranging from 6.75% to 11.0%, due in varying amounts through August 2001. The proceeds from the issuance of these notes were used to acquire certain computer and telecommunications equipment and office furniture. The loans are secured by the assets acquired with the proceeds of such notes. Certain of these notes are also guaranteed by Billing.

Historically, the Company has obtained financing for capital expenditures through term debt agreements and capital agreements that were guaranteed and cross-collateralized by the Company and Billing. These debt agreements were negotiated that the strength of the consolidated financial statements, earnings and cash flow of the consolidated group. Most of these debt agreements were secured by the assets of all the subsidicates within the consolidated group. The Company has received from certain lenders and

agreement amendments or separate loan agreements whereby the subject indebtedness will be secured by only the Company's assets. In other cases, the existing cross guarantees and security arrangements between the Company and Billing will remain in place for the duration of the facility. In this regard, the Company and Billing have agreed to pay each other a credit support fee of 1% of the average annual outstanding balance.

The credit facilities discussed above contain various restrictions and financial ratio maintenance requirements. Under one of its credit facilities, the Company is required to maintain a quarterly ratio of consolidated operating income, as defined in the agreement, to consolidated fixed charges of 1.5 to 1.0. Further, the Company is required to maintain a ratio of funded debt, as defined in the agreement, to total capitalization of not greater than 85%. Other agreements require the Company to maintain cash flow coverage ratios, as defined in the agreements, ranging between 1.25 and 1.40 and a minimum tangible net worth ranging between \$30.0 million and \$35.0 million. Under one agreement, the Company is prohibited from paying a cash dividend on its common stock. Cross-default provisions of the Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other loan agreements. Under the Company's most significant credit facilities, USLD has guaranteed the obligations of its subsidiaries. The Company was in compliance with all required covenants at September 30, 1996 and 1995.

Scheduled maturities for the years ending September 30, 1997 through 2001 are as follows (in thousands):

Year Ending September 30, 1997	\$ 5,854
1998	4,960
1999	2,759 1,653
2000	
Total debt	\$16,000

### Note 7. Leaves

The Company leases certain equipment and office space under operating leases. Rental expense for fiscal 1996, 1995 and 1994, was \$2.5, \$2.6 and \$2.3 million, respectively. Future minimum lease payments under non-cancelable operating leases at September 30, 1996, are as follows (in thousands):

/ear Ending September 30, 1997	\$2,231
1998	1,800
1999	476
2000	63
2001	74
Thereafter	179
otal minimum lease payments	\$4,823

The Company also leases various computer and telecommunications equipment under capital lease arrangements. Future minimum lease payments under these capital leases, together with the present value of the net minimum lease payments at September 30, 1996, are \$437,000 and are due in varying amounts through 1999.

### Note B. Share Capital

On June 1, 1994, the Company was authorized by its board of directors to purchase up to 1,000,000 shares of its outstanding common stock. Shares were purchased from time to time on the open market over the course of the twelve months that began June 1, 1994 as market and other relevant conditions warranted. During the twelve-month period ended May 31, 1995, the Company purchased an aggregate of 267,500 shares at an average market price of \$9.84 per share. All of these shares were purchased subsequent to July 1, 1994. In November 1994, the Company retired 100,000 shares of treasury stock carried at a cost of \$950,000. These shares were returned to authorized and unissued shares. In November 1995, the escrow agreement relating to the Company's acquisition of the long distance commercial customer base of a company in March 1995 and pursuant to which 16,869 shares of the Company's common stock were held in escrow was terminated. These 16,869 shares were returned to the Company and are being held as treasury shares. At September 30, 1996, the Company had 204,101 shares of treasury stock, carried at cost.

Other capital contributions in fiscal 1995 and 1996 are from a director of the Company and represent a settlement of certain securities matters. No cash dividends were paid on the Company's common stock during fiscal 1996, 1995 or 1994.

On December 12, 1995, the Board of Directors adopted the U.S. Long Distance Corp. 1995 Employee Restricted Stock Plan (the "Restricted Stock Plan"), which provides for the awarding of restricted stock to officers and certain key employees of the Company. An aggregate of 500,000 shares of common stock are reserved for awards under the Restricted Stock Plan. The number of shares of common stock to be awarded to an employee and other terms of the award are determined by a committee of disinterested persons who will administer the Restricted Stock Plan. The Restricted Stock Plan provides for certain restrictions upon the sale of the stock. Subsequently, the Restricted Stock Plan was amended to allow for immediate vesting at the discretion of the committee. In fiscal 1996, 188,000 shares of stock were granted under this plan. Compensation expense of \$553,000 was recognized upon the amortization of deferred compensation and is included in selling, general and administrative expense. An additional \$3.4 million of compensation expense was recognized in fiscal 1996 due to the acceleration of vesting of stock grants pursuant to the spin-off of Billing and is included in direct spin-off costs. At September 30, 1996, 312,000 shares were available for granting under this plan.

On April 12, 1996, the Company, upon authorization by its Board of Directors, adopted a Shareholder Rights Plan ("Rights Plan") and declared a dividend of one preferred share purchase right on each share of its outstanding common stock. The rights will become exercisable if a person or group acquires 15% or more of the Company's common stock or announces a tender offer, the consummation of which would result in ownership by a person or group of 15% or more of the common stock. These rights, which expire on April 12, 2006, entitle stockholders to buy one ten-thousandth of a share of a new series of participating preferred shares at a purchase price of \$90.00 per one ten-thousandth of a preferred share. The Rights Plan was designed to assure that stockholders receive fair and equal treatment in the event of any proposed takeover of the Company.

### Note 9. Noch Options and Stock Purchase Warrants

The Company has granted stock options to directors, employees and other affiliated parties as follows:

	Number of Shorts	Price Range of Shares Under Option
Outstanding, September 30, 1993	1,252,689	
Canceled	(141,054)	\$1.20 - \$3.59
	657,850	\$2.43 - \$3.59
Exercised	(112,386)	\$0.39 - \$2.53
Outstanding, September 30, 1994	1,657,099	
Canceled	(65,264)	\$2.03 - \$3.40
	300,500	\$2.43 - \$3.85
Fxereised.	1471.861)	\$0.39 - \$3.14
Outstanding, September 30, 1995	1,420,474	
Canceled	(665,144)	\$2.20 - \$2.95
	1,924,700	\$2.91 - \$8.48
Granted	(281,900)	\$2.20 - \$3.08
Exercised	2.398.130	
Outstanding, September 30, 1996	and Zunlay.	

In connection with the August 2, 1996 spin-off of Billing, further discussed in Note 3, the Company effected a tax-free distribution of 100% of the common stock of Billing to the Company's stockholders. Immediately prior to that distribution, Billing, under its employee stock plans, granted options to purchase Billing common stock to each holder of an outstanding option to purchase shares of the Company's common stock under the U.S. Long Distance Corp. 1990 Employee Stock Option Plan, as amended ("Employee Plan") and the U.S. Long Distance Corp. 1993 Non-Employee Director Stock Option Plan ("Director Plan"), respectively. In connection with the grant of the Billing options, the exercise price of the Company's options was adjusted via a formula adjustment designed to preserve the economic value of the Company's options existing immediately prior to the distribution. Except for the formula adjustment, the terms of each of the Company's adjusted option are substantially the same as those in effect prior to the distribution. The per share exercise price of the Company's options was adjusted based on the relative fair market values of the underlying common stock of each of the two companies, or by a factor of 25.9%. The fair market value per share of common stock of each company was defined as the average of the last sales price per share of that common stock on the Nasdaq National Market system for each of the ten consecutive trading days immediately subsequent to the date of distribution.

Stock options to purchase an aggregate of 117,500 shares were outstanding at September 30, 1996, were granted outside of any plan and are exercisable at prices ranging from \$4.38 to \$6.38 at varying dates through August 23, 2002. Stock options to purchase an aggregate of 65,000 shares were outstanding at September 30, 1996, were granted under the provisions of the Director Plan and are exercisable at prices ranging from \$2.78 to \$4.76 per share. The Director Plan options have certain vesting requirements and expire at varying dates through February 28, 2001. There were 115,000 shares remaining to be issued under the Director Plan at September 30,

1996. Stock options to purchase an aggregate of 2.215,630 shares were outstanding at September 30, 1996, were granted under the provisions of the Employee Plan, and are exercisable at puces ranging from \$0.39 to \$8.48 per share. The Employee Plan options, which have certain vesting requirements, expire at varying dates through August 22, 2002. The Employee Plan provides for the graining of incentive stock options and nonqualified stock options. As of September 30, 1996, there were 790,515 shares remaining to be issued under the Employee Plan. Options to purchase a total of 1,031,385, 756,524 and 610,792 shares of common stock were exercisable under all plans at September 30, 1996, 1995 and 1994, respectively.

The excess of the market value of the common stock on the date granted over the exercise price of such options results in compensation expense to the Company over the vesting period. Approximately \$145,000, \$255,000 and \$220,000 of compensation expense was recognized by the Company during fiscal 1996, 1995 and 1994, respectively. There were no deferred compensation costs netted against additional paid-in capital at September 30, 1996 while \$145,000 was netted against paid-in capital at September 30, 1995

Stock warrants to purchase 469,741 shares of common stock were outstanding at September 30, 1995. These warrants were issued in connection with the sale of the senior subordinated notes in July 1991 and were exercisable at \$0.01 per share. Warrants to purchase 469,741 and 608,459 shares of common stock were exercised in fiscal 1996 and 1995, respectively. There were no such warrants exercised in fiscal 1994. There were no such stock purchase warrants outstanding at September 30, 1996.

In addition, the Company has granted warrants to purchase 225,000 shares of common stock, pursuant to two telecommunications service agreements. The exercise price of the warrants was equal to the market value of the Company's common stock on the date of grant. Pursuant to the spin-off of Hilling, the exercise price associated with these warrants was adjusted to 53.24 per share. The warrants vest ratably over the contract periods.

### Note 10. Income Toxes

The income tax benefit is comprised of the following:

	Year Er	ded Septe	mber M.
	1926	1225	
	(le	thousand	4)
Current	\$ 119	\$2,574	\$ 1.965
Deferred	3,231	(2,058)	(1,207)
Income tax benefit	\$3,350	\$ 516	5 758

The income tax benefit for fiscal 1996, 1995 and 1994 differs from the amount computed by applying the statutory federal income tax rate of 35% for fiscal 1996 and 1995 and 34% for fiscal 1994 to loss from continuing operations before taxes. The reasons for these differences were as follows:

	Year East	ed Septer	aber 30.
	1996	1995	1994
	(im	thousand	4)
Computed income tax benefit at statutory rate	\$5,986	5910	\$1,099
Increases (reductions) in taxes resulting from:			
State income taxes	(311)	(146)	(185)
Amortization of asset valuations in excess of tax	(98)	(165)	(12)
Non-deductible expenses related to spin-off	(2,455)	0	0
Other, net	_228.	(83)	_040
Income tax benefit	\$3,350	\$516	5 758

The tax effect of significant temporary differences, which comprise the deferred tax assets and liabilities, are as follows:

	September 30. 1996 1995 (in thousands)	
Deferred tax assets:	\$ 1,713	<b>S</b> 0
Deferred compensation		SCOTIS LYAPING
Expense provisions	_1.460	- 88
Total pross deferred tax assets	3,173	88
Deferred tax flabilities:		
Tax depreciation and amortization in excess of book	(2,556)	(2,933)
Prepaid expenses	(262)	(222)
	_(407)	(216)
Other	(3.225)	(3.371)
Total gross deferred tax liabilities	Table State	DOMESTIC STREET
Net deferred tax liability	5 (52)	\$(3,283)

The Company has been notified by the Internal Revenue Service ("IRS") that a fiscal 1992 transaction between a wholly owned foreign subsidiary (Mega Plus Dialing, Inc.) and its U.S. subsidiary (Billing, formerly Zero Plus Dialing, Inc.) is proposed to be treated differently by the IRS than originally characterized by the Company. The IRS district office has issued a report that proposed an assessment of taxes, penalties and interest. The assessment has been appealed to the appellate division of the IRS. The Company and its tax counsel believe the possibility that the IRS will prevail in this matter is remote. Consequently, no accrual for this potential hability or any associated taxes, interest or penalties has been made. Management of the Company does not anticipate this matter will have a material impact on the Company's financial position or results of operations.

During fiscal 1996, the Company incurred expenses related to the spin-off of Billing. Under federal income tas law, expenses incurred for effecting a corporate reorganization are non-deductible capital expenditures. Approximately \$7.0 million of the spin-off expenses were determined to be non-deductible, resulting in a reduction of the income tax benefit of approximately \$2.5 million.

During fiscal 1996, the Company recognized a tax gain related to the liquidation of its wholly owned foreign subsidiary. Mega Plus Dialing, Inc. (MPDI). The gain arose in conjunction with the redemption of common and preferred shares of Billing held by MPDI. The Company paid Canadian federal taxes totaling US \$3.3 million on the gain. This tax payment generated a foreign tax credit for U.S. federal income tax purposes equal to this amount.

### Note 11. Benefit Plans

The Company adopted the U.S. Long Distance Corp. 401(k) Retirement Plan ("Retirement Plan") effective lanuary 1, 1992. Participation in the Retirement Plan is offered to eligible employees of the Company or its subsidiaries. Generally a employees of the Company or its subsidiaries who are 21 years of age and who have completed one year of service during which they are ed at least 1,000 hours are eligible for participation in the Retirement Plan.

The Retirement Plan is a defined contribution plan which allows participants to make voluntary salary determit contributions, on a pretax basis, of hetween 1% and 15% of their compensation in the form of voluntary payroll deductions up to a maximum amount as statutorily determined. In fiscal 1996, the Company made matching contributions of 50% of the first 3% of the participant's contribution. In fiscal 1994, the Company made matching contributions at a percentage determined annually of 25% of the first 6% of the participant's contribution. The Company may, from time to time, make additional discretionary contributions. No discretionary contributions were made in fiscal 1996 or 1995. During fiscal 1994, a discretionary contribution in the amount of acrossmately \$51,000 was made. During fiscal 1996, 1995 and 1994, the Company's contributions totaled approximately \$162,000. \$5,5,000 and \$198,000, respectively.

The Company adopted the U.S. Long Distance Corp. Executive Compensation Deferral Plan ("Executive Plan") and the U.S. Long Distance Corp. Director Compensation Deferral Plan ("Director Plan"), effective January 1, 1994. Particulation in the Executive Plan is offered to selected employees occupying management positions who are determined by the Company's board of directors, from time to time, to be eligible to participate in the Executive Plan. Participation in the Director Plan is offered to individuals occupying a position as an outside director. The Executive and Director Plans are defined contribution plans which provide that participants may make voluntary contributions, on a pretax basis, of between 1% and 100% of their eligible compensation. Under the Executive Plan, the Company made matching contributions equal to the lesser of 100% of a participant's contributions or an amount determined by a formula established by the plan. Matching contributions under the Director Plan were 33% of the participant's contributions. The Company has the right to make matching contributions of a different amount or no contributions under both plans. During fiscal 1906–1995 and 1994, the Company contributed \$114,000, \$87,000 and \$60,000 to the Executive Plan and \$75,000, \$15,000 and \$6,000 to the Director Plan, respectively.

Additionally, the Company adopted the U.S. Long Distance Corp. Executive Qualified Disability Plan ("Disability Plan provides long-term disability benefits for certain employees occupying positions through disability insurance coverage purchased by the Company and through Company funded payments. Because the Disability Plan are provided directly by the Company based on definitions contained in the insurance policies.

The U.S. Long Distance Corp. Employee Stock Purchase Plan (the "ESPP"), which was established under the resonance of Section 423 of the Internal Revenue Code of 1986, as amended, became effective July 1, 1995. The ESPP enables are a local who have completed at least six months of continuous service with the Company to purchase shares of the Company's common above at a 15% discount through voluntary payroll deductions.

### Note 12. Restructuring Charges

In the fourth quarter of fiscal 1996, the Company recorded restructuring charges of \$2.8 million. These restructuring include costs associated with consolidating customer service, credit and collection and other support functions, vacating facilities, terminating certain marketing contracts, writing down excess assets and providing severance payments.

### Note 13. Related Party Transactions

For purposes of governing certain ongoing relationships between the Company and Billing after the spin-off and to provide the an orderly transition, the Company and Billing have entered into certain agreements. Such agreements include (1) the December 1 Agreement, providing for, among other things, the spin-off and the division between the Company and Billing of Company and Company an habilities and material indemnification provisions, (ii) the Benefits Plans and Employment Matters Allocation Agreement and the for certain allocations of responsibilities with respect to benefit plans, employee compensation, and labor and employment in the Tax Sharing Agreement pursuant to which the Company and Billing agreed to allocate tax habilities that relate to periods program and after the Distribution Date; (iv) the Transitional Services and Sublease Agreement pursuant to which will provide certain and an artist and artists and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to which will provide certain and artists are also as a second pursuant to the second p temporary basis and sublease certain office space to Billing and Billing will provide certain services to the Company on a temporary (v) the Zero Plus-Zero Minus Billing and Information Management Services Agreement and the One-Plus Billing Management Services Agreement pursuant to which Billing will provide billing clearinghouse and information management and information management the Company for an initial period of three years, and (vi) the Telecommunications Agreement pursuant to which the Company will provide long distance telecommunications services to Billing for an initial period of three years, and (vii) the Leavis Agreement whereby the Company and Billing agree to pay certain usage charges. It is the intention of the Company and Billing that the impartmental Service and Sublease Agreement, the Zero Plus-Zero Minus Billing and Information Management Services Agreement - he-Plus Billing And Information Management Services Agreement, the Telecommunications Agreement, and the Leasing Agreement reflect terms and conditions similar to those that would have been arrived at by independent parties bargaining at arm's length. he are there can be no assurances that such agreements are on terms at least as favorable as could have been obtained from unaffiliated that such

The Company and Billing share a common individual on their boards of directors. Therefore, the companies are considered related parties for financial disclosure purposes. At September 30, 1996 and 1995, the Company had accounts receivable from Billing of \$1.3 million and \$242,000, as well as notes receivable of \$1.0 million and \$0, respectively. In addition, the Company had accounts payable to Billing of \$1.1 million and \$1.1 million at September 30, 1996 and 1995, as well an intercompany payable of \$0.000 for million, respectively. Operating revenues from Billing were \$3.6 million, \$1.7 million and \$924,000 for the years ended september 30, 1996, 1995 and 1994, respectively. Operating expenses related to Billing were \$5.3 million, \$5.3 million and \$5.3 million and \$5.3 million for the years ended September 30, 1996, 1995 and 1994, respectively.

From time to time, the Company has loaned to or was otherwise owed amounts from certain officers and direct staff of the Company. The highest amount outstanding of advances to officers and directors during fiscal 1996 and 1995 was \$212,000 and \$55-2,000 respectively. The amount outstanding at September 30, 1996 and 1995 was \$75,000 and \$212,000, respectively.

### Note 14. Commitments and Contingencies

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations, however, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on the Company's results of operations for the fiscal period in which such resolution occurred.

The Company is obligated to pay a minimum of approximately \$7.2 million during fiscal 1997 for usage charges under service agreements with certain long distance carriers. The Company anticipates exceeding the minimum usage volumes with these vendors.

### Note 15. Regulatory Matters

Billed Party Preference

An issue under consideration by the Federal Communications Commission (the "FCC") currently is termed Billed Party Preference ("BPP"). This term refers to a concept in which any long distance call outside the local telephone company's calling area, carried from a publicly available telephone, would be completed over the long distance carrier network of the billed party's previously expressed preference. This would be accomplished through a local telephone company database system that would match every calling card and telephone number to a preferred long distance company and then direct all calls accordingly. In April 1992, the FCC tentatively proposed adopting BPP. During the summer of 1992, comments from local telephone companies, long distance carriers and other industry participants revealed that the cost of imposing BPP could be in excess of \$1.0 billion and could require hundreds of millions of dollars each year to support its operation. The majority of these commentors were in opposition to the implementation of BPP. Commentors made clear that many technical impediments remain to full deployment of BPP. Other commentors claimed that no technology exists that could implement BPP without making call processing significantly less convenient for many operator services calls, particularly those requiring a live operator.

In August 1994, industry members responded to a Commission Further Notice of Proposed Rulemaking. The Commission had tentatively concluded, based upon their calculation of related cost information previously submitted by industry members, that the potential benefits of a BPP system appeared to outweigh its costs, although the Commission admitted the financial data it used in its study could be outdated. Once again, industry participants were resoundingly opposed to the Commission's proposal, including AT&T and most of the Regional Bell Operating Companies (the "RBOCs"). To date, the FCC has taken no further action.

If such a system were implemented successfully, the unique market niche of operator services provider presubscription, such as that of the Company, would be rendered virtually ineffectual, as an owner of publicly available telephones would be unable to direct operator assisted calls over the network of such owner's desired carrier. In any event, local telephone companies have indicated that, if so directed, approximately two to four years would be required to reconfigure their networks to BPPs specifications. Thus, while BPP remains viable, the Company believes that it is not likely to be implemented in the near term

On March 9, 1995, the FCC requested industry comment on two proposals it had recently received relative to the BPP proceeding. In an ex-parte petition, the National Association of Attorney's General ("NAAG") suggested that the FCC modify its current branding requirement such that operator service providers ("OSPs") would be required to announce at the beginning of each call more specific information for obtaining access to alternate carriers (the "NAAG Petition"). Another petition filed by a coalition of industry members, including most of the RBOCs, two competitive access providers, the American Public Communications Counsel ("APCC") and the Competitive Telecommunications Association ("CompTel"), recommended that the FCC impose certain rate thresholds for interstate operator assisted services, which the FCC would presume to be reasonable, and any OSP electing to charge rates higher than such threshold would be required to first prove to the FCC that such rates are justified based upon the underlying costs of the service (the "APCC Rate Cap Proposal"). The NAAG Petition was proposed to remain in effect until such time that BPP is adopted and fully implemented. The APCC Rate Cap Proposal was proposed to obviate the need to consider any further action regarding BPP.

Subsequently, in June 1996, the FCC issued a Second Further Notice of Proposed Rulemaking (SFNPRM) in this proceeding. In it, the FCC proposed adopting a rule which would require operator service providers to announce the rates for certain calls to the billed party prior to connecting the call, thereby allowing the billed party to disconnect such call without incurring any unwanted charges. In September, the FCC released its Second Request for Comment in the SFNPRM soliciting technical and other administrative details to support the proposed announcement requirement. Most commentors objected to the discriminatory nature of the proposal, which would have some carriers announcing rates while others would not. If any of these proposals are adopted by the FCC, the Company's operator service traffic could be negatively affected.

### MI J Legislation

On February 8, 1996, President Clinton signed the Telecommunications Act of 1996 into law. The new law allows the RBOCs to petition their respective "in-region" state regulatory agencies to seek authority from ECC to allow the applicant RBOC to provide long distance services. To obtain this authority, each state agency is required to certify to the ECC that the applicant RBOC has satisfied a legislative "checklist" that outlines the steps required for an RBOC to open its network to competition on a local basis. These steps include the provision of competitive network interconnection, unbundled access to network elements and other necessary access to poles, ducts, conduits and rights-of-way. Furthermore, applicant RBOCs must provide non-discriminatory access to white pages listings and telephone number assignments. Applicant RBOCs must provide local number portability, toll dialing parity and local service resale. The ECC is required to consult with the Department of Justice ("DOJ") to assist in determining if an applicant RBOCs cutry into the long distance business violates any anti-trust standards the DOJ considers appropriate. Ninety days after receiving such an application, the ECC is required to render its decision. RBOCs are required to establish separate subsidiaries

through which they could first offer in-region long distance services. RHCCs may provide out-of-region long distance services subject to existing laws and regulations governing long distance communications.

To date, no RBOC has requested authority for in-region interLATA authority, because the provisions set forth above have not been satisfied by any RBOC. However, many entities have reached interconnection agreements with RBOCs to date, including the Company, and many states have adopted rules governing local competition. It is reasonable to expect that the conditions for RBOC entry will be met in the near future, and carriers in the interLATA long distance business today, such as the Company, will encounter new, formidable competition.

### Texas PIU Issue

In a Final Order released in Docket 10127 on April 12, 1993, the Texas Public Utility Commission ("PUC") adopted new regulations governing the method by which interexchange carriers ("IXCs") such as the Company calculate intrastate access charges paid to local telephone companies. These new rules required an independent auditor's review and approval of an IXC's methodology of determining its own intrastate access usage. An independent audit by an accounting firm verified that the Company's process of calculating PIU is reasonable and statistically valid and, as such, no additional PIU or billing adjustments are required.

### Regulatory Rate Proceedings

During the course of normal operations, a regulated company may at any time come under specific scrutiny with regard to any of its rates, terms or conditions by which such service is rendered by the state or federal regulatory agency charged with such oversight responsibility, or by an attorney general or other jurisdictional consumer officials. In such cases, a regulated company can be required to, among other things, provide cost justification for the charges it imposes on some or all of its services, or to address perceived consumer inequities. After review of such justification, the regulatory agency generally has the authority to require a carrier to modify the process by which such services are rendered or to effect changes to its applicable rate structure. Consumer officials and attorneys general can pursue civil action if their concerns are not adequately addressed by the carrier. The Company operates in several jurisdictions in which its tariffs or services may, from time to time, fall under such scrutiny at the discretion of the governing regulatory agency or other officials. The Company could therefore be required, as a result of such an investigation and subsequent proceeding, to implement changes in its rate structure, which could ultimately affect its revenues. The Company cannot predict whether or not any such requirement may be imposed in any particular jurisdiction.

### Note 16. Selected Quarterly Financial Data (Unaudited)

In thousands, except per share amounts		Three Mont	a Ended	
	December 31,	March 31.	June 30,	September 30,
	1995	1996	1990	1994
Operating revenues	\$39,708	\$43,655	\$46,684	\$50,299
Loss from operations	(831)	(1,088)	(6,284)	(8,273)
Net loss from continuing operations	(246)	(1,080)	(4,016)	(7,812)
Income from discontinued operations, net	1,948	5,021	4,317	1,875
Net income (loss)	3,102	3,941	301	(5,937)
Net income (loss) per common share:	and the second			*****
Continuing operations	\$(0.06)	\$(0.08)	\$(0.25)	\$(0.50)
Discontinued operations	0.27	0.33	0.27	0.11
Net income (loss) per common share	0.21	0.25	0.02	(0.39)
		Three Man	to Ended	
	December 31, 1994	March 31, 	June 30, 1995	September 30,
	\$32,908	\$32,971	\$36,651	\$41,520
Operating revenues Income (loss) from operations	(641)	(700)	(974)	715
Net income (loss) from continuing operations	(641)	(663)	(867)	81
Income from discontinued operations, net	2,911	3,102	3,921	4,184
	2,270	2,439	3,054	4,272
Net income				
Net income (loss) per common share:	****	\$(0.05)	\$(0.06)	\$0.01
Continuing operations	\$(0.04)	0.22	0.27	0.28
Discontinued operations	0.20	0.22	0.41	100000000000000000000000000000000000000
Net income per common share	0.16	0.17	0.21	0.29

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS
ON ACCOUNTING AND FINANCIAL DISCLOSURE

Nonc.

### PART SH

### ITEM IO. DIRECTORS AND EXECUTIVE OF FICE IS OF THE COMPANY

The information required by this item is incorporated herein by reference from the information under the captions "Election of Directors" (Item 1 on proxy), "Management - Directors and Executive Officers," and "Section 16(a) Reporting" of the Company's definitive proxy statement to be filed pursuant to Regulation 14A with the Securities and Exchange Commission relating to its Annual Meeting of Stockholders to be held on February 25, 1997 (the "Definitive Proxy Statement")

### STEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference from the information under the caption "Management-Committees, Meetings and Compensation of the Board of Directors' Directors' Fees" and from the information under the caption "Executive Compensation" of the Company's Definitive Proxy Statement.

### TTEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is incorporated herein by reference from the information under the caption "Voting Securities and Principal Stockholders" of the Company's Definitive Proxy Statement.

### STEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated herein by reference from the information under the caption "Certain Transactions" of the Company's Definitive Proxy Statement.

### PARTIV

### TTEM 14. EXHIBITS. FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

- (a) The amounts Filed as Part of Report
- 1. Financial Statements:

The consolidated financial statements of the Company and the related report of the Company's independent public accountants thereon have been filed under Item 8 hereof.

### 2. Financial Statement Schedules:

The following financial statement schedule and the report of independent public accountants thereon are included in this report at the page indicated. All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted because such schedules are not required under the related instructions or are inapplicable or because the information required is included in the Consolidated Financial Statements or notes thereto.

	Page
Report of Independent Public Accountants.	42
Schedule II - Valuation and Qualifying Accounts	43

### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Hoard of Directors and Stockholders of U.S. Long Distance Corp.:

We have audited, in accordance with generally accepted auditing standards, the consolidated financial statements of U.S. Long Distance Corp. and subsidiaries and have issued our report thereon dated November 14, 1996. Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedule II is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSON LLP

San Antonio, Texas November 14, 1996

### U.S. LAING BOSTANCE COMP. AND SUBSIDIAMSES Valuation and Qualifying Accounts (in thereads)

			STATE WEST	Particular State of the Control		
Flocal		Balance at Baylaning of	Charged to Custo and	Charged to Other	Write-offi Charged to	Balance of
Xest		Decinal	Experience	Accounts	Allements	End of Period
1994	Allowance for doubtful accounts	\$2,861	\$5,095	\$0	\$(5,658)	\$2,298
1995	Allowance for doubtful accounts	\$2,298	\$6,231	\$0	\$(6,591)	\$1,938
1996	Allowance for doubtful accounts	\$1,938	\$8,388	\$0	\$(7,807)	\$2,519

### 3. Exhibits:

The exhibits listed below are filed as part of or incorporated by reference in this report. Where such lines is made by incorporation by reference to a previously filed document, such document is identified in parentheses. See the index of Exhibits included with the exhibits filed as part of this report.

Eshibit Massber	<b>Biographia</b>
3.1	Restated Certificate of Incorporation (Filed herewith)
3.2	Bylans, as amended (Filed herewith)
4.1	Form of Certificate Evidencing Common Stock (Filed herewith)
42	Amended Letter Agreement dated October 6, 1992, by and between Communications Central School Long Distance Corp. and U.S. Long Distance, Inc. (Exhibit 4.7 to Amendment No. 1 to Registration Statement of Form S-3, SEC File No. 33-71228, dated November 23, 1993) as amended by Letter Agreement dated August 1996 (Filed berewith)
4.3	Agreement dated March 23, 1993 by and between Paytel Northwest, Inc., U.S. Long Distance Corp. and S. Long Distance, Inc., as amended by Agreement dated August 23, 1995 (Exhibit 4.8 to September 30, 1997 and 10-K) and as amended by Addendum No. 3 to Telecommunications Services Agreement dated February 22, 1996 (Filed herewith)
4.4	Rights Agreement by and between the Company and U.S. Trust Company of Texas, N.A. dated April 17, 1996 (Exhibit 4.1 to Form 8-K filed April 17, 1996)
10.1	Amended and Restated Employment Agreement dated November 1, 1993, by and between the Common and Parris H. Holmes, Jr. (Exhibit 10.2 to September 30, 1993, Form 10-K) as amended by the First Amendment Amended and Restated Employment Agreement dated January 3, 1995 and Second Amendment to Amendment at Restated Employment Agreement, dated November 15, 1995 (Exhibit 10.2 to September 30, 1995, Form 10-K) and Agreement Regarding Vesting and Adjustment of Stock Options, dated June 25, 1996, by and reseen the Company, Billing Information Concepts Corp. and Parris H. Holmes, Jr. (Filed herewith)
10.2	Amended and Restated Employment Agreement, dated November 1, 1993, by and between the Company and Larry M. James as amended by First Amendment to Amended and Restated Employment Agreement dated innuary 3, 1995 and Second Amendment to Amended and Restated Employment dated November 15, 1995, and Screement Regarding Vesting and Adjustment of Stock Options, dated June 25, 1996, by and between the Company Billing Information Concepts Corp. and Larry M. James (Filed berewith)
10.3	Amended and Restated Employment Agreement, dated June 25, 1996, by and between the Company and A. Audic Long and Agreement Regarding Vesting and Adjustment of Stock Options, dated June 25, 1996, by and netween the Company, Billing Information Concepts Corp. and W. Audie Long (Filed herewith)
10-4	Form of Employment Agreement by and between the Company and its Vice Presidents (Exhibit 10.4 to September 30, 1993, Form 10-K)
10.5	1990 Employee Stock Option Plan, as amended (Filed herewith)
10.6	Form of Option Agreement by and between the Company and its Employees, Under the Employee Stock Option Plan (Exhibit 10.8 to September 30, 1992, Form 10-K)
10.7	Form of Stock Option Agreement for Directors, Key Employees and Advisors of U.S. Long Distance Corp. (Exhibit 4.14 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)
10.8	Form of Stock Option Agreement for Key Employees of U.S. Long Distance Corp. (Exhibit 4.15 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)

- Amended and Restated Loan and Security Agreement dated May 22, 1991, by and between Zero Plus Dialing, Inc. (currently Hilling Information Concepts, Inc., U.S. Long Distance Corp. and U.S. Long Distance, Inc. and Bell Atlantic TriCon Leasing Corporation ("Bell Atlantic") (currently FINOVA Capital Corporation) (Exhibit 10.10 to September 30, 1991, Form 10-K) and related Revolving Credit Note dated May 24, 1991, Term Note dated June 1992, Corporate Guaranties dated May 21, 1991, and First Amendment and Joinder to Amended and Restated Loan and Security Agreement dated December 17, 1992 (Exhibit 10.9 to September 30, 1992, Form 10-K)
- 10.10 Second Amendment to Amended and Restated Loan and Security Agreement dated April 2, 1993 by and between Zero Plus Dialing. Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.11 to September 30, 1993, Form 10-K)
- 10.11 Third Amendment to Amended and Restated Loan and Security Agreement dated October 1, 1993 by and between Zero Plus Dialing. Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.12 to September 30, 1993, Form 10-K)
- 10.12 Fourth Amendment to Amended and Restated Loan and Security Agreement dated October 1, 1993 by and between Zero Plus Dialing. Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.13 to September 30, 1993, Form 10-K)
- Fifth Amendment to Amended and Restated Loan and Security Agreement dated November 16, 1993 by and between Zero Plus Dialing, Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp. d/b/a Telecom West, Inc., STS Telecommunications, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.14 to September 30, 1993, Form 10-K)
- 10.14 Sixth Amendment to Amended and Restated Loan and Security Agreement dated December 7, 1993 by and between Zero Plus Dialing, Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp., STS Telecommunications, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.36 to September 30, 1994, Form 10-K)
- 10.15 Seventh Amendment to Amended and Restated Loan and Security Agreement dated March 17, 1994 by and between Zero Plus Dialing, Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp., California Acquisition Corp., Telecom Acquisition Corp., STS Telecommunications, Inc., Enhanced Services Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.37 to September 30, 1994, Form 10-K)
- 10.16 Letter Agreement dated December 2, 1993 by and between Hell Atlantic (currently FINOVA Capital Corporation) and U.S. Long Distance Corp. (Exhibit 10.15 to September 30, 1993, Form 10-K)
- 10.17 Office Lease Agreement dated September 29, 1988, by and between U.S. Long Distance, Inc. and Nowlin Building Partnership, Ltd., as amended (Exhibit 10.10 to September 30, 1992, Form 10-K)
- 10.18 Agreement of Lease dated September 1, 1992, by and between U.S. Long Distance, Inc. and Multi-Employer Property Trust (Exhibit 10.13 to September 30, 1992, Form 10-K)
- 10.19 Loan and Security Agreement dated July 25, 1991, by and between Buyer Acquisition Corporation (NTX) and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.13 to September 30, 1991, Form 10-K) and related Revolving Credit Note, Term Note, Subordination Agreement and Corporation Guaranties dated July 25, 1991 (Exhibit 10.14 to September 30, 1992, Form 10-K)
- 10.20 Loan and Security Agreement Nos. 2882, 2883, 2884 and 2885 by and between U.S. Long Distance Corp. and Charter Financial, Inc. dated August 29, 1996 (Filed herewith)
- 10.21 WCMA and Term WCMA Loan and Security Agreement No. 9608340801 by and between U.S. Long Distance, Inc. and Merrill Lynch Business Financial Services Inc. ("Merrill Lynch"), dated as of August 23, 1996, as amended by letter agreement dated November 5, 1996, and Term WCMA Note, dated August 23, 1996, made by U.S. Long Distance, Inc. and payable to Merrill Lynch (Filed herewith)

10.22	Operator Services Agreement by and between the Company and G-Five Corp., dated September 16, 1993 (Exhibit 10.33 to September 30, 1993, Form 10-K), as amended by Amendment to Operator Services Agreement dated August 31, 1995 (Filed herewith)
10.23	1993 Non-Employee Director Plan of U.S. Long Distance Corp. (Filed herewith)
10.24	Form of Director Option Agreement by and between the Company and Non-Employee Directors (Filed herewith)
10.25	Form of Director Fee Option Agreement by and between the Company and Non-Employee Directors (Filed herewith)
10.26	U.S. Long Distance Corp. Executive Qualified Disability Plan (Exhibit 10.42 to September 30, 1994, Form 10-K)
10.27	U.S. Long Distance Corp. Executive Compensation Deferral Plan, Restated Effective December 12, 1995 (Filed herewith)
10.28	U.S. Long Distance Corp. Director Compensation Deferral Plan, Restated Effective December 19, 1995 (Filed herewith)
10.29	U.S. Long Distance Corp. Employee Stock Purchase Plan (Exhibit 10.44 to September 30, 1995, Form 10-K)
10.30	U.S. Long Distance Corp. Restricted Stock Plan (Exhibit 10.45 to September 30, 1995, Form 10-K)
10.31	Merrill Lynch Special Prototype Defined Contribution Plan and Adoption Agreement for Merrill Lynch Special Prototype Defined Contribution Plan (401(k) Plan) (Filed herewith)
10.32	Distribution Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp (Exhibit 10.1 to Form 8-K filed August 2, 1996)
10.33	Benefit Plans and Employment Matters Allocation Agreement dated as of July 10, 1996 between the Company and Hilling Information Concepts Corp. (Exhibit 10.2 to Form 8-K filed August 2, 1996)
10.34	Tax Sharing Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp (Exhibit 10.3 to Form 8-K filed August 2, 1996)
10.35	Transitional Services and Sublease Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp. (Exhibit 10.4 to Form 8-K filed August 2, 1996)
10.36	Zero Plus-Zero Minus Billing and Information Management Services Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp. (Exhibit 10.5 to Form 8-K filed August 2, 1996)
10.37	Telecommunications Agreement dated as of July 10, 1996 between the Company and Billing Information Concept Corp. (Exhibit 10.6 to Form 8-K filed August 2, 1996)
11.1	Statement regarding computation of per share earnings (Filed herewith)
21.1	Subsidiaries of the Company (Filed herewith)
23.1	Consent of Arthur Andersen LLP (Filed herewith)
27.1	Financial Data Schedule (Filed herewith)
(b)	Reports on Form 8-K
	The Company filed a Report on Form 8-K on August 2, 1996, relating to the Distribution of Hilling Information Concepts Corp.

### -CHATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

U.S. LONG DISTANCE CORP.

By: // LARRY M. JAMES

Larry M. James President and

Chief Executive Officer

Date: December 19, 1996

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 19th day of December, 1996.

N PARRISH HOLMES IR Chairman of the Hoard Parris H. Holmes, Jr. President and Chief Executive Officer /s/ LARRY M. JAMES (Principal Executive Officer) Larry M. James Senior Vice President and Chief Financial Officer / PHILLIP L STORIN (Principal Financial and Accounting Officer) Phillip J. Storin Director /S' CHARLES E. AMATO Charles E. Amato Director /V GARY D. BECKER Gary D. Becker

### CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports included in this Form 10-K, into the Company's previously filed Registration Statements (SEC File No. 33-41039, 33-46567, 33-51604, 33-77404, 33-77612, 33-81686, 33-91260, 33-93942 and 333-09723).

ARTHUR ANDERSEN LLP

San Antonio, Texas December 16, 1996

### CINTED STATES SECURITIES AND EXCHANGE CURRENSON Washington, U.C. 20549

### FUMEN 10-K

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 18(4) OF THE SECURITIES EXCHANGE ACT OF 1934 For the Final Year Ended September 30, 1996

OR

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TRANSPISON REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECTION EXCHANGE ACT OF 1934 For the Transition Period from 10

Commission File Number: 0-18195

U.S. LEING DESTANCE CURP. (Exact Name of Registrant as Specified in its Charter)

Delaware

(State of Incorporation)

74-2522103 (LR.S. Employer Identification No.)

9311 Non Pedro, Suite 100, Son Antonio, Texas (Address of Principal Executive Office) 78216 (Zip Code)

(210) 525-9009 (Registrant's Telephone Number, Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act: Name

Securities Registered Pursuant to Section 12(g) of the Act: Common Stock, Par Value \$0.01 Per Share (Title of Class)

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 III. No II

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. [3]

The aggregate market value of the Registrant's outstanding Common Stock held by non-affiliates of the Registrant at December 13, 1996 was \$129,312,069. There were 15,076,381 shares of the Registrant's Common Stock outstanding at December 13, 1996.

### ENGLINGENTS INCUMPERATED BY REFERENCE.

Portions of the Registrant's Definitive Proxy Statement to be filed in connection with the 1997 Annual Meeting of Stockholders to be held on February 25, 1997, are incorporated by reference in Part III hereof.

### U.S. LONG BESTANCE CORP.

### Annual Report on Form 10-K For The Fincal Year Ended September 30, 1996

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	PARTI
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20	Lagal Proceedings
	Submission of Matters to a Vote of Security Holders
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1.3	Market for the Company's Common Equity and Related Stockholder Matters
	Sciented Financial Data
	Management's Discussion and Analysis of Financial Condition and Results of Operations
	Financial Statements and Supplementary Data
	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
	CAST UNI
100	Directors and Executive Officers of the Company
	Executive Compensation
	Security Ownership of Certain Beneficial Owners and Management
	Certain Relationships and Related Transactions
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	THE RESERVE OF THE PARTIES OF THE PARTY OF T
i.	Exhibits, Financial Statement Schedules, and Reports on Form B-K
	Signatures

## STEM I. MUSINESS

statements that involves risks and uncertainties. Actual results of US Long Distance Corp. and its substatures (collectively the Vingung?) may differ materially from the results discussed in the forward-leading statements. Certain factors that could contribute to such differences are discussed with the forward-leading attempent throughout this report and are summarized in "Minispences". Discussion and Junipass of Financial Condition and Results of Operations - Forward-Londong Statements Continuous Language. Other than historical and factual statements, the matters and items discussed in this domaid Report on From 10 K are forward looking

calling center services. company's revenues increased at a compounded annual rate of 60%, totaling \$180.3 million for fiscal 1996. The Company offers an integrated group of communication services including direct dial long distance, prepaid calling cards, travel cards, data transmission and The Company is a fully-integrated long distance communications company. From fiscal 1991 through fiscal 1996, the y's resenues increased at a compounded annual rate of 60%, totaling \$180.3 million for fiscal 1996. The Company offers an

The long distance telephone industry has changed significantly since the mandated diventione by American Telephone and Telephone ("AT&T") of its 22 local telephone companies in 1984 Regulations mandating equal access to the existing telecommunications network led to the creation of hundreds of new long distance companies. Competition now persoles across all competition of long distance telephone services at the control of long distance telephone telephone version operate mainted and colling and services, and Bill Bill specialized in bound long distance telephone services. While AT&T and to a lever catent. MCT Telecommunications Corporation ("MCT") and Sprint Corporation ("Sprint"), together dominate the estimated \$78 lever catent. MCT Telecommunications industry, management believes that a growing share of the market is serviced by smaller long ATAT. Mail and Sprint ties such as the Company. Industry sources estimate that approximately 80% of the long distance market is shared arriving

The Telecommunications Act of 1996, which was signed into law on February 8, 1996, is the first major overhaul of the telecommunications has since the divertifier of AT&T. This act allows below manufactions provides such as the Company to provide local telephone service. The local telephone service industry is estimated to be a \$95 billion reducty and is dominated by the Regional thet Operating Companies (EECCs). The Company is actively pursuing its contract into the local service industry. The Company is convently certified to offer local service in three states and has certification pending in four other states. The Company has signed an interconnection agreement with Sentimenters fiell enabling the Company to provide local telephone service to business and resolutions and telephone service to business and resolution comparer in the long distance industry. However, the applicant RHOC must first satisfy a legislative "checklist" that outlines the steps required for an RBOC to open its network to competition on a local basis.

On July 10, 1996, the Company's Based of Directors approved a plan to spin-off the Company's commercial billing clearinghouse and information management services business ("Billing Group Business") as a separate public company (the Thurshation"). To effect the spin-off, the Board approved the distribution of the outstanding shares of common stack of its wholly owned substituty that comed and operated the Billing Group Business, Billing Information Concepts Corp. ("Billing"), to its stackholders. The Distribution was tan-feer for federal income tan purposes to the stockholders of the Company, and the Company will not recognize income, gain or loss as a result of the Distribution, except for direct spin-off costs. The Distribution was completed on August 2, 1996.

# Direct Died Lang Metaner Services

long distance services to contamers in 47 states at September 30, 1996. However, the Company focuses its direct sales efforts in the West Court, Pacific Northwest, Southwest and Southeast regions of the United States to take advantage of network efficiencies. In addition to its basic "one-plus" service, the Company provides inbound 800 service, travel and prepaid calling card services, private line services, data transmission services, wholesale carrier services and other customer-specific products. The Company is a full-service long distance carrier corrently providing direct dial long distance services to small and medium-sized commercial customers and, to a lesser extent, residential customer accounts. The Company was authorized to provide direct dial

The Company began offering direct dial long distance services following its entry into the direct dial long distance business in August 1991 through the acquisition of three related direct dial long distance companies in Texas. At September 30, 1996, the Company serviced approximately 47,000 commercial and residential contours accounts. The Company carried an average of 106.5 million minutes per month of long distance traffic during the fiscal quarter ended September 30, 1996, as compared to 62.6 million and 44.7 million during the fiscal quarters ended September 30, 1995, and 1994, the Company had 5119.4 million, 584.5 million and 56.2 million, respectively, in direct dual long distance revenues, comprising 66%, 59% and 51% of total specialing revenues in each period, respectively.

## Andrew Charter

Direct dial long distance revenues industrywide are estimated to be approximately \$78 billion in 1995, up from approximately \$73 billion in 1995. AT&T, MCI and Sprint dominate the long distance industry, building yources estimate that these companies control a combined market share of approximately 80%. These companies offer comprehensive communications services in a wider array of products than other long distance companies and typically target national, multi-state business customers and millions of residential long distance and modification advertising. The Company believes that over 500 smaller long distance companies account for the remaining 20% of the market. These companies typically concentrate on smaller regional and local business customers. Companies that the direct dial long distance industry has bisocically been based upon price. More recently, the focus has been moving towards customer service, product design and innovation, customized billing capabilities, transmission quality and availability of service.

## Side's and Adarberry

The Company's direct dial long distance sales personnel are located throughout the Company's service area and are responsible for marketing to communical accounts. The Company supervices sales and marketing efforts from its corporate local-parters and utilizes various advertising media to enhance its communical marketing efforts and to attract and retain residential customers. The Company examines the calling profiles of target markets and designs long distance services that specifically fill certain demands. For example, the Company issues long distance calling cards contamized to include a customer's corporate logo and has also customized prepaid calling cards to be used as promotional marketing tools. The Company also directly markets to employees of commercial customers for their residential service. In addition to its own sales force, the Company markets its direct dial long distance services through authorized agents, other carriers and affinity organizations (strategic parametrispo).

professio The Company currently has an exclusive marketing agreement with Nolan Ryan, formerly a player with the Texas Rangers A rofessional baseball team and a potential half of fame candidate, who acts as the Company's spokesman for its direct dial long distance ervices and whose picture appears in the Company's advertisements and product literature, including prepaid calling cards.

### Chrantina

The Company completes calls that are originated when a pre-subscribed customer dials "I" plus the wea code and number or when a customer actives the Company's activest through dial-up access to reach any distortion intermalismal destination. All long distance calls placed over the Company's activest, are directed to call destination points by computerized digital network switching equipment operating at one of the Company's switching centers. The switching equipment receives a customer's direct dial call, verifies the caller's billing purposes. The Company's switching equipment actives the most cost-efficient transmission circuit or path available prior to switching and completing each call. The Company employs state-of-the-art digital switching equipment at the Company's switching centers in Houston, Texas, Warn, Texas, Seattle, Washington; and Los Angeles, California. The Company has also purchased a digital switch in Atlanta, Georgia, and will take procession of it in January 1997.

actwork de To satisfy increasing or anticipated usage of its long distance network and to ensure that its network is optimally accessible when etwork demand is heavy, the Company, from time to time, adds circuit capacity at each existing switching center by increasing the anther of telecommunications ports and access lines. The Company stilities state of the art Common Channel Signaling System 7, which is currently operational for virtually all originating and terminating traffic within the Company's markets. This network protocol ignificantly reduces connect time delays and provides additional technical capabilities and efficiencies for the routing of calls.

## Competitive Advantages

The Company competes with AT&T, NCI and Sprint and numerous local, regional and national carriers on the basis of its products and services, competitive pricing and local identity. The Company, generally, prices its services up to 20% below AT&T, NCI and Sprint comparable services offerings. In addition, by designing long distance products and services that fill specific market needs, the Company enhances its ability to compete with AT&T, MCI and Sprint and others.

The Company believes that its emphasis on customer service distinguishes itself from many of its competitors. The Company has takin an integrated team approach to sales and service by increasing the number of sales support representatives in its field offices to maintain sequencie and automate the contours order entry function. Additionally, the Company implemented a computerized builetin board service called Advantage Direct, which is similar to the remote access service offered to its operator services customers. This service almost contours and evaluate calling patterns and volume by department or location. Moreover, in competing with service regional and local long distance carriers, the Company believes it holds a competitive advantage within its territory because the Company's regional concentration of traffic over its network facilities allows for certain cost efficiencies of a national carrier. In addition, the Company believes that its local identity in the markets it serves provides an advantage in marketing its services and competing with

long distance carriers based outside of the target regions. Management believes that the Company has developed the expertise in information systems moreowry to meet the needs of its direct dual long distance customers. For instance, the Company provides an invoice indicating call detail in a form that assists customers in controlling and monitoring communications costs for various projects or

The Company amploys digital switching equipment utilizing a network comprised largely of high quality fiber-optic circuitry to assimize communications quality. The Company believes that its use of a digital fiber-optic network is particularly advantageous in materiag both its voice and does transmission services. The Company also designs redundant and diverse routes to each major service area to case availability.

The communications industry is ever-changing, and the recently passed Telecommunications Act of 1936 is expected to have a major impact on the industry's competitive conforment. In essence, the RBOCs will be competing with long distance curriers for both demostic and international long distance customers. The Company believes it is prepared to meet this challenge by capitalizing on its experienced management team and takes force, personalized customer service, quality products and services and competitive pricing

## Structure and Grounds Opportunities

The Company's strategic focus in the direct dial long distance industry is to compute with AT&T, MCI and Sprint primarily on the basis of compantitive pricing, while offering a compansite or higher level of service. Moreover, the Company intends to remain focused on small and maximum sized commercial continuers and will continue its efforts to develop innovative and cost-efficient services that most the acoust of its continuers. The Company intends to introduce new communications products, such as local service, internet profess the Company the largest opportunity for growth. The local services including the introduction of the local service product. Company's existing §1,000 continuer accounts are already utilizing this service from the local exchange carrier in each locality. The Company's policies that it has the potential to capitalize on its relationship with existing customers to bundle the focul product with its existing products and existing customers with the integrated communication services they desire. To a lesser extent, the Company also continues to market to existential customers.

The Company expects to back for opportunities to expand its long distance business, both by internal growth and through expanditions. The primary focus of the Company's expandition activities is to make additional acquisitions that will grow the Company's direct dual long distance business. The Company betteves its operator services business afforth it the opportunity to expand its direct dual long distance business on a more controlled basis than many of its competitors. By having a concentration of operator services call traffic in a particular gargaphic region, the Company can utilize any long distance facilities it installs or acquires to service a ready base of call traffic, thereby lowering the marginal transmission costs for any direct dual long distance traffic that the Company acquires to develops in that region. The Company believes this cost advantage and only improves the potential profitability of both the Company's operator services and direct dual long distance services businesses in such region, but also expands the number of companies that would be operator expiritions candidates in that region.

The Company continually evaluates business appartunities, including potential acquisitions. One or more of such acquisitions could result in a substantial change in the Company's operations and financial condition. The success of the Company's equivilians and the availability of management resources to oversee the operation candidates, the availability of funds to finance equivilians and the availability of management resources to oversee the operation of acquired businesses. While the Company has, from time to time, had discussions with communications companies, it has no agreements or pending negotiations with respect to any equivilian at the date of this report that would have a material impact on the Company's financial position or results of operations. There is no assurance that any acquisitions will be completed.

## Operator Service

The Company provides operator assisted services for private pay behaltones, butch, notets, university demistrates and hospitals. The Company's operator astroices are accessed when eath requiring operator assistance and/or alternate billing options are placed from continuer because. Such services involve the use of live and automated operators to receive, valuate and complete the calls. The Company processes collect, third-party, person-to-person and calling card calls and, generally, shares a percentage of call revenues with

At September 30, 1996, the Company provided operator services to approximately 135,900 head, made, hospital and domains; made, in addition, at September 30, 1996, the Company had service contents with private pay triaghness owners covering approximately 61,300 pay triaghness. The Company carried 7.6 million average mandaly minutes of operator services traffic during the founds quantity of facel 1995, and facel 1995, and 1995, approximally. The Company's quantum services receives assumed to \$60.0 million, \$39.6 million, \$34.7 million in facel 1996, 1995 and 1994, respectively. sety 135,900 head, mosel, hospital and dermitory ste pay telephone owners covering approximately

## Industry Cheroteu

Ame has the hospitality and pay tripp Management believes that there are approximately 125 operator services providers competing within the long distance includes include to demand the operator services market, supplying operator services for traffic originating in the tompitality and pay telephone includes. Additionally, MCI and Sprint provide operator services and are considered by next to be major competition. Excluding AT&T, MCI, Sprint, General Telephone Operating Companies (GTE) and the RBOCs, sent to be five to the Company is one of the five largest providers of operator services.

nivate pay an sporting and customs Many aparator services providers, including the Company, initially focused on the hospitality industry. More recently, as the new pays elephone industry has grown and taken market share from the public pay telephone market traditionally served by AT&T.

my operator services providers gained incremed market share by providing service to the owners of private and public pay telephones appearable between the Company and other operator services providers is based upon commission programs, quality of service.

## Nick's and Marketing

Company's a The Company audies in ope floors, Florids and California on an amount companie, making e d net companies, in is generated. The Company also participates in various industry trade shows and promotes its operator services through trade anguaism. The Company contomices its communications services to provide, among other things, individualized itend call branding to contomers. as operator services anticomally through the combined effort of regional sales representatives based in this and a services of agents. The Company's conjurate sales force focuses on larger accounts, such as sale functions, begind chains, large private pay telephone companies and universities. The reputsy's operator services on a nationwide basis and typically receive a commission based upon the Company also participates in various industry trade of

### Chrantina

The Company owns and operates its own operator center in San Antonio, Texas, which employed 311 operators and support of at September 30, 1996. The Company provides live and automated operator services 24 hours per day, 365 days per year, and savers multi-lingual operators versed in Spanish, French, German, Japanese and a variety of other languages. The Company maintains a faintened emorphory cell handling system that enables its operators to access police, fire and other emorphory agencies within the indicates of the telephone from which the cell is placed. The Company utilizes its own transmission facilities when possible or tracts to use facilities of other long distance actions providers as necessary.

The Company switches the majority of its operator assisted calls at its four main switching centers. Many operator assisted calls remained to the Company's switching centers via call processing equipment installed at customer locations or in customer pay have equipment. This call processing equipment is programmed to recognize calls requiring operator assistance and to access the pany's activate by dealing the Company's access number, then passing the call record information to one of the switching centers. Company validates the authorized code or adaptions number to be billed and then completes the call, while recording the date, administrator and time of day for adaptates billing purposes. At September 30, 1998, the Company was authorized to complete animal and internate calls placed throughout the United States, as well as introduce calls within 46 states.

## Competitive Advantages

Management believes that the Company enjoys several competitive advantages over many others in the operator services industry. By vinus of the Company's large call volumes solutive to many other operator services providers and the cost efficiencies it realizes by studied a large periodic operator services traffic over its own facilities and maintaining its own operator center, the Company is after to provide high quality transmission on an efficient and economical back. Additionally, because it is the source of commission payments to its operator services contament, the Company believes that its financial stability and history of timely payments allow it to company officially against many matter, under-capitalized operator services providers. Moreover, the Company's flexible rate quitiens after it to offer customization programs to its customers as compared to larger operator services providers. Story against any maker, such

In 1994, the Company implemented a computerized bulletin buard service called Stealth that allows its customers to access the system from remote locations and obtain customized and sophisticated reporting of calling patterns and volumes for each customer location or pay telephone. This advanced reporting system allows the Company's operator services customers to analyze their traffic on a daily basis and maximize telecommunications revenues by, for example, relocating underutilized telephones. The Company's detailed reporting also allows its customers to reconcile the accuracy or integrity of their commissions. The Company employs a skilled, professional staff of customer service employees and technicians, who provide service 24 hours per day, 365 days per year.

### Strategy and Growth Opportunities

The Company has developed a strong presence in operator services throughout the United States. Through its direct sales force and agents and its participation in state, regional and national trade associations, the Company intends to pursue geographic expansion on a nationwide basis. The Company will continue to market its operator services business to both the private pay telephone and hospitality industries and present new products and services for these markets.

The Company's existing relationship with operator service customers, who typically own or manage numerous private just telephones or latels, provides a unique opportunity for the Company. The Company will have the potential to provide local access to a large volume of phone lines, yet limited number of customers. These characteristics will allow the Company to quickly and efficiently enter the local services market in targeted areas.

### Curporate Synergy

Management believes that the Company has certain operating advantages and cost efficiencies through the integration of its two businesses. The combined traffic volumes of the Company's operator services and direct dial long distance businesses operate to lower the Company's transmission costs for both of these businesses in geographic regions where the Company operates long distance switching equipment. In addition, the Company's sales force can provide integrated long distance solutions by offering both operator services and direct dial long distance telephone services and, in the near future, local services. The opportunity to bundle products and services strengthens customer relationships and, thus, customer retention.

### **Covernment Regulation**

### General

The Company competes in an industry that, to a large degree, continues to be regulated by government agencies. At approximately the same time as the required divestiture of the Hell telephone companies by AT&T in 1984, the Federal Communications Commission (the "FCC") announced rules that were created to foster a self-regulating, interstate telecommunications industry, relying upon competitive forces to heap rates and services in check. Management believes that the current direct dial marketplace demonstrates substantial progress toward the fulfillment of these objectives. For example, the cost of a long distance call has significantly declined while the number of long distance companies has multiplied. Competition has encouraged these direct dial long distance companies to find ever more efficient methods of carrying calls.

### Operator Services

On October 15, 1990, President Bush signed into law the Telephone Operator Consumer Service Improvement Act of 1990. Congress directed the FCC to impose upon the interstate operator services market certain rules and regulations designed to increase consumer awareness concerning the operator services provider carrying the call, the information the caller can request of the operator, and the alternatives available to the consumer for reaching other long distance carriers. Operator services providers were required to file with the FCC informational tariffs that describe the rules and regulations governing the provision of interstate operator assisted telecommunications and to include all rates that may apply to an interstate call. Furthermore, operator services providers were required to submit, on a Congressionally prescribed timetable, certain reports relating to rate changes, complaints and costs. Based on these reports, on November 16, 1992, the FCC submitted to Congress its "Final Report Pursuant to the Telephone Operator Consumer Services Improvement Act of 1990." The purpose of this report was to identify whether incremed regulatory scrutiny by the FCC was required to satisfy Congressional objectives. The FCC determined that "...market forces are securing rates and charges that are just and reasonable." and therefore stated "...we conclude that no further action is necessary...".

Al September 30, 1996, the Company was authorized to carry intrastate operator assisted traffic in 46 states. Authorization is pending approval in one other state. State regulatory agencies have the authority to impose their own rules and regulations governing the provision of intrastate operator services, including regulation of rates. Many states have rules similar if not identical to those imposed by the FCC on interstate operator assisted calls. At the date of this report, the Company was in material compliance with the requirements of each of the individual state regulatory agencies and continues to pursue authorization to provide intrastate operator services in other

targeted states. Certain states are expected to introduce or revise their rules governing operator services providers within the next year Currently, the Company does not anticipate significant difficulty in complying with the new or revised rules.

### Direct Dial Long Distance Services

The FCC has regulatory jurisdiction over interstate and international telecommunications common carriers, like the Company. Under Section 214 of the Federal Communications Act, the FCC must certify a communications common carrier before it may provide international services. The Company has obtained Section 214 authorization to provide international switched services by means of resale. The FCC has ruled that "non-dominant" common carriers, like the Company, need not apply for Section 214 authorization for the provision of domestic U.S. interstate services.

At September 30, 1996, the Company was authorized to provide intrastate long distance service within 47 states. Regulations within each of these states, as they pertain to completing direct dial long distance calls for the Company's customers within the state, are virtually static and pone no foreseeable concern. As the Company expands the geographic scope of its direct dial long distance business, it will seek state regulatory approvals as necessary to provide intrastate long distance service.

### Billed Party Preference

Another issue under consideration by the FCC currently is termed "Billed Party Preference," or BPP. This term refers to a concept in which any long distance call outside the local telephone company's calling area carried from a publicly available telephone usuald be completed over the long distance carrier network of the billed party's previously expressed preference. This would be accomplished through a local telephone company database system that would match every calling card and telephone number to a preferred long distance company and than direct all calls accordingly. In April 1992, the FCC tentatively proposed adopting BPP. During the summer of 1992, elements from local telephone companies, long distance carriers and other industry participants revealed that the cost of imposing BPP could be in excess of \$1.0 billion and could require hundreds of millions of dollars each year to support its operation. The majority of these commentors were in opposition to the implementation of BPP. Certain commentors made clear that many technical impediments remain to full deployment of BPP. Other commentors claimed that no technology exists that could implement BPP without making call processing significantly less convenient for many operator services calls, particularly those requiring a live operator.

In August 1994, industry members responded to a Commission Further Notice of Proposed Rulemaking. The Commission had tentatively concluded, based upon their calculation of related cost information previously submitted by industry members, that the potential benefits of a BPP system appeared to outweigh its costs, although the Commission admitted the financial data it used in its study could be outdated. Once again, industry participants were resoundingly opposed to the Commission's proposal, including AT&T and most of the RBOCs. To date, the FCC has taken no further action.

If such a system were implemented successfully, the unique market niche of operator services provider presubscription, such as that of the Company, would be analyzed virtually ineffection, as an owner of publicly available telephones would be unable to direct operator assisted calls over the network of such owner's desired carrier. It is difficult to assess the industry support for BPP given the inherent problems described above, and the FCC continues to consider implementation of the proposal. In any event, local telephone companies have indicated that, if so directed, approximately two to four years would be required to reconfigure their networks to BPP's specifications. Thus, while BPP remains viable, the Company believes that it is not likely to be implemented in the near term.

On March 9, 1995, the FCC requested industry comment on two proposals it had recently received relative to the BPP proceeding. In an ex-parte position, the National Association of Attorney's General ("NAAG") suggested that the FCC modify its current branding requirement such that operator service providers ("OSPs") would be required to announce at the beginning of each call more specific information for obtaining access to alternate carriers (the "NAAG Petition"). Another petition filed by a coalition of industry members, including most of the RBOC's two competitive access providers, the American Public Communications Counsel ("APCC") and the Competitive Telecommunications Association ("CompTel"), recommended that the FCC impose certain rate thresholds for interstate operator assisted services, which the FCC would presume to be reasonable, and any OSP electing to charge rates higher than such threshold would be required to first prove to the FCC that such rates are justified based upon the underlying costs of the service (the "APCC Rate Cap Proposal"). The NAAG Petition was proposed to remain in effect until such time that HPP is adopted and fully implemented. The APCC Rate Cap Proposal was proposed to obviate the need to consider any further action regarding BPP.

In June 1996, the FCC issued a Second Further Notice of Proposed Rulemaking (SFNPRM) in this proceeding. In it, the FCC proposed adopting a rule which would require OSPs to announce the rates for certain calls to the billed party prior to connecting the call, thereby allowing the billed party to disconnect such call without incurring any unwanted charges. In September, the FCC released its Second request for Comment in the SFNPRM soliciting technical and other administrative details to support the proposed

mouncing rates while others would not est. Most commenters objected to the discriminatory nature of the proposal, which would have some carriers

If adapted, the NAAG Petition or any form of modified call branding could have a negative effect upon the number of calls completed over OSP networks such as the Company's, if end users elect to act upon the additional branding announcement regarding rates or access to other carriers. Furthermore, additional network time would be commend without a corresponding increase in revenue. If the APCC Rate Cap Proposal is adopted, OSPs such as the company may be immediately required to lower their interstate rates until such time as the FCC roles upon an attempt to justify higher, existing rates. OSPs may be required to adjust the amount of commission payments made to their subscriber customers as a result of implementation of such a proposal, or effect other operational changes to offset any reduction in interstate operator services revenue. The Company cannot predict when and if any final ruling on either proposal might be issued.

### MFJ Logislation

REDUCS to petition their respective "in-region" state regulatory agencies to seek authority from the FCC to allow the applicant RHOC to provide long distance services. To obtain this authority, each state agency is required to certify to the FCC that the applicant RHOC has satisfied a legislative "checkline" that outlines the steps required for an RHOC to open its network to competitive on a local basis. These steps include the provision of competitive network interconnection, unbandled access to network elements and other necessary to poles, dues, conclude and rights of way. Furthermore, applicant RHOCs must provide non-discriminatory access to white page listings and telephone nonliner assignments. Applicant RHOCs must provide had number portability, tell dusting parity and lucal service sends. The FCC is required to consult with the Department of Justice ("DOF") to assist in determining if an applicant RHOCs may provide an applicant may be long dustines violates any anti-trust standards the DOJ considers appropriate. Ninety days after receiving such as application, the FCC is required to render in decision. RHOCs are required to establish separate subsidiaries because which they could first offer in-region long distance services. RHOCs may provide out-of-region long distance services. object to existing have and regulations governing long distance communications. On February 8, 1996, President Clinton signed the Telecommunications Act of 1996 into law. The new law allows the to publish their respective "in-region" state regulatory agencies to seek authority from the FCC to allow the applicant RHOC to publish their respective "in-region" state regulatory agencies to seek authority from the FCC to allow the applicant RHOC.

To date, no RBOC has requested authority for in-region interLATA authority, because the provisions set forth above have not been satisfied by any RBOC. However, many entities have reached interconnection agreements with RBOCs to date, including the Company, and many states are impending rules governing local competition. It is reasonable to expect that the conditions for RBOC entry will be used in the near future, and carriers in the interLATA long distance business today, such as the Company, will encounter new, formidable competition.

### Texas PIU have

In a Final Order released in Docket 10127 on April 12, 1993, the Texas Public Utility Commission ("PUC") adopted new regulations governing the method by which intereschange carriers ("IXCa") such as the Company calculate intrastate access charges paid to local telephone companies. These new rules required an independent auditor's review and approval of an IXC's methodology of determining its own intrastate access usage. An independent audit by an accounting firm verified that the Company's process of calculating PIU is remonable and statistically valid and, as such, no additional PIU or billing adjustments are required.

## Regulatory Rate Proceedings

During the course of normal operations, a regulated company may, at any time, come under specific scrutiny with regard to any of its rates, terms or conditions by which such service is rendered by the state or federal regulatory agency charged with such oversight responsibility, or by an atterney general or other jurisdictional consumer officials. In such cases, a regulated company can be required to modify the process by which such services are rendered or to effect changes to a some or all of its services, or to address officials and attenues, general can pursue civil action if their concerns are not adequately approache rate structure. Consumer officials and attenues, general partialistics in which its tariffs or services may, from time to time, fall under such scrutiny at the discretion of the governing regulatory agency or other officials. The Company could therefore be required, as a result of such an investigation and subsequent proceeding, to implement changes in its rate structure, which could ultimately affect its revenues. The Company content whether or not any such requirement may be imposed in any particular periodiction.

### Salt I

At September 30, 1995, the Company had 602 full-time employers, including 15 officers, 224 sales and marketing personnel, 68 authorit, technical and operations personnel, 111 accounting, administrative and support personnel and 184 telephone operators and continue approximatives agreementatives and related support personnel. At September 30, 1996, the Company also employed 181 part-time

edieves that its employee relations are good mer service representatives. None of the Company's employees are represented by a union. The Company

## ITEM 2 PAWERTIES

7,000 square a Pedro, San An At September 30, 1996, the Company occupied approximately 93,500 square feet of space for its corporate offices at 9311 San Pedro, San Antonic, Texas, and Billing has assumed the liability for and occupies approximately 18,000 square feet of space at the same exists until April 1, 1997, at which time the space reverts back to the Company. The approximate 111,500 square feet is leaved assume to a lease approximate that expires in January 1999 Additionally, at September 30, 1996, the Company leaved approximately 7,000 square feet of space for its operator septices center at 200 Danbury, San Antonio, Texas, and approximately 56,000 square feet in approximately 56,000 square feet in on. The Company believes that its facilities are adequate to need its current needs

## STEM 3. LEGAL PRIX TELNINGS

On December 18, 1996, the Securities and Exchange Commission filed a civil injunctive action in the Federal District Court for the District of Columbia alleging that Mr. Partis 11. Holmes, Jr., Chairman of the Board of the Company, failed to file timely twelve reports regarding certain 1991 and 1992 transactions in the stock of the Company as required by Section 16(a) of the Securities Commission regarding their 1996, without admining or Commission regarding their personal framactions in the securities of their companies to file monthly reports with Commission regarding their personal transactions in the securities of their company. Mr. Holmes settled this action on December, 1996, without admitting or denying the allegations of the complaint, by consenting to the to the entry of an injunction burning are violations with respect to these requirements and paying a civil penalty of \$50,000.

The Commission has conducted an investigation relating to trading in the securities of Value-Added Communications, Inc. ("VAC"), an appearance services previder based in Dallas, Texas, and of the Company (In the Matter of Trading in the Securities of Value-Added Communications, Inc. (180-2765)). A proposed merger between the Company and VAC was terminated in Lebruary 1993. The investigation concerned whether certain persons may have purchased securities while in possession of material mon-public information or disclosured this information to others. The Commission Staff has notified Mr. Holmes of its decision to terminate this THE PERSON

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business. The Company believes it is amiliarly that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations; however, due to the inherent uncertainty of higgstion, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on e Company's results of operat coss for the fiscal period in which such resolution occurred

# TEM A SUBMISSION OF MATTERS TO A POTE OF SECURITY HIM LIKES

During the fourth quarter of the fincal year, no matter was submitted by the Company to a vote of its stockholders through the ion of proxies or otherwise.

### PARTH

# MAINET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKWOODER MATTERS

S 100.00

## NAMES OF PERSONS

9 J. 198 common stock, per value \$0.01 per share (the "Com het System. These price quotations reflect inter-dealer prices. mon Stock"), is quoted on the Nasdaq National Market hid prices for the Common Stock from October 1, 1994.

Fixed Year Ended September 30, 1997: 1st quarter (through December 13, 1996)	A quate (No-Distriction) (1)	Final Year Ended September 30, 1990:		Fiscal Year Ended September 30, 1995 1st quarter
3, 197:				Aud Sapanabar 30, 1989;
\$ 10%	5 5 5 6 5 7 7 8	 2 8 2 2 8 3	5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5	iğ I
\$ 714	5 25 / 10	, , , , , ,	55. 55.	<u>.</u> .

sales price of the Co At Deca ber 13, 1996, there were 15,076,381 shares of Common Stock cuestanding, held by 641 holders of record. The last of the Common Stock on Decomber 13, 1996, was \$6.07<sub>ja</sub> per share.

### Stividens of Pulley

ty has never declared or paid any cash dividends on the Common Stock. The Company presently intends to retain all tion and development of its business and dues not anticipate paying any cash dividends on the Common Stock in the

as \$6,77 for the Con On May 14, 1996, the Co. tel stock of 15th and of Directors approved the spin-off of Billing. On August 2, 1996, the Company ack of Billing. The average stock price for the first 10 business days after the distribution

### **ITEM 6. SELECTED FINANCIAL DATA**

The selected financial data presented below are derived from the audited Consolidated Financial Statements of the Company. The data presented below for the fiscal years ended September 30, 1996, 1995 and 1994 should be read in conjunction with the Consolidated Financial Statements, the Notes thereto and the other financial information included elsewhere in this report. All periods presented reflect the spin-off of Billing as discontinued operations as of September 30, 1991. See Note 3 to the Consolidated Financial Statements for further discussion of the spin-off. The Company has never declared cash dividends on its Common Stock, nor does it anticipate doing to in the foreseeable future.

		Floral Yo	or Ended Ser	tember M.	
	1996	1995	_1594_	_1993_	_1992_
		(In theuse	nde, except pe	r shore data)	
Consolidated Income Statement Date:				-	
Total operating revenues	\$180,346	\$144,050	\$117,541	\$80,119	\$48,050
Not loss from continuing operations	\$(13,754)	\$ (2,083)	\$ (2,475)	\$(1,265)	\$(1,835)
Net loss from continuing operations per common share	\$ (0.09)	\$ (0.14)	\$ (0.18)	\$ (0.10)	\$ (0.16)
	_1226_	1995	_1994_	_1993_	1992
		TO THE PARTY AND PARTY.	to thousand:		
Complete of Dates and Dates				and the section of	
Total assets (1)	\$99,244	\$86,027	\$79,413	\$64,835	\$36,573
Long-term obligations, less current portion	\$10,341	\$16,168	\$16,684	\$13,266	\$17,603
	_1996_	1995	_1554_	_1993_	1992
			(la themand		
Operating Data (executively:					
Operator services minutes per month (7)	7,600	8,300	9,100	10,600	4,800
Pay telephones serviced (h)	61.3	60.9	52.0	44.8	15.9
Roses serviced (N	135.9	136.9	122.0	106.0	90.7
Direct dial long distance minutes per month (1)	105,400	62,600	44,700	17,200	10,300

<sup>(1)</sup> Excludes net assets of discontinued operations.

<sup>(2)</sup> Calculated based upon a monthly average over the fiscal quarter ended on the date indicated.

<sup>(3)</sup> At end of the period.

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

### Forward Looking Statements - Cautionary Statements

This Annual Report on Form 10-K contains certain "forward-looking statements" within the meaning of Section 27A of tile Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Specifically, all statements other than statements of historical facts included in this report regarding the Company's financial position, business strategy and plans and objectives of management of the Company for future operations are forward-looking statements. These forward-looking statements are based on the beliefs of the Compeny's management, as well as assumptions made by and information currently available to the Company's management. When used in this report, the words "anticipate," "believe." "estimate," "expect" and "intend" and words or phrases of similar import, as they relate to the Company or Company management, are intended to identify forward-looking statements. Such statements reflect the current view of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions related to certain factors including without limitations, competitive factors. general economic conditions, customer relations, relationships with vendors, the interest rate environment, governmental regulation and supervision, seasonality, the operation of the Company's networks, transmission costs, product introductions and acceptance, seclinological change, changes in industry practices, one-time events and other factors described herein ("cautionary statements") Although the Company believes that the expectations are reasonable, it can give no assurance that such expectations will prove to be correct. Based upon changing conditions, should any one or more of these risks or uncertainties materialize, or should any underlying assumptions prine incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the applicable cautionary statements.

### General

The following is a discussion of the consolidated financial condition and results of operations of the Company for fiscal 1996, 1995 and 1994. It should be read in conjunction with the Consolidated Financial Statements of the Company, the Notes thereto and the other financial information included elsewhere in this report. For purposes of the following discussion, references to year periods refer to the Company's fiscal years ended September 30 and references to quarterly periods refer to the Company's fiscal quarters ended December 31, March 31, June 30 and September 30.

On July 10, 1996, the Company's Board of Directors approved a plan to spin-off the Company's Billing Group Business as a separate public company. To effect the spin-off, the Board approved the distribution of the outstanding shares of common stock of its wholly owned subsidiary that owned and operated the Billing Group Business, Billing, to the Company's stockholders. The Distribution was tax-free for federal income tax purposes to the Company's stockholders, and the Company did not recognize income, gain or loss as a result of the Distribution except for direct spin-off costs. The Distribution was completed on August 2, 1996.

The accompanying Consolidated Statements of Income reflect the operating results of Billing as discontinued operations in accordance with Accounting Principles Board Opinion No. 30. Prior period operating results have been restated to reflect continuing operations. The Consolidated Pro Forma Statements of Income are also included and discussed in a separate section below.

### Overview

Revenues grew to \$180.3 million in 1996 from \$144.1 million in 1995 and \$117.5 million in 1994. During the five-year period ended September 30, 1996, revenues grew at a 60% annual compounded rate. The Company's gross profit margin was 34.3% in 1996, 34.7% in 1995 and 37.9% in 1994. The decrease in gross margin from 1994 to 1996 was largely due to the growth of lower gross margin direct dial long distance revenues as a percentage of total revenues.

The Company's selling, general and administrative ("SG&A") expenses as a percentage of revenues were 28.1%, 28.9% and 32.8% in 1996, 1995 and 1994, respectively. The decrease from 1994 to 1996 was primarily the result of tighter expense controls and increased efficiencies. Depreciation and amortization expenses as a percentage of revenues were 6.5%, 7.0% and 7.2% in 1996, 1995 and 1994, respectively.

Net loss from continuing operations of \$13.8 million, \$2.1 million and \$2.5 million was reported for 1996, 1995 and 1994, respectively. The Company reported net income of \$1.4 million, or \$0.09 per share, for 1996, \$12.0 million, or \$0.83 per share, for 1995; and \$6.1 million, or \$0.43 per share, for 1994. Fiscal 1996 results were down compared to 1995 and 1994 due to \$13.0 million of direct spin-off costs and \$2.8 million in restructuring charges incurred in fiscal 1996. As further discussed in the Outlook, the Company believes that it has the competitive product offerings, personnel and financial resources for continued business success.

### Results of Operations

The following table presents certain items in the Consolidated Statements of Income as a percentage of total operating revenues for the years ended September 30, 1996, 1995 and 1994:

	1996	1995	1994
Operating revenues:			
Direct dial long distance services	66.2%	58.6%	53.5%
Operator Services	33.8	41.4	46.5
Total operating revenues	100.0%	100.0%	100.0%
Operating expenses:			
Cost of services	65.7%	65.3%	62.1%
Selling, general and administrative	28.1	28.9	32.8
Spin-off costs	72	0.0	0.0
Restructuring charges	1.6	0.0	0.0
Depreciation and amortization	6.5	_7.0	7.2
Loss from operations	.0.15	0.25-	C.Ir.

### Operating Revenues

Revenues in 1996 increased by 25% to \$180.3 million from \$144.1 million in 1995 and by 53% from \$117.5 million in 1994. Growth in direct dial long distance services revenues accounted for \$34.9 million of the total increase in revenues from 1995 to 1996.

Direct Dial Long Distance Services. Direct dial long distance services revenue increased 41% to \$119.4 million in 1996 compared to \$84.5 million in 1995 and 90% compared to \$62.8 million in 1994. The increase in revenue is primarily attributable to growth in the number of customers serviced. The Company believes that there are opportunities for continued expansion, both internally and externally through acquisitions, in both of its primary businesses. However, because direct dial long distance services represent the largest market in which the Company is active, management believes that this business presents the Company with its greatest revenue growth opportunity. The Company believes that its base of operator services business affords it the opportunity to expand its direct dial long distance business on a more cost effective basis than many of its direct dial long distance competitors. Accordingly, the Company continues to consider potential acquisitions. Acquisition activity is focused primarily on small to medium-sized companies that will grow the Company's direct dial long distance business. While the Company has, from time to time, had discussions with such companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report that would have a material impact on the Company's financial position or results of operations.

Operator Services: Operator services revenue was \$60.9 million in 1996 compared to \$59.6 million in 1995 and \$54.7 million in 1994. The Company processed 17.5 million operator services calls in 1996 compared to 17.4 million in 1995 and 17.2 million in 1994. The Company serviced an average of approximately 66,100 pay telephones and 128,300 hospitality rooms per month for 1996, compared to an average of approximately 55,200 pay telephones and 130,300 hospitality rooms per month for 1995 and 48,200 pay telephones and 103,000 hospitality rooms per month for 1994. Although the volume of operator services calls has increased, the related increase in revenues have been, and will continue to be, offset by several factors, including an increase in the percentage of pay telephones serviced by the Company located in states that impose rate fariff regulations on operator services providers and an increasing awareness on the part of the consumer of the ability to select a carrier of choice by dialing access codes of other carriers ("dial-around"). Additionally, changes in federal or state regulations could negatively impact revenues of the Company (see Note 15 to the Consolidated Financial Statements).

### Operating Expenses

Cost of Services. The gross profit margin was 34.3%, 34.7% and 37.9% during 1996, 1995 and 1994, respectively. The decline in gross profit margins from 1994 to 1996 is primarily due to the change in the Company's revenue mix. The Company's direct dial long distance services gross margins have increased, however, the improvement was offset by an increase in the direct dial long distance services revenue as a percentage of total revenue. Such revenues have a lower gross margin than the operator services revenue and accounted for 66%, 59% and 53% of revenue during 1996, 1995 and 1994, respectively. The direct dial long distance services margin has increased primarily as a result of continued improvements in networking efficiencies and reductions in transmission costs.

Selling, General and Administrative. SG&A expenses for 1996 were \$50.7 million, representing 28.1% of revenues, compared to \$41.6 million in 1995, or 28.9% of revenues, and \$38.5 million in 1994, or 32.8% of revenues. SG&A expenses as a percentage of revenues have continued to decrease as a result of tighter expense controls and efforts to streamline the Company's operations.

Procest Spin-off Coast. Direct spin-off coast represent coast incurred in connection with the Distribution of Billing. The \$13.0 million amount represents certain professional and filing fees, payments teapmed for terminating or restrictioning employment contracts, tax payments triggered by the spin-off and non-cash expenses associated with the vesting of stock grants.

Restructuring Charges. The \$2.8 million in restructure charges for 1996 includes costs associated with consolidating customer service, credit and collection and other support functions; vacating certain office facilities; terminating certain marketing contracts, writing down excess assets and providing severance payments.

Appreciation and Americation: Depreciation and amortization expense was \$11.8 million, \$10.0 million and \$8.4 million in 1996, 1995 and 1994, respectively. Depreciation and amortization expense as a percentage of revenues decreased to 6.5% in 1996 from 7.0% in 1995 and 7.2% in 1994. This decrease as a percentage of revenue is primarily attributable to the increase in revenues and was achieved despite a charge of \$727,000 related to asset write-offs in the fourth quarter of fiscal 1996.

### Loss from Continuing Operations

Lass from continuing operations in 1996 increased to \$16.5 million from \$1.6 million in 1995 and \$2.4 million in 1994. Excluding direct spin-off costs and restructuring charges, the Company would have reported a loss from continuing operations of \$667,000 in 1996. The continued improvement in operations is primarily attributable to the decrease in SG&A expenses as a percentage of revenues, as discussed above, and the increase in revenues.

### Other Expense, net

Net other expense decreased to \$628,000 in 1996 from \$999,000 and \$865,000 in 1995 and 1994, respectively. The decrease is primarily attributable to a lower level of indebtedness over the past year.

### Income Taxes

The Company's effective tax rate is higher than the federal statutory rate due to the addition of state income taxes and certain deductions taken for financial reporting purposes which are not deductible for federal income tax purposes.

### Net Income

The Company reported net income of \$1.4 million, \$12.0 million and \$6.1 million in 1996, 1995 and 1994, respectively. The decrease in 1996 is attributable to the direct spin-off crists and restructuring charges incurred.

### Effects of Spin-off of Milling Group Business

The Consolidated Statements of Income included in this report reflect the continuing and discontinued operations of the Company for the years ended September 30, 1996, 1995 and 1994. Included below is supplemental unaudited pro-forma financial information that management believes is important to provide an understanding of the results of the Company on a stand-alone basis. Consolidated Pro-Forma Statements of the last four fiscal years as well as for each quarter of fiscal 1996 and 1995. These unaudited Consolidated Pro-Forma Statements of Income are based on the historical statements of the periods presented adjusted to reflect the items discussed in the accompanying Notes to the unaudited Consolidated Pro-Forma Financial Statements. The unaudited Consolidated Pro-Forma Statements of Income give effect to the spin-off as if it had occurred on September 30, 1992. The pro-forma adjustments reflect the terms of the spin-off agreements, which are expected to have a continuing impact on the Company.

The unaudited consolidated pro forma financial information is presented for informational purposes only and should be read in communition with the accompanying notes and with the Company's historical Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" set forth herein. The pro-forma financial statements should not be considered indicative of the operating results which the Company will achieve in the future if it were operated on an independent, stand-alone basis because, among other things, these statements are based on historical rather than prospective information and upon certain assumptions which are subject to change.

The unaudited Comolidated Pro Forma Statements of Income of the Company reflect, in management's opinion, all adjustments necessary to fairly state the pro-forma results of operations for the periods presented and to make the unaudited pro-forma statements not misleading.

# U.S. LEING BISTANCE CURP. and SUBSIDIARIES. CUMBELLIDATED PRO PURMA STATEMENTS OF INCUME.

			HE SELECTION OF SE
Total operating revenues	1 AC 001	# # # # # # # # # # # # # # # # # # #	17.54
	EST.19	50,012	44,597
Sciling, general and administrative expense	MKZ-11		E
	(667)	(1,600)	(2.38)
	10.75	9	
	(%)	0.500)	0.21
	¥	1.092	Ę.
Not have being company from	039	(1,507)	(1,875)
Extraordinary loss			
	\$ (251)	\$(1.307)	\$(1.87)
Ke las per commune there	(yeek	\$	\$0.53
Weighted average common shares and common share equivalents outstanding	ş	14.587	I.
Operating resonance			
Direct dial long distance stricts (*)	\$25,034	\$29,046	\$31,306
Total operating revenues	39,708	4365	46,68
Coal of services	NICK.	27.875	30.498
	13,322	I.7	5.1
eral and administr	11,382	12,929	17.134
Depreciation and amortization expense	71117	Legal P	2.70
Other cuprate, and			0.50
house (loss) before income as benefit (movision)			
house to bearful (provision) (5)			(62)
	1 (20)	1000	\$ 197
Net income (bas) per commen share	<b>X</b> 004)	\$(0.05)	28
Weighted average common shares and common share equivalents			
The second secon	HJEST	15,189	

### U.S. LAING DISTANCE CORP. and SUBSBILLARDS. CONSIGNATED PRO PORMA STATEMENTS OF INCUSE.

### (in thousands, except per share amounts) (Unaudited)

	Three Months Loded			
	Dec. 31,	Mar. 31, 1995	June 30, 1995	Sept. 10.
Pro forma				
Operating revenues:				
Direct dial long distance services (A)	\$19,968	\$19,896	\$21,210	\$23,410
Operator services	12,940	13.075	15,441	18,119
Total operating revenues	32,908	32,971	36,651	41,520
Cost of services	21,312	21,619	24,708	26,399
Ciross pendia	11,596	11,352	11,943	15,121
Selling, general and administrative expense (**)	9,881	9,624	10,264	11,811
Depreciation and amortization expense.	_2355	_2.428	_2,653	2.596
Profit (loss) from operations	(640)	(700)	(974)	714
Other expense, net	(275)	(240)	(260)	(224)
Income (loss) before income tax benefit (provision)	(915)	(940)	(1,234)	490
Income tax henefit (provision) (17)	384	395	519	(296)
Net income (loss)	\$ (531)	\$ (545)	\$ (715)	5 284
Net income (loss) per common share	\$(0.04)	\$(0.04)	\$(0.05)	\$0.02
Weighted average common shares and common share equivalents				
constanding	14,208	14,497	14,759	14,886

### Notes to unandited consolidated pro forma financial statements

- (A) The long distance and 800 services provided by the Company to Billing have, historically, been eliminated in consolidation. The pro-forms statements of income reflect an adjustment for these long distance and 800 services revenues to achieve arm's length pricing consistent with the Telecommunications Agreement that has been executed between the Company and Billing.
- (B) The billing clearinghouse and information management services provided by Billing to the Company have, historically, been eliminated in consolidation. The pro-forma statements of income reflect an adjustment for these billing clearinghouse and information management costs to achieve arm's length pricing consistent with the Zero Plus-Zero Minus Billing and Information Management Services Agreement and the One-Plus Billing and Information Management Services Agreement that have been executed between Billing and the Company.
- (C) In order to reflect the operating results of the Company on normalized basis, these unaudited Consolidated Pro Forma Statements of Income exclude direct spin-off costs and restructuring charges. Direct spin-off costs were \$13.0 million and \$6.3 million for the year and quarter ended September 30, 1996, respectively. Restructuring charges were \$2.8 million for the year and quarter ended September 30, 1996.
- (D) On the unmulted Consolidated Pro Forma Statements of Income, the Company reflects a pro-forma benefit (provision) for income taxes at a 42% tax rate for all periods presented for purposes of comparability. Actual tax amounts will be higher in the third and fourth quarters of fiscal 1996 due to nondeductibility of certain nonrecurring expenses associated with the spin-off and restructuring.

### Î

results may differ materially. The statements custa ned in this Outhook are based on current expectations. These statements are forward looking, and actual

The industry in which the Company operates is very competitive and is characterized by rapid change. In addition, the Company has faced, and continues to face, regulatory issues which have affected or which may affect operating revenues and operating profit. The continued success of the Company is dependent on its ability to adapt to these competitive and regulatory changes, in developing strategies to achieve continued growth in operating revenues and operating profits, the Company anticipates continuing geographic expansion, expanding its product offerings and controlling costs to improve gross margins and reduce NGA A. expense as a percentage of revenue.

The Company continues to evaluate and take actions to improve the profitability of its existing products, to identify new products to fully utilize the Company's existing sales distribution channels and to evaluate programs that are expected to increase revenues and independent sales agents. The Company has implemented, among other things, a regionalized approach to include local access and internet services, as well as frame relativenees. Furthermore, management is in the process of expanding product offerings to include local long distance services, as well as frame relationships and increase continues releasing product. The company also plans to expand its distance services to employees of commercial customer base in selected markets through direct marketing efforts, as well as by offering long distance services to employees of commercial customers. To expand its fourprist nationally over the next several years, as purchased a digital switch in Atlanta, Georgia, and will customers. To expand its fourprist nationally over the next several years, has purchased a digital switch in Atlanta, Georgia, and will take possession of it in January 1997. In addition, the Company continues to expandition candidates in strategic prographic areas to expand its market. However, the Company has no agreement or perioding expansions with respect to any acquisition at the date of this report that would have a material impact on the Company's liminosis. personal or remains of operations

The Company has implemented a number of actions designed to improve overall profitability and reduce the Company's gross margins, management is focused on maximizing network efficiencies by implementing technological improvements and reducing unit costs. In November 1995, the Company joined the Associated Communication Companies of America (CACCA') which provides members with opportunities to pead purchasing power to acquire lower transmission rates from interachange carriers through volume discounts and to work in partnership with other members to expitative on resource sharing arrangements such as switch partitioning and network sharing. The Company already has realized, from this arrangement, certain benefits during the last half of fiscal 1996 and expects continued benefits as the arrangement continues to be placed in Lastly, management has attenualized and resignated certain corporate, administrative and overhead functions to be infrastructure with the anadier operation that resulted from the spin-off.

investments in telecommunications circuits, switches, equipment and software. These investments, generally, are timed to coincide closely with anticipated revenue growth. In addition, the Company continues to increase its sales and marketing, customer support network operations and field services commitments in anticipation of the expansion of its customer base in targeted geographic markets. The Company expects to continue to expand the breach and scale of its network and related sales and marketing, customer support and operations activities. The Company attempts to carefully plan these expansion efforts to minimize the effect to profitability; however, they can cause the Company to incur significant increases in expresses from time to time in anticipation of potential future growth in the Company's customer base and targeted geographic markets. Over the past several years, the Company has undertaken a program of developing new products and expanding its existing service offerings, prographic focus and network. In connection with these new products and services, the Company has made significant

The Company's falure results of operations and the other forward looking statements contained in this Outlook, in particular the statements regarding revenue growth and reducing cost structure, involve a number of risks and uncortainties. In addition to the factors discussed above, other factors that could cause actual results to differ materially are the following: business conditions and the general recursory, competitive factors, acceptance of new products and pricing pressures, availability of leased network facilities, risk of collection of accounts receivable, technological advancements, regulatory factors, higgains and other factors as discussed in the cautionary

The Company believes that it has the competitive product offerings, personnel and financial resources for continued business success; however, fishure revenues, costs and profits all are influenced by a number of factors and are subject to certain risks and uncertainties, as discussed above.

### Liquidity and Capital Resources

The Company's cash balance increased to \$8.8 million at September 30, 1996, from \$0 at September 30, 1995. This increase is attributable to the transfer of cash from Billing to the Company pursuant to the spin-off of Billing. Cash has, historically, been managed by a centralized cash management department in Billing. Consequently, cash was not allocated among the Company's subsidiaries and was recorded on the balance short of Billing. Total comolidated cash was \$22.9 million at September 30, 1995, none of which is reflected on the Company's balance short for financial reporting purposes. Working capital was \$20.1 million at September 30, 1996, compared to \$11.7 million at September 30, 1995. The Company's current ratio was 1.7:1 at September 30, 1996, versus 1.5:1 at September 30, 1995. Additionally, the Company's cash flow provided by operations was \$1.6 million for fiscal 1996 and \$1.8 million for 1995. Cash flow provided by operating activities would have been \$5.8 million had the Company not incurred direct spin-off costs and restructuring charges.

Accounts receivable increased to \$35.9 million at September 30, 1996 from \$30.5 million at September 30, 1995. This increase is attributable primarily to a higher level of direct dial long distance services revenues in the fourth quarter of 1996 compared to the fourth quarter of 1995. Trade accounts psyable and accrued liabilities increased to \$10.9 million and \$13.6 million, respectively, at September 30, 1996 from \$10.7 million and \$6.7 million at September 30, 1995. The increases in accounts psyable and accrued liabilities are due to the overall expansion of the Company's business. Prepaids and other current assets increased to \$6.0 million at September 30, 1996 from \$4.1 million at September 30, 1995. This increase is attributable to an increase in a receivable from Hilling for equipment loss under the Company's financing facility pursuant to the spin-off. The decrease in other assets to \$4.9 million at September 30, 1996 from \$6.5 million at September 30, 1995 is due to the normal amortization of these assets and a \$727,000 write-down of customer lists associated with cortain acquisitions.

Capital expenditures amounted to approximately \$11.0 million during 1996. These expenditures were related primarily to the purchase of telecommunications equipment, computer equipment and software, and office furniture. During 1996, the Company financed approximately \$3.5 million of equipment through long-term borrowings. During 1997, the Company anticipates capital expenditures of \$18.0 million to \$22.0 million to service the Company's projected growth. Approximately \$10.0 million to \$12.0 million of these capital expenditures are expected to be purchases of telecommunications equipment, approximately \$5.0 million to \$7.0 million are expected to be purchases of computer hardware and software to develop systems to support the anticipated growth of the Company's business and the remainder is expected to be for purchases of office furniture and equipment. The Company anticipates financing these capital expenditures primarily through term notes with various lending institutions. Although line of credit commitments have been made by various lenders for equipment purchases, there is no assurance that the Company will be able to obtain satisfactory financing for these capital expenditures.

The Company's operations and expansion into new geographic markets will continue to require substantial capital investment for the development and procurement of transmission facilities and telecommunications and office equipment. In addition, any acquisitions that the Company may consummate may require substantial capital investment. The Company believes that it has the ability to continue to accure long-term equipment financing and that this ability, combined with cash flow generated from operations and available borrowing capacity under its existing credit facilities, will be sufficient to fund capital expenditures, working capital needs and debt repayment requirements for the foresecable future.

The Company has a revolving credit receivable financing facility which allows the Company to borrow against its own direct dial long distance services and operator services accounts receivable. At September 30, 1996, the Company had approximately \$14.0 million available for horrowing and did not have any amounts borrowed under this facility. Any borrowings under this facility will bear interest at the prime rate plus .5%. This facility is collateralized by the related accounts receivable and by virtually all of the assets of the Company not otherwise pledged as security under other debt agreements.

The Company is a guaranter on a \$45.0 million credit receivable financing facility for Billing. Under the terms of the Transitional Services and Sublease Agreement entered into pursuant to the spin-off, the Company's potential liability as guaranter is compensated at the rate of 1% of the average annual outstanding balance. At September 30, 1996, Billing had \$19.0 million outstanding under this facility. Both the revolving credit financing facility and the guarantee arrangement terminate on December 31, 1996. The Company anticipates executing agreements in the near future which would provide the Company with receivable financing facilities exceeding \$10.0 million.

In fincal 1996, the Company entered into a \$10.0 million equipment financing facility with an interest rate float at the 30-day commercial paper rate plus 2.70%. No amounts were outstanding under this facility at September 30, 1996. The agreement provides for a one-year period during which the Company may finance up to \$10.0 million in equipment on an interest payment only basis. Upon completion of this period in September 1997, the note amount will convert to a series of term notes with 20% of the total amount borrowed due in each of the next five years. Any amounts not due in a given year may be prepaid and reborrowed at the Company's discretion.

The Company has various fixed rate notes with interest rates ranging from 6.75% to 11.0%, due in varying amounts through August 2001. The proceeds from the issuance of these notes were used to acquire certain computer and telecommunications equipment and office furniture. The loans are secured by the assets acquired with the proceeds of such notes. Certain of these notes are also guaranteed by Billing.

Historically, the Company has obtained financing for capital expenditures through term debt agreements and capital lease agreements that were guaranteed and cross-collateralized by the Company and Billing. These debt agreements were negotiated based on the strength of the consolidated financial statements, earnings and cash flow of the consolidated group. Most of these debt agreements were secured by the assets of all the subsidiaries within the consolidated group. The Company has received from certain lenders lean agreement amendments or superate loss agreements whereby the subject indebtodness will be secured by only the Company's assets. In other cases, the existing cross guarantees and security arrangements between the Company and Billing will remain in place for the duration of the facility. In this regard, the Company and Billing have agreed to pay each other a credit support fee.

The credit facilities discussed above contain various restrictions and financial ratio maintenance requirements. Under one of its credit facilities, the Company is required to maintain a quarterly ratio of consolidated operating income, as defined in the agreements, to consolidated fixed charges of 1.5 to 1.0. Further, the Company is required to maintain a ratio of funded debt, as defined in the agreement, to total capitalization of not greater than 85%. Other agreements require the Company to maintain cash flow coverage ratios, as defined in the agreements, ranging between 1.25 and 1.40 and a minimum tangible net worth ranging between \$30.0 million and \$35.0 million. Under one agreement, the Company is prohibited from paying a cash dividend on its common stock. Cross-definal provisions of the Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other luan agreements. Under the Company's most significant credit facilities. USLID has guaranteed the obligations of its subsidiaries. The Company was in compliance with all required covenants at September 30, 1996 and 1995.

The Company continually evaluates business opportunities, including potential acquisitions. The primary focus of the Company's acquisition activities is to make additional acquisitions that will grow the Company's direct dial long distance business. One or more of such acquisitions could result in a substantial change in the Company's operations and financial condition. The success of the Company's acquisition activities will depend, among other things, on the availability of acquisition candidates, the availability of funds to finance acquisitions and the availability of management resources to oversee the operation of acquired businesses. While the Company has, from time to time, had discussions with other telecommunications companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report that would have a material impact on the Company's financial position or results of operations.

As consideration for any acquisitions, the Company may issue common stock, preferred stock, convertible debt or other securities, in addition to or in lieu of the payment of cash, that could result in dilution of the percentage ownership of public stockholders. The Company does not intend to seek stockholder approval for any such acquisitions or security issuances unless required by applicable law or regulations.

### Secondity

Approximately 95% of the Company's direct dial long distance revenues is generated by commercial customers and, accordingly, the Company experiences general decreases in long distance revenues around national holidays when commercial traffic is reduced. The Company typically experiences decreases in operator services revenues in the fall and winter months as pay telephone usage declines due to cold and inclement weather in many parts of the United States. As a result of the seasonal variations discussed above, revenue reported in the Company's first flocal quarter ending December 31 (which includes the Thanksgiving, Christmas and New Year's Eve holidays), historically, has been the lowest level of any quarter of the year. Conversely, due to increased traffic from pay telephones during the spring and summer months and a lower concentration of national holidays, the Company has historically experienced its highest revenue levels in the third and fourth quarters of the fiscal year. Hecause the Company's fixed operating expenses do not decrease during the first flocal quarter, the Company's profitability is also, generally, at its lowest level for any quarter of the year.

### Cities of Inflation

Inflation is not a material factor affecting the Company's business. Prices charged to the Company for switching equipment and transmission costs have not materially changed during the year. General operating expenses such as salaries, employee benefits and occupancy costs are, however, subject to normal inflationary pressures.

### **New Accusating Standards**

The Company is not currently, nor does it expect to be, materially affected by any new standards recently issued by the Financial Accounting Standards Board.

### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The consolidated financial statements of the Company and the related report of the Company's independent public accountants thereon are included in this report at the page indicated.

	Page
	22
Report of Independent Public Accountants	
Consolidated Balance Sheets at September 30, 1996 and 1995	1
Consolidated Statements of Income for the Years Ended September 30, 1996, 1995 and 1994	24
Consolidated Statements of Stockholders' Equity for the Years Ended September 30, 1996, 1995 and 1994	25
Consolidated Statements of Cash Flows for the Years Ended September 30, 1996, 1995 and 1994	26
Notes to Consolidated Financial Statements	27

# HEPCHIT OF IMPEREMBENT PUBLIC ACCUMINTANTS

To the Board of Directors and Stockholders of U.S. Long Distance Corp.:

subsidiaries as of September 30, 1996 and 1995, and the related consolidated statements of income, stackholders' equity and cash flaws for each of the three years in the period ended September 30, 1996. These financial statements are the required bids of the Compuns's agement. Our responsibility is to express an opinion on these financial statements based on our audies We have audited the accumpanying convolidated balance sheets of U.S. Long Distance Cusp. (a Delaware corporation) and

perfects 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 us lades ersing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial tensors presentation. We believe that our audits provide a reasonable basis for our opinion We conducted our audies in accordance with generally accepted auditing standards. Have standards require that we plan and

In our opinion, the financial statements referred to ahove present fairly, in all material respects, the financial position of U.S. Lung Distance Corp. and subsidiaries as of September 30, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1996, in conformity with generally accepted accounting principles

stang for incume laws. As explained in Note 2 to the Consolidated Financial Statements, effective October 1, 1993, the Company changed its method of

ARTHUR ANIXESENLLP

San Autonio, Texas November 14, 1986

### U.S. LONG DISTANCE CURP. AND SUBSIMARIES

### CONSIDERATED BALANCE SHEETS (in thousands)

### ASSETS

	Senter	sber 30.
	1776_	1995
Current assets:		
Cash and cash equivalents	5 B,B42	\$ 0
Accounts receivable, net of allowances for doubtful accounts of \$2,519 (1996) and \$1,938 (1995)	35,867	30,548
Prepalds and other	6,002	4,077
Tidal current assets	50,711	34,625
Property and equipment	58,370	47,800
Less accumulated depreciation and amortization	(28,793)	(19,196)
Net property and equipment	29,577	28,694
Equipment held under capital lesses, net of accumulated depreciation of \$1,458 (1996) and \$1,958 (1995)	282	1.540
Other assets:		
Excess of cost over net assets acquired, net of accumulated amortization of \$2,065 (1996) and \$1,502 (1995)	13,804	14.685
Other assets, net of accumulated amortization of \$4,892 (1996) and \$4,443 (1995)	4.870	6.483
Net assets of discontinued operations (see Note 3)	0	39.083
Total assets	\$99,244	\$125,110
LIAMILITIES AND STOCKHOLDERS' EQUITY	*************	*********
Current liabilities:		
Trade accounts payable	\$10,909	\$ 10.748
Accrued liabilities	13.581	6.684
Current portion of long-term debt	5,854	5,147
Current portion of obligations under capital leases	294	372
Total current liabilities	30.638	22,951
Other liabilities	52	1,318
Lang-term debt, less current portion	10.146	12.327
Obligations under capital leases, less current portion	143	523
Payable to Billing Information Concepts Corp., net	0	17,860
Commitments and contingencies (See Note 6, 10 and 14)		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, no shares issued or outstanding at September 30, 1996 or 1995		
Common stock, \$0.01 par value, 50,000,000 shares authorized; 15,255,977 and 14,281,866 shares		
issued and 15,051,876 and 14,094,634 shares outstanding at September 30, 1996 and 1995,		
respectively	153	143
Additional paid-in capital	54,554	49,304
Retained carnings	5,465	20,473
Treasury stock	_(1.907)	_(1,789)
Total stockholders' equity	58.265	68,131
Total liabilities and stockholders' equity	\$99,244	\$125,110

The accompanying notes are an integral part of these consolidated financial statements.

### U.S. LONG BISTANCE CURP. AND SUBMISSIANSES

### CHRISHABATED STATEMENTS OF INCOME. (In thousands, except per there amounts)

	Fur the Year Ended September 30.		
	1996	1995	1994
Operating revenues: Direct dial long distance services	\$ 119,401	5 84,484 _59,566	\$ 62,834 _54,707
Total operating revenues	180,346	144,050	117,541
Cort of services	118,493	94.038	72,944
Gross profit	61,853	50,012	44,597
Selling, general and administrative expense	50,722 12,969	41,580 0	38,541 0
Restrictoring charges	2,840 11,798	10.032	8,424
Depreciation and amortization expense	TO THE RESERVE		
Loss from continuing operations	(16,476)	(1,600)	(2,368)
Other income (expense):	894	682	473
Interest expense	(1,356)	(1,643)	(1,4479)
Other, net	(166)		279
Total other income (expense)		(999)	(\$66)
Loss from continuing operations before income tax benefit	(17,104)	(2,599)	(3,233)
lacoure tax benefit		516	758
Net has from continuing operations	(13,754)	(2,083)	(2,475)
Discontinued operations (Note 3): Income from discontinued operations, net of income taxes of \$9,292 (1996),			
\$8,661 (1995) and \$5,938 (1994)	_15.161	_14,118	8.565
Net income	\$ 1,407	\$ 12,035	\$ 6,090
Net incume (luss) per common share:			
Continuing operations	\$ (0.09)	\$ (0.14)	\$ (0.18)
Discontinued operations	0.96	0.97	0.61
Net income per common share	\$ 0.09	\$ 0.83	\$ 0.43
Weighted average cummon shares and cummon share equivalents outstanding	15,398	14,587	14,069

The accompanying notes are an integral part of these consolidated financial statements

### U.S. LONG BESTANCE CORP. AND SUBSBEARDES

### COMMUNICATED STATEMENTS OF STOCKHOLDERS EQUITY

### For the Years Ended September 30, 1994, 1995 and 1996 (in thousands)

					Additional		
	_Comm	Amount	Shares	Ampuni	Poid-in Capital	Retained Entraines	Treasury Stock
Halances at September 30, 1993	11,913	\$119	0	\$0	\$36,113	\$ 1,998	\$ (93)
Proling with Telecom West Inc	270		0		5	123	. 0
Exercise of stock options and							
warrants	113	and he is the	0	0	827	0	0
Issuance of common stock	636	6	. 0	0	5,358	0	. 0
Issuance of treasury stock	0	. 0	0	U	237	0	141
Purchase of treasury stock	0	0	0		0	0	(1,637)
Net income	0	0	0	0		_6,090	0
Halances at September 30, 1994	12,932	129		0	42,540	8,211	(1,661)
Posting with L.D. Network, Inc	175	2	0	0	1	227	0
Exercise of stock options and							
warrants	1,000	- 11	0	0	4,805		0
Issuance of common stock	195	2	0	0	2,422	0	0
Retirement of treasury stock	(100)	(1)	. 0	0	(949)	0	950
Purchase of treasury stock	0			0	0	0	(1,075)
Other capital contribution	. 0	0	. 0	0	485	0	0
Net income	0	0	0		0	12,035	0
Halances at September 30, 1995	14,282	143	0	0	49,304	20,473	(1,789)
Issuance of common stock	223	2	0	0	1,210	0	0
Return of escrowed shares	. 0	0	0	0		0	(118)
Exercise of stock options and							
Waltanis	751		0	0	3,913	0	0
Other capital contribution			0		127	0	0
Spin-off of Billing Information				Vision Committee			
Concepts Corp	0	0	0	0		(16,415)	0
Net income	0	0	0	0	0	_1.407_	0
Halances at September 30, 1996	15,256	\$153			\$54,554	\$ 5,465	\$(1,907)

The accompanying notes are an integral part of these consolidated financial statements

### U.S. LONG BESTANCE CURP. AND SUBSIDIARIES

### COMBOLIDATED STATEMENTS OF CASH FLOWS (to themselds)

	For the Year Easted September 30.		
		1995	
Cash flows from operating activities:			
Net loss from continuing operations	\$ (13,754)	\$ (2,083)	\$ (2,475)
Adjustments to reconcile net loss from continuing operations to net cash			
provided by operating activities:			
Depreciation and amortization	11,798	10,032	8,424
Provision for lones on accounts receivable	8,388	6,231	5,095
Defenred compensation	4,078	255	220
Loss on write-down of property and equipment	1,084	171	48
Changes in current assets and liabilities, net of effects from purchase of			
direct diel long distance companies:			
lacrease in accounts receivable	(13,001)	(12,882)	(6,535)
(Increase) decrease in prepaids and other	(766)	600	(1,997)
Increase (decrease) in accounts payable	161	(4,222)	4,853
Increase (decrease) in accreed highlinies	6,897	1,869	(300)
Increase (decrease) in other liabilities	(3.266)	_1,843.	1,398
Net cash provided by operating activities	1,619	1,814	8,731
Net cash provided by discontinued operations	16,661	6,549	1,007
Cash flows from investing activities:			1200
Perchases of property and equipment	(11,007)	(9,761)	(7,036)
Acquisition of direct dial long distance companies, net of cash acquired.	0.	(175)	(565)
Proceeds from sale of anoth.	45	632	179
Other investing activities	(315)	(54)	(880)
Net cash used in investing activities	(11,297)	(9,358)	(8,302)
Cash flows from floancing activities:			
Proceeds from insurance of debt	3,500	4,784	7,339
Payments on debt	(5,742)	(5,512)	(4.875)
Payments on capital leases.	(458)	(1,267)	(2,544)
Financing costs	0	0	(267)
Proceeds from issuance of common stock, net of issuance costs	4,550	4,065	470
Perchase of incasery stock	0	_(1,075)	_(1.559)
Net cash provided by (used in) financing activities	1.859	995	_U.436)
Net increase in cash and cash equivalents	8,842	0	0
Cash and cash equivalents, beginning of year		0	0
Cash and cash equivalents, end of year	5 8.842	5_0	5 0

The accompanying notes are an integral part of these complicated financial statements.

# U.S. LOPIG BESTANCE CURE. AND SUBMEMARIES NOTES TO CUMULABATED FINANCIAL STATEMENTS September 3s, 1985, 1995 and 1994

## Nate I. Business Activity

U.S. Long Distance Cosp. ("USLD") was rechmenticated from Canada and reincorporated under the Delaware Cosporation Law Act in the State of Delaware, United States of America, in 1987. USLD and its subsidiaries (collectively, the "Company") offer an integrated group of communications services including direct dist long distance, prepaid calling cards, travel cards, data transmission and calling center services. The Company's network consists of a highly advanced, digital switching system which provides nationwisk, largely filter-optic, access throughout the United States.

The Company is a full-service long distance carrier currently providing direct dust long distance services to small and medium-sized commercial customers and, to a leaser extent, residential customers. In addition, the Company provides operator arvived services for private pay telephoners, hutch, match, university dormatories and hospitals. In fiscal 1996, direct dust long distance services represented approximately two-shiels of the Company's revenues, while operator services represented approximately one-third of

# Near 2. Summary of Elgaliferant Accounting Pulletes

Principles of Consolidation and Basis of Presentation

The accompanying committated financial statements include the accounts of USLD and its wholly owned substitutes. All sufficient intercompany accounts and transactions have been eliminated in consolidation. Certain current period and prior period cause have been rechamified for companion purposes.

On August 2, 1996, the Company completed the spin-off of its billing clearinghouse and information management services business. Billing information Concepts Corp. ("Billing"). The spin-off has been accounted for as a discontinued operation and accordingly, the Company restated its consolidated financial statements for all periods presented prior to that date in accordance with Accounting Principles Board ("APB") Opinion No. 30. Financial disclosures for all periods presented reflect that restatement.

Cash was bisterically managed by a controlled cash assaugement department in Billing. Consequently, cash was not allocated among USLD's subsidiaries and was recorded on the belance sheet of Billing. Total consolidated cash was \$22.9 million at September 30, 1995, none of which is reflected on the Company's belance sheet for financial reporting purposes.

The intercompany payable to Billing has been reported as a separate line item in the restated balance sheet under the caption. "Psychic to Billing, act" between the liability and stackbolders' equity sections of the balance sheet. See further discussion of discontinued operations in Note 3.

## Listimates in the Financial Statements

The proparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and habilities and disclosure of contingent assets and habilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could liffer from those estin

## Revenue Recognition Policies

The Company recognises revenue from its direct dial long distance and operator services as such services are performed

### Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the related assets, which range from three to ion years. Upon disposition, the cost and related accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss is reflected in other income for that period. Expenditures for maintenance and repairs are charged to expense as incurred. Direct installation costs and major improvements are capitalized.

## Excess of Cast Over Net Assets Acquired

Excess of cost over set assets acquired represents the excess of the consideration paid over the fair value of the net assets acquired. The initial acquisition of the direct dial long distance business is being amortized using the straight-line method over 40 years. If subsequent acquisitions of direct dial long distance businesses are being amortized over 20 years. The Company annually assesses the appropriatement of the asset valuations and the amortization periods.

### (Mary Assets

Other assets include financing coins related to the issuance of long-term debt, which have been deferred and are amountized over the life of each respective agreement, acquisition costs of direct dial long distance customer bases, which are amounted over the expected metal life of the customer bases, and costs incurred to acquire operator services agreements, which are amounted over the life of each respective comment. In addition, a conflictate of deposit held as necessity for an equipment financing facility, long-term deposits and the long-term portion of notes receivable have been included in other assets.

## For Value of Financial Instruments

The estimated this value amounts of the Company's financial instruments have been determined by the Company using appropriate valuation methodologies and approximate their recorded book values at September 30, 1996 and 1995. The carrying values of the Company's cash, receivables, accounts payable, debt and all other financial instruments approximate their fair market values.

### Advertising Expense

The Company charges advertising costs to expense as the costs are incurred. Total advertising expense was \$1.1 million \$543,000 and \$796,000 for the years could September 30, 1996, 1995 and 1994, respectively.

### Incume Taxes

In February 1992, the Financial Accounting Standards Board (TASBT) issued Statement of Financial Accounting Standards (TSFAST) No. 109, "Accounting for Income Tases," which the Company adapted effective October 1, 1993. Under SFAS No. 109, deferred to inhibition and assess are recorded based on crusted income tax rates that are expected to be in effect in the period in which the deferred tax liability or must is expected to be netted or realized. A change in the tax laws or rates results in adjustments to the deferred tax liabilities or must. The effects of such adjustments are required to be included in income in the period in which the tax laws or rates are changed. The adoption of SFAS No. 109 did not have a material impact on the Company's financial position or results of operations. Prior to October 1, 1993, the Company accounted for income taxes in accordance with the provisions of APB Opinion No. 11.

## Net Income (Loss) For Common Share

Net income (loss) per common share was computed by dividing net income (loss) applicable to common stock by the weighted average number of common shares and common share equivalents outstanding through the applicable period. The weighted average number of shares outstanding at each year end the to assumed conversions of options and warrants that were outstanding the respective periods.

Cash payments and non-cash activities during the periods indicated were as follows

Dividend pursuant to spin-off of Billing	Resultanguistic serie-off conts due from Billiage	Refun of record framer that	ORIGIN CHRISTIAN IN COMPRESSION WHITE SHARE	cat obligations	Capital lease and debt obligations incurred	Common stock issued in connection with acquivitions	Lubitities assumed in connection with acquisitions	Noncash investing and financing activities:  Averts accurred in connection with acquisitions	Cash payments for interest	
ж,ж	794	=	1,421	•	1.159	•	•	•	\$1,763	91
•	•	•	1,236	•	470	3	35	919	1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1	1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1
•	•	•	392	1,637	295	4,962	4,273	11,560	. ž	ā;

For purposes of determining each flows, the Company considers all temporary each investments purchased with an original materials of three months or less to be each equivalents.

## Revent Accounting Pressums ements

In March 1995, FASH issued SFAS No. 121, "Accusating for the Impairment of Long-Lived Assets and for Long-Lived Assets to the Disposed Of." SFAS No. 121 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In fiscal 1996, the Company determined that certain companies opinional, customer liets and goodwill were impaired and, accordingly, wrote down these assets by \$1.8 million, of which \$1.1 million is included in restructuring charges and \$727,000 is included in depreciation and amortization expense.

prescribed by APB Opinion No. 25 must make pro-forms disclosures of net income and earnings per share as if the fair value based method of SFAS No. 123 had been applied. The accounting and disclosure requirements of SFAS No. 123 are effective for transactions entered into in facel years that begin after December 15, 1995. The Company intends to measure compensation costs in accordance with APB Opinion No. 25 and to provide pro-forms disclosures of net income and earnings per share as if the fair value based method of accounting under SFAS No. 123 had been applied. Therefore, management of the Company dues not anticipate SFAS No. 123 will have a In October 1995, FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 defines a fair value based method for employee stock options or similar equity instruments. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period of the award, which is usually material impact on the Company's financial position or results of operations e vesting period. However, SFAS No. 123 also allows entities to continue to measure compensation costs using the intrinsic value estad prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees." Entities electing to remain with the accounting

In June 1996, FASB issued SFAS No. 125 "Accounting for Transfers and Servicing of Financial Asset: and Extinguishments of Liabilities." SFAS No. 125 provides accounting and reporting standards for, among other things, the transfer and servicing of financial assets, such as factoring receivables with recourse. SFAS No. 125 is effective for transfers and servicing of financial assets occurring after December 31, 1996, and is to be applied prospectively. Earlier or retroactive application is not permitted. Management of the Company because the adoption of SFAS No. 125 will have a material impact on the Company's financial position or results of SHAME LAND

## Nate A Discussioned Operations

che August 2, 19%, the Company completed the spin-off of folling, its billing clearinghouse and information management services business. The spin-off has been accounted for as a discontinued operation and, accordingly, the Company restated its Consolidated Financial Statements for all periods presented prior to that date. The spin-off was a tax-free distribution of 100% of the common stack of Billing to the Company's stackholders. Revenue of the discontinued operations of Billing was \$85.8 million, \$80.8 million and \$57.7 million in fiscal 1996, 1995 and 1994, respectively. Not income of the discontinued operations of Billing was \$15.2 million, \$14.1 million and \$8.6 million in fiscal 1996, 1995 and 1994, respectively. In connection with the spin-off, the

Company extered not an agreement with Hilling under which the intercompany payable/receivable balances were longiven Additionally, Hilling agreed to neimburse the Company for direct out-of-packet expresses associated with the spin-off and to transfer cash to the Company to provide the Company a working capital balance of \$21.5 million at the spin-off date. The net effect of this agreement resulted in the Company recording the distribution as a dividend in the amount of \$16.4 million for financial statement purposes. Direct spin-off costs recorded as operating expresses in the year ended September 30, 1996 were approximately \$11.0. costs associated with accelerated stock grants. sillion and include professional fees, tax payments triggered by the spin-off, payments called for under employment agreements and

The summarized components of net assets of discontinued operations at September 10, 1995 were as follows (in thousands)

### Note & Acquisition

for 270,000 shares of its common stock. The business combination has been accounted for as a proling-of-interests combination. The accompanying consolidated financial statements include the operating results of TWI since the effective date of the business combination. The complificated financial statements for periods prior to the combination have not been restated to include the accounts and results of operations of TWI due to the transaction not having a significant impact on the Company's prior period. financial position or results of operations. On October 1, 1993, the Company acquired Telecom West Inc. ("TWT"), a direct dial long distance company, in exchange 000 shares of its common stock. The business combination has been accounted for as a positing-of-interests combination. The

During fiscal 1994, the Company acquired four other separate, privately-owned direct dial long distance companies located in Texas and California. These acquisitions have been accounted for as purchases and, accordingly, the results of operations of each company have been included in the Company's consolidated financial statements since the respective dates of acquisition. An aggregate of \$1.0 million cash and 650,000 shares of the Company's common stack were issued in connection with these purchases. traight-line hasis over five years. ransactions. Total assets acquired and liabilities assumed for these acquired companies were approximately \$2.8 million and \$1.1 million, respectively. The encess of the aggregate purchase price over the fair value of aggregate net tangible assets acquired is previously \$8.0 million, of which approximately \$6.9 million has been recorded as goodwill and is being amortized on a straight net busis over 20 years. The remaining balance has been recorded as the purchase price for customer lists and is being amortized on a

LDN due to the transaction not having a significant impact on the Company's prior period financial position or results of operations On October 6, 1994, the Company acquired L.D. Network, Inc. ("LDN"), a direct dial long distance company, in exchange for 175,000 shares of its common stock. The business combination has been accounted for as a pushing-of-interests combination. The accompanying consolidated financial statements include the operating results of LDN since October 1, 1994. The consolidated ial statements for periods prior to the combination have not been restated to include the accounts and results of operations of

In March 1995, the Company acquired the long distance commercial customer have of a company and certain assets of another company. These acquisitions have been accusated for as purchases and, accordingly, the results of operations of each acquisition have been included in the Company's consolidated financial statements since the respective effective cases of acquisition Cash of \$175,000 and 78,000 shares of the Company's common stock were issued in connection with these purchase transactions. Total assets acquired and liabilities assumed for these acquisitions were approximately \$1.1 million and \$200,000, respectively. The excess of the purchase price over the fair value of aggregate net tangible assets acquired is approximately \$1.0 million, of which approximately \$316,000 has been recorded as goodwill and is being amortized on a straight-line basis over 20 years. The remaining balance has been recorded as the purchase price for costomer lists and is being amortized on a straight-line basis over five years.

No pro forms financial information with regard to any acquisitions has been presented as the acquisitions do not have a significant impact, either individually or in the aggregate, on the Company's prior or current period financial position or results of operations. The Company granted certain registration rights to the persons receiving its common stock in the acquisitions and caused its subsidiaries to enter into employment agreements with certain principals of the acquired companies.

### Note 5. Property and Equipment

Property and equipment consist of the following:

	1926	1995 meands)
Communications equipment	\$40,573	\$33,652
Furniture, fixtures and equipment	15,018	11,437
Leasehold improvements	2,779	2.711
Less accumulated depreciation	(28,793)	(19,106)
Net property and equipment	\$29,577	\$28,694

### Note 6, Bold

Long-term debt is comprised of the following:

	1996 (in the	1995 mands)
Fixed interest rate term notes	\$16,000	\$17,474
Less - Current purtiun	_5,854	_5.147
Long-term debt, less current portion	2101146	\$12,327

The Company has a revolving credit receivable financing facility which allows the Company to borrow against its own operator services accounts receivable and certain direct dial long distance services accounts receivable. At September 30, 1996, the Company load approximately \$14.0 million available for borrowing and did not have any amounts borrowed under this facility. At September 30, 1995, the Company did not have any amounts borrowed under this facility. Any borrowings under this facility will bear interest at the prime rate plus .5%. This facility is collateralized by the related accounts receivable and by virtually all of the assets of the Company not otherwise pledged as security under other debt agreements. This financing facility terminates on December 31, 1996.

The Company is a guaranter on a \$45.0 million credit receivable financing facility for Billing. Under the terms of the Transitional Services and Sublease Agreement discussed further in Note 13, the Company's potential liability as guaranter is compensated by Billing at the rate of 1% of the average annual outstanding balance. At September 30, 1996, Billing had \$19.0 million outstanding under this facility. The guarantee arrangement terminates on December 31, 1996.

In fiscal 1996, the Company entered into a \$10.0 million equipment financing facility with an interest rate at the 30-day commercial paper rate, as defined in the agreement, plus 2.70%. No amounts were outstanding under this facility at September 30, 1996. The agreement provides for a one-year period during which the Company may finance up to \$10.0 million in equipment on an interest payment only basis. Upon completion of this period in September 1997, the outstanding horrowings will convert to a series of term notes with 20% of the total amount burrowed due in each of the next five years. Any amounts not due in a given year may be prepaid and reborrowed at the Company's discretion. A commitment fee of \$75,000 was paid in connection with this facility. It is being amortized over five years.

The Company has various fixed rate notes with interest rates ranging from 6.75% to 11.0%, due in varying amounts through August 2001. The proceeds from the issuance of these notes were used to acquire certain computer and telecommunications equipment and office furniture. The loans are secured by the assets acquired with the proceeds of such notes. Certain of these notes are also guaranteed by Billing.

Historically, the Company has obtained financing for capital expenditures through term debt agreements and capital lease agreements that were guaranteed and cross-collateralized by the Company and Hilling. These debt agreements were negotiated based on the strength of the consolidated financial statements, earnings and cash flow of the consolidated group. Most of these debt agreements were secured by the assets of all the subsidiaries within the consolidated group. The Company has received from certain lenders from

proment assendments or separate burn agreements whereby the subject indebtedness will be secured by only the Company's avers. In her cases, the existing cross guarantees and security arrangements between the Company and Billing will remain in place for the aration of the facility. In this regard, the Company and Billing have agreed to puy each other a credit support fee of 1% of the average Marie Contract

USLD has general to total capitalisation of not greater than 60% and total debt to total capitalization of not greater than 85%. Other agreements require the "anguny to maintain cash flow coverage ratios, as defined in the agreement, ranging between 1.25 and 1.40 and a maintain tangeble net worth ranging between \$30.0 million and \$35.0 million. Under one agreement, the Company's probabled from paying a cash dividend as its common stack. Cross-default provisions of the Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other four agreements. Under the Company's most significant credit facilities. Stall has guaranteed the obligations of its subsidiaries. The Company was in compliance with all required covernants at September 10. facilities, the Company is required to maintain a c lidered fixed charges of 1.5 to 1.0. Further, the Cor The credit facilities discu and above contain various restrictions and financial ratio maintenance requirements. Under one of its quired to maintain a quarterly ratio of consolidated operating income, as defined in the agreement, to 1.0. Further, the Company is required to maintain a ratio of funded debt, as defined in the agreement.

tities for the years ending September 30, 1997 through 2001 are as follows (in thousands)

### Nute 7. Lanes

The Company Issues \$2.5, \$2.6 and \$2.3 a 1996, are as follows (in thousands): mes certain oqu t and office space under operating leases. Rental expense for fiscal 1996, 1995 and 1991 n rease payments under non-cancel ble operating leaves at September 10

The Company also leases various computer and telecommunications equipment under capital lease arrangements. Future minimum lease payments under these capital leases, together with the present value of the net minimum lease payments at September 34, 1996, are \$437,000 and are the in varying amounts through 1999.

### Note B. Share Capital

On June 1, 1994, the Company was authorized by its board of directors to purchase up to 1,000,000 shares of its outstanding manus stock. Shares were purchased from time to time on the open market over the course of the twelve months that began June 1, 1944 as market and other relevant conditions warranted. During the twelve-month period ended May 31, 1995, the Company echased an approprie of 267,500 shares at an average market price of 59.84 per share. All of these shares were purchased brequent to July 1, 1994, in November 1994, the Company retired 100,000 shares of treatury stock carried at a cost of 5950,000 these shares returned to authorized and unissated shares, in November 1995, the encrow agreement relating to the Company spicialism of the long distance commercial customer hase of a company in March 1995 and pursuant to which 16,869 shares of the requirement at the Company and are being appears); common stock were held in occors was terminated. These 16,869 shares were returned to the Company and are being quisition of the long distance communical customer have of impusy's common stock were held in occurs was terminate td as teamny shares. At September 30, 1996, the Company puny had 204,101 shares of treasury stock, carried at cost

Other capital contributions in facal 1995 and 1996 are from a director of the Company and represent a settlement of certain s matters. No cash dividends were paid on the Company's common stock during fiscal 1996, 1995 or 1994.

On December 12, 1995, the Board of Directors adopted the U.S. Long Distance Corp. 1995 Employee Restricted Stock Plan\*), which provides for the awarding of restricted stock to officers and certain key employees of the Company. An aggregate of 500,000 shares of cummon stock are reserved for awards under the Restricted Stock Plan. The number of shares of common stock to be awarded to an employee and other terms of the award are determined by a committee of disinterested persons who will administer the Restricted Stock Plan. The Restricted Stock Plan provides for certain restrictions upon the sale of the stock. Subsequently, the Restricted Stock Plan was amended to allow for immediate vesting at the discretion of the committee. In fiscal 1996, 188,000 shares of stock were grunted under this plan. Compensation expense of \$553,000 was recognized upon the amortization of deferred compensation and is included in selling, general and administrative expense. An additional \$3.4 million of compensation expense was recognized in fiscal 1996 due to the acceleration of vesting of stock grants pursuant to the spin-off of Billing and is included in direct spin-off costs. At September 30, 1996, 312,000 shares were available for granting, under this plan.

On April 12, 1996, the Company, upon authorization by its Hoard of Directors, adopted a Shareholder Rights Plan ("Rights Plan") and declared a dividend of one preferred share purchase right on each share of its outstanding common stock. The rights will become exercisable if a person or group acquires 15% or more of the Company's common stock or announces a tender offer, the consummation of which would result in ownership by a person or group of 15% or more of the common stock. These rights, which expire on April 12, 2006, antitle stockholders to buy one ten-thousandth of a share of a new series of participating preferred shares at a purchase price of \$90.00 per one ten-thousandth of a preferred share. The Rights Plan was designed to assure that stockholders receive fair and equal treatment in the event of any proposed takeover of the Company.

### Note 9. Stock Chatless and Stock Porchase Warrants

The Company has granted stock options to directors, employees and other affiliated parties as follows:

	Number of Shorts	Prior Ronge of Shares Under Option
Outstanding, September 30, 1993	1,252,689	
Canceled	(141,054)	\$1.20 - \$3.59
Granted	657,850	\$2.43 - \$3.59
Exercised	(112.386)	\$0.39 - \$2.53
Outstanding, September 30, 1994	1,657,099	
Canceled	(65,264)	\$2.03 - \$3.40
Gusted	300,500	\$2.43 - \$3.85
Exercised	1471.861)	\$0.39 - \$3.14
Outstanding, September 30, 1995	1,420,474	
Caroched	(665,144)	\$2.20 - \$2.95
Gented	1,924,700	\$2.91 - \$8.48
Farrised	(281,990)	\$2.20 - \$3.08
	2 200 130	
Outstanding, September 30, 1996	4.75.174	

In connection with the August 2, 1996 spin-off of Billing, further discussed in Note 3, the Company effected a tax-free distribution of 100% of the common stock of Billing to the Company's stockholders, Immediately prior to that distribution, Billing, under its employee stock plans, granted options to purchase Billing common stock to each holder of an outstanding option to purchase shares of the Company's common stock under the U.S. Long Distance Corp. 1990 Employee Stock Option Plan, as amended ("Employee Plan") and the U.S. Long Distance Corp. 1993 Non-Employee Director Stock Option Plan ("Director Plan"), respectively. In connection with the grant of the Billing options, the entercine price of the Company's options was adjusted vin a formula adjustment designed to preserve the economic value of the Company's options existing immediately prior to the distribution. Except for the formula adjustment, the terms of each of the Company's adjusted option are substantially the same as those in effect prior to the distribution. The per share exercise price of the Company's options was adjusted based on the relative fair market values of the underlying common stock of each of the two companies, or by a factor of 25,9%. The fair market value per share of common stock of each company was defined as the average of the last sales price per share of that common stock on the Nasdan National Market system for each of the ten consecutive trading days instendiately subsequent to the date of distribution.

Stock options to purchase an aggregate of 117,500 shares were outstanding at September 30, 1996, were granted outside of any plan and are exercisable at prices ranging from \$4.38 to \$6.38 at varying dates through August 23, 2002. Stock options to purchase an aggregate of 65,000 shares were outstanding at September 30, 1996, were granted under the provisions of the Director Plan and are exercisable at prices ranging from \$2.78 to \$4.76 per share. The Director Plan options have certain vesting requirements and expire at varying dates through Fobruary 28, 2001. These were 115,000 shares remaining to be issued under the Director Plan at September 30,

1996. Stock options to purchase an aggregate of 2,215,630 shares were outstanding at September 30, 1996, were granted under the provisions of the Employee Plan, and are exercisable at prices ranging from \$0.39 to \$8,40 per share. The Employee Plan options, which have certain vesting requirements, expire at varying dates through August 22, 2002. The Employee Plan provides for the granting of incentive stock options and nonqualified stock options. As of September 30, 1996, there were 790,515 shares remaining to be issued under the Employee Plan. Options to purchase a total of 1,031,385, 756,524 and 610,792 shares of common stock were exercisable under all plans at September 30, 1996, 1995 and 1994, respectively.

The excess of the market value of the common stock on the date granted over the exercise price of such options results in compensation expense to the Company over the vesting period. Approximately \$145,000, \$255,000 and \$220,000 of compensation expense was recognized by the Company during fiscal 1996, 1995 and 1994, respectively. There were no deferred compensation costs netted against additional paid-in capital at September 30, 1996 while \$145,000 was netted against paid-in capital at September 30, 1995

Stock wareauts to purchase 469,741 shares of common stock were outstanding at September 30, 1995. These warrants were insued in connection with the sale of the senior subordinated notes in July 1991 and were exercisable at \$0.01 per share. Warrants to purchase 469,741 and 608,459 shares of common stock were exercised in fiscal 1996 and 1995, respectively. There were no such warrants exercised in fiscal 1994. There were no such stock purchase warrants outstanding at September 30, 1996.

In addition, the Company has granted warrants to purchase 225,000 shares of common stock, pursuant to two telecommunications service agreements. The exercise price of the warrants was equal to the market value of the Company's common stock on the date of grant. Pursuant to the spin-off of Billing, the exercise price associated with these warrants was adjusted to \$3.24 per share. The warrants vest ratably over the contract periods.

### Note 10. Income Taxes

The income tax benefit is comprised of the following:

	Your Er	and Sente	mber.M.	
	1226	1995	1994	
	Ç le	thousand	1)	
Current	\$ 119	\$2,574		
Defenred	3.231	(2,058)	(1,207)	
Income tas benefit	\$1,350	\$ 516	SERVICE STREET	

The income tax benefit for fiscal 1996, 1995 and 1994 differs from the amount computed by applying the statutory federal income tax rate of 35% for fiscal 1996 and 1995 and 34% for fiscal 1994 to loss from continuing operations before taxes. The reasons for these differences were as follows:

	Year Em	and Section	mber M.
	1926	1725	1294
Computed income tax banefit at statutory rate Increases (reductions) in taxes resulting from:	\$5,986	\$910	\$1,099
Americation of asset valuations in excess of tax  Non-deductible expenses related to spin-off	(311) (98) (2,455)	(146) (165) 0	(185) (12)
Cohor, est	228 \$3,350	\$516 (\$3)	_(144) 5_758

The tax effect of significant temporary differences, which comprise the deferred tax assets and liabilities, are as follows:

	Septem 1996 (in the	1995 (1995 (mands)
Defenred fax assets:	\$ 1,713	<b>s</b> 0
Deferred compensation		All the said the said to the s
Expense provisions	1.460	88
Total gross deferred tax assets	3,173	ax.
Deferred tax liabilities:		
Tax depreciation and amortization in excess of bank	(2,556)	(2,933)
Prepaid expenses	(262)	(222)
	(407)	(216)
Total gross deferred tax habitates	.(3,225)	JJ371)
Net deferred tax liability	\$ (52)	\$(3,283)

The Company has been notified by the Internal Revenue Service ("IRS") that a fiscal 1992 transaction between a wholly owned foreign subsidiary (Mega Plus Dinling, Inc.) and its U.S. subsidiary (Hilling, formerly Zero Plus Dinling, Inc.) is proposed to be treated differently by the IRS than originally characterized by the Company. The IRS district office has issued a report that proposed an assessment of taxes, penalties and interest. The assessment has been appealed to the appellate division of the IRS. The Company and its tax counsel believe the possibility that the IRS will prevail in this matter is remote. Consequently, no accusal for this potential liability or any associated taxes, interest or penalties has been made. Management of the Company does not anticipate this matter will have a material impact on the Company's financial position or results of operations.

During fiscal 1996, the Company incurred expenses related to the spin-off of Billing. Under federal income tax law, expenses incurred for effecting a corporate reorganization are non-deductible capital expenditures. Approximately \$7.0 million of the spin-off expenses were determined to be nun-deductible, resulting in a reduction of the income tax benefit of approximately \$2.5 million.

During fiscal 1996, the Company recognized a tax gain related to the liquidation of its wholly owned foreign subsidiary. Meta Plus Dialing, Inc. (MPDI). The gain arose in conjunction with the redemption of common and preferred shares of Billing held by MPDI. The Company paid Canadian federal taxes totaling US \$3.3 million on the gain. This tax payment generated a foreign tax credit for U.S. federal income tax purposes equal to this amount.

### Note 11. Bracit Plans

The Company adopted the U.S. Long Distance Corp. 401(k) Retirement Plan ("Retirement Plan") effective January 1, 1992. Participation in the Retirement Plan is offered to eligible employees of the Company or its subsidiaries. Generally, all employees of the Company or its subsidiaries who are 21 years of age and who have completed one year of service during which they worked at least 1,000 hours are eligible for participation in the Retirement Plan.

The Retirement Plan is a defined contribution plan which allows participants to make voluntary salary deferral contributions, on a pretax basis, of between 1% and 15% of their compensation in the form of voluntary payroll deductions up to a maximum amount as statutorily determined. In fiscal 1996, the Company made matching contributions of 50% of the first 3% of the participant's contribution. In fiscal 1995 and 1994, the Company made matching contributions at a percentage determined annually of 25% of the first 6% of the participant's contribution. The Company may, from time to time, make additional discretionary contributions. No discretionary contributions were made in fiscal 1996 or 1995. During fiscal 1994, a discretionary contribution in the amount of approximately \$51,000 was made. During fiscal 1996, 1995 and 1994, the Company's contributions totaled approximately \$162,000, \$150,000 and \$198,000, respectively.

The Company adopted the U.S. Long Distance Corp. Executive Compensation Deferral Plan ("Executive Plan") and the U.S. Long Distance Corp. Director Compensation Deferral Plan ("Director Plan"), effective January 1, 1994. Participation in the Executive Plan is offered to selected employees occupying management positions who are determined by the Company's board of directors, from time to time, to be eligible to participate in the Executive Plan. Participation in the Director Plan is offered to individuals occupying a position as an outside director. The Executive and Director Plans are defined contribution plans which provide that participants may make voluntary contributions, on a pretax basis, of between 1% and 100% of their eligible compensation. Under the Executive Plan, the Company made matching contributions equal to the lesser of 100% of a participant's contributions or an amount determined by a formula established by the plan. Matching contributions under the Director Plan were 33% of the participant's contributions. The Company has the right to make matching contributions of a different amount or no contributions under both plans. During fiscal 1996, 1995 and 1991, the Company contributed \$114,000, \$87,000 and \$60,000 to the Executive Plan and \$75,000, \$15,000 and \$6,000 to the Director Plan, respectively.

Additionally, the Company adopted the U.S. Long Distance Corp. Executive Qualified Disability Plan ("Disability Plan"), effective January 1, 1994. The Disability Plan provides long-term disability henefits for certain employees occupying management positions through disability insurance coverage purchased by the Company and through Company funded payments. Benefits under the Disability Plan are provided directly by the Company based on definitions contained in the insurance policies.

The U.S. Long Distance Corp. Employee Stock Purchase Plan (the "ESPP"), which was established under the requirements of Section 423 of the Internal Revenue Code of 1986, as amended, became effective July 1, 1995. The ESPP enables employees who have completed at least six months of continuous service with the Company to purchase shares of the Company's common stock at a 15% discount through voluntary payroll deductions.

### Note 12. Restructuring Charges

In the fourth quarter of fiscal 1996, the Company recorded restructuring charges of \$2.8 million. These restructuring charges include costs associated with consolidating customer service, credit and collection and other support functions, vacating certain office facilities, terminating certain marketing contracts, writing down excess assets and providing severance payments.

### Note 13. Related Party Transactions

For purposes of governing certain ongoing relationships between the Company and Billing after the spin-off and to provide for an orderly transition, the Company and Billing have entered into certain agreements. Such agreements include: (i) the Distribution Agreement, providing for, among other things, the spin-off and the division between the Company and Hilling of certain assets and liabilities and material indemnification provisions, (ii) the Benefits Plans and Employment Matters Allocation Agreement, providing for certain allocations of responsibilities with respect to benefit plans, employee compensation, and labor and employment matters. (iii) the Tax Sharing Agreement pursuant to which the Company and Hilling agreed to allocate tax liabilities that relate to periods prior to and after the Distribution Date; (iv) the Transitional Services and Sublease Agreement pursuant to which will provide certain services on a temporary basis and sublease certain office space to Billing and Billing will provide certain services to the Company on a temporary basis. (v) the Zero Plus-Zero Minus Billing and Information Management Services Agreement and the One-Plus Billing and Information Management Services Agreement pursuant to which Hilling will provide billing clearinghouse and information management services to the Company for an initial period of three years; and (vi) the Telecommunications Agreement pursuant to which the Company will provide long distance telecommunications services to Hilling for an initial period of three years; and (vii) the Leasing Agreement. whereby the Company and Billing agree to pay certain usage charges. It is the intention of the Company and Billing that the Transitional Service and Subleaue Agreement, the Zero Plus-Zero Minus Billing and Information Management Services Agreement, the One-Plus Billing And Information Management Services Agreement, the Telecommunications Agreement, and the Leasing Agreement reflect terms and conditions similar to those that would have been arrived at by independent parties bargaining at arm's length, however, there can be no assurances that such agreements are on terms at least as favorable as could have been obtained from unaffiliated third parties

The Company and Billing share a common individual on their boards of directors. Therefore, the companies are considered telated parties for financial disclosure purposes. At September 30, 1996 and 1995, the Company had accounts receivable from Billing of \$1.3 million and \$242,000, as well as notes receivable of \$1.0 million and \$0, respectively. In addition, the Company had accounts payable to Billing of \$1.1 million and \$1.1 million at September 30, 1996 and 1995, as well an intercompany payable of \$0 and \$17.0 million, respectively. Operating revenues from Billing were \$3.6 million, \$1.7 million and \$924,000 for the years ended September 30, 1996, 1995 and 1994, respectively. Operating expenses related to Billing were \$5.3 million, \$5.3 million and \$5.3 million for the years ended September 30, 1996, 1995 and 1994, respectively.

From time to time, the Company has loaned to or was otherwise owed amounts from certain officers and directors of the Company. The highest amount outstanding of advances to officers and directors during fiscal 1996 and 1995 was \$212,000 and \$894,000, respectively. The amount outstanding at September 30, 1996 and 1995 was \$75,000 and \$212,000, respectively.

### Note 14. Commitments and Contingoncies

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations, however, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect or the Company's results of operations for the fiscal period in which such resolution occurred.

The Company is obligated to pay a minimum of approximately \$7.2 million during fiscal 1997 for usage charges under service agreements with certain long distance carriers. The Company anticipates exceeding the minimum usage volumes with these vendors

### Note 15. Regulatory Motters

Billed Party Preference

An issue under consideration by the Federal Communications Commission (the "FCC") currently is termed Billed Parts Preference ("BPP"). This term refers to a concept in which any long distance call outside the local telephone company's calling area carried from a publicly available telephone, would be completed over the long distance carrier network of the billed party's previously expressed preference. This would be accomplished through a local telephone company database system that would match every calling card and telephone number to a preferred long distance company and then direct all calls accordingly. In April 1992, the FCC tentatively proposed adopting BPP. During the number of 1992, comments from local telephone companies, long distance carriers and other industry participants revealed that the cost of imposing BPP could be in excess of \$1.0 billion and could require hundreds of millions of dollars each year to support its operation. The majority of these commentors were in opposition to the implementation of BPP. Commentors made clear that many technical impediments remain to full deployment of BPP. Other commentors claimed that no technology exists that could implement BPP without making call processing significantly less convenient for many operator services calls, particularly those requiring a live operator.

In August 1994, industry members responded to a Commission Further Notice of Proposed Rulemaking. The Commission had tentatively concluded, based upon their calculation of related cost information previously submitted by industry members, that the potential benefits of a BPP system appeared to outweigh its costs, although the Commission admitted the financial data it used in its study could be outdated. Once again, industry participants were resoundingly opposed to the Commission's proposal, including AT&T and most of the Regional Hell Operating Companies (the "RHOCs"). To date, the FCC has taken no further action.

If such a system were implemented successfully, the unique market niche of operator services provider presubscription, such as that of the Company, would be rendered virtually ineffectual, as an owner of publicly available telephones would be unable to direct operator assisted calls over the network of such owner's desired carrier. In any event, local telephone companies have indicated that, if so directed, approximately two to four years would be required to reconfigure their networks to BPP's specifications. Thus, while BPP remains viable, the Company believes that it is not likely to be implemented in the near term.

On March 9, 1995, the FCC requested industry comment on two proposals it had recently received relative to the BIP proceeding. In an ex-parte petition, the National Association of Attorney's General ("NAAG") suggested that the FCC modify its current branding requirement such that operator service providers ("OSPs") would be required to announce at the beginning of each call more specific information for obtaining access to alternate carriers (the "NAAG Petition"). Another petition filed by a coalition of industry members, including most of the RBOCs, two competitive access providers, the American Public Communications Counsel ("APCC") and the Competitive Telecommunications Association ("CompTel"), recommended that the FCC impose certain rate thresholds for interstate operator assisted services, which the FCC would presume to be reasonable, and any OSP electing to charge rates higher than such threshold would be required to first prove to the FCC that such rates are justified based upon the underlying costs of the service (the "APCC Rate Cap Proposal"). The NAAG Petition was proposed to remain in effect until such time that BIP is adopted and fully implemented. The APCC Rate Cap Proposal was proposed to obviate the need to consider any further action regarding BIPP.

Subsequently, in June 1996, the FCC issued a Second Further Notice of Proposed Rulemaking (SFNPRM) in this proceeding. In it, the FCC proposed adopting a rule which would require operator service providers to announce the rates for certain calls to the billed party prior to connecting the call, thereby allowing the billed party to disconnect such call without incurring any nowanted charges. In September, the FCC released its Second Request for Comment in the SFNPRM soliciting technical and other administrative details to support the proposed announcement requirement. Most commentors objected to the discriminatory nature of the proposal, which would have some carriers announcing rates while others would not. If any of these proposals are adopted by the FCC, the Company's operator service traffic could be negatively affected.

MFJ Legislation

On February 8, 1996, President Clinton signed the Telecommunications Act of 1996 into law. The new law allows the RBOCs to petition their respective "in-region" state regulatory agencies to seek authority from FCC to allow the applicant RBOC to provide long distance services. To obtain this authority, each state agency is required to certify to the FCC that the applicant RBOC has satisfied a legislative "checklist" that outlines the steps required for an RBOC to open its network to competition on a local basis. These steps include the provision of competitive network interconnection, unbundled access to network elements and other necessary access to poles, ducts, conduits and rights-of-way. Furthermore, applicant RBOCs must provide non-discriminatory access to white pages listings and telephone number assignments. Applicant RBOCs must provide local number portability, toll dialing parity and local service resule. The FCC is required to consult with the Department of Justice ("DOJ") to assist in determining if an applicant RBOC's entry into the long distance business violates any anti-trust standards the DOJ considers appropriate. Ninety days after receiving such an application, the FCC is required to render its decision. RBOC's are required to establish separate subsidiaries

through which they could first offer in-region long distance services. RHOCs may provide out-of-region long distance services subject to existing lows and regulations governing long distance communications.

To date, no RBOC has requested authority for in-region interLATA authority, because the provisions set forth above have not been satisfied by any RBOC. However, many entities have reached interconnection agreements with RBOCs to date, including the Company, and many states have adopted rules governing local competition. It is reasonable to expect that the conditions for RBOC entry will be met in the near future, and carriers in the interLATA long distance business today, such as the Company, will encounter new, formidable competition.

### Texas PHI Issue

In a Final Order seleated in Docket 10127 on April 12, 1993, the Texas Public Utility Commission ("PUC") adopted new regulations governing the method by which intereschange carriers ("IXCs") such as the Company calculate intrastate access charges poid to local telephone companies. These new rules required an independent auditor's review and approval of an IXC's methodology of determining its own intrastate access usage. An independent audit by an accounting firm verified that the Company's process of calculating PBU is reasonable and statistically valid and, as such, no additional PIU or billing adjustments are required.

### Regulatory Rate Proceedings

During the course of normal operations, a regulated company may at any time come under specific scrutiny with regard to any of its rates, terms or conditions by which such service is rendered by the state or federal regulatory agency charged with such oversight responsibility, or by an attorney general or other jurisdictional consumer officials. In such cases, a regulated company can be required to, among other things, provide cost justification for the charges it imposes on some or all of its services, or to address perceived communer inequities. After review of such justification, the regulatory agency generally has the authority to require a carrier to modify the process by which such services are rendered or to effect changes to its applicable rate structure. Company operates in several jurisdictions in which its tariffs or services may, from time to time, fall under such scrutiny at the discretion of the governing regulatory agency or other officials. The Company could therefore be required, as a result of such an investigation and subsequent proceeding, to implement changes in its rate structure, which could ultimately affect its revenues. The Company cannot predict whether or not any such requirement may be imposed in any particular jurisdiction.

Note 16. Selected Quarterly Pinancial Bata (Unaudited)

In thousands, except per share amounts		There Man		
	Becomber 31,	Morch 31,	June 30,	September 30,
	1995	1996	1996	1226
Operating revenues	\$39,708	\$43,655	\$46,684	\$50,299
Lass from operations	(831)	(1,088)	(6,284)	(8,273)
Net loss from continuing operations	(846)	(1,080)	(4,016)	(7,812)
Income from discontinued operations, set	3,948	5,021	4,317	1,875
Net income (loss)	3,102	3,941	301	(5,937)
Net income (loss) per common share:				
Continuing operations	\$(0.06)	\$(0.08)	\$(0.25)	\$(0.50)
Discontinued operations	0.27	0.33	0.27	011
Net income (loss) per common share	0.21	0.25	0.02	(0.39)
		Three Mani	le Ended	
	December 31.	March 31.	June 30.	Soutember 30.
	1994	1995	1995	1995
Operating revenues	\$32,908	\$32,971	\$36,651	\$41,520
Income (loss) from operations	(641)	(700)	(974)	715
Net income (loss) from continuing operations	(641)	(663)	(867)	88
Income from discontinued operations, not	2.911	3,102	3,921	4.184
Nel acuse	2,270	2,439	3,054	4,272
Net income (loss) per common share:				
Continuing operations	\$(0.04)	\$(0.05)	5(0.06)	\$0.01
Discontinued operations	0.20	0.22	0.27	0.28
Net income per common share	0.16	0.17	0.21	0.29

TTEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

### PART M

### STEM IN. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

The information required by this item is incorporated herein by reference from the information under the captions "Election of Directors" (Item 1 on proxy), "Management - Directors and Executive Officers," and "Section 16(a) Reporting" of the Company's definitive proxy statement to be filed pursuant to Regulation 14A with the Securities and Exchange Commission relating to its Annual Meeting of Stockholders to be held on February 25, 1997 (the "Definitive Proxy Statement").

### REEM NO. EXECUTIVE COMPENSATIONS

The information required by this item is incorporated herein by reference from the information under the caption "Management Committees, Meetings and Compensation of the Board of Directors' Fees" and from the information under the caption "Executive Compensation" of the Company's Definitive Prixy Statement.

### TYPM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is incorporated herein by reference from the information under the caption "Voting Securities and Principal Stockholders" of the Company's Definitive Proxy Statement.

### STEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated herein by reference from the information under the caption "Certain Transactions" of the Company's Definitive Proxy Statement

### PART IS

### TTEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES. AND REPORTS ON FORM 8-8.

### (a) Documents Filed as Part of Report

### 1. Financial Statements:

The consolidated financial statements of the Company and the related report of the Company's independent public accountants thereon have been filled under Item 8 hereof.

### 2. Financial Statement Schedules:

The following financial statement schedule and the report of independent public accountants thereon are architect in this report at the page indicated. All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted because such schedules are not required under the related instructions or are inapplicable or because the information required is included in the Connolidated Financial Statements or notes thereto.

	Pas
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### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Hoard of Directors and Stockholders of U.S. Long Distance Corp.:

We have audited, in accordance with generally accepted auditing standards, the consolidated financial statements of U.S. Long Distance Corp. and subsidiaries and have issued our report thereon dated November 14, 1996. Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedule II is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

San Antonio, Texas November 14, 1996

### U.S. LAING MOSTANCE COMP. AND SUBSIDIARIES Valuation and Qualifying Accussis (in thousands)

Floral		Balance of Sugarating of	Charged to Custo and	Charged to Other	Write-offs Charged to Allesantes	Makener at
Year 1994	Allowance for desirable accounts	Englad \$2,861	\$5,095	\$0 \$0	\$(5,658) \$(6,591)	\$2,298 \$1,938
1995	Alternates for doubtful accounts	\$2,298 \$1,938	\$6,231 \$8,388	\$0	\$(7,807)	\$2,519

### 3. Enhibits:

The exhibits listed below are filed as part of or incorporated by reference in this report. Where such filing is made by incorporation by reference to a previously filed document, such document is identified in parentheses. See the Index of Exhibits included with the exhibits filed as part of this report.

Exhibit Number	Description
3.1	Restated Certificate of Incorporation (Filed herewith)
3.2	Bylaws, as amended (Filed herewith)
4.1	Form of Certificate Evidencing Common Stock (Filed herewith)
42	Amended Letter Agreement dated October 6, 1992, by and between Communications Central, Inc., U.S. Long Distance Corp. and U.S. Long Distance, Inc. (Exhibit 4.7 to Amendment No. 1 to Registration Statement on Form S-3, SEC File No. 33-71228, dated November 23, 1993) as amended by Letter Agreement dated January 11, 1995 (Exhibit 4.7 to September 30, 1995, Form 10-K) and as amended by Letter Agreement dated August 21, 1996 (Filed Increwith)
43	Agreement dated March 23, 1993 by and between Paytel Northwest, Inc., U.S. Long Distance Corp. and U.S. Long Distance, Inc., as amended by Agreement dated August 23, 1995 (Exhibit 4.8 to September 30, 1995, Form 10-K) and as amended by Addendum No. 3 to Telecommunications Services Agreement dated February 22, 1996 (Filed herewith)
4.4	Rights Agreement by and between the Company and U.S. Trust Company of Texas, N.A. dated April 12, 1996. (Exhibit 4.1 to Form 8-K filed April 17, 1996)
10.1	Amended and Restated Employment Agreement dated November 1, 1993, by and between the Company and Parris 11. Holmes, Jr. (Exhibit 10.2 to September 30, 1993, Form 10-K) as amended by the First Amendment to Amended and Restated Employment Agreement dated January 3, 1995 and Second Amendment to Amended and Restated Employment Agreement, dated November 15, 1995 (Exhibit 10.2 to September 30, 1995, Form 10-K) and Agreement Regarding Vesting and Adjustment of Stock Options, dated June 25, 1996, by and between the Company, Billing Information Concepts Corp. and Parris H. Holmes, Jr. (Filed herewith)
10.2	Amended and Restated Employment Agreement, dated November 1, 1993, by and between the Company and Larry M. James as amended by First Amendment to Amended and Restated Employment Agreement dated January 3, 1995 and Second Amendment to Amended and Restated Employment dated November 15, 1995, and Agreement Regarding Vesting and Adjustment of Stock Options, dated June 25, 1996, by and between the Company. Billing Information Concepts Corp. and Larry M. James (Filed herewith)
10.3	Amended and Restated Employment Agreement, dated June 25, 1996, by and between the Company and W. Audie Long and Agreement Regarding Vesting and Adjustment of Stock Options, dated June 25, 1996, by and between the Company, Billing Information Concepts Corp. and W. Audie Long (Filed herewith)
10.4	Form of Employment Agreement by and between the Company and its Vice Presidents (Exhibit 10.4 to September 30, 1993, Form 10-K)
10.5	1990 Employee Stock Option Plan, as amended (Filed herewith)
10.6	Form of Option Agreement by and between the Company and its Employees, Under the Employee Stock Option Plan (Exhibit 10.8 to September 30, 1992, Form 10-K)
10.7	Form of Stock Option Agreement for Directors, Key Employees and Advisors of U.S. Long Distance Corp. (Exhibit 4.14 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)
10.6	Form of Stock Option Agreement for Key Employees of U.S. Long Distance Corp. (Exhibit 4.15 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991)

- Amended and Restated Loan and Security Agreement dated May 22, 1991, by and between Zero Plus Dialing. Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp. and U.S. Long Distance, Inc. and Hell Atlantic TriCon Leasing Corporation ("Bell Atlantic") (currently FINOVA Capital Corporation) (Exhibit 10.10 to September 30, 1991, Form 10-K) and related Revolving Credit Note dated May 24, 1991, Term Note dated June 1992, Corporate Guaranties dated May 24, 1991, and First Amendment and Joinder to Amended and Restated Loan and Security Agreement dated December 17, 1992 (Exhibit 10.9 to September 30, 1992, Form 10-K)
- 10.10 Second Amendment to Amended and Restated Loan and Security Agreement dated April 2, 1993 by and between Zero Plus Dialing, Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.11 to September 30, 1993, Form 10-K)
- 10.11 Third Amendment to Amended and Restated Loan and Security Agreement dated October 1, 1993 by and between Zero Plus Dialing, Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Hell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.12 to September 30, 1993, Form 10-K)
- Fourth Amendment to Amended and Restated Loan and Security Agreement dated October 1, 1993 by and between Zero Plus Dialing. Inc. (currently Hilling Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Hell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.13 to September 30, 1993, Form 10-K)
- 10.13 Fifth Amendment to Amended and Restated Loan and Security Agreement dated November 16, 1993 by and between Zero Plus Dialing, Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp. d/b/a Telecom West, Inc., STS Telecommunications, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.14 to September 30, 1993, Form 10-K)
- 10.14 Sixth Amendment to Amended and Restated Loan and Security Agreement dated December 7, 1993 by and between Zero Plus Dialing, Inc. (currently Hilling Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp., STS Telecommunications, Inc. and Hell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.36 to September 30, 1994, Form 10-K)
- 10.15 Seventh Amendment to Amended and Restated Loan and Security Agreement dated March 17, 1994 by and between Zero Plus Dialing, Inc. (currently Billing Information Concepts, Inc.), U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp., California Acquisition Corp., Telecom Acquisition Corp., STS Telecommunications, Inc., Enhanced Services Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Enhibit 10.37 to September 30, 1994, Form 10-K)
- 10.16 Letter Agreement dated December 2, 1993 by and between Hell Atlantic (currently FINOVA Capital Corporation) and U.S. Long Distance Corp. (Exhibit 10.15 to September 30, 1993, Form 10-K)
- 10.17 Office Lease Agreement dated September 29, 1988, by and between U.S. Long Distance, Inc. and Nowlin Building Partnership, Ltd., as amended (Exhibit 10.10 to September 30, 1992, Form 10-K)
- 10.18 Agreement of Lease dated September 1, 1992, by and between U.S. Long Distance, Inc. and Multi-Employer Property Trust (Exhibit 10.13 to September 30, 1992, Form 10-K)
- 10.19 Loan and Security Agreement dated July 25, 1991, by and between Buyer Acquisition Corporation (NTX) and Hell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.13 to September 30, 1991, Form 10-K) and related Revolving Credit Note, Term Note, Subordination Agreement and Corporation Guaranties dated July 25, 1991 (Exhibit 10.14 to September 30, 1992, Form 10-K)
- 10.20 Loan and Security Agreement Nos. 2882, 2883, 2884 and 2885 by and between U.S. Long Distance Corp. and Charter Financial, Inc. dated August 29, 1996 (Filed herewith)
- 10.21 WCMA and Term WCMA Laun and Security Agreement No. 9608340801 by and between U.S. Long Distance, Inc. and Merrill Lynch Business Financial Services Inc. ("Merrill Lynch"), dated as of August 23, 1996, as amended by latter agreement dated November 5, 1996, and Term WCMA Note, dated August 23, 1996, made by U.S. Long Distance, Inc. and poyable to Merrill Lynch (Filed herewith)

23.1	21.	=	<b>6</b> 27	Ş	10.35	Ē	5	10.12	2	<u>5</u> 00	2	5	10.27	10.26	10.73	10.24	10.23	Ē
Consent of Arthur Anderson LLP (Filed herewith)	Substituties of the Company (Filed Incomits)	Statement regarding computation of per share earnings (Filed herewith)	Telecommunications Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp. (Exhibit 10.6 to Form B-K filed August 2, 1996)	Zero Plan-Zero Minus Billing and Information Management Services Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp. (Exhibit 10.5 to Form E-K filed August 2, 1996)	Transitional Services and Sublease Agreement dated as of July 10, 1996 between the Company and Hilling Information Concepts Corp. (Exhibit 10.4 to Form 8-K filed August 2, 1996)	Tax Sharing Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp. (Exhibit 10.3 to Form 8-K filed August 2, 1996)	Benefit Plans and Employment Matters Allocation Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Cosp. (Exhibit 10.2 to Form 8-K filed August 2, 1996)	Distribution Agreement dated as of July 10, 1996 between the Company and Billing Information Concepts Corp. (Exhibit 10.1 to Form 8-K filed August 2, 1996)	Merrill Lynch Special Prototype Defined Contribution Plan and Adoption Agreement for Merrill Lynch Special Prototype Defined Contribution Plan (401(k) Plan) (Filed herewith)	U.S. Long Distance Corp. Restricted Stock Plan (Exhibit 10.45 to September 30, 1995, Form 10-K)	U.S. Long Distance Corp. Employee Stock Purchase Plan (Exhibit 10.44 to September 30, 1995, Form 10-K)	U.S. Long Distance Corp. Director Compensation Deferral Plan, Restated Effective December 19, 1995 (Filed honoroids)	U.S. Long Distance Cosp. Executive Compensation Defental Plan, Restated Effective December 12, 1995 (Filed horswith)	U.S. Long Distance Corp. Executive Qualified Disability Plan (Exhibit 10.42 to September 30, 1994, Form 10-K)	Form of Directly Fee Option Agreement by and between the Company and Non-Employee Directors (Filed barrowith)	Form of Director Option Agreement by and between the Company and Non-Employee Directors (Filed herewith)	1993 Nam-Employee Director Plan of U.S. Long Distance Corp. (Filed herewith)	Operator Services Agreement by and between the Company and G-Five Corp., dated September 16, 1903 (Exhibit 10.33 to September 30, 1993, Form 10-K), as amended by Amendment to Operator Services Agreement dated August 31, 1995 (Filed Instruction)

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Financial Data Schedule (Filed herewith)

3

Acquests on Form A-K

Company filled a Report on Form B-K on August 2, 1996, relating to the Distribution of Billing Information capts Corp.

### **SECNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

U.S. LONG DISTANCE CORP.

Hy: Js/LARRY M. JAMES
Larry M. Junes
President and
Chief Executive Officer

Date: December 19, 1996

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 19th day of December, 1996.

/s/ PARRIS H. HOLDIES, IR. Paris H. Holmes, Jr.	Table Chairman of the Board
// LARRY M. JAMES Larry M. James	President and Chief Executive Officer (Principal Executive Officer)
/s/ PHILLIP J. STORIN Phillip J. Storin	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)
// CHARLES E. AMATO Charles E. Amato	Director
M GARY D. BECKER Gary D. Becker	Director

### CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports included in this Form 10-K, into the Company's previously-filed Registration Statements (SEC File No. 33-41039, 33-46567, 33-51604, 33-77404, 33-77612, 33-81686, 33-91260, 33-93942 and 333-09723).

ARTHUR ANDERSEN LLP

San Antonio, Texas December 16, 1996

Office Lease Agreement dated September 29, 1988, by and between U.S. Long Distance, Inc. and 10.17 Nowlin Building Partnership, Ltd., as amended (Exhibit 10.10 to September 30, 1992, Form 10-K) Agreement of Lease dated April 26, 1991, by and between Zero Plus Dialing, Inc. and HBH 10.18 Properties, as amended (Exhibit 10.11 to September 30, 1992, Form 10-K) Agreement of Lease dated October 20, 1992, by and between Zero Plus Dialing, Inc. and 10.19 Northpoint Atrium Building, Ltd. (Exhibit 10.12 to September 30, 1992, Form 10-K) Agreement of Lease dated September 1, 1992, by and between U.S. Long Distance, Inc. and 10.20 Multi-Employer Property Trust (Exhibit 10.13 to September 30, 1992, Form 10-K) Loan and Security Agreement dated July 25, 1991, by and between Buyer Acquisition Corporation 10.21 (NTX) and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.13 to September 30, 1991, Form 10-K) and related Revolving Credit Note, Term Note, Subordination Agreement and Corporate Guaranties dated July 25, 1991 (Exhibit 10.14 to September 30, 1992, Form 10-K) Adoption Agreement for Professional and Businessmen's Association, Inc., Non-Standardized 10.22 401(k) Profit Sharing Plan and Trust (Exhibit 4.11 to Registration Statement on Form S-8, SEC File No. 33-46567, dated March 19, 1992) Professional and Businessmen's Association, Inc., Regional prototype Defined Contribution Plan 10.23 and Trust (Exhibit 4.12 to Registration Statement on Form S-8, SEC File No. 33-46567, dated March 19, 1992) Loan Agreement, Promissory Note, Security Agreement and Guaranty dated August 8, 1991, by 10.24 and between National Telephone Exchange, Inc. and First City, Texas - San Antonio, N.A., as amended, and Loan Assumption and Consent Agreement dated September 30, 1992, by and between U.S. Long Distance, Inc., U.S. Long Distance Corp., National Telephone Exchange, Inc. and First City, Texas - San Antonio, N.A. (Exhibit 10.17 to September 30, 1992, Form 10-K) Promissory Note, Security Agreement, as amended, and Corporate Guaranty dated October 30, 10.28 1990, by and between U.S. Long Distance Corp., U.S. Long Distance, Inc. and Ellco Leasing Corporation (Exhibit 10.21 to September 30, 1992, Form 10-K) Loan Agreement, as amended, Promissory Note, and Security Agreement dated March 27, 1992. 10.29 by and between National Telephone Exchange, Inc. and First City, Texas - San Antonio, N.A. and Loan Assumption and Consent Agreement dated September 30, 1992, by and between U.S. Long Distance, Inc., U.S. Long Distance Corp., National Telephone Exchange, Inc. and First City. Texas - San Antonio, N.A. (Exhibit 10:22 to September 30, 1992, Form 10-K) Purchase Money Security Agreements dated September 17, 1992, and October 27, 1992, by and 10.30 between U.S. Long Distance Corp. and Charter Financial, Inc. (Exhibit 10.23 to September 30, 1992, Form 10-K) Agreement and Plan of Merger by and between U.S. Long Distance Corp. and USLD Acquisition 10.31 Corp. and Telecom West, Inc. and Ed Lassman, John Kalita and Larry Ostlie, dated September 30, 1993 (Exhibit 10.31 to September 30, 1993, Form 10-K) Stock Purchase Agreement by and between U.S. Long Distance Corp., STS Telecommunications, 10.32 Inc. and J. T. Poorman, Lou Poorman, Brad Poorman, Tony Poorman and NTS Communications, Inc., dated November 2, 1993 (Exhibit 10.32 to September 30, 1993, Form 10-K) Operator Services Agreement by and between the Company and G-Five Corp., dated 10.33 September 16, 1993 (Exhibit 10.33 to September 30, 1993, Form 10-K). 1993 Stock Option Plan for Non-Employee Directors (Exhibit 10:34 to September 30, 1993, Form 10.34 10-K) Form of Director Option Agreement by and between the Company and Non-Employee Directors. 10.35 subject to stockholder approval (Exhibit 10.35 to September 30, 1993, Form 10-K) Sixth Amendment to Amended and Restated Loan and Security Agreement dated December 7. 10.36 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance, Inc., U.S. Long Distance Corp., U.S. Billing, Inc., USLD Acquisition Corp., STS Telecommunications, Inc. and Bell Atlantic

(currently FINOVA Capital Corporation) (Exhibit 10.36 to September 30, 1994, Form 10-K)

## ITEM I. BUNINESS

management services company. From fiscal 1990 through fiscal 1995, the Company's revenues increased at a compounded amusic rate of 63%, totaling \$225.0 million for fiscal 1995. The Company has three primary areas of business: direct dial long distance telecommunications services, primarily serving small and medium-sized commercial customers; operator services for the hospitality and private pay telephone industries; and billing clearinghouse and information management services for other direct dial long distance and operator services companies. U.S. Long Distance Corp. (the "Company") is a fully-integrated long distance telecommunications and information

Corporation ("Sprint"), together dominate the estimated \$73 billion long distance telecommunications industry, management believes that a growing share of the market is serviced by smaller long distance companies such as the Company Industry The long distance telephone industry has changed significantly since the mandated divestiture by American Telephone and Telegraph Co. ("AT&T") of its 22 local telephone companies in 1984. Regulations mandating equal access to the existing telecommunications network led to the creation of hundreds of new long distance companies. Competition now pervades across all categories of long distance telephone services, including both domestic and international direct dial long other approximate 10% is serviced by lower-tier companies such as the Company. distance telephone services, operator assisted and calling card services, and 800 and specialized in-bound long distance telephone services. While AT&T, and to a lesser extent MCI Telecommunications Corporation ("MCI") and Sprint sources estimate that approximately 90% of the long distance market is shared among AT&T, MCI and Sprint, while the

recently among the first such companies to be certified to offer local service in Texas under such a new law and is currently telecommunications providers such as the Company to provide local telephone services in certain areas. The Company was exploring the business appartunities created by this certification The local telephone industry is also undergoing change with new regulations approved recently that allow

## **Direct Dial Long Dietamo Services**

carrier services and other customer-specific products. provides inbound 800 service, travel and debit card services, private line services, data transmission services, wholesale The Company, through its long distance telecommunications subsidiary, U.S. Long Distance, Inc., is a full-service long distance carrier currently providing direct dial long distance services to small and medium-sized commercial customers and, to a lesser extent, residential customers. U.S. Long Distance, Inc. was authorized to provide direct dial long distance services to customers in 46 states as of September 30, 1995, but focuses its direct sales efforts on the West Coast, Southwest and Pacific Northwest to take advantage of network efficiencies. In addition to its basic "one-plus" service, the Company

September 30, 1995, the Company serviced approximately 37,500 commercial and residential customers. The Company carried an average of 62.6 million minutes per month of long distance traffic during the fiscal quarter ended September 30. 1995, as compared to 44.7 million and 17.2 million during the fiscal quarters ended September 30, 1994 and 1993, respectively. In fiscal 1993, 1994 and 1995, the Company had \$28.6 million, \$61.4 million and \$81.5 million, respectively, in direct dial long distance revenues, comprising 21%, 34% and 36% of total operating revenues in each period, respectively. The Company began offering direct dial long distance services following its entry into the direct dial long distance business in July 1991 through the acquisition of three related direct dial long distance companies in Texas. As of

### Industry Overview

market. These companies typically concentrate on smaller regional and local business customers. Management estimates that the Company's share of direct dial long distance revenues makes it one of the ten largest public long distance Direct dial long distance revenues industrywide are estimated to have been approximately \$73 billion in 1994, up from approximately \$66 billion in 1993. AT&T and, to a lesser extent, NCT and Sprint, dominate the long distance industry multi-state business customers and millions of residential long distance users through national television and media advertising. The Company believes that over 500 smaller long distance companies account for the remaining 10% of the and control a combined market share of approximately 90%. These large national companies offer comprehensive sications services in a wider array of products than other long distance companies and typically target national.

Office Lease Agreement dated September 29, 1988, by and between U.S. Long Distance, Inc. and 10.17 Nowlin Building Partnership, Ltd., as amended (Exhibit 10.10 to September 30, 1992, Form 10-K) Agreement of Lease dated April 26, 1991, by and between Zero Plus Dialing, Inc. and HBH 10.18 Properties, as amended (Exhibit 10.11 to September 30, 1992, Form 10-K) Agreement of Lease dated October 20, 1992, by and between Zero Plus Dialing, Inc. and 10.19 Northpoint Atrium Building, Ltd. (Exhibit 10.12 to September 30, 1992, Form 10-K) Agreement of Lease dated September 1, 1992, by and between U.S. Long Distance, Inc. and 10.20 Multi-Employer Property Trust (Exhibit 10.13 to September 30, 1992, Form 10-K) Loan and Security Agreement dated July 25, 1991, by and between Buyer Acquisition Corporation 10.21 (NTX) and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.13 to September 30, 1991, Form 10-K) and related Revolving Credit Note, Term Note, Subordination Agreement and Corporate Guaranties dated July 25, 1991 (Exhibit 10.14 to September 30, 1992, Form 10-K) Adoption Agreement for Professional and Businessmen's Association, Inc., Non-Standardized 10.22 401(k) Profit Sharing Plan and Trust (Exhibit 4.11 to Registration Statement on Form S-8, SEC File No. 33-46567, dated March 19, 1992) Professional and Businessmen's Association. Inc., Regional prototype Defined Contribution Plan 10.23 and Trust (Exhibit 4.12 to Registration Statement on Form S-8, SEC File No. 33-46567, dated March 19, 1992) Loan Agreement, Promissory Note, Security Agreement and Guaranty dated August 8, 1991, by 10.24 and between National Telephone Exchange, Inc. and First City, Texas - San Antonio, N.A., as amended, and Loan Assumption and Consent Agreement dated September 30, 1992, by and between U.S. Long Distance, Inc., U.S. Long Distance Corp., National Telephone Exchange, Inc. and First City, Texas - San Antonio, N.A. (Exhibit 10.17 to September 30, 1992, Form 10-K) Promissory Note, Security Agreement, as amended, and Corporate Guaranty dated October 30, 10.28 1990, by and between U.S. Long Distance Corp., U.S. Long Distance, Inc. and Elico Leasing Corporation (Exhibit 10.21 to September 30, 1992, Form 10-K) Loan Agreement, as amended, Promissory Note, and Security Agreement dated March 27, 1992, 10.29 by and between National Telephone Exchange, Inc. and First City, Texas - San Antonio, N.A. and Loan Assumption and Consent Agreement dated September 30, 1992, by and between U.S. Long Distance, Inc., U.S. Long Distance Corp., National Telephone Exchange, Inc. and First City, Texas - San Antonio, N.A. (Exhibit 10.22 to September 30, 1992, Form 10-K) Purchase Money Security Agreements dated September 17, 1992, and October 27, 1992, by and 10.30 between U.S. Long Distance Corp. and Charter Financial, Inc. (Exhibit 10.23 to September 30, 1992, Form 10-K) Agreement and Plan of Merger by and between U.S. Long Distance Corp. and USLD Acquisition 10.31 Corp. and Telecom West, Inc. and Ed Lassman, John Kalita and Larry Ostlie, dated September 30, 1993 (Exhibit 10.31 to September 30, 1993, Form 10-K) Stock Purchase Agreement by and between U.S. Long Distance Corp., STS Telecommunications, 10.32 Inc. and J. T. Poorman, Lou Poorman, Brad Poorman, Tony Poorman and NTS Communications, Inc., dated November 2, 1993 (Exhibit 10.32 to September 30, 1993, Form 10-K) Operator Services Agreement by and between the Company and G-Five Corp., dated 10.33 September 16, 1993 (Exhibit 10.33 to September 30, 1993, Form 10-K) 1993 Stock Option Plan for Non-Employee Directors (Exhibit 10:34 to September 30, 1993, Form 10.34 10-K) Form of Director Option Agreement by and between the Company and Non-Employee Directors, 10.35 subject to stockholder approval (Exhibit 10.35 to September 30, 1993, Form 10-K) Sixth Amendment to Amended and Restated Loan and Security Agreement dated December 7. 10.36 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance, Inc., U.S. Long Distance Corp., U.S. Billing, Inc., USLD Acquisition Corp., STS Telecommunications, Inc. and Bell Atlantic

(currently FINOVA Capital Corporation) (Exhibit 10.36 to September 30, 1994, Form 10-K)

Ξ.	10.45	10.43	10.60		•	1039		1037 .
Statement regarding computation of per share carnings (Filed herewith)	U.S. Long Distance Corp. Restricted Stock Plan (Filed herewith)  U.S. Long Distance Corp. Restricted Stock Plan (Filed herewith)	U.S. Long Distance Corp. Director Compensation Deferral Plan (Exhibit 10.43 to September 30, 1994, Form 10-K), as amended (Filed herewith)	1994, Form 10-K), as amended (Fried herewith)  U.S. Long Distance Corp. Executive Qualified Disability Plan (Exhibit 10.42 to September 30, 1994, Form 10-K)	October 1, 1994 (Exhibit 10.40 to September 30, 1994, Form 10-K)  U.S. Long Distance Corp. Executive Compensation Deferral Plan (Exhibit 10.41 to September 30,	Corp., Donyda, Inc., d/b/a Call America of Palm Desert and Call America of San Diego, and Donald C. Chen, Nancy C. Chem and David M. Chem, dated March 14, 1994 and effective March 15, 1994 (Exhibit 10.39 to September 30, 1994, Form 10-K)  Agreement and Plan of Merger by and between U.S. Long Distance Corp., U.S. Long Distance,	Corp., Inland Call America, Inc. and the individual slockholders of Inland Call America, Inc., dated March 1, 1994 (Exhibit 10.38 to September 30, 1994, Form 10-K)  Agreement and Plan of Merger by and between U.S. Long Distance Corp., California Acquisition	1994 by and between Zero Plus Dialing, Inc., U.S. Long Distance, Inc., U.S. Long Distance Corp., U.S. Billing, Inc., USLD Acquisition Corp., California Acquisition Corp., Telecom Acquisition Corp., STS Telecommunications, Inc., Enhanced Services Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.37 to September 30, 1994, Form 10-K) Agreement and Plan of Marger by and between U.S. Long Distance Corp., Telecom Acquisition	Seventh Amendment to Amended and Restated Loan and Security Agreement dated March 17.

## (b) Reports on Form 8-K

None

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 38549

### FORM IPK

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE For the Fiscal Year Ended September 30, 1995 SECURITIES EXCHANGE ACT OF 1934

8

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE For the Transition Period from SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 0-18195

# U.S. LONG DISTANCE CORP.

(Exact Name of Registrant as Specified in its Charter)

Delamare (State of Incorporation)

74-2522163 (I.R.S. Employer Identification No.)

72216 (Zip Code)

9311 San Pedra, Suite 388, San Antonia, Texas (Address of Principal Executive Office)

(210) 525-9009

(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:
Common Stock, Par Value \$8.01 Per Share
(Title of Class)

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

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.

as of December 15, 1995. as of December 15, 1995 was \$197,686,678. There were 14,124,599 shares of the Registrant's Common Stock outstanding The aggregate market value of the Registrant's outstanding Common Stock held by non-affiliates of the Registrant

# DOCUMENTS INCOMPORATED BY REFERENCE.

29, 1996, are incorporated by reference in Part III hereof. Portions of the Registrant's Definitive Proxy Statement for the 1996 Annual Meeting of Stockholders to be held on February

### U.S. LONG DISTANCE CORP.

### Annual Report on Form 10-K

### For The Fiscal Year Ended September 30, 1995

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## ITEM I. BUSINESS

services for other direct dial long distance and operator services companies services for the hospitality and private pay telephone industries; and billing clearinghouse and information management management services company. From fiscal 1990 through fiscal 1995, the Company's revenues increased at a compounded annual rate of 63%, totaling \$225.0 million for fiscal 1995. The Company has three primary areas of business direct diallong distance telecommunications services, primarily serving small and medium-sized commercial customers, operator U.S. Long Distance Corp. (the "Company") is a fully-integrated long distance telecommunications and information

Corporation ("Sprint"), together dominate the estimated \$73 billion long distance telecommunications industry, management believes that a growing share of the market is serviced by smaller long distance companies such as the Company Industry sources estimate that approximately 90% of the long distance market is shared among AT&T, MCI and Sprint, while the other approximate 10% is serviced by lower-tier companies such as the Company. distance telephone services, operator assisted and calling card services, and 800 and specialized in-bound long distance telephone services. While AT&T, and to a lesser extent MCI Telecommunications Corporation ("MCI") and Sprint pervades across all categories of long distance telephone services, including both domestic and international direct dial long the causing telecome Telephone and Telegraph Co. ("AT&T") of its 22 local telephone companies in 1984. Regulations mandating equal access to The long distance telephone industry has changed significantly since the mandated divestiture by American numications network led to the creation of hundreds of new long distance companies. Competition now

exploring the business appurtunities created by this certification. recently among the first such companies to be certified to offer local service in Texas under such a new law and is currently telecommunications providers such as the Company to provide local telephone services in certain areas. The Company was The local telephone industry is also undergoing change with new regulations approved recently that allow

# Direct Diel Lang Distance Services

and Pacific Northwest to take advantage of network efficiencies. In addition to its basic "one-plus" service, the Company provides inbound 200 service, travel and debit card services, private line services, data transmission services, wholesale carrier services and other customer-specific products. long distance carrier currently providing direct dial long distance services to small and medium-sized commercial customers and, to a lesser extent, residential customers. U.S. Long Distance, Inc. was authorized to provide direct dial long distance services to customers in 46 states as of September 30, 1995, but focuses its direct sales efforts on the West Coast. Southwest The Company, shrough its long distance telecommunications subsidiary, U.S. Long Distance, Inc., is a full-service

September 30, 1995, the Company serviced approximately 37,500 commercial and residential customers. The Company carried an average of 62.6 million minutes per month of long distance traffic during the fiscal quarter ended September 30, 1995, as compared to 44.7 million and 17.2 million during the fiscal quarters ended September 30, 1994 and 1993, respectively. In fiscal 1993, 1994 and 1995, the Company had \$28.6 million, \$61.4 million and \$81.5 million, respectively, in direct dial long distance revenues, comprising 21%, 34% and 36% of total operating revenues in each period, respectively. The Company began offering direct dial long distance services following its entry into the direct dial long distance business in July 1991 through the acquisition of three related direct dial long distance companies in Texas. As of

### Industry Overview

advertising. The Company believes that over 500 smaller long distance companies account for the remaining 10% of the market. These companies typically concentrate on smaller regional and local business customers. Management estimates that the Company's share of direct dial long distance revenues makes it one of the ten largest public long distance Direct dial long distance revenues industrywide are estimated to have been approximately \$73 billion in 1994, up from approximately \$66 billion in 1993. AT&T and, to a lesser extent, NCI and Sprint, dominate the long distance industry nelecommunications services in a wider array of products than other long distance companies and typically target national, multi-state business customers and millions of residential long distance users through national television and media and control a combined market share of approximately 90%. These large national companies offer comprehensive

Company has developed the expertise in information systems necessary to meet the needs of its direct dial long distance customers. For instance, the Company provides an invoice indicating call detail in a form that assists customers in controlling and monitoring telecommunications costs for various projects or departments. carriers based outside of the target region. Management believes that, through its experience in billing services, the

circuitry to maximize communications quality. The Company believes that its use of a digital fiber-optic network is particularly advantageous in marketing its data transmission services The Company employs digital switching equipment utilizing a network comprised largely of high quality fiber-optic

Strategy and Granth Opportunities

to residential customers. Due to the difficulty of billing residential accounts cost effectively, this market has traditionally not been a focus of regional and local long distance companies. The Company believes that its billing services operation can cost effectively bill these accounts through its agreements with local telephone companies. develop numerative and cost-efficient services that meet the needs of its customers. The Company also continues to market Company intends to remain focused on small and medium-sized commercial customers and will continue its efforts to The Company's strategic focus in the direct dial long distance industry is to compete with AT&T. MCI and Sprint, primarily on the basis of competitive pricing, while offering a comparable or higher level of service. Moreover, the

of its competitors. By having a concentration of operator services call traffic in a particular geographic region, the Company can utilize any long distance facilities it installs or acquires to service a ready base of call traffic, thereby lowering the services and direct dial long distance services businesses in such region, but also expands the number of companies that marginal transmission costs for any direct dial long distance traffic that the Company acquires or develops in that region. The Company believes this cost advantage not only improves the potential profitability of both the Company's operator through acquisitions. The Company has continued its acquisition activities, the primary focus of which is to make additional These acquisitions generated \$3.4 million in revenue for fiscal year 1995 and accounted for approximately 17% of the would be attractive acquisition candidates in that region. Pursuant to its acquisition strategy, the Company acquired three separate, privately-owned direct dial long distance companies and customer bases located in California during fiscal 1995. business affords it the opportunity to expand its direct dial long distance business on a more cost-effective basis than many acquisitions that will grow the Company's direct dial long distance business. The Company believes its operator services acrease in direct dial long distance revenues from fiscal 1994 The Company expects to look for opportunities to expand its long distance business, both by internal growth and

candidates, the availability of funds to finance acquisitions and the availability of management resources to oversee the operation of acquired businesses. While the Company has, from time to time, had discussions with telecommunications companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report. The success of the Company's acquisition strategy will depend, among other things, on the availability of acquisition

### Operator Services

Company processes collect, third-party, person-to-person and calling card calls, bills these calls through its billing subsidiary and generally shares a percentage of call revenues with its customers locations. Such services involve the use of live and automated operators to receive, validate and complete the calls. The services are accessed when calls requiring operator assistance and/or alternate billing options are placed from customer The Company provides operator assisted services for private pay telephones, hotels, motels, university domnitories and hospitals through its long distance telecommunications subsidiary, U.S. Long Distance, Inc. The Company's operator

owners covering approximately 60,900 pey telephones. The Company carried 8.3 million average monthly minutes of operator services traffic during the fourth quarter of fiscal 1995, as compared to 9.1 million and 10.6 million average monthly minutes during the fourth quarters of fiscal 1994 and 1993, respectively. The Company's operator services revenues amounted to \$63.5 million, \$67.9 million and \$68.0 million in fiscal 1993, 1994 and 1995, respectively. At September 30, 1995, the Company provided operator services to approximately 136,600 hotel, motel, hospital and dormitory rooms. In addition, at September 30, 1995, the Company had service contracts with private pay telephone telecommunications companies in the United States. Competition in the direct dial long distance industry is based upon price and, to a lesser extent, upon customer service, product design and innovation, customized billing capabilities, transmission quality and availability of service.

### Sales and Marketing

The Company's direct dial long distance sales personnel are located throughout the Company's service area and are responsible for marketing to commercial accounts. The Company supervises sales and marketing efforts from its corporate headquarters and utilizes various advertising media to enhance its commercial marketing efforts and to attract and retain residential customers. The Company examines the calling profiles of target markets and designs long distance services that specifically fill certain demands. For example, the Company issues long distance calling cards customized to include a customer's corporate logo and has also customized debit cards to be used as promotional marketing tools. In addition to its own sales force, the Company markets its direct dial long distance services through authorized agents, other carriers and affinity organizations (strategic partnerships).

The Company currently has an exclusive marketing agreement with Nolan Ryan, formerly a player with the Texas Rangers® professional baseball team and a potential hall of fame candidate, who acts as the Company's spokesman for its direct dial long distance services and whose picture appears in the Company's advertisements and product literature, including debit cards.

### Operations

The Company completes calls that are originated when a pre-subscribed customer dials "1" plus the area code and number or when a customer selects the Company's network through dial-up access to reach any domestic or international destination. All long distance calls placed over the Company's network are directed to call destination points by computerized digital network switching equipment operating at one of the Company's switching centers. The switching equipment receives a customer's direct dial call, verifies the caller's billing status and authorization codes, routes the call to the dialed destination, monitors the call's duration and collects other information for billing purposes. The Company's switching equipment selects the most cost-efficient transmission circuit or path available prior to switching and completing each call. The Company employs state-of-the-art digital switching equipment at the Company's switching centers in Houston and Waco, Texas, Seattle, Washington and Los Angeles, California.

To satisfy increasing or anticipated usage of its long distance network and ensure that its network is optimally accessible when network demand is heavy, the Company, from time to time, adds circuit capacity at each existing switching center by increasing the number of telecommunications ports. The Company has upgraded its network with the addition of Common Channel Signaling System 7, which is currently operational for virtually all originating and terminating traffic within the Company's markets. This network protocol significantly reduces connect time delays and provides additional technical capabilities and efficiencies for the routing of calls.

### Competitive Advantages

The Company competes with AT&T, MCI and Sprint and numerous local and regional carriers on the basis of its products and services, competitive pricing, and local identity. The Company generally prices its services up to 25% below AT&T, MCI and Sprint comparable service offerings. In addition, by designing long distance products and services that fill specific market needs, the Company enhances its ability to compete with AT&T, MCI and Sprint.

The Company believes that its emphasis on customer service distinguishes itself from many of its regional and local competitors. The Company has taken an integrated team approach to sales and service by increasing the number of sales support representatives in its field offices to maintain responsive service after the sale. Additionally, the Company has recently implemented a computerized bulletin board service called Advantage Direct, which is similar to the remote service officed to its operator services customers. This service allows customers to monitor and evaluate calling patterns and volume by department or location. Moreover, in competing with certain regional and local long distance carriers, the Company believes it holds a competitive advantage within its regional territory because the Company's regional concentration of traffic over its network facilities allows for the cost efficiencies of a national carrier. In addition, the Company believes that its local identity in the markets it serves provides an advantage in marketing its services and competing with long distance

access the system from remote locations and obtain customized and sophisticated reporting of calling patterns and volumes for each customer location or pay telephone. This advanced reporting system allows the Company's operator services customers to analyze their traffic on a daily basis and maximize telecommunications revenues by, for example, relocating understillated telephones. The Company's detailed reporting also allows its customers to reconcile the accuracy or integrity schnicians, who provide service 24 hours per day, 365 days per year. In 1994, the Company implemented a computerized bulletin board service called Stealth that allows its customers to The Company employs a highly skilled professional staff of customer service employees and

# Strategy and Grough Opportunities

sales force and agents and its participation in state, regional and national trade associations, the Company intends to pursue rivate pay telephone and hospitality industries and present new products and services for these markets. pographic expansion on a nationwide basis. The Company will continue to market its operator services business to both the The Company has developed a strong presence in operator services throughout the United States. Through its direct

# Milling Charleghouse and Information Services

clearinghouse services provides such companies with a more cost-effective means of billing and collecting residential and billing and collecting the revenues generated from their services because these carriers know only the billing telephone number and not the name or address of the party to be billed. However, due to up-front financial fees, significant investments in systems and infrastructure and volume requirements, most operator services providers do not find it practical or cost effective to establish direct billing and collection relationships with local telephone companies similar to the relationships the Company has established. In addition to providing billing clearinghouse services for operator services providers, the Company also offers its service to local and regional direct dial long distance carriers. Although such carriers can bill their customers directly, billing through the local telephone companies by utilizing the Company's billing charges from all but a small portion of United States and Canadian households and businesses. Without access to the billing The Company, through its subsidiary, Zero Plus Dinling, Inc., is a major third-party billing clearinghouse for call records resulting from telephone calls carried by its customers. These customers are direct dial long distance telephone companies and operator services providers. Call records are generated when consumers place calls from telephones presubscribed to a customer's network or customer telephones that require operator assistance and/or alternative billing ptions, such as collect and illing arrangements with o maller commercial accounts. The Company achieves discounted billing costs due to its aggregated volumes and passes here discounted costs on to its billing clearinghouse services customers. nd collection services of the local telephone companies, operator services providers would not have a practical means of as collect and person-to-person calls, third-party billing and calling card billing. Through its contractual tenests with over 1,200 local telephone companies, the Company has the ability to collect long distance

Services Billing, Inc. These services include the processing of call records related to 900 services as well as the billing of cellular and paging monthly service fees and telephone equipment charges. In addition to its billing clearinghouse services, the Company also offers billing management services. Under billing management agreements, the Company provides data illing agreements with the local telephone companies rocessing, accounting, tax processing and reporting, and end-user customer service for customers who have their own Beginning in 1994, the Company began providing enhanced billing services through its subsidiary. Enhanced

operator services providers, direct dial long distance telephone companies and store-and-forward pay telephone owners 1995 flacal years, respectively (excluding call records that the Company processed for its own direct dial long distance services and operator services businesses). Billing services revenues were \$42.0 million, \$52.4 million and \$75.5 million in facal 1993, 1994 and 1995, respectively. services revenues (approximately 3% of total consolidated operating revenues) in fiscal 1995, and the Company's five largest billing services customers represented approximately 26% of billing services revenues (9% of total revenues) in fiscal 1995. The Company billed 149.8 million, 238.6 million and 444.9 million third-party calls during the 1993, 1994 and Revenues from the Company's largest billing services customer represented approximately 8% of the Company's billing At September 30, 1995, the Company provided billing and information services to 271 customers, consisting of

### Industry Overview

distance telecommunications industry. AT&T continues to dominate the operator services market, supplying operator services for traffic originating from both the hospitality and pay telephone industries. Additionally, MCI and Sprint provide operator services and are considered by management to be major competitors. Excluding AT&T, MCI, Sprint, GTE and Regional Bell Operating Companies, management believes the Company is one of the five largest providers of operator Management believes that there are approximately 125 operator services providers competing within the long

Many operator services providers, including the Company, initially focused on the hospitality industry. More recently, as the private pay telephone industry has grown and taken market share from the public pay telephone market traditionally served by AT&T, many operator services providers gained increasing market share by providing service to the based upon commission programs, quality of service, reporting and customer service. owners of private and public pay telephones. Competition between the Company and other operator services providers is

### Sales and Marketing

The Company markets its operator services nationally through the combined effort of regional sales representatives based in Illinois, Minnesota, Texas and California and a network of agents. The Company's corporate sales force focuses on larger accounts, such as hotel management companies, multi-unit franchises, hospital chains, large private pay telephone companies and universities. The Company's agents market the Company's operator services on a nationwide basis and typically receive a commission based upon the volume of business generated. The Company also participates in various industry trade aboves and promotes its operator services through advertisements in trade magazines. The Company customizes its telecommunications services to provide, among other things, individualized reports and specialized call unding to cur

### Operations

The Company owns and operates its own operator center in San Antonio, Texas, which employed 259 operators and support staff at September 30, 1995. The Company provides five and automated operator services 24 hours per day, 365 days per year, and features multi-lingual operators versed in Spanish, French, German, Japanese and a variety of other languages. The Company maintains a sophisticated emergency call handling system that enables its operators to access police, five and other emergency agencies within the jurisdiction of the telephone from which the call is placed. The Company utilizes its own transmission facilities when possible or contracts to use facilities of other long distance network providers as necessary

The Company switches the majority of its operator assisted calls at its four main switching centers. Many operator assisted calls are transmitted to the Company's switching centers via dialing equipment installed at customers' locations or in customer pay telephone equipment. This dialing equipment is programmed to recognize calls requiring operator assistance and to access the Company's network by dialing the Company's access number, then passing the call record information to one of the switching centers. The Company validates the calling card or telephone number to be billed and then completes the call, while recording the date, distance, duration and time of day for subsequent billing purposes. As of September 30, 1995, the Company was authorized to complete international and interstate calls placed throughout the United States, as well as intrastate calls within 45 states.

# Competitive Advantages

Management believes that the Company enjoys several conspetitive advantages over many others in the operator services industry. By virtue of the Company's large call volumes relative to many other operator services providers and the cost efficiencies it realizes by routing a portion of its operator services traffic over its own facilities and maintaining its own operator center, the Company is able to provide high quality transmission on an economical basis. Additionally, because it is the source of commission payments to its operator services customers, the Company believes that its financial stability and history of timely payments allow it to compate effectively against many smaller, under-capitalized operator services providers. Moreover, the Company's flexible rate options allow it to offer customized commission programs to its customers as compared to larger operator services providers.

# Competitive Advantages

Commencing in 1990, the Company designed, developed and implemented an innovative billing clearinghouse and information management system. Management believes that this system, due to its unique design, affords the Company a competitive advantage in the following areas: effective customer accounting and reporting, expedited payment on customers' accounts receivable; improved collectibility; and monitoring of local telephone company billing and collection efforts.

receivable, improve the quality of their services and, ultimately, enhance their profitability. To ensure that each customer is responsible only for its own uncollectible call records and customer service rebates, the Company developed systems and procedures enabling it to accurately attribute uncollectible amounts to specific customers. The Company provides its customers with detailed information that can be used to manage their accounts

When the local telephone company responds to inquiries from the billed party, its primary motivation is frequently to accommodate this party rather than to pursue collection. Recognizing this fact, the Company negotiated with certain local telephone companies for the right to respond directly to such inquiries. As a result of handling such inquiries, the Company has realized an improvement in its collection rates.

companies' billing systems in order to detect billing errors. Since the inception of this business, the Company has Quality Assurance Department and Teleo Relations Department continually monitor the performance of the local telephone Billing and collection are dependent upon state-of-the-art systems and procedures. However, many of the local telephone companies are still using billing and collection systems that were developed prior to the AT&T divestiture and are not capable of providing the quality of billing and collection services that the Company's customers desire. The Company's discovered and collected for its customers significant amounts attributable to billing errors made by local telephone

# Strategy and Growth Opportunities

management services for companies in the operator services and direct dial long distance businesses. The Company believes that its billing services are attractive to long distance telephone companies who serve or desire to serve small businesses and residential consumers on a more cost-effective basis. Billing through the Company's contractual arrangements with the local telephone companies is less expensive for smaller accounts and provides higher collection rates than if the customer were billed directly by the long distance telephone company. The Company processed a monthly average of approximately 20.8 million direct dial calls and 10.0 million operator assisted calls during the year ended September 30, 1995 (excluding monthly call records processed for the Company's own direct dial long distance services and operator services businesses) The Company intends to continue to pursue opportunities in billing clearinghouse services and information

to gross profit because the Company charges a percentage of the amount collected for the customer for certain such records instead of the fixed rate per record associated with its other services. The Company's management continues to explore ways to further utilize its billing systems and expertise to provide services within both its existing service markets and direct dial billing customers to billing management agreements with the Company. The Company also processed 4.4 million call records in fiscal 1995 related to its enhanced billing services, which offer the potential to make a significant contribution of call records processed by the Company related to billing management services grew from 11.4 million in fiscal 1994 to 70.7 million in fiscal 1995. This growth has occurred primarily as a result of the migration of several of the Company's developing markets as products and services are increasingly billed through the local telephone companies During fiscal 1995, the Company experienced significant growth in its billing management business. The number

### Corporate Symesty

Management believes that the Company has certain operating advantages and cost efficiencies through the integration of its three businesses. The combined traffic volumes of the Company's operator services and direct dial long distance businesses operate to lower the Company's transmission costs for both of these businesses in geographic regions where the Company operates long distance switching equipment. In addition, within its direct dial regions, the Company's sales force can provide integrated long distance solutions to the hospitality industry by offering both operator services and direct dial long distance selephone services. The volume of call records from the Company's operator services business also

### Industry (hyerview

The Company believes that there are four major commercial billing clearinghouses in the telephone industry in the United States, the largest of which are the Company and OAN Services, Inc., a wholly owned subsidiary of Electronic Data Systems, Inc., itself a subsidiary of General Motors Corporation. Competition among the clearinghouses is based on the quality of information reporting, collection history, the speed of collections and the price of services. In addition, AT&T, MCI, Sprint and certain other long distance companies have established their own billing arrangements with local telephone companies, but they do not offer these services to other direct dial long distance carriers and operator services providers.

### Sales and Marketing

The Company markets its billing, reporting systems and information management services to its customers through a direct sales and marketing effort based at its headquarters in San Antonio, Texas. Most of the Company's sales activity is through active participation in industry trade shows and educational seminars and workshops. The Company advertises to a limited extent in trade journals and other industry publications.

### Operations

The Company uses the billing and collection facilities of the local telephone companies to bill and collect long distance telephone charges (call records) on behalf of its long distance company customers. Upon receipt of the customers' revenues from the local telephone companies, the Company reconciles its customer accounts, provides informational reporting and distributes the collected funds to the appropriate customers. The Company also performs the screening, editing and information management functions required to track the call records throughout the billing and collection process, to inform its customers about the quality and quantity of their call records and to handle rate adjustments and refunds on behalf of its customers. In addition, the Company provides accounting reconciliation and reporting and payment systems necessary to provide accountability and auditability for the revenues billed for each customer by each local telephone company. The Company also aggregates and pays state and local telecommunications and sales taxes on behalf of its customers and in most cases handles billing inquiries from consumers. The Company introduced a billing management product in 1993 whereby the Company assists direct dial long distance and operator services companies in obtaining their own billing and collection agreements with the local telephone companies and provides a range of administrative and management services to these customers.

The Company operates two independent computer systems to ensure continual "up time" for its billing clearinghouse and information management processes. One such system is dedicated to the daily billing and information management processing activities. The other serves as a back-up to the primary system and is used to store six months of billing detail. This detail is immediately accessible to the Company's customer service representatives who handle billing inquiries. The collection period from the time the Company submits call records to the local telephone companies until the local telephone companies return the collected funds to the Company generally ranges from 40 to 90 days. Because timely submission of call records to the local telephone companies is critical to prompt collections and high collection rates, the Company has made the necessary investment in computer systems to ensure that its customers' call records are processed and submitted to the local telephone companies in a timely manner, generally within 24 hours of receipt by the Company.

The Company has a revolving line of credit with FINOVA Capital Corporation (FINOVA), the successor to Greyhound Financial Corporation, secured by accounts receivable and other unencumbered assets of the Company, in order to offer an advanced funding program to its billing customers. The Company borrows funds under this credit facility to purchase certain eligible billing customers' accounts receivable. An eligible customer can receive cash for 50% to 80% of its accounts receivable within five business days of submitting its call records to the Company for processing, generally 35 to 85 days earlier than the normal local telephone company payment cycle. The Company advances funds nearly every business day under this program. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Advanced Funding Program and Receivable Financing Facility."

complying with the new or revised rules provide intrastate operator services in other targeted states. Certain states are expected to introduce or revice their rules compliance with the require similar if not identical to those imposed by the FCC on interstate operator assisted calls. The Company remains in material As of September 30, 1995, the Company was authorized to carry intrastate operator assisted traffic in 45 states. Authorization is pending approval in one other state. State regulatory agencies have the authority to impose their own rules and regulations governing the provision of intrastate operator services, including regulation of rates. Many states have rules governing operator services providers within the next year. The Company does not articipate significant difficulty in ments of each of the individual state regulatory agencies and continues to pursue authorization to

# Direct Dial Long Distance Services

Company. Under Section 214 of the Federal Communications Act, the FCC must certify a communications common carrier before it may provide international services. The Company has obtained Section 214 authorization to provide international switched services by means of resale. The FCC has ruled that "non-dominant" common carriers, like the Company, need not apply for Section 214 authorization for the provision of domestic U.S. interstate services. The FCC has regulatory jurisdiction over interstate and international telecommunications common carriers, like the

and had an application pending in one other. Regulations within each of these states, as they pertain to completing direct dial long distance calls for the Company's customers within the state, are virtually static and pose no foreseeable concern. As the Company expands the geographic scope of its direct dial long distance business, it will obtain state regulatory approvals as necessary to provide intrastate long distance service. As of September 30, 1995, the Company was authorized to provide intrastate long distance service within 46 states

# Interstate Access Transport Proceeding

largest long distance carriers could experience up to a 0.8% decrease in total cost. However, information filed with the FCC by the local telephone companies in September 1993 shows the impact differentials between large and small long distance central offices. These rate structures previously were designed such that local telephone companies assessed an equal charge In an effort to encourage competition in the provision of interstate access services, the ECC granted increased pricing flexibility to local telephone companies for "access transport" services. Access transport refers to the connection provided by local telephone companies between long distance carriers' long distance facilities and the telephone companies' could significantly impact the Company. carriers to be much greater in certain cases. If such differential is substantial with respect to the Company, the differentia were able to offer more cost effective access to those long distance carriers with very high access volumes in a particular local market. Accordingly, although all carriers were affected differently, long distance carriers with lesser access per unit of access to all long distance carriers, regardless of the volume of local access that these long distance carriers independently purchased. Under the newly adopted pricing plan, beginning in December 1993, local telephone companies listance carrier in terms of access requirements would experience no more than a 1% increase in total cost and that the equirements experienced increases in their overall average access cost. The FCC initially projected that the smallest long

The pricing plan was implemented on December 30, 1993 and is to be in effect until further Commission action. The FCC could grant local telephone companies further flexibility and could potentially impose a greater burden upon the operations of the Company's direct dial long distance services after further review of this issue at some later date. The FCC originally believed that, by November 1995, the proliferation of competitive access providers and increased long distance likelihood of any future revisions or investigations, nor the course or effect of the FCC's actions on this issue and the September 22, 1995, the FCC instead indefinitely extended the interim transport rules. Management is unable to predict the carrier network efficiencies would offset any inequities caused by volume-sensitive access pricing. In an Order released

services, once certain threshold conditions are met. The offering of such discounts could produce cost advantages for long distance carriers with large volumes of transport traffic. This FCC action is subject to pending petitions for reconsideration. In a related matter, the FCC has authorized local telephone companies to offer volume discounts on access transport assists in lowering the marginal costs for the Company's billing services due to increased economies of scale. Furthermore, lower billing costs permit the Company to cost effectively provide direct dial long distance services to residential and small business consumers.

Management also believes that the Company's participation and experience in the direct dial long distance and operator services businesses position the Company to better understand the needs of customers for its billing clearinghouse and information management services, assist the Company in designing billing and information management services that effectively meet the needs of its billing customers, and enable the Company to react more quickly to market changes.

### **Government Regulation**

#### General.

The Company competes in an industry that, to a large degree, continues to be regulated by government agencies. At approximately the same time as the required divestiture of the Bell telephone companies by AT&T in 1984, the Federal Communications Commission (the "FCC") announced rules that were created to foster a self-regulating, interstate telecommunications industry, relying upon competitive forces to keep rates and services in check. Management believes that the current direct dial marketplace demonstrates substantial progress toward the fulfillment of these objectives. For example, the cost of a long distance call has significantly declined while the number of long distance companies has multiplied. Competition has encouraged these direct dial long distance companies to find ever more efficient methods of carrying calls.

### **Billing Services**

Billing on behalf of independent long distance providers using local telephone company monthly bills also emerged as a consequence of the AT&T divestiture. Bell and GTE telephone companies are required by antitrust consent decrees to offer billing services for all long distance companies if they provide billing and collection (including disconnection of service to the consumer for nonpayment of long distance charges) for any long distance company. Subsequent to that decision, the FCC determined that interstate billing and collection services were to be provided by the local telephone companies on an unregulated basis. The Company, therefore, contracted with local telephone companies for billing and collection services free from the regulatory control of the FCC.

In some states, billing and collection of intrastate telecommunications records are subject to regulatory jurisdiction. For example, a state regulatory commission may require that the local telephone company provide billing and collection services to any entity that desires to obtain such services, and these services must be offered at the same rates and terms to any such entity. These rates and terms, which are "tariffed," are incorporated by reference into the billing and collection agreements between the Company and the local telephone companies and are subject to any change that is approved by the applicable state regulatory agency. Because intrastate billing volume is outweighed by interstate billing volume, the state regulation of billing and collection is not anticipated to pose significant consequences to the overall operations of the Company.

### Operator Services

On October 15, 1990, President Bush signed into law the Telephone Operator Consumer Service Improvement Act of 1990 ("TOCSIA"). Congress directed the FCC to impose upon the interstate operator services market certain rules and regulations designed to increase consumer awareness concerning the operator services provider carrying the call, the information the caller can request of the operator, and the alternatives available to the consumer for reaching other long distance carriers. Operator services providers were required to file with the FCC informational tariffs that describe the rules and regulations governing the provision of interstate operator assisted telecommunications and to include all rates that may apply to an interstate call. Furthermore, operator services providers were required to submit, on a Congressionally prescribed timetable, certain reports relating to rate changes, complaints and costs. Based on these reports, on November 16, 1992, the FCC submitted to Congress its "Final Report Pursuant to the Telephone Operator Consumer Services Improvement Act of 1990." The purpose of this report was to identify whether increased regulatory scrutiny by the FCC was required to satisfy Congressional objectives. The FCC determined that "...market forces are securing rates and charges that are just and reasonable..." and therefore stated "...we conclude that no further action is necessary..." on behalf of the FCC at this time.

# Other Regulatory Akatters

competition through their continuing monopoly control of local services. directed to consult with the Department of Justice to obtain their opinion regarding the RBOX's' potential to impede Decree of 1983. On March 23, 1995, the Senate Commerce Committee, chaired by Senator Pressler of South Dakota, endorsed the "Telecommunications Competition and Deregulation Act of 1995" (S.652). The full Senate passed S.652 by a vote of 81 to 18 on June 15, 1995. Pressler's bill requires a 90-day application review by the FCC. The FCC is Legislation has been introduced in the 104th Congress which, if enacted, would supersede the AT&T Consent

after enactment of the law and must operate any long distance unit as a separate subsidiary for eighteen months. Long distance carriers will have the opportunity to reself local exchange service at RBOC "wholesale" costs. Similar to the 1905" (H.R. 1555), which eliminates any role for the Department of Justice in codifying the terms of the MFJ. The House measure proposes to allow RBOCs to seek authority to provide long distance services from the FCC, who will use a legislative checklist in considering such applications. RBOCs will be permitted to make such application six months Senate proposal, no precondition of measurable local competition is imposed upon RBOC entry into long distance Correspondingly, on August 4, 1995, the House of Representatives passed "The Telecommunications Act of

is apposed to some of the elements in each of these proposals; therefore, it is currently less than certain such legislation differences in the proposals. If a consensus is reached by the Conferences, and approved again by both the House and the Sensie, they could present a final bill for executive signature shortly thereafter. The Administration has indicated that it will become law. Both Houses have initiated preliminary discussions in the Joint Conference Committee to attempt to resolve the

The Company cannot predict if such legislation will ultimately be endorsed by the Executive Branch and made law. If the MFJ were to be superseded by legislation, Southwestern Bell and the other RBOCs could be permitted to offer long distance services in competition with the Company and could prove to be formidable in terms of their marketing strength and other resources. Furthermore, if such companies are permitted to retain control of long distance access services to the Company's customers after being granted such permission, such control might materially and adversely affect the Company's ability to continue to offer similar or comparable services.

Such flexibility could make AT&T an even more formidable competitor than it has been. The Company cannot predict AT&Ts petition on October 12, 1995. AT&T has been given additional flexibility in its service offering and pricing. he impact of the FCC action. In September 1993, AT&T petitioned the FCC to reclassify it as a "non-dominant" carrier. The FCC granted

# Regulatory Rate Proceedings

predict whether or not any such requirement may be imposed in any particular jurisdiction agency or other officials. The Company could therefore he required, as a result of such an investigation and subsequent proceeding, to implement changes in its rate structure, which could ultimately affect its revenues. The Company cannot which its tariffs or services may, from time to time, fall under such scrutiny at the discretion of the governing regulatory regulatory agency generally has the authority to require a carrier to modify the process by which such services are rendered or to effect changes to its applicable rate structure. Consumer officials and attorneys general can pursue civil on some or all of its services, or to address perceived consumer inequities. cases, a regulated company can be required to, among other things, provide cost justification for the charges it imposes charged with such oversight responsibility, or by an attorney general or other jurisdictional consumer officials. In such regard to any of its rates, terms or conditions by which such service is rendered by the state or federal regulatory agency action if their concerns are not adequately addressed by the carrier. The Company operates in several jurisdictions in During the course of normal operations, a regulated company may at any time come under specific scrutiny with After review of such justification, the

# Billed Party Preference

FCC tentatively proposed adopting BPP. During the summer of 1992, comments from local telephone companies, long distance carriers and other inclusive participants revealed that the cost of imposing BPP could be in excess of \$1 billion and could require hundreds of millions of dollars each year to support its operation. The majority of these commentors were in opposition to the implementation of BPP. Commentors made clear that many technical impediments remain to full deployment of BPP. Other commentors claimed that no technology exists that could implement BPP without making call processing significantly less convenient for many operator services calls, particularly those requiring a live operator. refers to a concept in which any long distance call outside the local telephone company's calling area carried from a publicly available telephone would be completed over the long distance carrier network of the billed party's previously expressed preference. This would be accomplished through a local telephone company database system that would match every calling and telephone number to a preferred long distance company and then direct all calls accordingly. In April 1992, the Another issue under consideration by the ECC currently is termed "Billed Party Preference." or BPP. This term

In August 1994, industry members responded to a Commission Further Notice of Proposed Rulemaking. The Commission had tentatively concluded, based upon their calculation of related cost information previously submitted by industry members, that the potential benefits of a BPP system appeared to outweigh its costs, although the Commission admitted the financial data it used in its study could be outdated. Once again, industry participants were resoundingly opposed to the Commission's proposal, including AT&T and most of the Regional Bell Operating Companies (the "RBOCs"). To date, the FCC has taken no further action.

implementation of the proposal. In any event, local telephone companies have indicated that, if so directed, approximately two to four years would be required to reconfigure their networks to BPP's specifications. Thus, while BPP remains viable, the Company believes that it is not likely to be implemented in the near term. If such a system were implemented successfully, the unique market niche of operator services provider presubscription, such as that of the Company, would be rendered virtually ineffectual, as an owner of publicly available telephones would be unable to direct operator assisted calls over the network of such owner's desired carrier. It is difficult to assess the industry support for BPP given the inherent problems described above, and the FCC continues to consider

rates higher than such threshold would be required to first prove to the FCC that such rates are justified based upon the underlying costs of the service (the "APCC Rate Cap Proposal"). The NAAG Petition was proposed to remain in effect Companies, two competitive access providers, the American Public Communications Counsel ("APCC") and the Competitive Telecommunications Association ("CompTel"), recommended that the FCC impose certain rate thresholds FCC modify its current branding requirement such that operator service providers ("OSPs") would be required to announce at the beginning of each call more specific information for obtaining access to alternate carriers (the "NAAG Petition"). Another petition filed by a coalition of industry members, including most of the Regional Bell Operating BPP proceeding. In an ex-parte petition, the National Association of Attorney's General ("NAAG") suggested that the until such time that BPP is adopted and fully implemented. The APCC Rate Cap Proposal was proposed to obviate the need to consider any further action regarding BPP. for interstate operator assisted services, which the FCC would presume to be reasonable, and any OSP electing to charge On March 9, 1995, the FCC requested industry comment on two proposals it had recently received relative to the

without a corresponding increase in revenue number of calls completed over OSP networks such as the Company's, if end users elect to act upon the additional brancing associates regarding access to other carriers. Furthermore, additional network time would be consumed If adopted, the NAAG Petition or any form of modified call branding could have a negative effect upon the

Furthermore, if the APCC Rate Cap Proposal is adopted. OSPs such as the company may be immediately required to lower their interstate rates until such time as the FCC rules upon an attempt to justify higher, existing rates. OSPs may be required to adjust the amount of commission payments made to their subscriber customers as a result of SETVICES REVENUE. aplementation of such a proposal, or effect other operational changes to offset any reduction in interstate operator

The Company cannot predict when and if any final ruling on either proposal might be issued

### **ITEM 3.** LEGAL PROCEEDINGS

In December 1993, the Securities and Exchange Commission (the "SEC"), Division of Enforcement, instituted an informal inquiry relating to certain of the Company's accounting practices, including revenue recognition and accounting related to the Company's accounts receivable, purchased receivables and other assets, and related disclosures. When the Company's Board of Directors learned of the SEC's informal inquiry, Arthur Andersen LLP, the Company's independent public accountants, was engaged to conduct a special review of the Company's accounting policies and procedures. This review was managed by a senior partner of Arthur Andersen LLP who was not then involved in the annual audit process. This special review provided strong additional assurance that the financial statements of the Company were fairly stated and in conformity with generally accepted accounting principles. Representatives of the Company and Arthur Andersen LLP have met with the Enforcement Division of the SEC to discuss the issues raised by the inquiry. On May 5, 1994, the Company was informed that the SEC had instituted a formal order of private investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934, as amended (In The Matter of U.S. Long Distance (HO-2852)), relating to, among other things, the Company's financial condition, results of operations, assets and liabilities, revenues and revenue recognition and agreements and transactions. Prior to August 1994, the Commission issued subpoenas requesting documentation in a number of areas from the Company, from Arthur Andersen LLP, the Company's independent auditors, and from certain third parties, including former employees of the Company. The Company has and will continue to cooperate fully with the SEC. Although the Company cannot predict when the SEC's private investigation will be concluded, based upon its review of facts and circumstances, management does not believe that the SEC's review of this matter will result in any adjustment to the Company's previously reported financial statements.

The SEC's Division of Enforcement instituted a formal order of private investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934, as amended (In the Matter of Trading in the Securities of Value-Added Communications, Inc. (HO-2765)) on August 25, 1993. The investigation relates to the trading in the securities of both the Company and Value-Added Communications, Inc. ("VAC"), an operator services provider based in Dallas, Texas. A proposed merger between the Company and VAC was terminated in February 1993. Specifically, the SEC has alleged, among other things, that certain individuals may have employed devices, schemes or artifices to defraud others in connection with the purchase or sale of the securities of either the Company, VAC or both. The SEC may impose a variety of civil, criminal and administrative remedies and/or sanctions against any individual or entity found to have violated the federal securities laws. The Company is not aware of any facts or circumstances that would indicate that the Company or any of its management violated the federal securities laws by trading on material, nonpublic information.

Section 16(b) of the Exchange Act generally provides that any imputed profit realized by directors, officers and beneficial owners of more than 10% of the Company's outstanding Common Stock (or certain convertible securities) within any floating six-month period must be paid to the Company. The rule, therefore, automatically imposes a debt in favor of the Company on any director, officer or 10% stockholder for any so-called "short-swing" profits, even if a profit was never recognized by such statutory insider. In October 1994, Parris 11. Holmes, Jr., filed with the SEC Forms 4 reflecting previously unreported transactions in the securities of the Company during the period of approximately September 1991 through November 1992. Mr. Holmes paid the Company a total of \$191,712 between January 1995 and May 1995, pursuant to Section 16(b) of the Securities Exchange Act of 1934, in connection with those transactions. Subsequent to those filings, Mr. Holmes, with the assistance of counsel, continued to review certain additional transactions in the common stock of the Company, including certain transactions made in 1991 and prior years by a corporation in which members of his family had a substantial interest. In July 1995, upon completion of such review, Mr. Holmes filed additional Forms 4 reflecting previously unreported transactions in the securities of the Company during the years 1990 through 1992.

In July 1995 the Company received letters from counsel for two of its shareholders, Messrs. Morales and Portnoy, demanding that the Company seek reimbursement from Mr. Holmes of all short-swing profits from trading in the Company's securities allegedly due the Company under Section 16(b). In August and September, a Special Committee of the outside directors of the Board of Directors of the Company, assisted by Price Waterhouse LLP and outside legal counsel, reviewed information relating to the foregoing transactions and in mid-September reached an agreement with Mr. Holmes to resolve the Company's claims under Section 16(b) by an additional payment of \$293,637.40 from Mr. Holmes. Mr. Holmes paid this amount to the Company on September 19, 1995.

### Texas PIU Issue

an independent auditor's review and approval of an IXC's methodology of determining its own intrastate access usage. The auditors' reports were to be submitted to the LECs for review and implementation beginning on June 15, 1994. Commission ("PUC") adopted new regulations governing the method by which interexchange carriers ("IXCs") such as the Company calculate intrastate access charges paid to local exchange companies ("LECs"). These new rules required In a Final Order released in Docket 10127 on April 12. 1993 ("Final Order"), the Texas Public Utility

Southwestern Bell of the Final Order because the PUC improperly delegated regulatory authority outside the PUC. Southwestern Bell, Cause No. 94-06509, that Allcomm was entitled to an injunction against enforcement by the PUC and Permanent injunctive relief was granted to Alkomm in this cause on June 17, 1994. The decision was appealed by the PUC and Southwestern Bell. However, on June 13, 1994, Travis County Judge Hume Cofer found in Allcomm Long Distance. Inc. v. P.C. and

On June 15, 1994, the Company, along with several other IXCs ("Intervenors") sought intervention and similar injunctive relief in a new cause filed with Judge Cofer, Cause No. 94-06509-A, American Telco, Inc. et al. v. PUC and Southwestern Bell. The Intervenors reached an agreement in accordance with Rule 11, Texas Rules of Civil Procedures. with the PUC and Southwestern Bell which provided, among other things, that in lieu of submitting audit reports to Southwestern Bell, Intervenors would have such reports held under scal by a designated third party until a final, nonappealable judgment is rendered in the Alkomm case. In the interim, latervenors such as the Company are not prohibited from continuing to establish access charge levels based upon their own respective methodologies

However, management estimates that, under the most extreme application of the independent auditors' proposed methodologies, the difference between applying the alternative methodologies would result in prospective increased intrastate access charge expense of between \$3 million and \$4 million annually. concluding that the trial court erred in finding that the PUC had exceeded its statutory authority. Further, the Texas Court of Appeals rendered judgment that the Final Order is enforceable against Alkomm. On September 25, 1995. Although filed a writ of error regarding this matter with the Supreme Court of the State of Texas. If the writ of error is Company to compensate the LECs for any resulting differences in calculating access charges. The Company cannot predict the timing nor the outcome of the filing of the writ of error nor actions that may be undertaken by the LECs either before or after a final outcome on this case is reached. Based on advice of legal counsel, management believes there will Company will be required by further PUC action to adopt modified methodologies that could subsequently obligate the denied or if the action of the Texas Court of Appeals is sustained by the Supreme Court on appeal, it is likely that the he no retroactive liability to the Company prior to the Allcomm matter becoming a final and non-appealable order. On June 22, 1995, the Texas Court of Appeals overturned the lower court's decision in the Alkomm matter

employees are represented by a union. The Company believes that its employee relations are good Company also employed 340 part-time telephone operators and customer service representatives. None of the Company's At September 30, 1995, the Company had 861 full-time employees, including 26 officers, 204 sales and marketing personnel, 72 network, technical and operations personnel, 225 accounting, administrative and support personnel, and 334 telephone operators and customer service representatives and related support personnel. At September 30, 1995, the

# ITEM 2. PROPERTIES

At September 30, 1995, the Company occupied approximately 83,000 square feet of space for its corporate offices at 9311 San Pedro, San Antonio, Texas, substantially all of which is leased pursuant to a lease agreement that expires in January 1999. Additionally, at September 30, 1995, the Company leased approximately 17,000 square feet of space for its operation services center at 2200 Dambury, San Antonio, Texas, and approximately 81,000 square feet in the aggregate for 29 sales and operations offices throughout Texas, Oklahoma, New Mexico, Louisiana, California, Oregon and Washington. At such date, the Company also occupied an additional 43,000 square feet located in North San Antonio for a customet service facility. The Company believes that its facilities are adequate to meet its current needs.

### PART N

### ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

#### Market Information

The Company's common stock, par value \$0.01 per share (the "Common Stock"), is quoted on the Nasdaq National Market under the symbol "USLD." The table below sets forth the high and low bid prices for the Common Stock from October 1, 1993, through December 11, 1995, as reported by the Nasdaq National Market. These price quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

		Len
Fiscal Year Ended September 30, 1994:		
1st quarter	\$221/4	\$121/2
2nd quarter	\$14%	\$ 9%
3rd quarter	\$141/4	\$ 91/4
4th quarter	\$11%	\$ 8%
Fiscal Year Ended September 30, 1995:		
lst quarter	\$121/4	5 9%
2nd quarter	\$16	\$11%
3rd quarter	\$17/4	\$14%
4th quarter	\$174	\$14%
Fiscal Year Ended September 30, 1996:		
1st quarter (through December 15, 1995)	\$151/4	\$107/

### Stockholders

At December 15, 1995, there were 14,124,599 shares of Common Stock outstanding, held by 748 holders of record. The last reported sales price of the Common Stock on December 15, 1995, was \$14½ per share.

### **Dividend Policy**

The Company has never declared or paid any cash dividends on the Common Stock. The Company presently intends to retain all earnings for the operation and development of its business and does not anticipate paying any cash dividends on the Common Stock in the foreseeable future. Furthermore, certain covenants in various credit agreements of the Company prohibit the payment of dividends on the Common Stock.

On October 23, 1995, Morales filed a civil action against Mr. Holmes and the Company in the United States District Court for the Southern District of New York. Morales seeks to recover from Mr. Holmes, for the benefit of the Company, pre-judgment interest on the profits already recovered by the Company and to recover from the Company Morales' attorney's and accountant's fees. The response of Mr. Holmes and the Company to Morales' complaint are due in January.

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations; however, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on the Company's results of operations for the fiscal period in which such resolution occurred.

### **ITEM 4.** SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of the fiscal year, no matter was submitted by the Company to a vote of its stockholders through the solicitation of proxies or otherwise.

- (1) Includes the results of operations of the Company's direct dial long distance business after July 25, 1991, the date of acquisition
- (2) Reflects the utilization of net operating loss carryforwards.
- (3) Reflects the utilization of a net operating loss carryforward and an extraordinary loss attributable to a \$547,000 (\$0.05 per share) write-off, net of income taxes, of unamortized discount and capitalized financing costs resulting from the prepayment of indebtedness in the fiscal quarter ended June 30, 1993.
- (4) The Company has never declared cash dividends on its Common Stock, nor does it anticipate doing so in the foreseeable future
- (5) Preferred stock dividends of \$199,000 for the fiscal year ended September 30, 1991, were deducted from income before extraordinary items and net income in arriving at income applicable to common stockholders for purposes of determining per share amounts.
- (6) Calculated based upon a monthly average over the fiscal quarter ended on the date indicated
- (7) Does not include call records that the Company processed for billing management customers or its own direct dial long distance services and operator services businesses.
- (8) At end of the period.

### ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below are derived from the audited Consolidated Financial Statements of the Company. The data presented below for the fiscal years ended September 30, 1993, 1994 and 1995 should be read in conjunction with the Consolidated Financial Statements, the Notes thereto and the other financial information included in this report.

	Fintal Year Ended September M. (In thousands, except per shore data)				
	2991 ""	1992		1294	1995
Consolidated Income Statement Date:					
Operating revenues:					
Billing services	\$ 16,327	\$ 31,028	\$ 41,966	\$ 52,438	\$75,525
Operator services	17,245	34,809	63,529	67,907	68,020
Direct dial long distance services	3,133	19,214	28,631	61.407	81,481
Total operating revenues	36,705	85,051	134,126	181,752	225,026
Operating expenses:					
Cost of services	25,078	58,956	93,544	126,725	156,380
Selling, general and administrative	8,320	16,986	25,095	36,234	40,426
Depreciation and amortization	2,022	3,542	5,937	9,378	11,248
lacome from operations	1,285	5,567	9,550	9,415	16,972
Other income (expense)	12	(1,393)	(1,071)	955	3.208
Income before income taxes and extraordinary stems	1,297	4.174	8,479	10,370	20,180
Provision for income taxes	(590)	(1,735)	(3,303)	(4,280)	(8,145)
Income before extraordinary stems	707	2,439	5,176	6,090	12,035
Extraordinary stems	518 <sup>(2)</sup>	1.533 (2)	(316)(4)	0	0
Not income	\$ 1,225	\$ 3,972	\$ 4,860	\$ 6,090	\$12,035
Per share information (4)					
Income before extraordinary stems	\$0.06	\$0.21	\$0.43	\$0.43	50.83
Net income	\$0.12**	\$0.35	\$0.40	\$0.43	\$0.83
Weighted average common shates outstanding	8,848	11,509	12,117	14,069	14,587
			- A visite A		
			la thousands)		
	_191_	_1992_	_1991_	_1594_	_1995_
Capabidated Balance Short Data:	****			\$12,864	\$28.974
Working capital (deficit)	\$(1,573)	\$ 1,557	\$ 9,114	110,148	129.523
Current assets	42,718	72,519	94,678		186.893
Total axets	61,962	99,669	137,657	164,093	18.213
Long-term obligations, less current portion	12,213	18,209	13,956	49,216	64.131
Total stockholders' equity	5,458	10,498	34,137	49,216	68.131
			unale: Al.		
	STREET, STREET	anada, escep	billing cherin	ghouse custos	MT)
	_1001_	_1992_	1987	_1994_	_1995_
Operating Buta:	6,500	10.800	15,100	24,100	38.500
Fitting Can Iccards processed per mount	71	115	142	167	271
Billing services customers (%)  Operator services minutes per month (%)	3.100	4.800	10,400	9.100	8.300
	5.9	15.9	44.5	52.0	609
Pay telephones services ***  Rooms serviced ***	626	90.7	1060	122.0	136.6
Reoms serviced "  Direct dial long distance numbers per month "	7,900	10.300	17,200	44.700	62,600
Datest and with distance immunes het means	7,500	10,500	1,200		

# Year Embed September 38, 1995 Compared to Year Embed September 38, 1994

Operating Revenues

direct dial long distance services revenues accounted for \$23.0 million and \$20.1 million, respectively, of the total acrease in revenues. Revenues in 1995 increased by 24% to \$225.0 million from \$181.8 million in 1994. Growth in billing services and

new business from direct dial long distance carriers that signed billing agreements with the Company during the past year, as well as expanded business from existing direct dial long distance customers. Direct dial long distance billing call records represented 20.8 million and 8.9 million of the average number of records processed per month in 1995 and own direct dial long distance services and operator services businesses). This volume increase was primarily the result of representing an increase of 44%. The increase in revenue is attributable to an increase in the number of billing call records processed. An average of 30.8 million billing call records were processed per month in 1995 compared to an average of 19.9 million per month during 1994 (in both years, excluding call records that the Company processed for its 1994, respectively. Billing Services. Billing services revenue in 1995 totaled \$75.5 million, compared to \$52.4 million for 1994,

select a carrier of choice by dialing access codes of other carriers ("300 dial-around"). The growth in the number of phones serviced has, however, enabled the Company to increase its call volume. The Company processed 17.4 million operator services calls in 1995 compared to 17.2 million in 1994. Although operator services minutes carried by the Company declined from 104.7 million in 1994 to 87.4 million in 1995, the Company was able to maintain its 1994 revenue level through the increased call volume, an improvement in its revenue collection percentage, and an increase in fixed charges per call. These fixed charges included operator services charges, premise-imposed fees, and automated call 1995. com 1994. Although the Company has experienced significant growth in the number of pay telephones and hospitality rooms serviced, this growth has not resulted in a corresponding increase in revenue. This has been caused by several factors, including an increase in the percentage of pay telephones serviced by the Company located in states that impose rate arocessing charges. Operator Services. Operator services revenue was \$68.0 million in 1995 compared to \$67.9 million in 1994. The pasty serviced an average of approximately 55,200 pay telephones and 130,300 hospitality rooms per month for compared to an average of approximately 48,200 pay telephones and 103,200 hospitality rooms per month for

In addition to the above factors, operator services revenue for 1995 was approximately \$5.6 million lower due to certain billing modifications made in June and July of 1994. These modifications decreased the amount of time charged to consumers for the use of the Company's operator services and were necessary to bring changes made in the Company's billing practices in prior years into compliance with certain regulatory requirements. To date, the Company has not paid any significant refunds or claims relating to the period of noncompliance and does not expect to in the

Company believes that there are opportunities for continued expansion, both internally and externally acquisitions, in all three of its primary businesses. However, because direct dial long distance services represent the largest market in which the Company is active, management believes that this business presents the Company with its greatest revenue growth opportunity. The Company believes that its base of operator services business affords it the opportunity to expand its direct dial long distance business on a more cost effective basis than many of its direct dial long distance companies. Accordingly, the Company continues to consider potential acquisitions. This activity is focused primarily on small to medium-sized companies that will grow the Company's direct dial long distance business. While the Company has, from time to time, had discussions with such companies, it has no agreements or pending negotiations with respect to any acquisition at the date of this report. 1995 compared to \$61.4 million in 1994. Management estimates that approximately 17% of the increase in direct dial long distance revenues from the prior year is attributable to the three direct dial long distance companies and customer bases acquired since October 1, 1994. The remaining portion of the increase is attributable to internal growth. The Direct Dial Long Distance Services. Direct dial long distance services revenue increased 33% to \$81.5 million in

# MANAGEMENT'S DINCUSSION AND ANALISES OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

TEM 7.

fiscal 1993, 1994 and 1995. It should be read in conjunction with the Consolidated Financial Statements of the Company, the Notes thereto and the other financial information included chewhere in this report. For purposes of the following periods refer to the Company's fiscal quarters ended December 31. March 31, June 30 and September 30 liscussion, references to year periods refer to the Company's fiscal year ended September 30 and references to quarterly The following is a discussion of the consolidated financial condition and results of operations of the Company for

### Overview

due to the growth of higher gross margin billing services and direct dial long distance revenues as a percentage of total nevenues. Gross margin remained flat from 1993 to 1994 primarily due to higher network costs as a percentage of revenue, which were offset by the growth of higher gross margin direct dial long distance services revenues as a percentage of total revenues. year period ended September 30, 1995, revenues grew at a 63% compounded rate. The Company's gross profit margin acreased to 30.5% in 1995 from 30.3% in both 1994 and 1993. The increase in gross margin from 1994 to 1995 was largely Revenues grew to \$225.0 million in 1995 from \$181.8 million in 1994 and \$134.1 million in 1993. During the five-

expenses as a percentage of revenues were 5.0%, 5.2% and 4.4% in 1995, 1994 and 1993, respectively. tighter expense controls and increased efficiencies. The increase from 1993 to 1994 was due primarily to the increased connection with two Securities and Exchange Commission (SEC) investigations (see Note 10 to the Consolidated The Company's selling, general and administrative ("SGRA") expenses as a percentage of revenues were 18.0%, 19.9% and 18.7% in 1995, 1994 and 1993, respectively. The decrease from 1994 to 1995 was primarily the result of percentage of Company revenues derived from the direct dial long distance business, which incurs higher SG&A ancial Statements) and two class action lawsuits that were dismissed in April 1994. Depreciation and amortization of sevenues than the Company as a whole, and legal and accounting costs that were incurred in

respectively. Net incom to \$12.0 million, or \$0.83 per share, for 1995 from \$4.9 million, or \$0.40 per share, for 1993 Income from operations of \$17.0 million, \$9.4 million and \$9.6 million was reported for 1995, 1994 and 1993. e has grown each year from 1993 to 1995, with net income reported by the Company increasing

## Mesods of Operation

operating revenues for the years ended September 30, 1993, 1994 and 1995. The following table presents certain items in the Consolidated Statements of Income as a percentage of total

Operating expenses: Cost of services. Selling, general and administrative	Operating revenues: Billing services Operator services Direct dial long distance services Total operating revenues
£23	
इंड सं	37.4 37.4 37.4
F F E S	10 Prop 10 Pro

long distance services and operator services businesses). This volume increase was the result of new business from customers that signed billing agreements with the Company during the past year, as well as expanded business from existing customers. Direct dial long distance billing call records represented 8.9 million and 2.6 million of the average number of records processed per month in 1994 and 1993, respectively.

in a corresponding increase in revenue. This has been caused by several factors, including an increase in the percentage of pay telephones serviced by the Company located in states that impose rate turiff regulations on operator services providers and an increasing ammentes on the part of the consumer of the ability to select a carrier of choice by dialing access codes of other carriers ("300 dial-around"). Operator Services. Operator services revenue grew by 7% to \$67.9 million in 1994, compared to \$63.5 million in 1993. The growth was primarily the result of the changes in the Company's operator services billing practices as discussed below and, to a leaser extent, the increased number of pay relephones serviced by the Company. The Company serviced an average of 48,200 pay telephones per month for 1993. Although the Company has experienced significant growth in the number of pay telephones serviced, this growth has not resulted the Company has experienced significant growth in the number of pay telephones serviced, this growth has not resulted

S1,513,000 and \$2,106,000, respectively. These amounts were collected from consumers over a 17-month period, were not in compliance with certain regulatory requirements and may be subject to refund in various regulatory jurisdictions. It is not possible to estimate the ultimate carnings impact, if any, of potential refunds and other related claims. However, based upon its review of facts and circumstances, management does not believe that any such refunds or claims will have a material adverse impact on the financial condition or results of operations of the Company. Any potential claims paid to consumers or regulatory agencies will be partially offset by refunds of commissions that were paid to the Company's agents and pay telephone owners. The Company further modified its operator services billing practices in June and July of 1994 to comply with all regulatory requirements in those areas in which it provides services billing practices. Company has refined turiffs to provide an enhanced description of the Company's operator services billing practices. The Company made several changes in its operator services billing practices beginning in February 1993. Such changes increased the amount of time charged to consumers for the use of the Company's operator services. These changes increased operator services revenue by \$599,000 and \$1,631,000 for the third and fourth quarters of fiscal 1993.

Direct Did Long Distance Services. Direct dial long distance services revenue increased by 114% to \$61.4 million in 1994, compared to \$28.6 million in 1993. Approximately 55% of this increase was attributable to the acquisition of five direct dial long distance companies and customer bases during the year ended September 30, 1994 (See Note 3 to the Consolidated Financial Statements). The remaining portion of the increase was attributable to internal growth achieved through the efforts of an expanded wholesale carrier services sales force and 800 portability, as well as a higher quality sales force which was more effective in securing business from larger customers.

### Operating Expense

Cour of Services. The gross profit margin for both 1994 and 1993 was 30.3%, even though the gross profit margin declined for both the operator services and direct dial long distance services businesses in 1994. These declines did not impact the consolidated gross profit margin because of the significant increase in the Company's higher gross margin direct dial long distance services revenues as a percentage of total revenues. These revenues accounted for 34% of the Company's total consolidated revenues for 1994 company of 1995 of 1993. Although there was no year-to-year improvement, gross profit margins improved in each successive quarter of 1994, with 33.5% being reported for the fourth quarter, the highest quarterly level reported by the Company during the past three fiscal years.

The gross profit margin duclines for both operator services and direct dial long distance services in 1994 were primarily due to higher flued networking costs, both as a percentage of revenues and dollar level, during the first six months of 1994. These higher costs were partly the result of expansion of networking capacity in the Pacific Northwest and on the West Cosst. Specifically, because of certain regulatory developments in the State of California, the Company did not begin to provide its operator services to certain pay telephones under contract as soon as it had expected. Thus, the Company incurred naturely costs without gaining the full benefit of the associated revenues. The Company provided certain operator services to substantially all pay telephones currently subject to this contract by the end of the second

Operating Expenses

Cost of Services. The gross profit margin of 30.5% reported for 1995 increased from 30.3% achieved in the prior year. This improvement is due primarily to the growth in the Company's higher gross margin billing services and direct dial long distance services revenues as a percentage of total revenues. Such revenues accounted for 70% of the Company's total consolidated revenues for 1995 compared to 63% for 1994. Although management continues to undertake measures to improve gross profit margins, the impact of regulatory issues (see Note 11 to the Consolidated Financial Statements) could pressure future gross profit margins.

Selling, General and Administrative. SG&A expenses for 1995 were \$40.4 million, representing 18.0% of revenues, compared to \$36.2 million in 1994, or 19.9% of revenues. SG&A expenses as a percentage of revenues decreased from the prior year primarily as a result of tighter expense controls and efforts to streamline the Company's operations. To a lesser extent, the improvement was also the result of cost efficiencies gained from integrating acquired companies. The reduction in SG&A expenses was achieved despite the fact that a higher percentage of Company revenues was derived from the direct dial business for 1995. A higher percentage of SG&A expense is incurred to support direct dial revenues than to support other revenues earned by the Company.

Depreciation and Amortization. Depreciation and amortization expense was \$11.2 million in 1995 compared with \$9.4 million in the prior year. Depreciation and amortization expense as a percentage of revenues decreased to 5.0% in 1995 from 5.2% in 1994. This decrease is primarily attributable to the increase in revenues from the prior year.

Income from Operations

Income from operations in 1995 increased to \$17.0 million from \$9.4 million in 1994. This increase is primarily attributable to the decrease in SG&A expenses as a percentage of revenues, as discussed above, and the increase in revenues.

Other Income (Expense)

Net other income (expense) increased to \$3.2 million in 1995 from \$955,000 in 1994. The improvement was primarily attributable to increased net interest income as a result of financing a higher level of customer receivables under the Company's advanced funding program and financing a higher percentage of these receivables with internally nenerated funds.

Income Taxes

The Company's effective tax rate decreased to 40.4% in 1995 from 41.3% in 1994. The Company's effective tax rate is higher than the federal statutory rate due to the addition of state income taxes and certain deductions taken for financial reporting purposes which are not deductible for federal income tax purposes.

Net Income

The Company reported net income of \$12.0 million in 1995 compared to net income of \$6.1 million in 1994. Net income for 1995 reflected continued growth in billing services revenues and expansion of the Company's direct dial long distance services business through both internal growth and acquisitions and improvement in the Company's gross profit margin.

Year Ended September 30, 1994 Compared to Year Ended September 30, 1993

Operating Revenues

Revenues in 1994 increased by 36% to \$181.8 million from \$134.1 million in 1993. Growth in direct dial long distance services, billing services and operator services accounted for \$32.8 million, \$10.5 million and \$4.4 million, respectively, of the increase in revenues.

Billing Services. Billing services revenue increased by 25% to \$52.4 million in 1994, compared to \$42.0 million in 1993. The increase in revenue was due to an increase in the number of billing call records processed. An average of 19.9 million billing call records were processed per month during 1994, compared to an average of 12.5 million per month during 1993 (in both years, excluding call records that the Company processed for its own direct dial

# Liquidity and Capital Resource

1995, the Company had approximately \$22.0 million available for borrowing and no amounts borrowed against its own eligible receivables under this revolving credit receivable financing facility. See "Advanced Funding Program and Receivable Financing Facility" below. Working capital was \$29.0 million at September 30, 1995, compared to \$12.9 million at September 30, 1994. The Company's current ratio was 1.3.1 at September 30, 1995, versus 1.1.1 at September 30, 1995, versus 1.1.1 at September 30, 1995, versus 1.1.1 at September 30, 1995, versus 1.1.2 at September 30, 1995, versus 1.1.2 at September 30, 1995, versus 1.1.3 at September 30, to borrow against its own operator services and direct dial long distance services accounts receivable. At September 30, \$16.2 million for 1994. The Company's cash balance increased to \$22.9 million at September 30, 1995 from \$16.8 million at September 30, 1994. As an additional source of cash availability, the Company has a revolving credit receivable financing facility with FINOVA Capital Corporation ("FINOVA"), the successor to Greyhound Financial Corporation, that allows the Company

Accounts receivable increased to \$46.8 million at September 30, 1995 from \$35.2 million at September 30, 1994. This increase was primarily ambituable to a higher level of billing services and direct dial long distance services revenues in the fourth quarter of 1995 compared to the fourth quarter of 1994. Trade accounts payable and accrued liabilities increased to \$18.4 million and \$19.0 million, respectively, at September 30, 1995 from \$17.4 million and \$11.2 million at September 30, 1994. The increases in accounts payable and accrued liabilities are due to the overall expansion of the Company's business. Propaids and other current assets decreased slightly to \$4.6 million at September 30, 1995 from \$4.8 million at September 30, 1994 is due to the sale of the Company's minority interest in a professional baskethall team.

related to the purchase of selecommunications equipment, computer equipment and software, and office furniture. During 1995, the Compuny financed approximately \$5.7 million of equipment with BOT Financial Corporation, a subsidiary of the Black of Tokyo, through long-term borrowings. During 1996, the Company anticipates investing \$10 to \$15 million in additional equipment to service the Company's projected growth. Approximately \$6 million to \$8 million of these capital expected to be purchases of relocommunications equipment, approximately \$3 million to \$5 million are expected to be purchases of computer hardware and software to develop systems to support the anticipated growth of the Company's business and the remainder is expected to be for purchases of office furniture and equipment. The Company astitutions. unticipates financing these capital expenditures primarily through term notes or capital leases with various lending Capital expendits ares amounted to approximately \$11.7 million during 1995. These expenditures were primarily

equipment. In addition, any acquisitions that the Company may consummate may require substantial capital investment. The Company believes that it has the ability to continue to secure long-term equipment financing and that this ability, combined with cash flow generated from operations and available horrowing capacity under its existing credit facilities, will be sufficient to fund capital expenditures, working capital needs and debt repayment requirements for the The Company's operations and expansion into new geographic markets will continue to require substantial capital investment for the development and procurement of transmission facilities and telecommunications and office

The Company's credit facilities and equipment loans contain various restrictions and financial ratio maintenance requirements. Under the most restrictive terms of its credit facilities, the Company is required to maintain a quarterly ratio of consolidated operating income, as defined in the agreements, to consolidated fixed charges of at least 1.5 to 1.0 and is prohibited from paying dividends on its common stock. The Company may also be subject to certain limitations on its annual capital expenditures and on the issuance of additional secured debt, but can issue subordinated unsecured debt provided the ratio of tended debt (as defined in the applicable loan agreement) to total capitalization would exceed 60%. The agreements further limit the ability of certain of the Company's subsidiaries to remit dividends to the Company. Cross default provisions of the Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other loan agreements. Under the Company's most significant credit facilities, the Company has generally the obligations of its subsidiaries. The Company was in compliance with all required coverants at September 30, 1995 and 1994.

quarter of 1994. During the third quarter of 1994, networking coats began to decrease to a level consistent with the pervious year's results and continued to do so throughout the remainder of 1994. The increase in the percentage of networking costs to direct dial long distance revenues was also caused by the significant growth in the Company's wholesale carrier services revenues, which have a lower gross margin than other direct dial long distance revenues.

compared to \$25.1 million in 1993, or 18.7% of revenues. SG&A expanses as a percentage of revenues increased from the prior year primarily as a result of a higher percentage of Company revenues being derived from the direct dial business. A higher level of SG&A expanse is incurred in connection with direct dial long distance revenues than with other revenues canned by the Company. SC&A expenses were also higher from year to year as a result of the direct dial long distance companies acquired during the first six months of 1994 having higher SC&A expenses as a percentage of revenues than the Company as a whole and due to higher legal and accounting costs incurred in connection with the SEC's investigations and stockholder class action lawsuits. Selling, General and Administrative, SG&A expenses in 1994 were \$36.2 million, representing 19.9% of revenues.

Depreciation and Amortization. Depreciation and anortization expense was \$9.4 million in 1994, compared with \$5.9 million in 1993. Depreciation and amortization expense as a percentage of revenues increased to 5.2% in 1994 from 4.4% in 1993. This increase is primarily attributable to additional depreciation expense associated with capital equipment acquired to facilitate the growth of the Company's direct diel long distance and operator services businesses and the amortization of the cost of customer bases and contracts acquired and goodwill related to acquired companies.

# Income from Operation

Income from operations in 1994 decreased to \$9.4 million, representing 5.2% of revenues, compared to \$9.6 million, or 7.1% of revenues, in 1993. Higher SG&A and depreciation and amortization exponses were virtually offset agent gross profit

# Other Income (Expense)

\$1.1 million in 1993. The Net other income (expense) improved to set other income of \$955,000 in 1994 from set other expense of \$1.1 million in 1993. The improvement was primarily stributable to the retirement of the Company's Senior Subordinated that and reduced interest expenses as a result of recogniting the Company's revolving credit facility. These increases in an interest income were partially offset by increased interest costs associated with flanncing a higher level of capital and interest income were partially offset by increased interest costs associated with flanncing a higher level of capital

### Income Taxes

The Company's effective tax rate increased to 41.3% in 1994, from 39.0% in 1993. The Company's effective tax rate is higher than the federal standary rate due to state income taxes and certain deductions taken for financial reporting purposes which are not deductible for federal income tax purposes. The increase in the effective rate is primarily due to (1) higher state income taxes, (2) an increase in nondeductible amortization expenses related to acquisitions, and (3) an increase in nondeductible expenses caused by the tax law changes contained in the Omnibus Budget Reconciliation Act

The Company reported no extraordinary items in 1994. The extraordinary loss of \$316,000 in 1993 related to a \$547,000 write-off, set of income taxes, of summortized financing costs and unamortized discount associated with the Company's Senior Schordinated Notes, which were retired prior to their maturity date in connection with the Company's underwritten public offering in June 1993. This loss was partially offset by utilization of \$231,000 of the Company's not operating loss carryforward ("NOL").

### Net Incame

The Company continued to experience earnings growth during 1994, with net income of \$6.1 million in 1994, company to \$4.9 million in 1993, an increase of 25%. Net income for 1994 reflected continued growth of billing and operator services revenues and expansion of the Company's direct dial long distance services business through both internal growth and acquisitions.

Company's stockholders, all amounts contributed by employees will be returned. shares of the Company's common stock at a 15% discount through voluntary payroll deductions. Although the ESPP was approved by the Board of Directors on May 16, 1995, it is still subject to approval by a majority of the Company's stockholders at the annual stockholders' meeting to be held in February 1996. If the ESPP is not approved by the requirements of Section 423 of the Internal Revenue Code of 1986, as amended, became effective July 1, 1995. The ESPP enables employees who have completed at least six months of continuous service with the Company to purchase The U.S. Long Distance Corp. Employee Stock Purchase Plan (the "ESPP"), which was established under the

# Advanced Funding Program and Receivable Financing Facility

The Company has a revolving line of credit facility with FINOVA to draw upon to advance funds to its billing customers prior to collection of the funds by the Company's billing services business from the local telephone companies (see Note 2 to the Company's revolving line of credit facility, which extended its maturity to December 31, 1996 and provided the Company with more favorable terms. The revolving line of credit is \$45 million for the first and second years of the agreement and, at the option of the Company, \$60 million for the third year. Due to the growth in cash flow experienced by the Company, the option to increase the line of credit to \$60 million was not exercised by the Company. and has expered.

Because it generally takes 40 to 90 days to collect receivables from the local telephone companies, customers can significantly accelerate cash receipts by utilizing the Company's advanced funding program. The Company offers participation in this program to qualifying customers through its Advanced Payment Agreement. Under the terms of this agreement, the Company purchases the customer's accounts receivable for an amount equal to the face amount of the billing records submitted to the local telephone companies by the Company for billing and collection, less certain deductions. The purchase price is remitted by the Company to its customers in two payments.

parcentage of the value of the customer's call records submitted to the local telephone companies. This percentage is established by the Advanced Payment Agreement and generally ranges between 50% and 50%, but hypically averages approximately 70%. The Company pays the remaining balance of the purchase price upon collection of funds from the local telephone companies. The funds used to make the initial payments are generally borrowed under the Company's revolving line of credit facility with FINOVA. Since the facility was amended in December 1993, the Company has from time to time paid down a portion of the line with excess funds prior to collection of the related receivables from the local telephone companies. The Company had paid down \$18.8 million of the credit facility at September 30, 1995, and consequently, the outstanding balance of the line of credit represented approximately 42% of purchased receivables at September 30, 1995. The amount borrowed by the Company under this credit facility to finance the advanced funding program was \$23.0 million and \$25.2 million at September 30, 1995 and 1994, respectively. Within five days from receiving a customer's records, an initial payment is made to the customer based on a

Financing service fees charged to customers by the Company are recorded as interest income and are computed at a rate above the prime rate on the assount of advances (initial payments) outstanding to a customer during the period commencing from the date the initial payment is made until the Company recoups the full amount of the initial payment from receipts from local telephone companies. The interest rate charged to the customer by the Company is higher than the interest rate charged to the Company by FINOVA, in part to cover the administrative expenses incurred in providing this service. Horrowing costs are computed at a rate above the prime interest rate, but less than the rate charged by the Company on advances, and are based on the amount of borrowings outstanding during the period commencing from the date the funds are borrowed until the loan is repaid by the Company. Horrowing costs are recorded as interest expense. The result of these financing activities is the generation of a net amount of interest income that contributes to the net income of the Company.

As part of the Advanced Payment Agreement, the Company contractually purchases the customer accounts upon which funds are advanced. Further, the customer may grant a first lien security interest in other customer accounts and assets and will take other action as may be required to perfect the Company's first lien security interest in such assets. Under the terms of the agreement with FINOVA, the Company is obligated to repay amounts borrowed from FINOVA and advanced to its billing customers whether or not the purchased accounts receivable are actually collected.

The Company continually evaluates business opportunities, including potential acquisitions. The primary focus of the company activities is to make additional acquisitions that will grow the Company's direct dial long distance business. One or more of such acquisitions could result in a substantial change in the Company's operations and fluancial condition. The success of the Company's acquisition activities will depend, among other things, on the availability of acquisition candidates, the availability of funds to finance acquisitions and the availability of manageneric resources to oversee the operation of acquired businesses. The Company signed a letter of intent in August 1995 to acquire ITC, a privately-owned direct dial long distance company with headquarters in Salt Lake City, Utah, but terminated discussions with other telecommunications companies, it has no agreements or pending negotiations with respect to any equisition at the date of this report.

As consideration for any acquisitions, the Company may issue common stock, perferred stock, convertible debt or other accurities, in addition to or in lieu of the payment of cash, that could result in dilution of the percentage ownership of public stockholders. The Company does not intend to seek stockholder approval for any such acquisitions or accurity issuences unless required by applicable law or regulations. The Company issued an aggregate of 270,000 shares of its common stock during fiscal 1995 for the acquisitions of three direct dial long distance companies and customer bases (see Note 3 to the Compilidated Financial Statements). The Company has granted the holders of these hares certain registration rights, the cost of which will be home by the Company.

Subsequent to the acquisition of a company in frical 1994, the Company amended the terms of its purchase common stock to these former shareholders of the company, agreeing, among other things, to issue additional shares of its purchase common stock to these former shareholders, if necessary, to guarantee a specified acquisition price. On November 2, 1994, pursuant to the terms of the amended agreement, the Company paid an aggregate of \$41,360 in cash and issued an additional 100,000 shares to the former stockholders. In addition, the Company agreed to pay in cash within five days to such former stockholders the difference, if any, between the value of these additional shares on the daic they became available for sale through a registration statement declared effective by the Securities and Exchange Commission (SEC) and \$1,386,864. The registration statement covering the additional 100,000 shares was declared effective on January 24, 1995 and, based on the value of such shares as of that date, the Company paid a net aggregate amount of \$23,564 to the former stockholders. These additional shares have been included in the weighted average common shares outstanding for purposes of the earnings per thare calculations.

On June 1, 1994, the Company was authorized by its board of directors to purchase up to 1,000,000 shares of its believed that the Company's common stock was undervalued relative to the Company's financial position. The shares were purchased from time to time on the open market over the course of the twelve months that began June 1, 1994 as market and other relevant conditions warranted. During the twelve-month period ended May 31, 1995, the Company purchased 267,500 shares at an average market price of \$9.84 per share. Shares purchased under this program will be used for general corporate purposes, including as possible consideration for any acquisitions. In November 1994, the Company retired 100,000 shares of its common stock held as treasury stock. These shares were returned to authorized and unissued

On November 3, 1994, the Company filed a registration statement with the SEC covering 308,000 shares of the Company's common stock, to be offered and sold, from time to time, for the account of certain stockholders of the Company with certain registration rights. On January 24, 1995, this shelf registration statement was declared effective by the SEC. On April 24, 1995, the Company filed an additional registration statement with the SEC covering 170,000 shares of the Company's common stock, to be offered and sold, from time to time, by certain stockholders and optionholders of the Company by means of a combined prospectus that also relates to three previously filed shelf registration statement. An amendment to this registration statement was filed on May 4, 1995 and on May 8, 1995, this shelf registration statement was declared effective by the SEC. The 170,000 shares, as well as the 2,266,058 shares previously registered under the combined prospectur, are included in the Company's weighted average shares satisfanding for purposes of computing carmings per share. The Company will not receive any of the proceeds of the shares being offered under the combined prospectus other than minimal proceeds upon the exercise of warrants to purchase shares of common stock registered under a previous registration statement and \$858,000 upon the exercise of patens to purchase shares of common stock registered under this registration statement.

#### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of U.S. Long Distance Corp.:

We have audited the accompanying consolidated balance sheets of U.S. Long Distance Corp. (a Delaware corporation) and subsidiaries as of September 30, 1994 and 1995, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended September 30, 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 financial position of U.S. Long Distance Corp. and subsidiaries as of September 30, 1994 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1995, in conformity with generally accepted accounting principles.

As explained in Note 2 to the Consolidated Financial Statements, effective October 1, 1993, the Company changed its method of accounting for income taxes.

ARTHUR ANDERSEN LLP

San Antonio, Texas November 10, 1995

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and accordingly, the Company experiences general decreases in long distance revenues around national holidays when commercial traffic is reduced. The Company typically experiences decreases in operator services revenues in the fall and winter months as pay telephone usage declines due to cold and inclement weather in many parts of the United States. The Company believes the portion of revenues generated from its operator services billing customers may be similarly affected December 31 (which includes the Thanksgiving, Christmas and New Year's Eve holidays) historically has been the lowest level of any quarter of the year. Conversely, due to increased traffic from pay telephones during the spring and summer in the third and fourth quarters of the fiscal year. Because the Company's fixed operating expenses do not decrease during he first fiscal quarter, the Company's profitability is also, generally, at its lowest level for any quarter of the year. nomins and a lower concentration of national holidays, the Company has historically experienced its highest revenue levels Approximately 95% of the Company's direct dial long distance revenues is generated by commercial customers. sonal variations discussed above, revenue reported in the Company's first fiscal quarter ending

### Mart of Inflation

ignment and transmission costs have not materially changed during the year. General operating expenses such as salaries, ployee benefits and occupancy costs are, however, subject to normal inflationary pressures. inflation is not a material factor affecting the Company's business. Prices charged to the Company for switching

# New Accounting Standards

the Financial Accounting Standards Board. The Company is not currently, nor does it expect to be, materially affected by any new standards recently issued by

# ITEM & FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SCCOM The consolidated financial statements of the Company and the related report of the Company's independent public asits thereon are included in this report at the page indicated.

1995 Consolidated Statements of Cash Flows for the Years Ended September 30, 1993, 1994 and 1995 Consolidated Francis Statements	Report of Independent Public Accountants  Report of Independent Public Accountants  Consolidated Balance Sheets at September 30, 1994 and 1995  Consolidated Statements of Income for the Years Ended September 30, 1993, 1994 and 1995  Consolidated Statements of Stockholders' Equity for the Years Ended September 30, 1993, 1994 and
Statemor	State of Sta
s of Cast	Public Ac Sheets at 5 as of Stace
Flows fo	countants epiconter for the tholders'
r dke Yosa	30, 1994 Years Ea Equity for
s Ended S	and 1995 the Young
September 30	mber 30. Ended S
30, 1993	1993, 196 eptember
, 1993, 1994 and 1995	30, 1993.
d 1995	198 198 198
	•

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF INCOME

(So thousands, except per there associate)

		For the Year Ended Sentember M.		
	_1793_	THE R. P. LEWIS CO., LANSING.	1995	
Operating revenues:				
Billing services		\$ 52,438	\$ 75,525	
Operator services		67,907	68,020	
Direct dial long distance services.	The state of the s	_61.407	_81.481	
Total operating revenues	134.126	181.752	225,026.	
Operating expenses:				
Cost of services		126,725	156,380	
Selling, general and administrative	100 Per 100 Pe	36,234	40,426	
Depreciation and amortization	The state of the s	9.378	11248	
Total operating expenses	124.576	172.337	204.054	
lacone from operations.	9,550	9,415	16,972	
Other income (expense):				
Interest income	3,953	4,287	6.147	
Interest expense	(4,773)	(3,381)	(3,182)	
Other, set	_(251)	49	_243	
Total other income (expense)	(1,071)	955	3,208	
Income before provision for income taxes and extraordinary items		10,370	20,180	
Provision for income taxes		_(4.280)	(1145)	
Net income before extraordinary items	_5.176	6.090	12.035	
Extraordinary items:				
Utilization of net operating loss carryforwards	231	0	0	
Loss on early extinguishment of debt, net of income tax benefit of \$349	_(547)	0	0	
Net income applicable to common stock	14160	\$ 6.090	245.035	
Not income per common share:				
Net income before extraordinary items	\$0.43	\$0.43	\$0.83	
Extraordinary items	(0.03)	0.00	0.00	
Net income per share applicable to common stock	\$0.40	50.41	50.83	

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

(In theysends)

### ASSETS

		1995
	\$ 16,765	\$ 22,949
Cash and cash equivalents	35,223	46,752
Purchased receivables from billing customers	53,347	55,228
Prepaids and other	_4813	4.594
Total current assets.	110,148	129,523
Property and equipment	41,750	53,363
Property and equipment	(13,487)	(21,440)
Net property and equipment	28,263	31,923
Net property and equipment  Equipment held under capital leases, net of accumulated amortization of \$1,777 (1994) and		
S2,263 (1995)	2,458	3,096
Other assets:  Excess of cost over net assets acquired, net of accumulated amortization of \$925 (1994) and	14,943	14,685
\$1,502 (1995)	8.281	7,666
	\$164.093	\$186.893
Total assets  LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
- ·	\$ 17,358	\$ 18,405
The second secon	36,995	33,866 19,046
	11,201	23,030
- to the family for purchased receivables	25,235	5,432
	5,381	770
Count parties of chliestions under capital leases	_1.114_	100,549
- 1 - Lallida	97,284	
2.5	3,091	3,147 13,375
The state of the s	13,385	1.691
cat the complete leases less current Bortion	_1.117_	
Total liabilities	114,877	118,762
Commitments and contingencies (See Note 10)		
Commitments and contingences (ase two 197		
Stockholders' equity: Preferred shares, \$.01 per value, 10,000,000 shares authorized, no shares issued or	mi - 725	
	0	0
c of manufact to one one shares authorized, 12,931,343 source and		
13 761 #12 charge contatanding in 1994; 14.281,800 States issued and 19,079,079	130	143
41 1- 1005	129 42,540	49,304
a 2 state and in contain	CONTRACTOR OF THE PARTY OF THE	20,473
· · · · · · · · · · · · · · · · · ·		(1.789)
Toward stock		68.131
		\$186.893
Total liabilities and stockholders' equity	TIPHTAT	THE PARTY.

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year		
Cash flows from operating activities:			
Net income before extraordinary items	\$ 5,176	\$ 6,090	\$ 12,035
Adjustments to reconcile net income before extraordinary items to net cash			
provided by operating activities:			
Utilization of net operating loss carryforwards	231	0	0
Depreciation and amortization	5,937	9,378	11,248
Provision for losses on accounts receivable	448	1,254	2,289
Deferred compensation	216	244	273
Amortization of debt discount	144	0	0
Loss (gain) on disposition of property and equipment	(21)	48	171
Changes in current assets and liabilities, not of effects from purchase of			
direct dial long distance companies:			
Increase in accounts receivable	(12,050)	(6,078)	(13,527)
(Increase) decrease in prepaids and other	(2,709)	(1,868)	156
Increase in accounts payable	2,334	3,982	716
Increase in accrued liabilities	3,210	1,663	8,768
Increase in other liabilities	1.712	_1,454	_1.617
Net cash provided by operating activities	4,628	16,167	23,746
Cash flows from investing activities:			
Purchases of property and equipment	(16,115)	(7,720)	(11,683)
Acquisition of direct dial long distance companies, net of cash acquired	0	(565)	(175)
Payments for purchased receivables from billing customers, net	(6,384)	(6,078)	(1,881)
Collections of proceeds due (payments made) to third party customers, net	2,203	13,046	(3,129)
Proceeds from sale of assets	160	179	632
Other investing activities	_(4,760)	(1,453)	_(655)
Net cash used in investing activities	(24,896)	(2,591)	(16,891)
Cash flows from financing activities:			
Draws (payments) on revolving line of credit for purchased receivables, net	4,637	(10,826)	(2,205)
Proceeds from issuance of debt	11,531	7,704	5,701
Payments on debt	(14,243)	(4,919)	(5,660)
Payments on capital leases	(1,190)	(2,771)	(1,497)
Financing costs	(184)	(267)	0
Proceeds from issuance of common stock, net of issuance costs	21,181	470	4,065
Purchase of treasury stock	0	(1.559)	(1.075)
Net cash provided by (used in) financing activities	21.732	(12.168)	_(671)
Net increase in cash and cash equivalents	1,464	1,408	6,184
Cash and cash equivalents, beginning of year	_13,893	15,357	16.765
Cash and cash equivalents, end of year	\$ 15.357	\$ 16.765	\$ 22.949

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

### For the Years Ended September 30, 1993, 1994 and 1995 (to thousands)

					Additional		
	_Comm	er Stock	_freder	nd Stock.	Paid in	Retained	Treasury
	Sheen	Amount	Share	Amount	Capital	Ecenings	Stock
Balances at September 30, 1992	9,316	\$ 93	0	\$0	\$13,360	\$ (2,862)	\$ (93)
Exercise of stock options and	232						
warrants	740	7	0	0	2,426	0	0
Issuance of common stock	1,857	19	0	0	20,327		ALL LAND BOOK STORY
Net income	0	_0	_1	_0	0	_4,860.	_0
Balances at September 30, 1993	11,913	119	0	0	36,113	1,998	(93)
Pooling with Telecom West							
le:	270	3	0	0	5	123	0
Exercise of stock options and							
Warrands	113	1	6	0	827	0	0
Issuance of common stock	636	6	0	0	5,358	0	0
Issuance of treasury stock	0	0	0	0	237	0	66
Purchase of treasury stock	0	0	0	0	0	0	(1,637)
Net income	0	_0	_0	_0	0	6.090	0
Belances at September 30, 1994	12,932	129	0	0	42,540	8,211	(1,664)
Pooling with L.D. Network,	10,770	TO SELECT					
	175	2	0	0		227	0
Inc.	Wall land						
Exercise of stock options and	1,080	11	0	0	4,805	0	0
tasuance of common stock	195	2	o o	0	2,422	0	0
	(100)	(i)		0	(949)	0	950
Retirement of treasury stock	(100)	· · ·		0	0	0	(1,075)
Purchase of treasury stock	ě	Ö		0	485	0	0
Other capital contributions		o d	0	0	0	12.035	0
Net income	14.282	\$141		50	\$49,304	\$20,473	\$(1.789)
Balances at September 30, 1995		4134		-	-	ALC: NAME OF THE PARTY OF THE P	No.

The purchase price is remitted by ZPDI to its customers in two payments. Within five days from receiving a customer's records, an initial payment is made to the customer based on a percentage of the face amount of the customer's call records submitted by ZPDI to the local telephone companies. ZPDI pays the remaining balance of the purchase price to the customer upon collection of funds from the local telephone companies. The purchase date is the date the initial payment is made.

Any third-party accounts receivable purchased by ZPDI are recorded as purchased receivables from billing customers in an amount equal to the face amount of the billing records submitted to the local telephone companies by ZPDI for billing and collection. Concurrently, an equal amount is recorded as accounts payable to third-party billing customers. The amount of the initial payment made to the customer reduces accounts payable to third-party billing customers. The balance, reported as accounts payable to third-party billing customers (\$36,995,000 and \$33,866,000 at September 30, 1994 and 1995, respectively) consists of:

- an amount equal to the face value of all purchased receivables, reduced for any amounts paid as initial payments under Advanced Payment Agreements, and
- an amount equal to collections from local telephone companies that have not yet been remitted to customers.

The purchased receivables balance is relieved at the time the customer receivables are collected from the local telephone companies. Any differences between the amount initially recorded as a purchased receivable and the amount ultimately collected from the local telephone companies, resulting from the fees and deductions detailed above, are recorded as a reduction of the purchased receivable and accounts payable to third-party billing customers in an equal amount. The funds are remitted to the customer after ZPDI deducts finance service charges earned under the agreement.

Finance service charges are assessed to customers and are computed at a rate above the prime interest rate based on the amounts funded to customers. Finance service charges are recorded as interest income during the period from the date of initial payment until ZPDI recoups the full amount of the initial payment from receipts from local telephone companies. No other revenues or income are recorded in connection with the Advance Payment Agreement.

The following third-party receivables purchased and financed by ZPDI were outstanding at:

	1994	aber 30. 1995 usands)
Purchased receivables from billing customers	\$53,347	\$55,228
Purchase money borrowings under revolving credit facility for purchased receivables	\$25,235	\$23,030

The Company has virtually no collection risk related to its purchased accounts receivable and thus does not record an allowance for doubtful accounts related to such receivables. While the Company does not have the legal right of recourse against its billing customers with respect to purchased receivables, the Company does have the right of offset against all funds held for the account of such customers and may hold a first lien security interest in such billing customers' accounts, generally including those not acquired by the Company. The Company does, however, have some risk with regard to adjustments charged to it by the local telephone companies related to customers who are no longer serviced by the Company to the extent that these adjustments exceed funds withheld from such customers. Therefore, the Company has recorded an accrual for the estimated liability associated with such charges.

### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS September 30, 1993, 1994 and 1995

### Note I. Business Activity

U.S. Long Distance Corp. ("USLD") was organized under the laws of the Province of British Columbia, Canada, in 1983 and was domesticated and reincorporated under the Delaware Corporation Law Act in the State of Delaware, United States of America, in 1987. USLD and its subsidiaries (collectively, the "Company") currently provide operator services (calling card, collect, person-to-person, and third-party billing calls requiring operator assistance) to hotels, motels, hospitals, university domnitories and private pay telephone owners throughout the continental United States. The Company also operates as a full-service switch-based long distance carrier currently providing direct dial long distance services to small and medium-sized commercial customers and, to a lesser extent, residential customers and was authorized to provide direct dial long distance services to businesses and residents of 46 states as of September 30, 1995. Additionally, the Company provides billing clearinghouse and information management services to unaffiliated operator services providers and direct dial long distance companies.

### Note 2. Summary of Eignificant Accounting Policies

### Principles of Consolidation and Basis of Presentation

The accompanying consolidated financial statements include the accounts of USLD and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified for comparative purposes.

### **Revenue Recognition Policies**

The Company recognizes revenue from its operator and direct dial long distance services as such services are performed, net of an estimate for uncollectible revenue, based on historical experience. The Company recognizes revenue from its billing services upon transmission of billable calls to the local telephone companies, which calls are to be billed and collected by the Company.

### Third Party Billing Services

Zero Plus Dialing, Inc. (ZPDI), a subsidiary of USLD, provides billing services to operator services providers and direct dial long distance companies through billing agreements with the local telephone companies, which maintain the critical database of end-user names and addresses of the billed parties. Bills are generated by the local telephone companies and the collected funds are remitted to ZPDI, which in turn remits these funds, net of fees, to its billing customers. ZPDI records a trade accounts receivable and revenue for fees charged for its billing services. When the customer's receivables are collected by ZPDI from the local telephone companies, ZPDI's trade receivables are reduced by the amount corresponding to ZPDI's processing fees and the remaining funds are recorded as an accounts payable to third-party billing customers.

ZPDI offers participation in a receivable financing program to qualifying customers through its Advanced Payment Agreement. Under the terms of this agreement, ZPDI generally draws down on its revolving credit facility for purchased receivables and purchases the customer's accounts receivable for an amount equal to the face amount of the billing records submitted to the local telephone companies by ZPDI for billing and collection less:

- all local telephone company charges, rejects, unbillables and bad debt deductions;
- · all credits and adjustments granted to end users;
- · all ZPDI processing fees and sales taxes, if appropriate;
- all financing service charges assessed by ZPDI; and
- any and all losses, costs or expenses incurred by ZPDI in processing or collecting the customer accounts from all previously billed call records.

whose proceeds were used to retire the Senior Subordinated Notes and a 336,902 reduction in common share equivalents. The reduction in common share equivalents relates to the reduction in shares covered by the lender's stock purchase warrants as a result of the prepayment of the Senior Subordinated Notes.

The approximate weighted average number of shares used in computing net income per share for fiscal 1993, 1994 and 1995 was 12,117,000, 14,069,000, and 14,587,000 respectively.

### Statements of Cash Flows

Cash payments and non-cash activities during the periods indicated were as follows:

	Year Ended September 30,		
	1993	1994 in thousand	1995
Cash payments for interest	\$4,982	\$3,455	\$3,107
Cash payments for income taxes	36	3,451	7,215
Non-cash investing and financing activities:			
Assets acquired in connection with acquisitions	3,018	11,560	939
Liabilities assumed in connection with acquisitions		4,273	351
Common stock issued in connection with acquisitions		4,962	896
Capital lease and debt obligations incurred	3,077	628	1,727
Contingent obligations incurred	1,918	1,637	- OT-S
Tax benefit recognized in connection with stock	4 4 1 1 1		
option exercises	1,363	392	1,236

For purposes of determining cash flows, the Company considers all temporary cash investments purchased with an original maturity of three months or less to be cash equivalents.

#### Other

From time to time, the Company has loaned to or was owed amounts from certain officers of the Company. The highest amount outstanding of advances to officers during fiscal year 1995 was \$894,000 and the amount outstanding at September 30, 1995 was \$212,000.

### Note 3. Acquisitions

On March 4, 1993, the Company consummated its acquisition of the direct dial long distance customer base of Nueces Marketing Partners, Ltd. (formerly Travis Telecom of San Antonio, Inc. and Travis Telecom of West Texas. Inc.) for cash and notes payable. Nueces Marketing Partners, Ltd. provided direct dial long distance services to small and medium-sized businesses in the San Antonio, Texas and West Texas areas.

On July 1, 1993, the Company acquired the direct dial long distance customer base of U.S. Long Distance of Louisiana, Inc., a Louisiana corporation located in Lake Charles, Louisiana, for cash. The Company had no prior ownership interest in this entity nor was the Company an affiliate of this entity. In addition, the purchase agreement contained an earnout provision whereby the Company would be required to issue to the seller 10,000 shares of the Company's common stock if a specified revenue level was attained by this operation in the twelve-month period following the acquisition. In connection with the acquisition, and in consideration for assistance provided to the Company in obtaining a particular telephone contract, the Company issued 7,500 shares to an affiliate of the seller and granted the seller the right to earn and receive up to an aggregate of 120,000 shares of the Company's common stock upon the attainment of certain revenue levels under such telephone contract in the first three years following the

### Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the related assets, which range from three to seven years. Upon disposition, the cost and related accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss is reflected in other income for that period. Expenditures for maintenance and repairs are charged to expense as incurred. Direct installation costs and major improvements are capitalized.

### Excess of Cost Over Net Assets Acquired

Excess of cost over net assets acquired represents the excess of the consideration paid over the fair value of the net assets acquired and is being amortized using the straight-line method over forty years for the excess related to the initial acquisition of a direct dial long distance business and twenty years for the excess related to all subsequent acquisitions of direct dial long distance businesses. Periodically, the Company assesses the appropriateness of the asset valuations and the amortization periods.

#### Other Assets

Other assets include costs incurred to acquire billing agreements with local telephone companies for billing and collection services and certain customer service and other agreements. Such costs are being amortized over three to eight-year periods. Other assets also include financing costs related to the issuance of debt, which have been deferred and are amortized over the life of each respective agreement, the acquisition costs of direct dial long distance customer bases, which are amortized over the expected life of the customer bases, and costs incurred to acquire operator services agreements, which are amortized over the life of each respective contract. In addition, a certificate of deposit held as security for an equipment financing facility, long-term deposits and the long-term portion of notes receivable have been included in other assets.

### Fair Value of Financial Instruments

Cash and cash equivalents are valued at their carrying amounts, which are reasonable estimates of fair value. The fair value of all other financial instruments approximates cost as stated.

#### Income Taxes

In February 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," which the Company adopted effective October 1, 1993. Under SFAS No. 109, deferred tax liabilities and assets are recorded based on enacted income tax rates that are expected to be in effect in the period in which the deferred tax liability or asset is expected to be settled or realized. A change in the tax laws or rates results in adjustments to the deferred tax liabilities or assets. The effects of such adjustments shall be included in income in the period in which the tax laws or rates are changed. The adoption of SFAS No. 109 did not have a material impact on the Company's financial position or results of operations. Prior to October 1, 1993, the Company accounted for income taxes in accordance with the provisions of Accounting Principles Board Opinion No. 11, "Accounting for Income Taxes."

#### Net Income Per Common Share

Net income per common share was computed by dividing net income applicable to common stock by the weighted average number of common shares and common share equivalents outstanding during the applicable period. The weighted average number of shares outstanding during each fiscal year differs from the number of shares outstanding at each year end due to assumed conversions of options and warrants that were outstanding during the respective periods and for the assumed issuance of common stock contingently issuable as discussed in Note 3.

Had the prepayment of the Senior Subordinated Notes, discussed more fully in Note 4, and the common stock offering, discussed in Note 6, occurred at the beginning of fiscal 1993, net income per common share would have been \$0.49. The supplemental pro forms net income per share amount was calculated including adjustments for discount and capitalized financing cost amortization, debt management fees and interest expense. In addition, the number of common shares used to compute the per share amount has been adjusted to include the addition of 913,000 shares of common stock.

On October 6, 1994, the Company acquired L.D. Network, Inc. ("LDN"), a direct dial long distance company, for 175,000 shares of its common stock, 17,500 of which were deposited in an escrow account to satisfy certain indemnification obligations. All of the shares held in escrow related to this acquisition have been included in the weighted average shares outstanding for purposes of the earnings per share calculations. These shares were released from escrow on April 12, 1995. The business combination has been accounted for as a pooling-of-interests combination. The accompanying consolidated financial statements include the operating results of LDN since October 1, 1994. The consolidated financial statements for periods prior to the combination have not been restated to include the accounts and results of operations of LDN due to the transaction not having a significant impact on the Company's prior period financial position or results of operations.

In March 1995, the Company acquired the long distance commercial customer base of a company and certain assets of another company in bankruptcy. Both the customer base and the assets acquired are located in Southern California. These acquisitions have been accounted for as purchases and, accordingly, the results of operations of each acquisition have been included in the Company's consolidated financial statements since the respective effective dates of acquisition. No pro forms financial information with regard to these acquisitions has been presented as the acquisitions do not have a significant impact, either individually or in the aggregate, on the Company's prior or current period financial position or results of operations. An aggregate of \$175,000 cash and 95,000 shares of the Company's common stock were issued in connection with these purchase transactions. Of these shares, 16,869 were deposited in an escrow account to satisfy certain indemnification obligations (see Note 12). All of the shares held in escrow have been included in the weighted average shares outstanding for purposes of the earnings per share calculations. Total assets acquired and liabilities assumed for these acquisitions were approximately \$1.1 million and \$280,000, respectively. The excess of the purchase price over the fair value of aggregate net tangible assets acquired is approximately \$1.0 million, of which approximately \$316,000 has been recorded as goodwill and is being amortized on a straight-line basis over twenty years. The remaining balance has been recorded as the purchase price for customer lists and is being amortized on a straight-line basis over five years.

The Company granted certain registration rights to the persons receiving its common stock in the acquisitions and caused its subsidiaries to enter into employment agreements with certain principals of the acquired companies.

### Note 4. Debt

Long-term debt is comprised of the following:

	Septem	M. M.
	(in then	1273 1000(1)
Revolving line of credit for purchased receivables, with a company, 9.25% at September 30, 1995 (prime rate (8.75%) plus .5%), due in varying amounts through		
December 1996	\$25,235	\$23,030
Variable interest rate term notes	1,191	397
Fixed interest rate term notes	17,575	18,410
Total debt	44,001	41,837
Less - Current portion	30.616	28.462
	\$13.385	\$13.375

The Company has a revolving line of credit with a company to finance the purchase of certain eligible accounts receivable. Any amounts horrowed to purchase receivables under this revolving credit facility are due upon the Company's collection of the related receivables. In December 1993, the Company and the lender executed an amendment to the Company's revolving line of credit facility that extended its maturity to December 31, 1996 and provided the Company with more favorable terms. The revolving line of credit is \$45,000,000 for the first and second years of the agreement and, at the option of the Company, \$60,000,000 for the third year. The option to increase the line of credit to \$60,000,000 was not exercised by the Company and expired in December 1995. The revolving credit receivable financing facility also allows the

price of \$11.50 per share upon the attainment of certain revenue levels under the telephone contract in the fourth and fifth years following the acquisition. The Company initially valued the customer base of U.S. Long Distance of Louisiana. Inc. and the telephone contract at the value of the consideration given by the Company, including cash, common stock issued, and the 130,000 contingently issuable shares acquisition and a warrant to acquire up to an aggregate of 80,000 shares of the Company's common stock at an exercise

the provision of the Company's services. The Company is cooperating with its customer in the customer's civil lawsuit against the customer's former employees. As a result of the foregoing, on May 9, 1994, the Company amended the terms of the purchase agreement, agreeing, among other things, to issue 60,000 shares of its common stock to the seller to fully remaining liability related to this telephone agreement. previously recorded, were reduced by approximately \$630,000 in the third quarter of fiscal 1994 to reflect final issuance of the 60,000 shares, which occurred during May 1994. At September 30, 1994, the Company did not have any satisfy all contingent consideration requirements of the agreement and to grant certain registration rights with respect to employees may have improperly directed the Company with respect to the payment of certain commissions relating to charged for long distance services after the Company notified its customer that certain of the customer's former these shares. The carrying values of the customer base and contract, as well as the corresponding liability which was In May 1994, the Company renegotiated the terms of this telephone agreement to reduce both the term and rates

combination. The accompanying consolidated financial statements include the operating results of TWI since the effective date of the business combination. The consolidated financial statements for periods prior to the combination 270,000 shares of its common stock. 27,000 of which were deposited in an escrow account to satisfy certain indemnification obligations. All of the shares held in escrow related to this acquisition have been included in the weighted average shares outstanding for purposes of the earnings per share calculations. These shares were released from eacrow on October 1, 1994. The business combination has been accounted for as a pooling-of-interests significant impact on the Company's prior period financial position or results of operations. have not been restated to include the accounts and results of operations of TWI due to the transaction not having a On October 1, 1993, the Company acquired Telecom West Inc. (TWI), a direct dial long distance company, for

deposited in an excrow account to satisfy certain indemnification obligations. All of the shares held in excrow related to these acquisitions have been included in the weighted average shares outstanding for purposes of the earnings per share calculations. These shares were released from excrow on November 1, 1994. Total assets acquired and liabilities assumed for these acquired companies were approximately \$2.8 million and \$3.3 million, respectively. The excess of the aggregate purchase price over the fair value of aggregate net tangible assets acquired is approximately \$8.0 million, of which approximately \$6.9 million has been recorded as goodwill and is being amortized on a straight-line basis over 20 years. The remaining balance has been recorded as the purchase price for customer lists and is being amortized on a During fiscal 1994, the Company acquired four other separate, privately-owned direct dial long distance companies located in Texas and California. These acquisitions have been accounted for as purchases and, accordingly, the Company's common stock were issued in connection with these purchase transactions. Of these shares, 6,000 were presented as the acquisitions do not have a significant impact, either individually or in the aggregate, on the Company's the results of operations of each company have been included in the Company's consolidated financial statements since prior or current period financial position or results of operations. An aggregate of \$948,000 cash and 550,000 shares of the respective dates of acquisition. No pro forma financial information with regard to these acquisitions has been straight-line basis over five years.

available for sale through a registration statement declared effective by the Securities and Exchange Commission and \$1,386,064. The registration statement covering the additional 100,000 shares was declared effective on January 24, 1995 and, based on the value of such shares as of that date, the Company paid a net aggregate amount of \$23,564 to the former stockholders. These additional shares have been included in the weighted average common shares outstanding for additional 100,000 shares to the former stockholders. In addition, the Company agreed to pay in cash within five days to such former stockholders the difference, if any, between the value of these additional shares on the date they became Subsequent to the acquisition of one of these companies, the Company amended the terms of its purchase agreement with the former shareholders of the company, agreeing, among other things, to issue additional shares of its common stock to these former shareholders, if necessary, to guarantee a specified acquisition price. On Nevember 2, purposes of the earnings per share calculations. 1994, pursuant to the terms of the amended agreement, the Company paid an aggregate of \$41,360 in cash and issued an

#### Note 5. Leanes

The Company leases equipment and office space under operating leases. Rental expense for fiscal 1993, 1994 and 1995, was \$1,744,000, \$2,886,000 and \$3,118,000, respectively. Future minimum lease payments under non-cancelable leases at September 30, 1995, are as follows (in thousands):

Year Ending September 30,	
1996	\$2,769
1997	2,528
1998	1,890
1999	465
2000	63
Thereafter	253
Total minimum lease payments	\$7,968

The Company also leases various computer and telecommunications equipment under capital lease arrangements. Future minimum lease payments under these capital leases, together with the present value of the net minimum lease payments at September 30, 1995, are as follows (in thousands):

Year Ending September 30,	
1996	\$ 989
1997	931
1998	631
1999	332
Total minimum lease payments	2,883
Less: Amount representing interest	(422)
Present value of net minimum lease payments	\$2.461

#### Note 6. Share Capital

During fiscal 1993, the Company sold, through an underwritten common stock offering, 1,850,000 shares of common stock, receiving net proceeds of approximately \$20,269,000 after expenses of approximately \$755,000. Additionally, warrants to purchase 450,000 shares of common stock were exercised by certain selling stockholders at \$0.01 per share in connection with the underwritten common stock offering.

On June 1, 1994, the Company was authorized by its board of directors to purchase up to 1,000,000 shares of its outstanding common stock. The shares were purchased from time to time on the open market over the course of the twelve months that began June 1, 1994 as market and other relevant conditions warranted. During the twelve-month period ended May 31, 1995, the Company purchased 267,500 shares at an average market price of \$9.84 per share. All of these shares were purchased subsequent to July 1, 1994. In November 1994, the Company retired 100,000 shares of treasury stock carried at a cost of \$950,000. These shares were returned to authorized and unissued shares. At September 30, 1995, the Company had 187,232 shares of treasury stock, carried at cost.

Other capital contributions are from a senior officer of the Company and represent a settlement of certain securities matters. No dividends were paid on the Company's common stock during fiscal 1993, 1994 or 1995.

Company to borrow against its own operator services and direct dial long distance services accounts receivable. At September 30, 1995, the Company had approximately \$22.0 million available for borrowing and did not have any amounts borrowed against its own receivables under this facility. Any horrowings under this facility hear interest at the prime rate guaranteed by the Company not otherwise pledged as security under other debt agreements. Performance under the revolving credit facility has been plus .5%. This facility is collateralized by the related accounts receivable and by virtually all of the assets of the Company

write-off of the related unamortized original issue discount and unamortized financing costs. resulted in an extraordinary loss of approximately \$547,000, set of approximately \$349,000 of income tax benefits, from the \$10,000,000 of its 13% Senior Subordinated Notes due 1995 (Senior Subordinated Notes) with certain investment funds on August 5, 1991. In June 1993, the Senior Subordinated Notes were retired using a portion of the net proceeds received from he Company's June 1993 underwritten common stock offering. The early retirement of the Senior Subordinated Notes To finance the acquisition of three related direct dial long distance companies in July 1991, the Company placed

furniture. The loans are guaranteed by the Company and are secured by the assets acquired with the proceeds of such notes various fixed rate notes with rates ranging from 6.75% to 11%, due in varying amounts through October 2000. The proceeds from the issuance of these notes were used to acquire certain computer and telecommunications equipment and office The Company has a variable rate term note at a rate of prime plus 1.25%, due in July 1997. The Company also has

operating income, as defined in the agreements, to consolidated fixed charges of at least 1.5 to 1.0 and is prohibited from paying dividends on its common stock. The Company also may be subject to certain limitations on its annual capital Company's most significant credit facilities may place the Company in default of such facilities should it fail to satisfy provisions of certain other loan agreements. Under the Company's most significant credit facilities, the Company has guaranteed the obligations of its subsidiaries. The Company was in compliance with all required covenants at September 30. expenditures and on the issuance of additional secured debt, but can issue subordinated unsecured debt provided the ratio of Under the most restrictive terms of its credit facilities, the Company is required to maintain a quarterly ratio of consolidated 1994 and 1995 nit the ability of certain of the Company's subsidiaries to remit dividends to the Company. Cross-default provisions of the led debt, as defined in the applicable loan agreement, to total capitalization not greater than 60%. The agreements further consolidated debt to total capitalization does not exceed \$5%. Further, the Company is required to maintain a ratio of The credit facilities discussed above contain various restrictions and financial ratio maintenance requirements.

Scheduled maturities for the years ending September 30, 1996 through 2000 are as follows (in thousands):

#### Note 7. Stock Options and Stock Purchase Warrants

The Company has granted stock options to directors and employees as follows:

	Number of Shares	Price Range of Shares Under Option
Outstanding, September 30, 1994	1,657,099	
Canceled	(65,264)	\$ 7.85 - \$13.13
Granted	300,500	\$ 9.38 - \$14.88
Exercised	(471,861)	\$1.50 - \$12.13
Outstanding, September 30, 1995	1.420.474	
Exercisable, September 30, 1995	756,524	

Stock options to purchase an aggregate of 48,000 shares were outstanding at September 30, 1995, were granted outside of any plan and are exercisable at prices ranging from \$4.62 to \$11.88 at varying dates through January 24, 2000. Stock options to purchase an aggregate of 40,000 shares were outstanding at September 30, 1995, were granted under the provisions of the Company's 1993 Non-Employee Director Stock Option Plan ("Director Plan") and are exercisable at prices ranging from \$10.75 to \$13.25 per share. The Director Plan options, which have certain vesting requirements, expire at varying dates through February 23, 1999. As of September 30, 1995, there were 140,000 shares remaining to be issued under the Director Plan. Stock options to purchase an aggregate of 1,332,474 shares were outstanding at September 30, 1995, were granted under the provisions of the 1990 Employee Stock Option Plan, as amended ("Employee Plan"), and are exercisable at prices ranging from \$1.50 to \$14.88 per share. The Employee Plan options, which have certain vesting requirements, expire at varying dates through April 12, 2000. The Employee Plan options, which have certain vesting requirements, expire at varying dates through April 12, 2000. The Employee Plan provides for the granting of incentive stock options and nonqualified stock options. As of September 30, 1995, there were 407,571 shares remaining to be issued under the Employee Plan. During fiscal 1993 and 1994, options to purchase a total of 289,705 and 112,386 shares of common stock were exercised, respectively.

The excess of the market value of the common stock on the date granted over the exercise price of such options results in compensation expense to the Company on the date the options vest. Approximately \$216,000, \$244,000 and \$273,000 of compensation expense was recognized by the Company during fiscal 1993, 1994 and 1995, respectively. Deferred compensation costs amounting to \$427,000 and \$154,000 at September 30, 1994 and 1995, respectively, have been netted against paid-in capital in the accompanying consolidated financial statements.

Stock purchase warrants to purchase 469,741 shares of common stock were outstanding at September 30, 1995. These warrants were issued in connection with the sale of the Senior Subordinated Notes described in Note 4 and are exercisable at \$.01 per share until August 5, 1999. During fiscal 1993, warrants to purchase 450,000 shares of common stock were exercised and the remaining warrants were reduced by 336,902 due to the early retirement of the Senior Subordinated Notes. An additional 608,459 warrants to purchase shares of common stock were exercised in 1995. There were no stock purchase warrants exercised in fiscal 1994.

In October 1992, the Company agreed to grant a non-transferable warrant to purchase 125,000 shares of common stock at an exercise price of \$12.38 per share, pursuant to a telecommunications service agreement. This agreement was replaced in January 1995 by a new agreement, pursuant to which the Company agreed to grant a non-transferable warrant to purchase 125,000 shares of common stock at an exercise price of \$12.50 per share. The exercise price of the warrant was equal to the market value of the Company's common stock on the date of grant. The exercise of the warrant is contingent upon the attainment of a certain operator services call volume billed by the Company pursuant to the telecommunications service agreement.

In July 1993, the Company agreed to grant a warrant evidencing the right to purchase up to 80,000 shares of common stock at an exercise price of \$11.50 per share and issue up to an additional 130,000 shares of common stock to the seller of a particular customer base. Under this agreement, the exercise of the warrant and the issuance of the common stock were contingent upon the attainment of certain revenue levels under a telephone contract and from the customer base. In May 1994, the Company issued 60,000 shares of its common stock to the seller to fully satisfy all contingent consideration requirements of the agreement.

In September 1995, the Company agreed to grant a warrant to purchase 100,000 shares of common stock at an exercise price of \$14.88 per share, pursuant to a telecommunications service agreement. The exercise price of the warrant was equal to the market value of the Company's common stock on the date of grant. The exercise of the warrant is contingent upon the attainment of a certain operator services call volume billed by the Company pursuant to the telecommunications service agreement.

#### Note & Income Taxes

The provision for income taxes is comprised of the following (in thousands):

	Year E	nded Septen	abet 39.
		1324	
Current	\$1.189	\$3,069	\$6,353
Deferred	2,114	_1.211	_1.792
	\$3,303	\$4.280	\$8,145

The provision for income taxes for fiscal 1993, 1994 and 1995 differs from the amount computed by applying the statutory federal income tax rate of 34% for fiscal 1993 and 1994, and 35% for fiscal 1995 to income before taxes. The reasons for these differences were as follows (in thousands):

	Year Es	abel Senten	der M.
Computed income tax provision at statutory rate	1995 \$2,883	\$3,526	\$7,063
Increases (reductions) in taxes resulting from:			
State income taxes	391	567	870
Amortization of asset valuations in excess of tax	40	146	202
Other, net	_00	41	10
Provision for income taxes	\$3,303	\$4.280	\$8.145

The tax effect of significant temporary differences, which comprise the deferred tax assets and liabilities, are as follows (in thousands):

	Septer	mber 39.
	1224	1995
Deferred tax assets:		
Expense provisions	\$102	5441
Alternative minimum tax credit carryforwards	796	0
Total gross deferred tax assets	898	441
Deferred tax liabilities:		
Tax depreciation and amortization in excess of book	(1,640)	(3,169)
Prepaid expenses	(260)	(244)
Other	_(396)	(175)
Total gross deferred tax liabilities	(2,296)	(3,588)
Net deferred tax liability	\$(1.398)	\$(3,147)

During fiscal 1993, the Company recognized, as an extraordinary item, a tax benefit of approximately \$231,000 resulting from the utilization of the Company's net operating loss carryforwards generated in fiscal years prior to fiscal 1993. No such tax benefit was recognized during fiscal 1994 or 1995.

For the year ended September 30, 1994, the Company had fully utilized its federal income tax net operating loss carryforwards available to reduce future income tax liabilities. For the year ended September 30, 1995, the Company had fully utilized its alternative minimum tax credit carryforward available to reduce current federal income tax liabilities.

taxes, interest or penalties has been made. The Company has been notified by the Internal Revenue Service ("IRS") that a fiscal 1992 transaction between a wholly owned foreign subsidiary (Mega Plus Dialing, Inc.) and its U.S. subsidiary (Zero Plus Dialing, Inc.) is proposed to be issue a report that will propose an assessment of income tax and related excise taxes, interest and penalties. The Company and its tax coursel disagree with the IRS's position, and, therefore, no accrual for this potential liability or any associated differently by the IRS than originally characterized by the Company. The Company understands that the IRS will

# Note 9. Branch Plans

Generally, all employees of the Company or its subsidiaries who are 21 years of age and who have completed one year of The Company adopted the U.S. Long Distance Corp. 401(k) Retirement Plan ("Retirement Plan") effective January 1, 1992. Participation in the Retirement Plan is offered to eligible employees of the Company or its subsidiaries. service during which they worked at least 1,000 hours are eligible for participation in the Retirement Plan

deferral. The Company may from time to time make additional discretionary contributions. During fiscal 1994, a discretionary contribution in the amount of approximately \$51,000 was made. No discretionary contributions were made in fiscal 1993 or 1995. During fiscal 1993, 1994 and 1995, the Company's contributions totaled approximately \$79,000. salary deferral contributions, on a pretax basis, of between 2% and 15% of their compensation in the form of voluntary payroll deductions up to a maximum amount as indexed for cost-of-living adjustments. The Company makes matching \$198,000 and \$150,000, respectively. contributions at a percentage determined annually of the first 6% of a participant's compensation contributed as salary The Retirement Plan is a defined contribution plan which provides that participants generally may make voluntary

basis, of between 1% and 100% of their eligible compensation. Under the Executive Plan, the Company makes matching contributions equal to the lesser of 100% of a participant's contributions or an amount determined based on a formula established by the plan. Matching contributions under the Director Plan are 33% of the participant's contributions. The Company has the right to make matching contributions of a different amount or no contributions under both plans. During fiscal 1994 and 1995, the Company contributed \$60,000 and \$87,000 to the Executive Plan and \$6,000 and \$15,000 to the the U.S. Long Distance Corp. Director Compensation Deferral Plan ("Director Plan") effective January 1, 1994 Director Plan, respectively. Director Plan is offered to individuals occupying a position as an outside director. The Executive and Director Plans are defined contribution plans which provide that participants may make voluntary salary deferral contributions, on a pretax Participation in the Executive Plan is offered to selected employees occupying management positions who are determined by the Company's board of directors from time to time to be eligible to participate in the Executive Plan. Participation in the The Company adopted the U.S. Long Distance Corp. Executive Compensation Deferral Plan ("Executive Plan") and

Plan") effective January 1, 1994. The Disability Plan provides long-term disability benefits for certain employees occupying management positions through disability insurance coverage purchased by the Company and through Company funded payments. Benefits under the Disability Plan are provided directly by the Company based on definitions contained in the Additionally, the Company adopted the U.S. Long Distance Corp. Executive Qualified Disability Plan ("Disability

Company's stockholders, all amounts contributed by employees will be returned was approved by the Board of Directors on May 16, 1995, it is still subject to approval by a majority of the Company's ESPP enables employees who have completed at least six months of continuous service with the Company to purchase requirements of Section 423 of the Internal Revenue Code of 1986, as amended, became effective July 1, 1995. The sockholders at the annual stockholders' meeting to be held in February 1996. If the ESPP is not approved by the haves of the Company's common stock at a 15% discount through voluntary payroll deductions. The U.S. Long Distance Corp. Employee Stock Purchase Plan (the "ESPP"), which was established under the Although the ESPP

#### Note 10. Commitments and Contingencies

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations, however, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on the Company's results of operations for the fiscal period in which such resolution occurred.

In December 1993, the SEC's Division of Enforcement instituted an informal inquiry relating to certain of the Company's accounting practices, including revenue recognition and accounting related to the Company's accounts receivable, purchased receivables and other assets, and related disclosures. When the Company's Board of Directors learned of the SEC's informal inquiry, Arthur Andersen LLP, the Company's independent public accountants, was engaged to conduct a special review of the Company's accounting policies and procedures. This review was managed by a senior partner of Arthur Andersen LLP who was not involved in the annual audit process. This special review provided strong additional assurance that the financial statements of the Company were fairly stated and in conformity with generally accepted accounting principles. Representatives of the Company and Arthur Andersen LLP have met with the Enforcement Division of the SEC to discuss the issues raised by the inquiry. On May 5, 1994, the Company was informed that the SEC had instituted a formal order of private investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934, as amended (In The Matter of U.S. Long Distance (18O-2852)), relating to, among other things, the Company's financial condition, results of operations, assets and liabilities, revenues and revenue recognition and agreements and transactions. Prior to August 1994, the Commission issued subpoenas requesting documentation on a number of areas from the Company, from Arthur Andersen LLP, the Company's independent auditors, and from certain third parties, including former employees of the Company. The Company has and will continue to cooperate fully with the SEC. Although the Company cannot predict when the SEC's private investigation will be concluded, based upon its review of facts and circumstances, management does not believe that the SEC's review of this matter will result in any adjustment to the Company's previously reported financial statements.

The SEC's Division of Enforcement instituted a formal order of private investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934, as amended (In the Matter of Trading in the Securities of Value-Added Communications, Inc. (HO-2765)) on August 25, 1993. The investigation relates to the trading in the securities of both the Company and Value-Added Communications, Inc. ("VAC"), an operator services provider based in Dallas, Texas. A proposed merger between the Company and VAC was terminated in February 1993. Specifically, the SEC has alleged, among other things, that certain individuals may have employed devices, schemes or artifices to defraud others in connection with the purchase or sale of the securities of either the Company, VAC or both. The SEC may impose a variety of civil, criminal and administrative remedies and/or sanctions against any individual or entity found to have violated the federal securities laws. The Company is not aware of any facts or circumstances that would indicate that the Company or any of its management violated the federal securities laws by trading on material, nonpublic information.

The Company is obligated to pay a total of approximately \$4,355,000 during fiscal 1996 for minimum usage charges under billing and collection agreements with certain local telephone companies. The Company is also obligated to pay a minimum of approximately \$11,700,000 during fiscal 1996 for usage charges under service agreements with certain long distance carriers. The Company anticipates exceeding the minimum usage volumes with these vendors.

#### Note 11. Regulatory Matters

#### Interstate Access Transport Proceeding

In January 1994, the Federal Communications Commission (the "FCC") granted increased pricing flexibility to local telephone companies for "access transport" services. These services refer to the connection provided by the local telephone companies between long distance telephone companies and the local telephone company central office serving the end user customers. Local telephone companies formerly assessed an equal charge per unit of access to all long distance telephone companies, regardless of the volume of access each long distance telephone company purchased.

After implementation of the FCC's new plan, local telephone companies now may discount access transport rates to the long distance telephone companies with the highest access volumes and increase access transport rates to long distance telephone companies with relatively lower access volume. The FCC originally projected the variance in these discounted and increased prices should not exceed 1.8%.

The pricing plan is to be in effect until further Commission action. The FCC could grant local telephone companies further flexibility and could potentially impose a greater burden upon the operations of the Company's direct dial long distance services after further review at some later date. The FCC originally believed that, by November 1995, the proliferation of competitive access providers and increased long distance carrier network efficiencies would offset any inequities caused by volume-sensitive access pricing. In an Order released September 22, 1995, the FCC instead indefinitely extended the interim transport rules. Management is unable to predict the likelihood of any future revisions or investigations, nor the course or effect of the FCC's actions on this issue and the Company at this time.

In a related matter, the FCC has authorized local telephone companies to offer volume discounts on access transport services, once certain threshold conditions are met. The offering of such discounts could produce cost advantages for long distance carriers with large volumes of transport traffic. This FCC action is subject to pending petitions for reconsideration.

#### Billed Party Preference

Billed Party Preference ("BPP") is a proposal still pending action or ruling by the FCC and refers to a concept in which any long distance call outside the local telephone company's calling area carried from a publicly available telephone would be automatically routed over the long distance telephone company network of the billed party's preference. This would be accomplished through a local telephone company database system that would match every calling card and telephone number to a preferred long distance telephone company and then route all calls accordingly.

In April 1992, the FCC tentatively proposed adopting BPP. During the summer of 1992, comments from local telephone companies, long distance telephone companies and other industry representatives revealed that the costs of imposing BPP could be in excess of \$1 billion and could require hundreds of millions of dollars each year to operate. Commentors made clear that many ancillary technical impediments would necessarily accompany deployment of BPP, as contemplated. Furthermore, equipment manufacturers could not support implementation of BPP until three years after such decision. Most commentors opposed the BPP proposal.

On June 6, 1994, the FCC released a "Further Notice of Proposed Rulemaking" in the BPP proceeding. Once again, the FCC expressed a clear interest in examining further the relative costs associated with BPP implementation. The FCC also requested that the industry provide suggestions for a more cost efficient alternative that might similarly meet the objectives of BPP, which are the facilitation of access to operator services networks, increased competition and lower end-user rates. The FCC received industry members' comments on August 1, 1994, which again were heavily against the adoption of this system.

If such a system were implemented successfully, the unique market niche of operator services providers, such as the Company, would be rendered virtually ineffectual, because operator services providers depend upon public telephone presubscription, and BPP takes the call routing decision away from the public telephone owner. It is difficult to assess the industry support for BPP, given the inherent technical problems it involves. AT&T is on record as opposing this proposal, and the Regional Bell Operating Companies (the "RBOCs") agree that they would not support it unless they were not held accountable for the costs of its implementation. The FCC has been investigating this proposal now for eight years, and the record in this proceeding shows that network reconfiguration would take two to four years beyond any positive FCC action. Thus, while BPP remains arguably viable, as demonstrated by the FCC's June 6, 1994 Notice, the Company believes it is not probable that it would be technically implemented in the near term.

On March 9, 1995, the FCC requested industry comment on two proposals it had recently received relative to the BPP proceeding. In an ex-parte petition, the National Association of Attorney's General ("NAAG") suggested that the FCC modify its current branding requirement such that operator services providers ("OSPs") would be required to announce at the beginning of each call more specific information for obtaining access to alternate carriers (the "NAAG").

Petition"). Another petition filed by a coalition of industry members, including most of the Regional Hell Operating Companies, two competitive access providers, the American Public Communications Counsel ("APCC") and the Competitive Telecommunications Association ("CompTel"), recommended that the FCC impose certain rate thresholds for interstate operator assisted services, which the FCC would presume to be reasonable, and any OSP electing to charge rates higher than such threshold would be required to first prove to the FCC that such rates are justified based upon the underlying costs of the service (the "APCC Rate Cap Proposal"). The NAAG Petition was proposed to remain in effect until such time that BPP is adopted and fully implemented. The APCC Rate Cap Proposal was proposed to obviate the need to consider any further action regarding BPP.

If adopted, the NAAG Petition or any form of modified call branding could have a negative effect upon the number of calls completed over OSP networks such as the Company's, if end users elect to act upon the additional branding announcement regarding access to other carriers. Furthermore, additional network time would be consumed without a corresponding increase in revenue.

Furthermore, if the APCC Rate Cap Proposal is adopted, OSPs such as the Company may be immediately required to lower their interstate rates until such time as the FCC rules upon an attempt to justify higher, existing rates. OSPs may be required to adjust the amount of commission payments made to their subscriber customers as a result of implementation of such a proposal, or effect other operational changes to offset any reduction in interstate operator services revenue.

The Company cannot predict when and if any final ruling on either proposal might be issued.

#### MFJ Legislation

Legislation has been introduced in the 104th Congress which, if enacted, would supersede the AT&T Consent Decree of 1983. On March 23, 1995, the Senate Commerce Committee, chaired by Senator Pressler of South Dakota, endorsed the "Telecommunications Competition and Deregulation Act of 1995" (S.652). The full Senate passed S.652 by a vote of \$1 to 18 on June 15, 1995. Pressler's bill requires a 90-day application review by the FCC. The FCC is directed to consult with the Department of Justice to obtain their opinion regarding the RBOCs' potential to impede competition through their continuing monopoly control of local services.

Correspondingly, on August 4, 1995, the House of Representatives passed "The Telecommunications Act of 1995" (H.R. 1555), which eliminates any role for the Department of Justice in codifying the terms of the MFJ. The House measure proposes to allow RBOCs to seek authority to provide long distance services from the FCC, who will use a legislative checklist in considering such applications. RBOCs will be permitted to make such application six months after enactment of the law and must operate any long distance unit as a separate subsidiary for eighteen months. Long distance carriers will have the opportunity to resell local exchange service at RBOC "wholesele" costs. Similar to the Senate proposal, no precondition of measurable local competition is imposed upon RBOC entry into long distance.

Both Houses have initiated preliminary discussions in the Joint Conference Committee to attempt to resolve the differences in the proposals. If a consensus is reached by the Conferees, and approved again by both the House and the Senate, they could present a final bill for executive signature shortly thereafter. The Administration has indicated that it is opposed to some of the elements in each of these proposals; therefore, it is currently less than certain such legislation will become law.

The Company cannot predict if such legislation will ultimately be endorsed by the Executive Branch and made law. If the MFJ were to be superseded by legislation, Southwestern Bell and the other RBOCs could be permitted to offer long distance services in competition with the Company and could prove to be formidable in terms of their marketing strength and other resources. Furthermore, if such companies are permitted to retain control of long distance access services to the Company's customers after being granted such permission, such control might materially and adversely affect the Company's ability to continue to offer similar or comparable services.

In September 1993, AT&T petitioned the FCC to reclassify it as a "non-dominant" carrier. The FCC granted AT&T's petition on October 12, 1995. AT&T has been given additional flexibility in its service offering and pricing. Such flexibility could make AT&T an even more formidable competitor than it has been. The Company cannot predict the impact of the FCC action.

#### Regulatory Rate Proceedings

During the course of normal operations, a regulated company may at any time come under specific scrutiny with regard to any of its rates, terms or conditions by which such service is rendered by the state or federal regulatory agency charged with such oversight responsibility, or by an attorney general or other jurisdictional consumer officials. In such cases, a regulated company can be required to, among other things, provide cost justification for the charges it imposes on some or all of its services, or to address perceived consumer inequities. After review of such justification, the regulatory agency generally has the authority to require a carrier to modify the process by which such services are rendered or to effect changes to its applicable rate structure. Consumer officials and attorneys general can pursue civil action if their concerns are not adequately addressed by the carrier. The Company operates in several jurisdictions in which its tariffs or services may, from time to time, fall under such scrutiny at the discretion of the governing regulatory agency or other officials. The Company could therefore be required, as a result of such an investigation and subsequent proceeding, to implement changes in its rate structure, which could ultimately affect its revenues. The Company cannot predict whether or not any such requirement may be imposed in any particular jurisdiction.

#### Texas PIU Issue

In a Final Order released in Docket 10127 on April 12, 1993 ("Final Order"), the Texas Public Utility Commission ("PUC") adopted new regulations governing the method by which interexchange carriers ("IXCs") such as the Company calculate intrastate access charges paid to local exchange companies ("LECs"). These new rules required an independent auditor's review and approval of an IXC's methodology of determining its own intrastate access usage. The auditors' reports were to be submitted to the LECs for review and implementation beginning on June 15, 1994.

However, on June 13, 1994, Travis County Judge Hume Cofer found in Allcomm Long Distance, Inc. v. PUC and Southwestern Bell, Cause No. 94-06509, that Allcomm was entitled to an injunction against enforcement by the PUC and Southwestern Bell of the Final Order because the PUC improperly delegated regulatory authority outside the PUC. Permanent injunctive relief was granted to Allcomm in this cause on June 17, 1994. The decision was appealed by the PUC and Southwestern Bell.

On June 15, 1994, the Company, along with several other IXCs ("Intervenors") sought intervention and similar injunctive relief in a new cause filed with Judge Cofer, Cause No. 94-06509-A. American Telco, Inc. et al. v. PUC and Southwestern Bell. The Intervenors reached an agreement in accordance with Rule 11, Texas Rules of Civil Procedures, with the PUC and Southwestern Bell which provided, among other things, that in lieu of submitting audit reports to Southwestern Bell. Intervenors would have such reports held under seal by a designated third party until a final, nonappealable judgment is rendered in the Allcomm case. In the interim, Intervenors such as the Company are not prohibited from continuing to establish access charge levels based upon their own respective methodologies.

On June 22, 1995, the Texas Court of Appeals overturned the lower court's decision in the Allcomm matter concluding that the trial court erred in finding that the PUC had exceeded its statutory authority. Further, the Texas Court of Appeals rendered judgment that the Final Order is enforceable against Allcomm. On September 25, 1995, Allcomm filed a writ of error regarding this matter with the Supreme Court of the State of Texas. If the writ of error is denied or if the action of the Texas Court of Appeals is sustained by the Supreme Court on appeal, it is likely that the Company will be required by further PUC action to adopt modified methodologies that could subsequently obligate the Company to compensate the LECs for any resulting differences in calculating access charges. The Company cannot predict the timing nor the outcome of the filing of the writ of error nor actions that may be undertaken by the LECs either before or after a final outcome on this case is reached. Based on advice of legal counsel, management believes there will be no retroactive liability to the Company prior to the Allcomm matter becoming a final and non-appealable order. However, management estimates that, under the most extreme application of the independent auditors' proposed methodologies, the difference between applying the alternative methodologies would result in prospective increased intrastate access charge expense of between \$3 million and \$4 million annually.

#### Note 12. Nahacquest Events

In November 1995, the escrow agreement pursuant to which 16,869 shares of the Company's common stock were held in escrow relating to the Company's acquisition of the long distance commercial customer base of a company in March 1995 was terminated. The 16,869 shares have been returned to the Company and will be held as treasury shares.

#### Note 13. Selected Quarterly Financial Data (Unaudited)

In thousands, except per share amounts		Three Monti	in Ended	
	Docember 31, 1994	March 31, 1995	Jene 30, 1995	Neptrusber M. 1995
Resenues	\$50,146	\$50,864	\$58,052	\$65,964
Income from operations	3.179	3,403	4,181	6,209
Net income	2,270	2,439	3,053	4,273
Net income per share of common stock	\$0.16	\$0.17	\$0,21	\$0.29
		These Mont	n Ended	
	Docember 31, 1993	Moreh 31, 1994	Jenr 30, 1994	September 34,
Revenues	\$38,792	\$42,181	\$48,387	\$52,392
Income (loss) from operations	(1,124)	817	3,803	5,919
Net income (loss)	(679)	563	2,385	3,821
Net income (loss) per share of common stock	\$(0.05)	\$0.04	\$0.17	\$0.27

TTEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS
ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

#### PART III

#### **ITEM 10.** DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

The information called for by this item is incorporated herein by reference from the information under the captions "Election of Directors" (Item 1 on proxy), "Management - Directors and Executive Officers," and "Section 16(a) Reporting" of the Company's definitive proxy statement to be filed pursuant to Regulation 14A with the Securities and Exchange Commission relating to its Annual Meeting of Stockholders to be held on February 29, 1996 (the "Definitive Proxy Statement").

#### ITEM 11. EXECUTIVE COMPENSATION

The information called for by this item is incorporated herein by reference from the information under the caption "Management - Committees, Meetings and Compensation of the Board of Directors - Directors' Fees" and from the information under the caption "Executive Compensation" of the Company's Definitive Proxy Statement.

#### SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information called for by this item is incorporated herein by reference from the information under the caption "Voting Securities and Principal Stockholders" of the Company's Definitive Proxy Statement.

#### **ITEM 13.** CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for by this item is incorporated herein by reference from the information under the caption "Certain Transactions" of the Company's Definitive Proxy Statement.

#### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

#### (a) Documents Filed as Part of Report

#### 1. Financial Statements:

The consolidated financial statements of the Company and the related report of the Company's independent public accountants thereon have been filed under Item 8 hereof.

#### 2. Financial Statement Schedules:

The following financial statement schedules and the report of independent public accountants thereon are included in this report at the page indicated. All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted because such schedules are not required under the related instructions or are inapplicable or because the information required is included in the Consolidated Financial Statements or notes thereto.

-		200
Mem	Independent Public Accountants	52
		42
Scheduk	I - U.S. Long Distance Corp. Condensed Financial Information	
Scheduk	II - Valuation and Qualifying Accounts	57

The accompanying notes are an integral part of these Consolidated Financial Statements.

#### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of U.S. Long Distance Corp.:

We have audited, in accordance with generally accepted auditing standards, the consolidated financial statements of U.S. Long Distance Corp. and subsidiaries and have issued our report thereon dated November 10, 1995. Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedules I and II are the responsibility of the Company's management and are presented for purposes of complying with the Securities and Exchange Commission's rules and are not part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly state in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

San Antonio, Texas November 10, 1995

### U.S. LONG DISTANCE CORP. Condensed Financial Information (Not Consolidated) CONDENSED BALANCE SHEETS

#### ASSETS

	34440704	iber 39.
Current assets:		
Accounts receivable	\$ 396	\$ 2,280
Prepaids and other	2.766	455
Total current assets	3,162	2,735
Due from affiliates, net	11,488	18,917
Investment in subsidiaries (equity method)	33,308	45,575
Net property and equipment	3,646	4,041
Other assets, net	2,392	1.756
Total assets	\$53,996	\$73.024
Current liabilities: Accounts payable	\$ 692 1,333 212	\$ 410 2,774 
Other current liabilities		
Total current liabilities	2,237	3,414
Other liabilities	1,659	248
Long-term debt, less current portion	788	1,188
Obligations under capital leases, less current portion	96	
Stockholders' equity:	129	143
Common stock	42,540	49.304
Additional paid-in capital	8.211	20,473
Retained earnings	(1.664)	(1.789)
Treasury stock	49.216	68.131
Total stockholders' equity	\$53,996	\$73.024
Total liabilities and stockholders' equity	11172	Take I

See notes to condensed financial statements.

### U.S. LONG DISTANCE CORP. Condensed Financial Information (Not Consolidated) CONDENSED STATEMENTS OF INCOME.

	200.000	THE SECTION LINES REPORTED TO		
	1993	(In theysand	L992 (a)	
Cost and expenses:  Operating and general expenses	\$ 549 1,198 (2,294)	\$ 859 105 	\$ 1,020 121 _(1,141)	
	547	0	0	
Equity in carnings of subsidiaries	4,860	6,090	12,035	
Net income before extraordinary items	5,407	6,090	12,035	
Extraordinary loss on early extinguishment of debt	(547)	0	0	
Net income applicable to common stock	\$4.860	\$6,090	\$12.035	

See notes to condensed financial statements.

### U.S. LONG DISTANCE CORP. Condensed Financial Information (Not Connelidated) CONDENSED STATEMENTS OF CASH FLOWS

	Enr. th. 1993	Year Ended Say 1790 (In thousands)	1999 1999
Cash flows from operating activities:  Net income before extraordinary item	\$ 5,407	\$ 6,090	\$ 12,035
Adjustments to reconcile net income before extraordinary item to net cash provided by (used in) operating activities:			
Equity in carnings from operations of subsidiaries	(4,860)	(6,090)	(12,035)
Depreciation and amortization expense.		859	1,020
Deferred compensation		244	273
Amortization of debt discount		0	0
Changes in operating assets and liabilities:			
Increase in current assets	(865)	(1,300)	(969)
Increase (decrease) in current liabilities	876	(764)	3,715
Increase in other liabilities	3,630	22	150
Transfers (to) from subsidiaries		_5,409	_(7.417)
Net cash provided by (used in) operating activities	_(8,572)	4,470	_(3.228)
Cash flows from investing activities:			
Purchases of property and equipment	(2,274)	(1,327)	(1,376)
Acquisition of direct dial long distance companies, net of cash acquired	. 0	(565)	(175)
Proceeds from sale of assets	. 0	0	602
Other investing activities	(476)	_(1,508)	822
Net cash used in investing activities	_(2.750)	_(3.400)	(127)
Cash flows from financing activities:			
Proceeds from issuance of debt		569	833
Payments on debt		(518)	(468)
Financing costs	. (147)	(32)	0
Proceeds from issuance of common shares		470	4,065
Purchase of treasury shares		_(1,559)	_(1,075)
Net cash provided by (used in) financing activities		_(1,070)	
Net change in cash and cash equivalents	. 0	0	0
Cash and cash equivalents, beginning of year	0	0	0
Cash and cash equivalents, end of year	. 5_0	سن	10

See notes to condensed financial statements.

#### NOTES TO CONDENSED FINANCIAL STATEMENTS

#### Note 1. Debt

See Note 4 to the Consolidated Financial Statements of the Company for disclosure of long-term obligations and guarantees.

#### Note 2. Dividends From Subsidiaries

No cash dividends were paid to U.S. Long Distance Corp. by its subsidiaries during the years ended September 30, 1993, 1994 or 1995.

#### Note J. Contingencies

See Note 10 to the Consolidated Financial Statements of the Company for disclosure of material contingencies.

#### Note 4. Nabacquent Events

See Note 12 to the Consolidated Financial Statements of the Company for disclosure of subsequent events.

#### U.S. LONG DISTANCE CORP. AND SUBSIDIARIES Valuation and Qualifying Accounts (In thousands)

Fincal		Balance at Beginning of	Charged to Costs and	Charged to	Write-offs Charged to	Balance at East					
Year	Description	Carted	Lynn	other Accounts	Allemance	of Parine					
1993	Allowance for doubtful accounts	\$431	\$ 448	\$0	\$ (63)	5816					
1994	Allowance for doubtful accounts	\$816	\$1,254	\$0	\$(1,449)	\$621					
1995	Allowance for doubtful accounts	\$621	\$2,289	\$0	\$(1,884)	\$1,026					

#### NOTES TO CONDENSED FINANCIAL STATEMENTS

#### Note 1. Debt

See Note 4 to the Consolidated Financial Statements of the Company for disclosure of long-term obligations and guarantees.

#### Note 2. Dividends From Subsidiaries

No cash dividends were paid to U.S. Long Distance Corp. by its subsidiaries during the years ended September 30, 1993, 1994 or 1995.

#### Note 3. Contingencies

See Note 10 to the Consolidated Financial Statements of the Company for disclosure of material contingencies.

#### Note 4. Subsequent Events

See Note 12 to the Consolidated Financial Statements of the Company for disclosure of subsequent events.

## 3. Exhibits

The exhibits listed below are filed as part of or incorporated by reference in this report. Where such filing is made by incorporation by reference to a previously filed document, such document is identified in parentheses. See the Index of Exhibits included with the exhibits filed as part of this report.

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	•		•	•		•				•		•	•	•	•	•
Transmission Agreement dated April 25, 1991, by and between the Company and MCI Telecommunications Corporation (Exhibit 10.1 to September 30, 1991, Form 10-K) as amended by Agreement dated April 6, 1995 (Filed herewith)	Registration Statement on Form S-3, SEC File No. 33-71228, dated November 23, 1993) and as an add by Letter Agreement dated January 11, 1995 (Filed herewith)  Agreement dated March 23, 1993 by and between Paytel Northwest, Inc., U.S. Long Distance Corp. and U.S. Long Distance, Inc. as amended by Agreement dated August 23, 1995 (Filed	Statement on Form S-3, SEC File No. 33-71228, dated November 23, 1993)  Amended Letter Agreement dated October 6, 1992, by and between Communications Central, Inc. U.S. Long Distance Com. and U.S. Long Distance, Inc. (Exhibit 4.7 to Amendment No. 1 to	Asset Purchase Agreement by and between U.S. Long Distance, Inc., R.J. Hono and U.S. Long Distance of Louisiana, Inc., dated July 1, 1993 (Exhibit 4.6 to Amendment No. 1 to Registration	No. 33-54448, dated May 17, 1993) Form of Warrant Certificate (Exhibit 4.5 to Amendment No. 2 on Form S-3 to Form S-1	Second Amendment of August 5, 1991, Securities Purchase Agreement dated May 13, 1993 (Exhibit 4.4 to Amendment No. 2 on Form S-3 to Form S-1 Registration Statement, SEC File	Amendment of August 5, 1991, Securities Purchase Agreement and Amendment of Warrant  16 1991 (Exhibit 4.1 to Securities 70 1991 Form 10-K)	"B" Fund, and Electra Holdings, Inc. (collectively, the "Purchasers"), Senior Subordinated Notes due 1995, dated August 5, 1991 made by the Company and payable to the Purchasers. Warrant Certificates, dated August 5, 1991, executed by the Company to the Purchasers, and the Guaranty, dated August 5, 1991, executed by U.S. Long Distance, Inc., Buyer Acquisition Corporation, Mega Plus Dialing, Inc., Zero Plus Dialing, Inc. and U.S. Billing Services, Inc. in favor of the	Securities on Form 10, dated December 21, 1989) Securities Purchase Agreement dated August 5, 1991, by and between the Company and Electra Securities Purchase Agreement dated August 5, 1991, by and between the Company and Electra Total P I C Scientific Development Capital	Bylaws of the Company (Exhibit 3.7 to September 30, 1992, Form 10-K)  Form of Certificate Evidencing Common Stock (Exhibit 4(a) to General Form for Registration of	Certificate of Elimination of Series A Preferred Stock dated May 21, 1993 (Exhibit 58 to	No. 33-41039, dated June 5, 1991)  Certificate of Amendment dated March 23, 1993 (Exhibit 3.7 to September 30, 1993, Form 10-K)	Certificate of Amendment to Certificate of Designation, Powers, Preferences and Rights of	(Exhibit 3.4 to September 30, 1990, Form 10-K)  Certificate of Amendment dated February 14, 1991 (Exhibit 4.5 to Registration Statement on	Certificate of Designation, Powers, Preferences, and Rights of the Series A Preferred Stock	Securities on Form 10, dated December 21, 1989 (Exhibit 4 to December 31, 1989, Form 10-Q) Certificate of Amendment dated Date 19, 1990 (Exhibit 4 to June 30, 1990, Form 10-Q)	Certificate of Incorporation, as amended (Exhibit 3(a) to General Form for Registration of

Amended and Restated Employment Agreement dated November 1, 1993, by and between the 10.2 Company and Parris H. Holmes, Jr. (Exhibit 10.2 to September 30, 1993, Form 10-K) as amended by the First Amendment to Amended and Restated Employment Agreement dated January 3, 1995 and Second Amendment to Amended and Restated Employment Agreement, dated November 15. 1995 (Filed herewith) Form of Amended and Restated Employment Agreement dated November 1, 1993, by and 10.3 between the Company and its named executive officers (Exhibit 10.3 to September 30, 1993. Form 10-K) as amended by the First Amendment to Amended and Restated Employment Agreement dated April 19, 1994 and Second Amendment to Amended and Restated Employment Agreement dated January 3, 1995 and Third Amendment to the Amended and Restated Employment Agreement dated November 15, 1995 (Filed herewith) Form of Employment Agreement by and between the Company and its Vice Presidents (Exhibit 10.4 10.4 to September 30, 1993, Form 10-K) 1990 Employee Stock Option Plan, as amended (Exhibit 4.11 to Registration Statement on Form 10.5 S-R. SEC File No. 33-51604, dated September 1, 1992) Form of Option Agreement by and between the Company and its Employees, Under the Employee 10.6 Stock Option Plan (Exhibit 10.8 to September 30, 1992, Form 10-K) Form of Stock Ontion Agreement for Directors, Key Employees and Advisors of the U.S. Long 10.7 Distance Corp. (Exhibit 4.14 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991) Form of Stock Option Agreement for Key Employees of U.S. Long Distance Corp. (Exhibit 4.15 10.8 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991) Form of Stock Option Agreement for Non-Employee Directors of U.S. Long Distance Corp. 10.9 (Exhibit 4.13 to Registration Statement on Form S-8, SEC File No. 33-41039, dated June 5, 1991) Amended and Restated Loan and Security Agreement dated May 22, 1991, by and between Zero 10.10 Plus Dialing, Inc., U.S. Long Distance Corp. and U.S. Long Distance, Inc. and Hell Atlantic TriCon Leasing Corporation ("Bell Atlantic") (currently FINOVA Capital Corporation) (Exhibit 10.10 to September 30, 1991, Form 10-K) and related Revolving Credit Note dated May 24, 1991, Term Note dated June 1992, Corporate Guaranties dated May 24, 1991, and First Amendment and Joinder to Amended and Restated Loan and Security Agreement dated December 17, 1992 (Exhibit 10.9 to September 30, 1992, Form 10-K) Second Amendment to Amended and Restated Loan and Security Agreement dated April 2, 1993 10.11 by and between Zero Plus Dialing, Inc., U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.11 to September 30, 1993, Form 10-K) Third Amendment to Amended and Restated Loan and Security Agreement dated October 1, 1993 10.12 by and between Zero Plus Dialing, Inc., U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.12 to September 30, 1993, Form 10-K) Fourth Amendment and Joinder to Amended and Restated Loan and Security Agreement dated 10.13 October 1, 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.13 to September 30, 1993, Form 10-K) Fifth Amendment and Joinder to Amended and Restated Loan and Security Agreement dated 10.14 November 16, 1993 by and between Zero Plus Dialing, Inc., U.S. Long Distance Corp., U.S. Long Distance, Inc., U.S. Billing, Inc., USLD Acquisition Corp. d/b/a Telecom West, Inc., STS Telecommunications, Inc. and Bell Atlantic (currently FINOVA Capital Corporation) (Exhibit 10.14 to September 30, 1993, Form 10-K) Letter Agreement dated December 2, 1993 by and between Bell Atlantic (FINOVA Capital 10.15 Corporation) and U.S. Long Distance Corp. (Exhibit 10.15 to September 30, 1993, Form 10-K) Data Processing Service Agreement dated December 1, 1989, as amended, by and between 10.16

U.S. Billing, Inc. (Exhibit 10.16 to September 30, 1993, Form 10-K)

Affiliated Computer Services, Inc. and U.S. Long Distance Corp., Zero Plus Dialing, Inc. and

#### SECNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

U.S. LONG DISTANCE CORP.

By: /s/ PARRIS H. HOLMES, IR Parris H. Holmes, Jr. Chairman of the Board and Chief Executive Officer

Date: December 18, 1995

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 18th day of December, 1995.

	Title Chairman of the Board and Chief Executive
Parris H. Holmes, Jr.	Officer (Principal Executive Officer)
/s/ LARRY M. JAMES Larry M. James	Chief Operating Officer, President and Director
/s/ MICHAEL E. HIGGINS Michael E. Higgins	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ CHARLES E. AMATO Charles E. Amato	Director
/s/ GARY D. BECKER Gary D. Becker	, Director
/s/ LEE COOKE Lee Cooke	Director

#### CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports included in this Form 10-K for the year ended September 30, 1995, into the Company's previously filed Registration Statements (SEC File No. 33-41039, 33-46567, 33-51604, 33-71228, 33-77404, 33-77612, 33-80866, 33-81686, 33-85912, 33-91260 and 33-93942).

ARTHUR ANDERSEN LLP

San Antonio, Texas December 19, 1995

#### ATTACHMENT 2 - MANAGERIAL CAPABILITY

#### LARRY M. JAMES President and Chief Executive Officer

Larry James joined U.S. Long Distance in 1988 as Vice President of Sales and Marketing. Five years later he was named President and Chief Operating Officer and was appointed to his current position this year. Under Mr. James' leadership, U. S. Long Distance has become one of the ten largest public long distance companies in the country with over 700 employees and 23 branch offices. For fiscal 1995, U.S. Long Distance reported revenues of \$225.0 million, a 24% increase over the previous year. The Company was included on Fortune magazine's 1993 and 1995 lists of the "100 Fastest Growing Companies in America".

In addition to his responsibilities at U. S. Long Distance, Mr. James was very active in shaping the Telecommunications Act of 1996. He also serves on the Executive Committee and the Board of Directors of the Competitive Telecommunications Association (CompTel), the nationally recognized council which represents the interests of the competitive telecommunications industry.

Mr. James began his career with the Haggar Company, and at the age of 22 became their youngest plant manager, overseeing the company's Lawton, Oklahoma plant. Two years later he was recruited by the Harold Scheer family, the owners of Santone Industries, to manage one of their plant operations. He was quickly promoted to Vice President of Manufacturing, managing 2,500 people in six facilities. Mr. James was subsequently promoted to Executive Vice President and General Manager of Santone Industries. Under his leadership the company grew to 14 plants within four years and revenues increased from \$15 million to \$74 million. Santone Industries was subsequently sold to Levi Straus in 1980.

Mr. James graduated from Louisiana Tech University in 1969 with a B. S. degree in Industrial Engineering. He has continued his education through M.B.A. courses at St. Mary's University in San Antonio.

#### PHILLIP J. STORIN Senior Vice President, Chief Financial Officer

Phillip Storin began his career with U.S. Long Distance as Vice President, Accounting in July 1992. In 1995, Mr. Storin was promoted to Corporate Controller and in May 1996 assumed the position of Chief Financial Officer. Mr. Storin has over 20 years of financial experience in publicly traded companies with a strong background in accounting, financial reporting and financial planning and analysis.

Prior to joining U.S. Long Distance, Mr. Storin served for five years as Director of Accounting for Dell Computer Corporation in Austin, Texas where he was charged with primary responsibility for all accounting and reporting matters. During this period, Dell grew from a company with \$70 million in annual revenues to a \$1 billion dollar international corporation. Prior to Dell, was with Datapoint Computer Corporation for five years where he held a number of financial management positions. Mr. Storin also spent six years with Westvaco Corporation in New York City.

Mr. Storin is a Certified Public Accountant and a Certified Management Accountant. He earned his B.B.A. degree in Accounting and his M.B.A. in Finance from Hofstra University in New York.

#### W. AUDIE LONG General Counsel and Senior Vice President

Audie Long has served in his present position with U. S. Long Distance since 1991. He joined the Company in 1990 as General Counsel and Vice President of Legal and Regulatory Affairs. Mr. Long has served as the Company's General Counsel since 1986 when he was in private practice.

Mr. Long received his B.B.A. from North Texas University and earned his Doctor of Jurisprudence from Southern Methodist University in Dallas.

#### JAMES S. SPEIRS Senior Vice President, Network Operations Chief Technical Officer

Jim Speirs has more than 20 years of Managerial and Technical Operations experience in the telecommunications industry, which includes 13 years with MCI/SBS, 5 years with Com Systems / TMC Communications as Senior Vice President and Chief Technical Officer, and the two years as Vice President, Network Engineering for Frontier/WCT. During his career, Mr. Speirs has held various management level positions responsible for Technical Sales Support, Marketing, Product Development, Program Management, Sales, Engineering, Provisioning, Service Coordination and Service Delivery. Mr. Speirs is currently responsible for all Network, Technical and Switching Operations areas including Network Planning and Provisioning, Network Security, Switch Site Operations and Field Operations.

Mr. Speirs received his Backelor of Science Degree in Communications Engineering (BSEE) from the University of Illinois.

STANLEY G. MASTERS
Senior Vice President, Sales and Customer Service

Stan Masters joined the Company in June 1991 as Director of Operator Services and Direct Dial Sales Agents. Mr. Masters was elected Vice President of Direct Sales in April 1993 and Senior Vice President of Sales the following year. Previously, Mr. Masters served as Western Region Agent Manager of Metromedia Communications where he recruited, trained and developed agents in the Midwest and Western United States.

From January 1989 through August 1990, Mr. Masters was employed by Telecom USA as Regional Manager, with profit and loss responsibility for 6 branch offices, and as Manager of Training-Western Region with responsibility for all sales agent training in the 14-state Western Region. Telecom USA was merged with MCI in August 1990.

RICHARD E. BURK Vice President, Strategic Planning

Richard Burk has over 20 years of experience in the telecommunications industry. Prior to joining U.S. Long Distance, Mr. Burk was President of Network Intelligence, a telecommunications consulting firm specializing in the planning and implementation of new business opportunities arising from state and federal telecommunications regulatory reform. He also served as Vice President of Operations for American Telco in Houston, the largest privately owned long distance company in the state after which he founded his own consulting business. While at Telco, Mr. Burk negotiated the first local interconnection agreement with Southwestern Bell.

Currently, Mr. Burk is serving his second term as President of the Texas Association of Long Distance Telephone Companies.

MARSON K. JENKINS, Ph.D. Vice President, Management Information Systems

Marion Jenkins joined the Company in 1996 and has the responsibility to oversee all corporate management information system functions as well as strategic systems and development planning. Dr. Jenkins has over 10 years experience in the telecommunications industry, most recently serving as Vice President of Sales and Service for American Telco, Inc. Additionally, he served on the Executive Steering Committee that provided direction to the Information Systems Department, including direct involvement with computer software development and maintenance, the conversion of a customer billing system and a network conversion. In addition, Dr. Jenkins has been integrally involved in high-level strategic planning and many of the different functional area of the telecommunications business.

Dr. Jenkins received his MS and Ph.D. degrees in Mechanical Engineering from Stanford University.

#### ATTACHMENT 3 - TECHNICAL CAPABILITY

USLD currently owns and operates four state-of-the art DSC DEX 600 switches, in Atlanta, Georgia, Houston, Texas, Seattle, Washington and Los Angeles, California USLD also owns and operates a DSC DEX 400 in Waco, Texas, and a state-of-the-art Operator Center including approximately one hundred and fifty operator stations, automatic call completion equipment and a debit card platform, in San Antonio, Texas USLD leases fiber optic transmission capacity from several underlying facilities-based providers and originates traffic from its own points-of presence ("POPs") throughout the country. USLD proposes to provide local exchange service in Florida initially on a resale basis, such that the facilities and services underlying USLD's products will be completely controlled by the incumbent LEC.