

ORIGINAL

SWIDLER BERLIN SHEREFF FRIEDMAN, LLP

JUN 11 10 12 AM '99
ADMINISTRATIVE
MAIL ROOM

WASHINGTON OFFICE
3000 K STREET, NW, SUITE 300
WASHINGTON, DC 20007-5116
TELEPHONE (202) 424-7500
FACSIMILE (202) 424-7647

NEW YORK OFFICE
919 THIRD AVENUE
NEW YORK, NY 10022-9998
TELEPHONE (212) 758-9500
FACSIMILE (212) 758-9526

June 10, 1999

VIA OVERNIGHT DELIVERY

Blanca S. Bayó
Director, Division of Records & Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0870

990747-JP

Re: Application for Approval of Proposed Transfer of Control of Campuslink Communications Systems, Inc. d/b/a Parklink Communications, Inc. to PaeTec Corp.

Dear Ms. Bayó:

PaeTec Corp. ("PaeTec") and Campuslink Communications Systems, Inc. d/b/a Parklink Communications, Inc. ("CCS") (collectively, "Applicants"), pursuant to Section 364.33 of the Florida Statutes, hereby request Commission approval of a transaction whereby PaeTec will acquire ownership and control of CCS. CCS is a nondominant carrier authorized by this Commission to provide resold intrastate interexchange and alternative local exchange telecommunications services within the State of Florida. PaeTec is the holding company parent of PaeTec Communications, Inc., a nondominant carrier that is authorized by the Commission to provide resold intrastate interexchange and alternative local exchange telecommunications services within the State of Florida. Neither PaeTec nor any of its subsidiaries is currently affiliated with CCS.

As described below, PaeTec will acquire control of CCS through a transaction whereby CCS will be merged with and into a new subsidiary of PaeTec (formed solely for purposes of accomplishing the acquisition) with CCS surviving the merger. Following consummation of the merger, CCS will be a direct, wholly owned subsidiary of PaeTec Corp. Although CCS will have a new corporate parent, CCS will continue to provide services to its existing customers under existing service arrangements, pursuant to its certification granted by this Commission. The proposed transaction, therefore, will be virtually transparent to CCS's Florida customers. Attached

DOCUMENT NUMBER-DATE

07148 JUN 11 99

REG. 6000-204-REPORTING

Blanca S. Bayó
June 10, 1999
Page 2

hereto as Exhibit A is a chart that illustrates the corporate structure of the parties prior to and immediately following consummation of the proposed transfer of control.^{1/}

Applicants respectfully request expedited treatment of this Application to permit them to consummate the transfer of control as soon as possible, but no later than August 15, 1999. An original and twelve (12) copies of this letter are enclosed. Please date-stamp the enclosed extra copy of this filing and return it in the attached self-addressed, postage prepaid envelope provided.

Applicants submit the following information in support of this Application.

I. THE PARTIES

A. PaeTec Corp.

PaeTec Corp. is a privately held Delaware corporation with principal offices located at 290 Woodcliff Drive, Fairport, New York 14450. PaeTec is the holding company parent of PaeTec Communications, Inc., a nondominant carrier that is authorized to provide alternative local exchange and intrastate interexchange telecommunications services within the State of Florida pursuant to Certificate Nos. 5756 and 5757, respectively.^{2/} Further information concerning PaeTec and a description of PaeTec Communications, Inc.'s legal, technical, managerial, and financial qualifications to provide telecommunications services were filed with PaeTec Communications, Inc.'s application for certification, filed in Docket Nos. 980919-TX and 980916-TI. That information is, therefore, already a matter of public record at the Commission, and Applicants respectfully request that it be incorporated by reference herein.

PaeTec has the technical, managerial, and financial qualifications to acquire control of CCS. PaeTec's management team has extensive experience in the provision of alternative local exchange and interexchange telecommunications services. Attached hereto as Exhibit B are the audited

^{1/} PaeTec ultimately intends to restructure its operating subsidiaries at some point subsequent to closing. Specifically, in order to improve efficiencies and achieve economies of scale in managing its subsidiaries, PaeTec will contribute all of its CCS stock to PaeTec Communications, Inc. CCS will, therefore, be an *indirect* subsidiary of PaeTec and a direct subsidiary of PaeTec Communications, Inc.

^{2/} See *Application of PaeTec Communications, Inc. for certificate to provide alternative local exchange telecommunications service*, Docket No. 980919-TX, Order (effective Dec. 5, 1998); *Application of PaeTec Communications, Inc. for certificate to provide interexchange telecommunications service*, Docket No. 980916-TI, Order (effective Dec. 5, 1998).

financial statements of PaeTec and its subsidiaries for the period May 19, 1998 (inception) to December 31, 1998. With its financial resources, and by virtue of its extensive experience in the provision of telecommunications services, PaeTec is well qualified to acquire control of CCS.

B. Campuslink Communications Systems, Inc. d/b/a Parklink Communications, Inc.

CCS is a privately held Delaware corporation with principal offices located at 1530 Eisenhower Place, Ann Arbor, Michigan 48108. CCS is a leading supplier of integrated telecommunications systems to educational institutions throughout the United States. In Florida, CCS is authorized to provide alternative local exchange and intrastate interexchange telecommunication services within the State of Florida pursuant to Certificate Nos. 5749 and 5750, respectively.^{3/} Further information concerning CCS's legal, technical, managerial, and financial qualifications to provide telecommunications services was filed with its applications for certification, filed in Docket Nos. 981224-TX and 981084-TI. That information is, therefore, already a matter of public record at the Commission, and Applicants respectfully request that it be incorporated by reference herein.

II. REQUEST FOR APPROVAL TO TRANSFER CONTROL OF CCS TO PAETEC

PaeTec and CCS have determined that they will realize significant economic and marketing efficiencies by establishing CCS as a wholly owned subsidiary of PaeTec. The proposed transaction is structured as a merger of CCS and PaeTec Merger Corp. ("Merger Sub"), a newly created Delaware subsidiary of PaeTec, formed specifically for purposes of consummating the transaction. Pursuant to Applicants' letter of intent, CCS will merge with and into Merger Sub, with CCS being the surviving entity.^{4/} Immediately following consummation of the merger, CCS will exist as a wholly owned subsidiary of PaeTec.

^{3/} See Application for certificate to provide alternative local exchange telecommunications service by Campuslink Communications Systems, Inc. d/b/a Parklink Communications, Inc., Docket No. 981224-TX, Order (effective Dec. 5, 1998); Application for certificate to provide alternative local exchange telecommunications service by Campuslink Communications Systems, Inc. d/b/a Parklink Communications, Inc., Docket No. 981084-TI, Order (effective Dec. 5, 1998) .

^{4/} At the time of merger, the shareholders of CCS will receive, in exchange for each of the issued and outstanding shares of capital stock of CCS, shares of PaeTec common stock according to a formula agreed to by the parties.

Although the proposed transaction will transfer ownership and control of CCS to PaeTec, the transaction will not involve a change in the manner in which CCS provides service to its Florida customers. Following consummation of the merger, CCS will continue to provide high quality telecommunications services to its Florida customers pursuant to its certification, with no change in the rates or terms and conditions of service currently enjoyed by its existing customers.^{5/} As such, the transaction will not cause inconvenience or confusion to CCS's customers nor otherwise have a negative impact on the operations of CCS. The transfer of control, moreover, will not result in any change in the management team that currently leads CCS. The transfer of control of CCS to PaeTec, therefore, will be virtually transparent to CCS's customers in terms of the services that they receive.^{6/}

III. PUBLIC INTEREST CONSIDERATIONS

Consummation of the proposed transfer of control will serve the public interest in promoting competition among providers of local and interexchange telecommunications services. Applicants anticipate that the contemplated business combination will result in a company better equipped to accelerate its growth as a competitive telecommunications service provider by allowing CCS access to PaeTec's substantial telecommunications resources and experience. In addition, the combination of PaeTec and CCS will ultimately provide Florida customers with a more diverse and comprehensive selection of services from a single source. Finally, the proposed transfer of control will allow Applicants to manage their telecommunications operations more efficiently, thereby permitting greater investment in facilities, customer services, and technological innovation.

In sum, the resulting corporate structure is expected to enhance significantly CCS's operational flexibility and efficiency, as well as its long term financial viability. These enhancements will inure directly to the benefit of Florida customers. The proposed transaction, therefore, will ensure the continued provision of high quality and innovative telecommunications

^{5/} Similarly, PaeTec Communications, Inc. will continue to provide services to its Florida customers under its existing service agreements, pursuant to its own grant of certification.

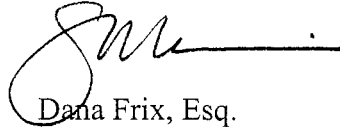
^{6/} As noted above, PaeTec plans to restructure its operating subsidiaries at some point subsequent to closing. Specifically, in order to improve efficiencies and achieve economies of scale in managing its subsidiaries, PaeTec will contribute all of its CCS stock to PaeTec Communications, Inc. CCS will, therefore, be an *indirect* subsidiary of PaeTec and a direct subsidiary of PaeTec Communications, Inc. The internal restructuring will also be virtually transparent to CCS customers in terms of the services they receive.

Blanca S. Bayó
June 10, 1999
Page 5

services to CCS's existing customers and should promote competition in the Florida telecommunications service market.

Please do not hesitate to contact us if you have any questions regarding this transaction.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Dana Frix', with a horizontal line extending to the right.

Dana Frix, Esq.
Grace R. Chiu, Esq.

Counsel for PaeTec Corp.

Enclosures

cc: Tom Williams (FL PSC)
Daniel J. Venuti, Esq. (PaeTec)
Joseph Golden (CCS)
Brett P. Ferenchak, Esq.

EXHIBITS

Illustrative Chart of Proposed Transfer of Control A

PaeTec Corp. Financial Statements B

EXHIBIT A

Illustrative Chart of Proposed Transfer of Control

Proposed Transfer of Control of
Campuslink Communications Systems, Inc. d/b/a Parklink Communications, Inc.
to PaeTec Corp.

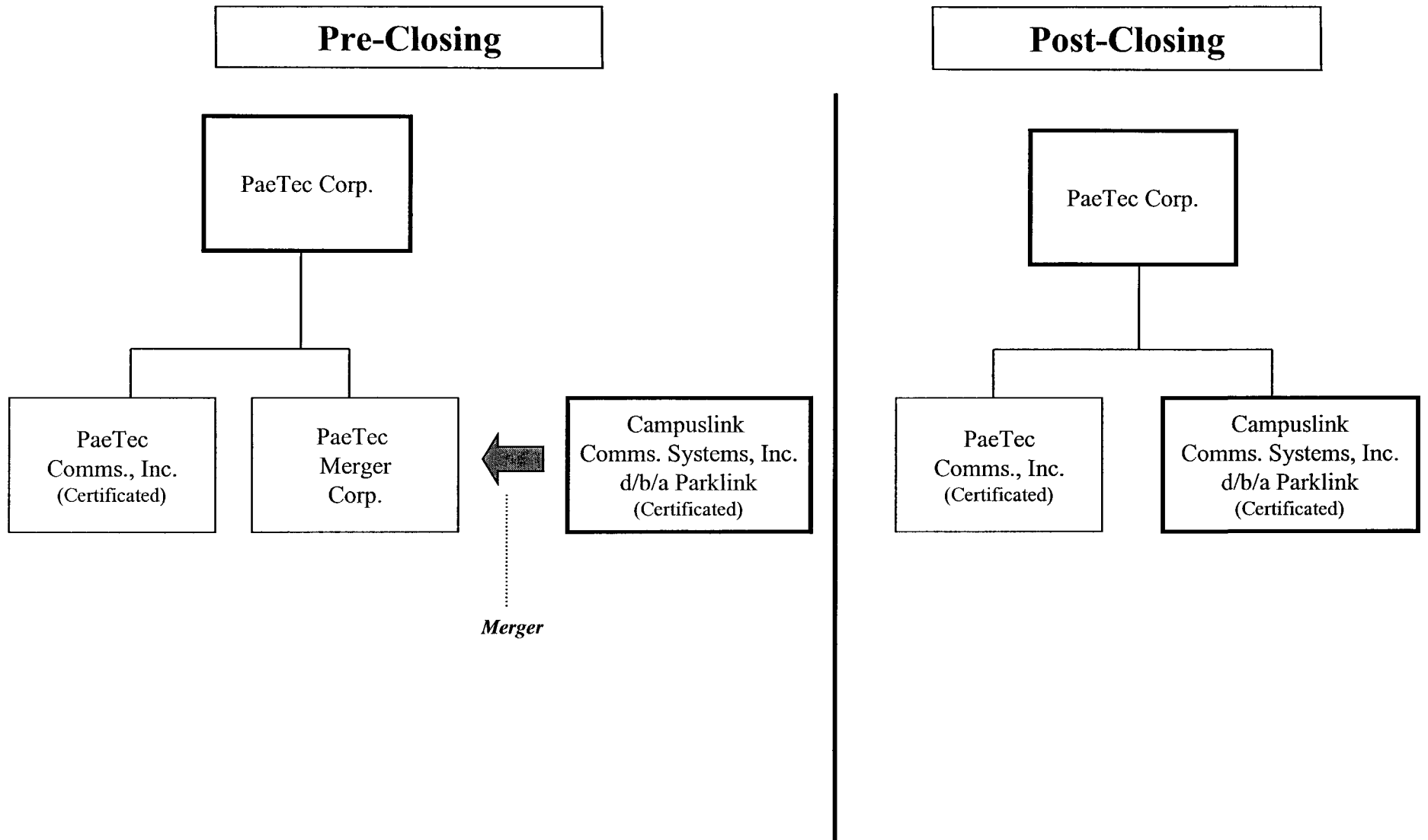


EXHIBIT B

PaeTec Corp. Financial Statements

**Deloitte &
Touche**



**PAETEC CORP. AND
SUBSIDIARIES**

**Consolidated Financial Statements as of
December 31, 1998 and for the Period
May 19, 1998 (Inception) to December 31, 1998
and Independent Auditors' Report**

PAETEC CORP. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENTS AS OF DECEMBER 31, 1998 AND FOR THE PERIOD MAY 19, 1998 (INCEPTION) TO DECEMBER 31, 1998:	
Consolidated Balance Sheet	2
Consolidated Statement of Operations	3
Consolidated Statement of Stockholders' Equity	4
Consolidated Statement of Cash Flows	5
Notes to Consolidated Financial Statements	6

Deloitte & Touche



Deloitte & Touche LLP
2200 Chase Square
Rochester, New York 14604-1998

Telephone: (716) 238-3300
Facsimile: (716) 232-2890

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of PaeTec Corp.

We have audited the accompanying consolidated balance sheet of PaeTec Corp. and subsidiaries (the Company) as of December 31, 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for the period from May 19, 1998 (inception) to December 31, 1998. 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 audit.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PaeTec Corp. and subsidiaries as of December 31, 1998, and the results of their operations and their cash flows for the period from May 19, 1998 (inception) to December 31, 1998 in conformity with generally accepted accounting principles.

Deloitte + Touche LLP

March 11, 1999

PAETEC CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET DECEMBER 31, 1998

ASSETS

CURRENT ASSETS:

Cash and cash equivalents	\$ 2,018,513
Short term investments	415,365
Accounts receivable, net	158,602
Prepaid expenses and other current assets	<u>192,900</u>

Total current assets 2,785,380

PROPERTY AND EQUIPMENT, NET 11,783,893

OTHER ASSETS:

Debt issuance costs	797,427
Other assets	<u>349,063</u>

Total other assets 1,146,490

TOTAL ASSETS \$15,715,763

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable	\$ 2,117,955
Accrued expenses	<u>962,784</u>

Total current liabilities 3,080,739

COMMITMENTS (Note 7)

STOCKHOLDERS' EQUITY:

Class A common stock	90,000
Class B common stock	62,850
Additional paid-in capital	18,334,037
Accumulated deficit	<u>(5,851,863)</u>

Total stockholders' equity 12,635,024

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY \$15,715,763

See notes to consolidated financial statements.

PAETEC CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS PERIOD FROM MAY 19, 1998 (INCEPTION) TO DECEMBER 31, 1998

REVENUE	\$ 150,067
COST OF SERVICES	<u>96,064</u>
GROSS MARGIN	54,003
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	5,770,476
DEPRECIATION AND AMORTIZATION	<u>242,915</u>
LOSS FROM OPERATIONS	(5,959,388)
INTEREST INCOME	<u>107,525</u>
NET LOSS	<u><u>\$(5,851,863)</u></u>

See notes to consolidated financial statements.

PAETEC CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
 PERIOD FROM MAY 19, 1998 (INCEPTION) TO DECEMBER 31, 1998

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Class A	Class B			
BALANCE, May 19, 1998	\$ -	\$ -	\$ -	\$ -	\$ -
Issuance of 8,999,952 shares of Class A common stock	90,000	-	14,042,720	-	14,132,720
Issuance of 6,285,048 shares of Class B common stock	-	62,850	4,291,317	-	4,354,167
Net loss	-	-	-	(5,851,863)	(5,851,863)
BALANCE, December 31, 1998	<u>\$ 90,000</u>	<u>\$ 62,850</u>	<u>\$ 18,334,037</u>	<u>\$ (5,851,863)</u>	<u>\$ 12,635,024</u>

See notes to consolidated financial statements.

PAETEC CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS PERIOD FROM MAY 19, 1998 (INCEPTION) TO DECEMBER 31, 1998

OPERATING ACTIVITIES:

Net loss	\$ (5,851,863)
Adjustments to reconcile net loss to net cash used by operating activities:	
Depreciation and amortization	242,915
Changes in assets and liabilities:	
Accounts receivable	(158,602)
Prepaid expenses and other current assets	(192,900)
Other assets	(349,063)
Accounts payable	2,117,955
Accrued expenses	<u>962,784</u>
Net cash used by operating activities	<u>(3,228,774)</u>

INVESTING ACTIVITIES:

Purchase of property and equipment	(12,026,808)
Net increase in short term investments	<u>(415,365)</u>
Net cash used by investing activities	<u>(12,442,173)</u>

FINANCING ACTIVITIES:

Proceeds from issuance of common stock	18,486,887
Payment for debt issuance costs	<u>(797,427)</u>
Net cash provided by financing activities	<u>17,689,460</u>

NET INCREASE IN CASH AND CASH EQUIVALENTS	2,018,513
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>-</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 2,018,513</u>

See notes to consolidated financial statements.

PAETEC CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS PERIOD FROM MAY 19, 1998 (INCEPTION) TO DECEMBER 31, 1998

1. DESCRIPTION OF BUSINESS

PaeTec Corp. and its wholly-owned subsidiaries, PaeTec Communications, Inc., and PaeTec International, Inc., ("PaeTec" or the "Company"), is a nationwide integrated communications provider ("ICP") offering switched local, long distance, and enhanced telecommunications services primarily to business and institutional customers.

Since its inception on May 19, 1998, the Company's principal activities have included developing its business plans, procuring governmental authorizations, raising capital, hiring management and other key personnel, working on the design and development of its local exchange telephone networks and operations support systems ("OSS"), acquiring equipment and facilities, and negotiating interconnection agreements. Accordingly, the Company has incurred operating losses and an operating cash flow deficit.

The Company began generating revenue in the fourth quarter of 1998 and expects to generate significant revenue in 1999, as compared to 1998, based on certain agreements currently in place, as well as the Company's plan to place in service a significant portion of property and equipment in 1999.

The Company's success will be affected by the problems, expenses, and delays encountered in connection with the formation of any new business, and the competitive environment in which the Company intends to operate. The Company's performance will further be affected by its ability to assess potential markets, secure additional financing or raise additional capital, implement interconnection and colocation with incumbent local exchange carrier ("ILEC") facilities, lease adequate trunking capacity from ILECs or competitive local exchange carriers ("CLECs"), purchase and install switches in its target markets, implement efficient OSS and other back office systems, develop a sufficient customer base, and attract, retain, and motivate qualified personnel. The Company's networks and the provisions of telecommunications services are subject to significant regulation at the federal, state, and local levels. Delays in receiving required regulatory approvals or the enactment of new adverse regulation or regulatory requirements may have a material adverse effect upon the Company. Although management believes that the Company will be able to successfully mitigate these risks, there is no assurance that the Company will be able to do so or that the Company will ever operate profitably.

Expenses are expected to exceed revenues in each location in which the Company offers service until a sufficient customer base is established. It is anticipated that obtaining a sufficient customer base will take a number of years, and positive cash flows from operations are not expected in the near future.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation - The accompanying financial statements include the accounts of PaeTec Corp. and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Cash and Equivalents - For purposes of reporting cash flows, the Company includes as cash and cash equivalents, cash, marketable securities and commercial paper with original maturities of three months or less.

Short-Term Investments - Short-term investments consist of certificates of deposit and are carried at fair market value.

Property and Equipment - Property and equipment are stated at cost less accumulated depreciation. Major renewals and betterments are capitalized, and ordinary repairs and maintenance are charged against operations in the period in which the costs are incurred.

Depreciation is computed using the straight-line method over estimated useful lives from the date placed in service as follows:

Computer hardware	3 years
Computer software	5 - 10 years
Leasehold improvements	15 years
Furniture and fixtures	3 - 7 years

Revenue Recognition - Revenue is recognized in the month in which the service is provided. All expenses related to services provided are recognized as incurred.

Long-Lived Assets - The Company reviews the carrying value of its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Measurement of any impairment would include a comparison of estimated future operating cash flows anticipated to be generated during the remaining life of the assets with their net carrying value. An impairment loss would be recognized as the amount by which the carrying value of the assets exceeds their fair value.

Concentration of Credit Risk - Financial instruments that potentially subject the Company to credit risk consist of cash, cash equivalents, short term investments and accounts receivable. The Company places its cash, cash equivalents and short term investments with high quality financial institutions. Cash, cash equivalents and short term investments in certain accounts as of December 31, 1998 exceeded the federal insured limit by \$2.2 million, however, the Company has not experienced any losses in such accounts. The Company grants credit to the majority of its customers based on an evaluation of the customer's financial condition, generally without requiring collateral. Exposure to losses on accounts receivables is principally dependent on each customer's financial condition. The Company monitors its exposure for credit losses and maintains allowances for anticipated losses.

Use of Estimates in 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 expenses during the reporting period. Actual results could differ from those estimates.

Comprehensive Income - The Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 130, *Reporting Comprehensive Income*. SFAS No. 130 requires all items recognized as components of comprehensive income, such as foreign currency translation or unrealized holding gains and losses on available-for-sale securities to be reported in a financial statement equal to that of other financial statements. For the period from May 19, 1998 (inception) to December 31, 1998, there were no items of comprehensive income to be reported other than the net loss, nor has the adoption of SFAS No. 130 had an effect on the financial condition, results of operations or cash flows of the Company.

3. PROPERTY AND EQUIPMENT, NET

The components of property and equipment at December 31, 1998 are as follows:

Computer hardware	\$ 1,985,124
Computer software	449,847
Leasehold improvements	25,961
Furniture and fixtures	17,789
Construction-in-progress	<u>9,548,087</u>
	12,026,808
Accumulated depreciation	<u>(242,915)</u>
Property and equipment, net	<u>\$11,783,893</u>

Construction-in-progress consists primarily of costs associated with the build-out of the Company's network switch sites, as well as development of the Company's back office systems.

4. STOCKHOLDERS' EQUITY

The authorized capital stock of the Company consists of: (1) 35,000,000 shares of common stock, \$.01 par value per share which is divided into two classes consisting of 27,500,000 shares of Class A common stock (8,999,952 shares of which were outstanding as of December 31, 1998) and 7,500,000 shares of Class B Common Stock (6,285,048 shares of which were outstanding as of December 31, 1998). In addition, 4,300,000 shares of Class A common stock are reserved for issuance under a stock option plan.

The shares of Class A common stock and Class B common stock are identical in all respects, except for voting rights and certain conversion rights with respect to the shares of Class B common stock. Shares of Class B common stock may be owned only by the holders of Class B common stock and their permitted transferees (as defined in the Company's Certificate of Incorporation). Any shares of Class B common stock transferred to any person automatically convert, at any time at the option of the holder thereof, into one share of Class A common stock. The Class A common stock has no conversion rights. The Class A common stock and the Class B common stock are entitled to vote on all matters which come before the stockholders, voting together as a single class on all matters, except as described below and as otherwise required by law. Each share of Class A common stock has one vote and each share of Class B common stock has 20 votes on all matters on which holders of common stock are entitled to vote. Holders of Class B common stock are entitled to elect three members of the Board of Directors and to vote with the holders of Class A common stock to elect any additional directors.

Holders of common stock are entitled to share ratably in dividends when and as declared by the Company's board of directors out of funds legally available. As of December 31, 1998, the Company had not declared or paid any dividends, and currently has no plans to declare or pay dividends in the future. Upon liquidation and dissolution of the Company, each holder of common stock is entitled to share ratably in all assets remaining after payment of all liabilities.

Stock Option Plan - The Company's 1998 Incentive Compensation Plan (the Option Plan) provides for the issuance of up to an aggregate 4,300,000 shares of the Company's Class A common stock. The Option Plan is designed to create an incentive for employees of the Company and is administered by a committee of the Board of Directors.

Employees of the Company are eligible to participate in the Option Plan. Annual grants vest over a four year term. Options granted upon hire vest over a four year term for sixty percent of the options granted, while the remaining forty percent vest over a four year term, commencing once the Company has achieved certain revenue targets. Options granted are not exercisable after the expiration of ten years from the date of grant of those options.

The Company adopted the disclosures-only provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock Based Compensation* (SFAS No. 123). No compensation cost has been recognized for the Option Plan as it relates to employees since the exercise price of the options on the date of grant approximated fair market value. Had compensation cost for the Company's Option Plan been recorded based on the fair value at the date of grant for awards consistent with the provisions of SFAS No. 123, the Company's 1998 net loss would have been increased to the pro forma amount indicated below:

Net loss - as reported	\$(5,851,863)
Net loss - proforma	\$(5,905,306)

The fair value of each option grant was calculated/estimated on the date of grant using the Black-Scholes option-pricing model and using assumed risk-free interest rates ranging from 4.60% to 5.40% and expected lives ranging from five to seven years. Since the Company is not publicly traded, a volatility factor assumption was not used in its fair value model. In calculating the fair value of the stock options described above via the Black-Scholes option-pricing model, the following per share fair market values of the Company's common stock were used:

May 1998-August 17, 1998	\$.40
August 18, 1998-September 14, 1998	\$.69
September 15, 1998-December 31, 1998	\$ 2.50

A summary of activity under the Option Plan for 1998 follows:

	Outstanding Options	Weighted-Average Exercise Price
Outstanding shares under option, May 19, 1998	-	\$ -
Options granted during 1998	<u>1,506,875</u>	<u>.77</u>
Outstanding shares under option, December 31, 1998	<u>1,506,875</u>	<u>\$.77</u>
Options exercisable at December 31, 1998	<u>-</u>	<u>\$ -</u>

The following table summarizes information concerning outstanding and exercisable options at December 31, 1998:

Range of Exercise Price	Number Outstanding	Weighted-Average		Number Exercisable	Weighted-Average Exercise Price
		Remaining Contractual Life-Years	Weighted-Average Exercise Price		
\$.40-\$2.50	1,506,875	9.5	.77	-	-

5. INCOME TAXES

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS 109"). SFAS 109 requires an asset and liability approach which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events which have been recognized in the Company's consolidated financial statements. The Company had approximately \$5.9 million of net operating loss carryforwards for federal income tax purposes at December 31, 1998. The net operating loss carryforwards will expire in the year 2014 if not previously utilized. The Company has recorded a valuation allowance equal to the net deferred tax assets at December 31, 1998, due to the uncertainty of future operating results. The valuation allowance will be reduced at such time as management believes it is more likely than not that the net deferred tax assets will be realized. Any reductions in the valuation allowance will reduce future provisions for income tax expense.

6. EMPLOYEE BENEFIT PLAN

The Company has a 401 (k) retirement savings plan under which employees can contribute up to 15% of their annual salary. Employees are eligible for participation upon employment. The Company may make a discretionary contribution, however, no such contribution was made for the period May 19, 1998 (inception) to December 31, 1998.

7. COMMITMENTS

Senior Debt - Effective November 16, 1998, the Company entered into a loan and security agreement (the "Senior Debt Agreement") with AT&T Commercial Finance Corporation. The Senior Debt Agreement provides for \$ 49 million in borrowing capacity for the Company to be used for capital purchases and other operating funding requirements. Initial borrowings under the Senior Debt Agreement are based on the London Interbank Offered Rate (LIBOR) plus an applicable margin. The applicable margin reduces based on certain performance measures. Borrowings are permitted for the first two years (the "Borrowing Period"). After the Borrowing Period, the Company has a six-year term for the repayment of such borrowings. As of December 31, 1998, there was no borrowing outstanding under the Senior Debt Agreement. The Senior Debt Agreement is subject to a .50% per annum unused commitment fee, payable quarterly beginning March 31, 1999. The Senior Debt Agreement includes a number of covenants, which require the maintenance of certain financial ratios and restrict the Company's ability to pay dividends and to incur additional indebtedness. Borrowings under the Senior Debt Agreement are secured by substantially all of the Company's assets.

Operating Leases - The Company has entered into various operating lease agreements, with expirations through 2007, for office space and equipment. Future minimum lease obligations related to the Company's operating leases as of December 31, 1998 are as follows:

1999	\$ 1,328,000
2000	973,000
2001	954,000
2002	862,000
2003	829,000
Thereafter	<u>1,690,000</u>
	<u>\$ 6,636,000</u>

Total rent expense for the period from May 19, 1998 (inception) to December 31, 1998 was \$ 223,310.