ORIGINAL

SWIDLER BERLIN SHEREFF FRIEDMAN, LLP

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

December 1, 1999

VIA OVERNIGHT MAIL

Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0870

991801-TI

Re: Application of NetLojix Telecom, Inc. for Authority to Provide Interexchange Telecommunications Service in Florida

Dear Ms. Bayo:

Enclosed for filing on behalf of NetLojix Telecom, Inc. ("NetLojix") please find an original and six (6) copies of NetLojix's application for authority to provide interexchange telecommunications service in Florida. Please find enclosed a check in the amount of $250.00 to cover the application filing fee.

Please date-stamp the enclosed extra copy of this filing and return in the self-addressed, stamped envelope provided. Should you have any questions concerning this filing, please do not hesitate to contact the undersigned.

Respectfully yours,

Kemal Hawa

Kemal M. Hawa

Counsel for NetLojix Telecom, Inc.

Enclosures

cc: Craig Clark
Ernest Gillespie
Russell Blau (w/o encl.)
Brett Ferenchak (w/o encl.)
Megan Rha (w/o encl.)

DIVISION OF TELECOMMUNICATIONS
BUREAU OF CERTIFICATION AND SERVICE EVALUATION

Application Form for Authority to Provide Interexchange Telecommunications Service Between Points Within the State of Florida

Instructions

- This form is used as an application for an original certificate and for approval of assignment or transfer of an existing certificate. In the case of an assignment or transfer, the information provided shall be for the assignee or transferee (See Appendix A).

- Print or Type all responses to each item requested in the application and appendices. If an item is not applicable, please explain why.

- Use a separate sheet for each answer which will not fit the allotted space.

- Once completed, submit the original and six (6) copies of this form along with a non-refundable application fee of **$250.00** to:

  Florida Public Service Commission
  Division of Records and Reporting
  2540 Shumard Oak Blvd.
  Tallahassee, Florida 32399-0850
  (850) 413-6770

  Note: **No filing fee is required** for an assignment or transfer of an existing certificate to another certificated company.

- If you have questions about completing the form, contact:

  Florida Public Service Commission
  Division of Telecommunications
  Bureau of Certification and Service Evaluation
  2540 Shumard Oak Blvd.
  Tallahassee, Florida 32399-0850
  (850) 413-6600

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

   (X) **Original certificate** (new company).

   (   ) **Approval of transfer of existing certificate:**
   Example, a certificated company purchases an existing certificated company and desires to retain the authority of both certificates.

   (   ) **Approval of assignment of existing certificate:**
   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 of transfer of control:**
   Example, a company purchases 51 % of a certificated company. The Commission must approve the new controlling entity.

2. Name of company:

   NetLojix Telecom, Inc. ("NetLojix" or "Applicant")

3. Name under which applicant will do business (fictitious name, etc.):

   NetLojix Telecom, Inc.

4. Official mailing address (including street name & number, post office box, city, state, zip code):

   NetLojix Telecom, Inc.

   501 Bath Street

   Santa Barbara, CA 93101

5. Florida address (including street name & number, post office box, city, state, zip code):

   NetLojix does not currently have an office in the State of Florida. If NetLojix does establish an office in the future, NetLojix will provide this information to the Commission, upon request.

6. Select type of business your company will be conducting √ (check all that apply):

( ) **Facilities-based carrier** - company owns and operates or plans to own and operate telecommunications switches and transmission facilities in Florida.

( ) **Operator Service Provider** - company provides or plans to provide alternative operator services for IXCs; or toll operator services to call aggregator locations; or clearinghouse services to bill such calls.

( ) **Reseller** - company has or plans to have one or more switches but primarily leases the transmission facilities of other carriers. Bills its own customer base for services used.

(X) **Switchless Rebiller** - company has no switch or transmission facilities but may have a billing computer. Aggregates traffic to obtain bulk discounts from underlying carrier. Rebills end users at a rate above its discount but generally below the rate end users would pay for unaggregated traffic.

( ) **Multi-Location Discount Aggregator** - company contracts with unaffiliated entities to obtain bulk/volume discounts under multi-location discount plans from certain underlying carriers, then offers resold service by enrolling unaffiliated customers.

( ) **Prepaid Debit Card Provider** - any person or entity that purchases 800 access from an underlying carrier or unaffiliated entity for use with prepaid debit card service and/or encodes the cards with personal identification numbers.

7. Structure of organization;

( ) Individual	( ) Corporation
(X) Foreign Corporation	( ) Foreign Partnership
( ) General Partnership	( ) Limited Partnership
( ) Other ______________________	

8. If individual, provide:

Not Applicable.

Name: ______________________________

Title: ______________________________

Address: ______________________________

City/State/Zip: ______________________________

Telephone No.: ____________________ **Fax No.:** ____________________

Internet E-Mail Address: ______________________________

Internet Website Address: ______________________________

9. **If incorporated in Florida**, provide proof of authority to operate in Florida:

   (a) The Florida Secretary of State Corporate Registration number:

   ____

10. **If foreign corporation**, provide proof of authority to operate in Florida:

    A copy of Applicant's Certificate of Authority to Transact Business in the State of Florida is attached as Exhibit 1.

    (a) The Florida Secretary of State Corporate Registration number:

    F99000005691

11. **If using fictitious name-d/b/a**, provide proof of compliance with fictitious name statute (Chapter 865.09, FS) to operate in Florida:

    Not Applicable.

    (a) The Florida Secretary of State fictitious name registration number: ______________________________

12. **If a limited liability partnership**, provide proof of registration to operate in Florida: **NOT APPLICABLE**

   (a) **The Florida Secretary of State registration number:** ______________________

13. **If a partnership**, provide name, title and address of all partners and a copy of the partnership agreement. **NOT APPLICABLE**

Name: ______________________

Title: ______________________

Address: ______________________

City/State/Zip: ______________________

Telephone No.: ______________ **Fax No.:** ______________

Internet E-Mail Address: ______________________

Internet Website Address: ______________________

14. **If a foreign limited partnership**, provide proof of compliance with the foreign limited partnership statute (Chapter 620.169, FS), if applicable.

   (a) **The Florida registration number:** ______________________

15. Provide **F.E.I. Number** (if applicable): 87-0378021

16. Provide the following (if applicable):

   (a) Will the name of your company appear on the bill for your services?

   (X) Yes ( ) No

   Yes, NetLojix Telecommunications, Inc.'s name will appear on bills sent to customers.

(b) If not, who will bill for your services?

Name: ______________________________

Title: ______________________________

Address: ______________________________

City/State/Zip: ______________________________

Telephone No.: ______________ **Fax No.:** ______________

(c) How is this information provided?

____

____

17. Who will receive the bills for your service?

( ) Residential Customers	(X) Business Customers
( ) PATs providers	( ) PATs station end-users
( ) Hotels& motels	( ) Hotel & motel guests
( ) Universities	( ) Universities dormitory residents
( ) Other: (specify) ______________________________	

18. Who will serve as liaison to the Commission with regard to the following?

(a) The application:

Name: Kemal M. Hawa, Esq.

Title: Swidler Berlin Shereff Friedman, LLP

Address: 3000 K Street, N.W., Suite 300

City/State/Zip: Washington, DC 20007

Telephone No.: (202) 424-7500 **Fax No.:** (202) 424-7645

Internet E-Mail Address: kmhawa@swidlaw.com, pwgarnett@swidlaw.com

Internet Website Address: www.swidlaw.com

(b) Official point of contact for the ongoing operations of the company:

Name: Michael D. Ussery

Title: Chief Financial Officer and Chief Accounting Officer

Address: NetLojix Telecom, Inc., 8721 Airport Freeway

City/State/Zip: Fort Worth, TX 76180

Telephone No.: (817) 788-3077 **Fax No.:** (817) 788-3355

Internet E-Mail Address: mussery@netlojix.com

Internet Website Address: www.netlojix.com

(c) Complaints/Inquiries from customers:

Name: Michael D. Ussery

Title: Chief Financial Officer and Chief Accounting Officer

Address: 8721 Airport Freeway

City/State/Zip: Fort Worth, Texas 76180

Telephone No.: (817) 788-3077 **Fax No.:** (817) 788-3355

Internet E-Mail Address: mussery@netlojix.com

Internet Website Address: www.netlojix.com

NetLojix's toll free number for customer inquiries is 1(877) NETLOJIX. NetLojix customer service representatives will be available during regular business hours, at its toll-free number for customer inquiries.

19. List the states in which the applicant:

(a) has operated as an interexchange telecommunications company.

NetLojix has not operated as an interexchange carrier in any state.

(b) has applications pending to be certificated as an interexchange telecommunications company.

NetLojix is currently applying for authorization, where required, throughout the United States to provide resold intrastate interexchange telecommunications.

(c) is certificated to operate as an interexchange telecommunications company.

NetLojix is not certificated to operate as an interexchange carrier in any states yet.

(d) has been denied authority to operate as an interexchange telecommunications company and the circumstances involved.

NetLojix has not been denied authority to offer service in any state.

(e) has had regulatory penalties imposed for violations of telecommunications statutes and the circumstances involved.

NetLojix has not been involved in any civil court proceeding with any violations of the telecommunications statues in any state.

(f) has been involved in civil court proceedings with an interexchange carrier, local exchange company or other telecommunications entity, and the circumstances involved.

NetLojix has not been involved in any civil court proceeding with any interexhchange carrier, local exchange company, or other telecommunications entity.

20. Indicate if any of the officers, directors, or any of the ten largest stockholders have previously been:

(a) 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.

None of NetLojix's officers, directors, or ten largest stockholders have previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or any crime nor will any such actions result from pending proceedings.

(b) an officer, director, partner or stockholder in any other Florida certificated telephone company. If yes, give name of company and relationship. If no longer associated with company, give reason why not.

Until September 1, 1999, the officers of NetLojix Telecom, Inc. (listed in Exhibit 4) held the same offices for Matrix Telecom, Inc. which operated as a carrier in Florida. Matrix Telecom, Inc. used to be a subsidiary of NetLojix's corporate parent, NetLojix Communications, Inc., until it was sold to another company.

The applicant will provide the following interexchange carrier services, √ (check all that apply):

a. __X__ **MTS with distance sensitive per minute rates**

______	Method of access is FGA
______	Method of access is FGB
X	Method of access is FGD
______	Method of access is 800

b. ______ **MTS with route specific rates per minute**

______ Method of access is FGA
______ Method of access is FGB
______ Method of access is FGD
______ Method of access is 800

c. __X__ **MTS with statewide flat rates per minute (i.e. not distance sensitive)**

______ Method of access is FGA
______ Method of access is FGB
__X__ Method of access is FGD
______ Method of access is 800

d. ______ **MTS for pay telephone service providers**

e. __X__ **Block-of-time calling plan (Reach Out Florida, Ring America, etc.).**

f. __X__ **800 service (toll free)**

g. __X__ **WATS type service (bulk or volume discount)**

__X__ Method of access is via dedicated facilities
__X__ Method of access is via switched facilities

h. ______ **Private line services (Channel Services)**
(For ex. 1.544 mbs., DS-3, etc.)

i. __X__ **Travel service**

______ Method of access is 950
__X__ Method of access is 800

j. ______ **900 service**

k. ______ **Operator services**

______ Available to presubscribed customers
______ Available to non presubscribed customers (for example, to patrons of hotels, students in universities, patients in hospitals).
______ Available to inmates

l. **Services included are:**

____________	Station assistance
____________	Person-to-person assistance
______X____	Directory assistance
____________	Operator verify and interrupt
______X____	Conference calling

22. Submit the proposed tariff under which the company plans to begin operation. Use the format required by Commission Rule 25-24.485 (example enclosed).

    Please see Exhibit 2.

23. Submit the following:

    A. Financial capability.

    The application **<u>should contain</u>** the applicant's audited financial statements for the most recent 3 years. If the applicant does not have audited financial statements, it shall so be stated.

    The unaudited financial statements should be signed by the applicant's chief executive officer and chief financial officer <u>affirming that the financial statements are true and correct</u> and should include:

    1. the balance sheet;

    2. income statement; and

    3. statement of retained earnings.

    Applicant is a recently incorporated company that is wholly owned by NetLojix Communications, Inc. NetLojix will rely on the parent company's substantial financial resources to provide the proposed services. Therefore, the financial statements of NetLojix Communications, Inc. is attached as Exhibit 3.

    NOTE: *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.*

Further, the following (which includes supporting documentation) should be provided:

1. **<u>A written explanation</u>** that the applicant has sufficient financial capability to provide the requested service in the geographic area proposed to be served. Please see Exhibit 3.

2. **<u>A written explanation</u>** that the applicant has sufficient financial capability to maintain the requested service. Please see Exhibit 3.

3. **<u>A written explanation</u>** that the applicant has sufficient financial capability to meet its lease or ownership obligations. Please see Exhibit 3.

B. Managerial capability; give resumes of employees/officers of the company that would indicate sufficient managerial experiences of each.

See Exhibit 4.

C. Technical capability; give resumes of employees/officers of the company that would indicate sufficient technical experiences or indicate what company has been contracted to conduct technical maintenance.

See Exhibit 4.

** APPLICANT ACKNOWLEDGMENT STATEMENT **

1. **REGULATORY ASSESSMENT FEE:** I understand that all telephone companies must pay a regulatory assessment fee in the amount of .15 of one percent of its gross operating revenue derived from intrastate business. Regardless of the gross operating revenue of a company, a minimum annual assessment fee of $50 is required.

2. **GROSS RECEIPTS TAX:** I understand that all telephone companies must pay a gross receipts tax of two and one-half percent on all intra and interstate business.

3. **SALES TAX:** I understand that a seven percent sales tax must be paid on intra and interstate revenues.

4. **APPLICATION FEE:** I understand that a non-refundable application fee of $250.00 must be submitted with the application.

UTILITY OFFICIAL:

Signature: [signature]   Date: December 1, 1999

Title: PRESIDENT   Telephone No.: (805) 884-6300

Address: NetLojix Telecom, Inc.
501 Bath Street
Santa Barbara, CA 93101

Fax No.: (805) 884-6311

ATTACHMENTS:

A - CERTIFICATE SALE, TRANSFER, OR ASSIGNMENT STATEMENT
B - CUSTOMER DEPOSITS AND ADVANCE PAYMENTS
C - CURRENT FLORIDA INTRASTATE NETWORK
D - AFFIDAVIT - FLORIDA TELEPHONE EXCHANGES AND EAS ROUTES
 - GLOSSARY

** APPENDIX A **

CERTIFICATE TRANSFER, OR ASSIGNMENT STATEMENT

1, (Name)____

(Title)______________________________________ of

____

(Name of Company)

and current holder of Florida Public Service Commission Certificate Number

#____________________ have reviewed this application and join in the petitioner's request for a:

( ) transfer

( ) assignment

of the above-mentioned certificate.

UTILITY OFFICIAL:

______________________________ ________________

Signature Date

______________________________ ________________

Title Telephone No.

Address:__________________________ ________________

Fax No.

____

____

____

____

NOT APPLICABLE

** APPENDIX B **

CUSTOMER DEPOSITS AND ADVANCE PAYMENTS

A statement of how the Commission can be assured of the security of the customer's deposits and advance payments may be provided in one of the following ways (applicant, please √ check one):

(x) The applicant will **not** collect deposits nor will it collect payments for service more than one month in advance.

(   ) The applicant intends to collect deposits and/or advance payments for more than one month's service and will file and maintain a surety bond with the Commission in an amount equal to the current balance of deposits and advance payments in excess of one month. (The bond must accompany the application.)

UTILITY OFFICIAL:

[signature]
Signature

December 1, 1999
Date

PRESIDENT
Title

(805) 884-6300
Telephone No.

Address: NetLojix Telecom, Inc.
501 Bath Street
Santa Barbara, CA 93101

(805) 884-6311
Fax No.

** APPENDIX C **

CURRENT FLORIDA INTRASTATE SERVICES

Applicant **has** ( ) or **has not** (x) previously provided intrastate telecommunications in Florida.

If the answer is has, fully describe the following:

a) What services have been provided and when did these services begin?

____

____

____

____

b) If the services are not currently offered, when were they discontinued?

____

____

____

____

UTILITY OFFICIAL:

Signature	December 1, 1999 Date
PRESIDENT Title	(805) 884-6300 Telephone No.
Address: NetLojix Telecom, Inc. 501 Bath Street Santa Barbara, CA 93101	(805) 884-6311 Fax No.

** APPENDIX D **

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 company service in the State of Florida. I have read the foregoing and declare that, to the best of my knowledge and belief, the information is true and correct. I attest that I have the authority to sign on behalf of my company and agree to comply, now and in the future, with all applicable Commission rules and orders.

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

UTILITY OFFICIAL:

Signature

December 1, 1999
Date

PRESIDENT
Title

(805) 884-6300
Telephone No.

Address: NetLojix Telecom, Inc.
501 Bath Street
Santa Barbara, CA 93101

(805) 884-6311
Fax No.

FLORIDA TELEPHONE EXCHANGES AND EAS ROUTES

ORIGINATING SERVICE: Provide the list of exchanges where you are proposing to provide originating service within thirty (30) days after the effective date of the certificate.

Describe the service area in which you hold yourself out to provide service by telephone company exchange. If all services listed in your tariff are not offered at all locations, so indicate.

In an effort to assist you, attached is a list of major exchanges in Florida showing the small exchanges with which each has extended area service (EAS).

FLORIDA EAS FOR MAJOR EXCHANGES

Extended Service Area	in These Exchanges
PENSACOLA:	Cantonment, Gulf Breeze, Milton, Holley-Navarre. Pace
PANAMA CITY:	Lynn Haven, Panama City Beach, Youngstown-Fountain, Tyndall AFB.
TALLAHASSEE:	Crawfordville, Havana, Monticello, Panacea, Sopchoppy, St. Marks.
JACKSONVILLE:	Baldwin, Ft. George, Jacksonville Beach, Callahan, Maxville, Middleburg, Orange Park, Ponte Vedra, Julington.
GAINESVILLE:	Alachua, Archer, Brooker, Hawthorne, High Springs, Melrose, Micanopy, Newberry, Waldo.
OCALA:	Belleview, Citra, Dunnellon, Forest, Lady Lake, McIntosh, Oklawaha, Orange Springs, Salt Springs, Silver Springs Shores.

Extended Service Area	in These Exchanges	
DAYTONA BEACH:	New Smyrna Beach	
TAMPA:	Central	None
	East	Plant City
	North	Zephyrhills
	South	Palmetto
	West	Clearwater
CLEARWATER:	St. Petersburg, Tampa-West, Tarpon, Springs.	
ST. PETERSBURG:	Clearwater.	
LAKELAND:	Bartow, Mulberry, Plant City Polk City, Winter Haven.	
ORLANDO:	Apopka, East Orange, Lake Buena Vista, Orlando, Oviedo, Sanford, Windermere, Winter Garden, Oviedo-Winter Springs, Reedy Creek, Geneva, Monteverde.	
TITUSVILLE:	Cocoa and Cocoa Beach.	
COCOA:	Cocoa Beach, Eau Gallie, Melbourne, Titusville.	
MELBOURNE:	Cocoa, Cocoa Beach, Eau Gallie, Sebastian	
SARASOTA:	Bradenton, Myakka, Venice	

Extended Service Area	in These Exchanges
FT. MYERS:	Cape Coral, Ft. Myers Beach, North Cape Coral, North Ft. Myers, Pine Island, Lehigh Acres, Sanibel-Captiva Islands.
NAPLES:	Marco Island and North Naples.
WEST PALM BEACH:	Boynton Beach and Jupiter.
POMPANO BEACH:	Boca Raton, Coral Springs, Deerfield Beach, Ft. Lauderdale.
FT. LAUDERDALE:	Coral Springs, Deerfield Beach, Hollywood, Pompano Beach.
HOLLYWOOD:	Ft. Lauderdale and North Dade.
NORTH DADE:	Hollywood, Miami, Perrine.
MIAMI:	Homestead, North Dade, Perrine

EXHIBITS

Exhibit 1	Certificate of Authority to Transact Business
Exhibit 2	Proposed Tariff
Exhibit 3	Financial Capability
Exhibit 4	Managerial and Technical Capabilities

EXHIBIT 1

Certificate of Authority to Transact Business

FLORIDA DEPARTMENT OF STATE
Katherine Harris
Secretary of State

November 3, 1999

C T CORPORATION SYSTEM

TALLAHASSEE, FL

Qualification documents for NETLOJIX TELECOM, INC. were filed on November 3, 1999 and assigned document number F99000005691. Please refer to this number whenever corresponding with this office.

Your corporation is now qualified and authorized to transact business in Florida as of the file date.

A corporation annual report will be due this office between January 1 and May 1 of the year following the calendar year of the file date. A Federal Employer Identification (FEI) number will be required before this report can be filed. If you do not already have an FEI number, please apply NOW with the Internal Revenue by calling 1-800-829-3676 and requesting form SS-4.

Please be aware if the corporate address changes, it is the responsibility of the corporation to notify this office.

Should you have any questions regarding this matter, please telephone (850) 487-6091, the Foreign Qualification/Tax Lien Section.

Buck Kohr
Corporate Specialist
Division of Corporations

Letter Number: 599A00053175

APPLICATION BY FOREIGN CORPORATION FOR AUTHORIZATION TO TRANSACT BUSINESS IN FLORIDA

IN COMPLIANCE WITH SECTION 607.1503, FLORIDA STATUTES, THE FOLLOWING IS SUBMITTED TO REGISTER A FOREIGN CORPORATION TO TRANSACT BUSINESS IN THE STATE OF FLORIDA:

99 NOV PM 2:17

1. Netlojix Telecom, Inc.
(Name of corporation: must include the word "INCORPORATED", "COMPANY", "CORPORATION", or words or abbreviations of like import in language as will clearly indicate that it is a corporation instead of a natural person or partnership if not so contained in the name at present.)

2. Delaware
(State or country under the law of which it is incorporated)

3. 77-0521934
(FEI number, if applicable)

4. August 25, 1999
(Date of incorporation)

5. Perpetual
(Duration: Year corp. will cease to exist or "perpetual")

6. Upon Qualification
(Date first transacted business in Florida. (See sections 607.1501, 607.1502, and 817.155, F.S.))

7. 501 Bath Street, Santa Barbara, California 93101
(Current mailing address)

8. provision of telecommunications services
(Purpose(s) of corporation authorized in home state or country to be carried out in the state of Florida)

9. Name and street address of Florida registered agent:

Name: C T Corporation System

Office Address: c/o C T Corporation System, 1200 South Pine Island Road

Plantation, Florida, 33324
(Zip Code)

10. Registered agent acceptance:
Having been named as registered agent and to accept service of process for the above stated corporation at the place designated in this application. I hereby accept the appointment as registered agent and agree to act in this capacity. I further agree to comply with the provisions of all statutes relative to the proper and complete performance of my duties, and I am familiar with and accept the obligation of my position as registered agent.

C T Corporation System

Kevin Gallagher
(Registered agent's signature) (Officer)

KEVIN J. GALLAGHER
ASSISTANT VICE PRESIDENT
(Type Name and Title of Officer)

(FL - 2189 - 11/16/94)
CT System

11. Attached is a certificate of existence duly authenticated, not more than 90 days prior to delivery of this application to the Department of State, by the Secretary of State or other official having custody of corporate records in the jurisdiction under the law of which it is incorporated.

12. Names and addresses of officers and/or directors:

A. DIRECTORS

99 NOV -3 PM 2:17

Chairman: ______

Address: ______

______

Vice Chairman: ______

Address: ______

______

Director: Anthony E. Papa

Address: 501 Bath Street

Santa Barbara, California 93101

Director: James P. Pisani

Address: 501 Bath Street

Santa Barbara, California 93101

B. OFFICERS

President: See attached list of officers

Address: ______

______

Vice President: ______

Address: ______

______

Secretary: ______

Address: ______

______

Treasurer: ______________________

Address: ______________________

____

NOTE: If necessary, you may attach an addendum to the application listing additional officers and/or directors.

13. ______________________
(Signature of Chairman, Vice Chairman, or any officer listed in number 12 of the application)

14. JAMES P. PISANI, PRESIDENT
(Typed or printed name and capacity of person signing application)

99 NOV -3 PM 2:17

(FLA. 2189)

Appendix to Florida
Application by Fgn. Corp. for Authorization to Transact Business in Florida

Officers of Netlojix Telecom, Inc.

99 NOV -3 PM 2: 17

1. Anthony E. Papa, Chief Executive Officer
   501 Bath Street
   Santa Barbara, California 93101

2. James P. Pisani, President/Secretary
   501 Bath Street
   Santa Barbara, California 93101

3. Michael D. Ussery, CFO/Chief Acct. Officer
   8721 Airport Freeway
   Fort Worth, Texas 76180

NETLOJIX TELECOM, INC.

OFFICERS AND DIRECTORS RIDER

99 NOV -3 PM 2:17

OFFICERS:

Name:	Office:	Address:
Anthony E. Papa	CEO	501 Bath Street Santa Barbara, CA 93101
James P. Pisani	President & Secretary	501 Bath Street Santa Barbara, CA 93101
Michael D. Ussery	CFO & Chief Accounting Officer	501 Bath Street Santa Barbara, CA 93101

DIRECTORS:

Anthony E. Papa	501 Bath Street Santa Barbara, CA 93101
James P. Pisani	501 Bath Street Santa Barbara, CA 93101

State of Delaware

Office of the Secretary of State

I, EDWARD J. FREEL, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY "NETLOJIX TELECOM, INC." IS DULY INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE AND IS IN GOOD STANDING AND HAS A LEGAL CORPORATE EXISTENCE SO FAR AS THE RECORDS OF THIS OFFICE SHOW, AS OF THE TWENTY-FIRST DAY OF SEPTEMBER, A.D. 1999.

AND I DO HEREBY FURTHER CERTIFY THAT THE FRANCHISE TAXES HAVE NOT BEEN ASSESSED TO DATE.

99 NOV -3 PM 2:17

Edward J. Freel, Secretary of State

3088370 8300

991395020

AUTHENTICATION: 9981784

DATE: 09-21-99

EXHIBIT 2

Proposed Tariff

TITLE SHEET

NETLOJIX TELECOM, INC.

RESALE TELECOMMUNICATIONS SERVICES

This tariff contains the descriptions, regulations, and rates applicable to the furnishing of resold interexchange telecommunications services provided by NetLojix Telecom, Inc. ("Carrrier") within the State of Florida. This tariff is on file with the Florida Public Service Commission and copies may be inspected, during normal business hours, at the Carrier's principal place of business, 501 Bath Street, Santa Barbara, CA 93101, telephone number 1-877-NETLOJIX.

CHECK SHEET

All sheets listed below are effective as of the date shown. Original and revised sheets as named below comprise all changes from the original tariff and are currently in effect as of the date on the bottom of this sheet.

Sheet	Revision	Sheet	Revision	Sheet	Revision	Sheet	Revision
1	Original	26	Original				
2	Original	27	Original				
3	Original	28	Original				
4	Original	29	Original				
5	Original	30	Original				
6	Original	31	Original				
7	Original	32	Original				
8	Original						
9	Original						
10	Original						
11	Original						
12	Original						
13	Original						
14	Original						
15	Original						
16	Original						
17	Original						
18	Original						
19	Original						
20	Original						
21	Original						
22	Original						
23	Original						
24	Original						
25	Original						

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont'd)

Sheet

TABLE OF CONTENTS (Cont'd)

Issued by:
Michael D. Ussery
NetLojix Telecom, Inc.
8721 Airport Freeway
Fort Worth, TX 76180

EXPLANATION OF SYMBOLS

Any tariff modification shall be marked in the right-hand margin of the replacing tariff sheet with symbols described to indicate the place, nature, and extent of the change in text.

D	Delete or Discontinue
I	Change Resulting In An Increase To A Customer's Bill
M	Moved from Another Tariff Location
N	New
R	Change Resulting In A Reduction To A Customer's Bill
T	Change In Text or Regulation But No Change In Rate or Charge

TARIFF FORMAT

A. Sheet Numbering - Sheet numbers appear in the upper right corner of the page. Sheets are numbered sequentially. However, new sheets are occasionally added to the tariff. When a new sheet is added between sheets already in effect, a decimal is added. For example, a new sheet added between sheets 14 and 15 would be 14.1.

B. Sheet Revision Numbers - Revision numbers also appear in the upper right corner of each page. These numbers are used to determine the most current sheet version on file with the Commission. For example, the 4th revised Sheet 14 cancels the 3rd revised Sheet 14. Because of various suspension periods, deferrals, etc. the Commission follows in their tariff approval process, the most current sheet number on file with the Commission is not always the tariff page in effect.

C. Paragraph Numbering Sequence - There are nine levels of paragraph coding. Each level of coding is subservient to its next higher level:

2.
2.1.
2.1.1.
2.1.1.A.
2.1.1.A.1.
2.1.1.A.1.(a).
2.1.1.A.1.(a).I.
2.1.1.A.1.(a).I.(i).
2.1.1.A.1.(a).I.(i).(1).

D. Check Sheets - When a tariff filing is made with the Commission, an updated check sheet accompanies the tariff filing. The check sheet lists the sheets contained in the tariff, with a cross reference to the current revision number. When new Sheets are added, the check sheet is changed to reflect the revision. All revisions made in a given filing are designated by an asterisk (*). There will be no other symbols used on the check sheet if these are the only changes made to it (i.e., the format, etc. remains the same, just revised revision levels on some Sheets). The tariff user should refer to the latest check sheet to find out if a particular sheet is the most current on file with the Commission.

TECHNICAL TERMS AND ABBREVIATIONS

Access Line - An arrangement which connects the customer's location to a NetLojix network switching center.

Account Code - A numeric code which enables a customer to identify individual users for administrative purposes.

Authorization Code - A numerical code, one or more of which may be assigned to a Subscriber, to enable Carrier to identify the origin of service User so it may rate and bill the call. All authorization codes shall be the sole property of Carrier and no Subscriber shall have any property or other right or interest in the use of any particular authorization code. Automatic numbering identification (ANI) may be used as or in connection with the authorization code.

Automatic Numbering Identification (ANI) - A type of signaling provided by a local exchange telephone company which automatically identifies the local exchange line from which a call originates.

Carrier or Company - NetLojix Telecom, Inc.

Calls - Telephone messages completed by customers or users.

Commission - Refers to the Florida Public Service Commission.

Common Carrier - A company or entity providing telecommunications services to the public.

Customer or Subscriber - The person, firm or corporation that orders service and is responsible for the payment of charges and compliance with the Carrier's tariff regulations.

TECHNICAL TERMS AND ABBREVIATIONS (Cont'd)

Feature Group D (FGD) - The method of "+1" access available through the switched netowork of the local exchange utility. FGD is also known as equal access.

Holidays - NetLojix Telecom, Inc.'s recognized holidays are New Year's Day, Martin Luther King, Jr. Day, President's Day, Memorial Day, Independence Day, Labor Day, Columbus Day, Veteran's Day, Thanksgiving Day and Christmas Day.

NetLojix - NetLojix Telecom, Inc.

Tariff - The entire body of regulated rates, tolls, rentals, changes, classifications, rules, procedures, policies, etc. adopted and filed with the Commission by a telephone utility in fulfilling its role of telecommunications service. The term may also be used in reference to similar documents filed with state regulatory agencies.

Telecommunications - The transmission of voice communications or, subject to the transmission capabilities of the service, the transmission of data, facsimile, signaling, metering, or other similar communications.

User or End User - A Customer, Joint User, or any other person(s) authorized by a Customer to use service provided under this tariff.

Issued by: Michael D. Ussery
NetLojix Telecom, Inc.
8721 Airport Freeway
Fort Worth, TX 76180

Section 1 - APPLICATION OF TARIFF

1.1 This tariff contains the regulations and rates applicable to resold intrastate interexchange telecommunications services provided by Carrier between one or more points within the State of Florida. Carrier's services are furnished subject to the availability of facilities and subject to the terms and conditions of this tariff.

1.2 The rates and regulations contained in this tariff apply only to the services furnished by Carrier and do not apply, unless otherwise specified, to the lines, facilities, or services provided by a local exchange telephone company or other common carrier for use in accessing the services of Carrier.

1.3 The Subscriber is entitled to limit the use of Carrier's services by Users at the Subscriber's facilities, and may use other common carriers in addition to or in lieu of Carrier.

1.4 NetLojix will provide resold intrastate interexchange telecommunications services on a 24 hour basis. NetLojix maintains a highly qualified customer service staff accessible via a toll-free number. When applying for service each prospective customer will be required to furnish NetLojix with the following information:

(a) Name of the party who will be responsible for payment for the interexchange service provided.

(b) Address or exact location of the premises where interexchange service is to be provided and billed.

Service shall be considered initiated hereunder upon the earlier of the following:

(a) First use by the customer of the NetLojix service, and,

(b) The receipt by NetLojix of a customer's initial payment for NetLojix service.

1.5 Service is provided and billed on the basis of usage except as otherwise specified beginning on the date that billing becomes effective, and continues to be provided after the initial period until the customer requests cancellation or until NetLojix disconnects service pursuant to the provisions of this Tariff.

SECTION 2 - REGULATIONS

2.1 Undertaking of the Carrier

2.1.1 Scope

Resold intrastate interexchange telecommunications is furnished in accordance with the conditions and regulations which are set forth in the body of this Tariff.

2.1.2 Limitations

A. Service is offered subject to the availability of facilities as provided under this Tariff.

B. NetLojix reserves the right to discontinue furnishing service, or limit the use of service necessitated by conditions beyond it's control; or when the customer is using service in violation of the law or the provisions of this Tariff.

C. All facilities provided under this Tariff are controlled by NetLojix and the customer may not transfer or assign the use of service of facilities, except with the express written consent of the Carrier. Such transfer or assignment shall only apply where there is no interruption of the use or location of the service or facilities.

D. Prior written permission from the Carrier is required before any assignment or transfer. All regulations and conditions contained in this Tariff shall apply to all such permitted assignees or transferees, as well as all conditions for service.

SECTION 2 - REGULATIONS (Cont'd)

2.1 Undertaking of the Carrier (Cont'd)

2.1.3 Liability of the Carrier

A. Except as otherwise stated in this section, the liability of Carrier for damages arising out of either: (1) the furnishing of its services, including but not limited to mistakes, omissions, interruptions, delays, or errors, or other defects, representations, or use of these services, or (2) the failure to furnish its service, whether caused by acts or omission, shall be limited to the extension of allowances to the Customer for interruptions in service as set forth in Section 2.1.5.

B. Except for the extension of allowances to the Customer for interruptions in service as set forth in Section 2.1.5, Carrier shall not be liable to a Customer or third party for any direct, indirect, special, incidental, reliance, consequential, exemplary or punitive damages, including, but not limited to, loss of revenue or profits, for any reason whatsoever, including, but not limited to, any act or omission, failure to perform, delay, interruption, failure to provide any service or any failure in or breakdown of facilities associated with the service.

C. The liability of Carrier for errors in billing that result in overpayment by the Customer shall be limited to a credit equal to the dollar amount erroneously billed or, in the event that payment has been made and service has been discontinued, to a refund of the amount erroneously billed.

SECTION 2 - REGULATIONS (Cont'd)

2.1 Undertaking of the Carrier (Cont'd)

2.1.3 Liability of Carrier (Cont'd)

D. Carrier shall not be liable for any claims for loss or damages involving:

1. Any act or omission of: (1) the Customer, (2) any other entity furnishing service, equipment or facilities for use in conjunction with services or facilities provided by Carrier; or (3) common carriers or warehousemen;

2. Any delay or failure of performance or equipment due to causes beyond Carrier's control, including but not limited to, acts of God, fires, floods, earthquakes, hurricanes, or other catastrophes; national emergencies, insurrections, riots, wars or other civil commotions; strikes, lockouts, work stoppages or other labor difficulties; criminal action taken against Carrier; unavailability, failure or malfunction of equipment or facilities provided by the Customer or third parties; and any law, order, regulation or other action of any governing authority or agency thereof;

3. Any unlawful or unauthorized use of Carrier's facilities and services;

4. Libel, slander, invasion of privacy or infringement of patents, trade secrets, or copyrights arising from or in connection with the transmission of communications by means of Carrier-provided facilities or services; or by means of the combination of Carrier-provided facilities or services with Customer-provided facilities or services;

SECTION 2 - REGULATIONS (Cont'd)

2.1 Undertaking of the Carrier (Cont'd)

2.1.3 Liability of Carrier (Cont'd)

D. Carrier shall not be liable for any claims for loss or damages involving: (Cont'd)

5. Breach in the privacy or security of communications transmitted over Carrier's facilities;

6. Changes in any of the facilities, operations or procedures of Carrier that render any equipment, facilities or services provided by the Customer obsolete, or require modification or alteration of such equipment, facilities or services, or otherwise affect their use or performance, except where reasonable notice is required by Carrier and is not provided to the Customer, in which event Carrier's liability is limited as set forth in section 2.1.3;

7. Defacement of or damage to Customer premises resulting from the furnishing of services or equipment on such premises or the installation or removal thereof;

8. Injury to property or injury or death to persons, including claims for payments made under Worker's Compensation law or under any plan for employee disability or death benefits, arising out of, or caused by, any act or omission of the Customer, or the construction, installation, maintenance, presence, use or removal of the Customer's facilities or equipment connected, or to be connected to Carrier's facilities;

SECTION 2 - REGULATIONS (Cont'd)

2.1 Undertaking of the Carrier (Cont'd)

2.1.3 Liability of Carrier (Cont'd)

D. Carrier shall not be liable for any claims for loss or damages involving: (Cont'd)

9. Any intentional, wrongful act of a Carrier employee when such act is not within the scope of the employee's responsibilities for Carrier and/or is not authorized by Carrier;

10. Any representations made by Carrier employees that do not comport, or that are inconsistent, with the provisions of this Tariff;

11. Any act or omission in connection with the provision of 911, E911, or similar services involving emergencies;

12. Any noncompletion of calls due to network busy conditions;

13. Any calls not actually attempted to be completed during any period that service is unavailable.

SECTION 2 - REGULATIONS (Cont'd)

2.1 Undertaking of the Carrier (Cont'd)

2.1.3 Liability of Carrier (Cont'd)

E. Carrier shall be indemnified, defended and held harmless by the Customer or end user from and against any and all claims, loss, demands, suites, expense, or other action or any liability whatsoever, including attorney fees, whether suffered, made, instituted, or asserted by the Customer or by any other party, for any personal injury to or death or any person or persons, and for any loss, damage or destruction of any property, including environmental contamination, whether owned by the Customer or by any other party, caused or claimed to have been caused directly or indirectly by the installation, operation, failure to operate, maintenance, presence, condition, location, use or removal of any Carrier or customer equipment or facilities or service provided by Carrier.

F. Carrier assumes no responsibility for the availability or performance of any cable or satellite systems or related facilities under the control of other entities, or for other facilities provided by other entities used for service to the Customer, even if Carrier has acted as the Customer's agent in arranging for such facilities or services. Such facilities are provided subject such degree of protection or nonpreemptibility as may be provided by the other entities.

G. Any claim of whatever nature against Carrier shall be deemed conclusively to have been waived unless presented in writing to Carrier within thirty (30) days after the date of the occurrence that gave rise to the claim.

H. CARRIER MAKES NO WARRANTIES OR REPRESENTATIONS, EXPRESS OR IMPLIED EITHER IN FACT OR BY OPERATION OF LAW, STATUTORY OR OTHERWISE, INCLUDING WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR USE, EXCEPT THOSE EXPRESSLY SET FORTH HEREIN.

SECTION 2 - REGULATIONS (Cont'd)

2.1 Undertaking of the Carrier (Cont'd)

2.1.4 Initial Service Periods and Termination of Service

The initial service period is one (1) month except as specified in other sections of this Tariff. The initial service period of any class may be greater than that specified above, or elsewhere in this Tariff, when facilities are not available and the customer's location or the character or quantity of the service requested is such that, upon termination of the customer's user thereof, the required facilities are not likely to be useful as a part of a properly designed telephone distribution system serving telephone users in or beyond the customer's location.

2.1.5 Credit Allowances for Interruption of Service

Credit allowance for the interruption of service which is not due to the Carrier's testing or adjusting, negligence of the customer, or to the failure of channels or equipment provided by the customer, are subject to the general liability provisions set forth. It shall be the obligation of the customer to notify the Carrier immediately of any interruption in service for which a credit allowance is desired. Before giving such notice, the customer shall ascertain that the trouble is not being caused by any action or omission by the customer within his control, or is not in wiring or equipment, if any, furnished by the customer and connected to the Carrier's facilities.

The customer shall be credited for an interruption of more than twenty-four hours as follows:

Credit Formula:

Credit = A/B x C
"A" - outage time in hours
"B" - total hours in a month (month = 720)
"C" - total monthly charge for affected facility

SECTION 2 - REGULATIONS (Cont'd)

2.2 Responsibilities of the Subscriber

2.2.1 The Subscriber is responsible for placing any necessary orders; for complying with tariff regulations; for the placement of any stickers or tent cards provided by Carrier or as required by law; and for assuring that Users comply with tariff regulations. The Subscriber shall ensure compliance with any applicable laws, regulations, orders or other requirements (as they exist from time to time) of any governmental entity relating to services provided or made available by the Subscriber to Users. The Subscriber is also responsible for the payment of charges for calls originated at the Subscriber's numbers which are not collect, third party, calling card, or credit card calls.

2.2.2 The Subscriber must pay Carrier for replacement or repair of damage to the equipment or facilities of Carrier caused by negligence or willful act of the Subscriber, Users, or other, by improper use of the services, or by use of equipment provided by the Subscriber, Users, or others.

2.2.3 The Subscriber must pay for the loss through theft of any Carrier equipment installed at Subscriber's premises.

2.2.4 The Subscriber shall indemnify and save Carrier harmless from all liability disclaimed by Carrier in this tariff, arising in connection with the provision of service by Carrier, and shall protect and defend Carrier from any suits or claims against Carrier and shall pay all expenses and satisfy all judgments rendered against Carrier in connection herewith. Carrier shall notify the Subscriber of any suite or claim against Carrier of which it is aware.

SECTION 2 - REGULATIONS (Cont'd)

2.3 Use of Service

The services tariffed are furnished subject to the condition that they will not be used for any unlawful purpose. Services will not be furnished if any law enforcement agency, acting within its jurisdiction, advises that such services are being used or are likely to be used in violation of the law.

2.4 Customer Equipment and Channels

2.4.1 Interconnection With Other Companies

Service furnished by NetLojix may be connected with services or facilities of another participating carrier or may be provided over facilities which are solely provided by local utilities and/or interexchange carriers other than NetLojix. Service furnished by NetLojix is not part of a joint undertaking with such other carriers.

2.5 Advance Payments and Deposits

NetLojix may require a Customer to make an advance payment before services and facilities are furnished. The advanced payment will not exceed an amount equal to two-month's estimated charges, as determined by NetLojix. The advance payment will be credited to the Customer's bill. An advance payment may be required in addition to a deposit.

2.5.1 Deposits

NetLojix may require a Customer to make a deposit to be held as a guarantee for payment of charges. A deposit does not relieve the Customer of the responsibility for prompt payment of bills on presentation. The deposit will not exceed an amount equal to:

A. two month's charges for a service or facility which has a minimum payment period of one month ; or

SECTION 2 - REGULATIONS (Cont'd)

2.5 Advance Payments and Deposits (cont'd)

2.5.1 Deposits (cont'd)

B. the charges that would apply for the minimum payment period for a service or facility which has a minimum payment period of more than one month; except that the deposit may include an additional amount in the event that a termination charge is applicable.

A deposit may be required in addition to an advance payment.

When a service or a facility is discontinued, the amount of a deposit, if any, will be applied to the Customer's account and any credit balance remaining will be refunded. Before the service or facility is discontinued, NetLojix may, at its option, return the deposit or credit it to the Customer's account.

Deposits held will accrue interest at a rate consistent with theFlorida P.S.C. where the Customer is billed. Customers who present a credit risk may also be required, at any time, to provide other assurances of, or security for, the payment of NetLojix's charges for its services as deemed necessary, including without limitation, advance payments for service, third party guarantees or payment, pledges or other grants of security interests in the Customers' assets, and similar arrangements. The required deposits or other security may be increased or decreased by NetLojix, as it deems appropriate in the light of changing conditions.

SECTION 2 - REGULATIONS (Cont'd)

2.6 Rendering and Payment of Bills

2.6.1 Rendering of Bills

Regular customer bills are issued monthly. Each bill contains the dates included in the billing period, dates for service charges associated with work performed and the last date for timely payment. Bills include the amount the customer is charged, stated by category, sales tax and excise tax, with separate entries for total amounts current or in arrears. Reasonable customer requested adjustments to monthly bills may be made if the Customer brings the desired adjustment to NetLojix's attention.

2.6.2 Due Dates

Customer payments are considered prompt when received by NetLojix or its agent by the due date on the bill. The due date is thirty (30) days after the bill is rendered. Any Customer not paying within thirty (30) days is considered delinquent.

SECTION 2 - REGULATIONS (Cont'd)

2.6 Rendering and Payment of Bills (Cont'd)

2.6.3 Payment for Service

The rates specified in this tariff are rates based on usage, billed monthly and payable in arrears. All Customers shall be permitted to have a last date for timely payment changeable for cause in writing. Such a change will become effective when acknowledged by NetLojix. Until acknowledged, no change in date of timely payment is recognized by NetLojix. The maximum payment required for restoration of service that existed prior to disconnection shall be the total past-due amount, applicable charges and Advance Payment and Deposit as specified elsewhere in this tariff. The Customer is held responsible for all charges for services furnished at the Customer's request and for all toll service furnished. It is the Customer's responsibility to contact NetLojix when no bill is received. Except as provided elsewhere in this tariff, the rate for a full billing period is specified in this tariff. If the prorating indicates a refund is due, the refund is applied as a bill credit.

2.6.4 Disputed Bills

In the event of a dispute concerning a bill, NetLojix may require the Customer to pay the undisputed portion of the bill. Following payment of the undisputed amount, efforts to resolve the complaint, using complaint procedures in this tariff, shall continue for no more than forty-five (45) days after the rendering of the disputed bill. During this period the service shall not be disconnected for nonpayment of the disputed amount.

SECTION 2 - REGULATIONS (Cont'd)

2.6 Rendering and Payment of Bills (Cont'd)

2.6.5 Customer Complaints

Customer complaints are handled by a full service customer service department. A customer or prospective customer may initiate a complaint or billing inquiry with NetLojix by either calling 1-877-NETLOJIX during normal business hours or submitting a written complaint to:

NetLojix Telecom, Inc.
501 Bath Street
Santa Barbara, CA 93101

NetLojix's response to the customer will generally be in the same form used by the customer. However, NetLojix may respond to written complaints by telephone when it believes such communications will be more effective in resolution of the issue. When a complaint or billing inquiry is received, a NetLojix customer service representative will determine if the call was processed by NetLojix, and if so, the type of call. If it is a fraud or unanswered call for which the customer should not be held responsible, NetLojix will refund all charges for the call. If there is a rate dispute, NetLojix will adjust the charges if an error is confirmed. The customer may at any point during the resolution of the complaint or billing inquiry seek review by a NetLojix supervisor or manager. If the customer wishes further review after investigation and final resolution by NetLojix, the customer may direct all appropriate information to the Federal Communications Commission or the Consumer Affairs Division of the Florida Public Service Commission. The Division's address is:

Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399 -0850
Phone: 1-850-413-6100
Complaint Line: 1-800-342-3552
E-mail: contact@psc.state.fl.us

SECTION 2 - REGULATIONS (Cont'd)

2.6 Rendering and Payment of Bills (Cont'd)

2.6.6 Discontinuance of Service

Carrier may terminate Service to a Customer for nonpayment of undisputed charges or other violation of this tariff or provision of law upon written notice, as required below, to the Customer without incurring any liability for damages due to loss of telephone Service to the Customer. Termination of Service will not occur on any Friday, Saturday, Sunday or legal holidays. Charges will not be considered past due until thirty (30) days from the closing date printed on the Customer's bill.

The Carrier may refuse or discontinue Service under the following conditions provided that the Customer shall be given five (5) days written notice, excluding Sundays and legal holidays, to comply with any rule or remedy any deficiency:

A. For non-compliance with or violation of any State, municipal, or Federal law, ordinance or regulation pertaining to telephone Service, including, but not limited to, the placement of harassing, annoying or repeated unwanted calls of which the Carrier receives notice.

B. For use of telephone Service for any purpose other than that described in the application.

C. For neglect or refusal to provide reasonable access to the Carrier or its agents for the purpose of inspection and maintenance of equipment owned by the Carrier or its agents.

D. For noncompliance with or violation of Commission regulation or the Carrier's rules and regulations on file with the Commission.

SECTION 2 - REGULATIONS (Cont'd)

2.6 Rendering and Payment of Bills (Cont'd)

2.6.6 Discontinuance of Service (Cont'd)

E. For failure of Customer to pay a bill for utility service when due.

F. For failure of Customer to meet the Carrier's credit requirements.

G. Without notice in the event of Customer use of equipment or services in such a manner as to adversely affect the Carrier's equipment or Service to others.

H. Without notice in the event of tampering with the equipment or services owned by the Carrier, the Underlying Carrier or their agents.

I. Without notice in the event of a condition determined to be hazardous to the Customer, to other Customers of the Carrier, to the Carrier's equipment, the public, or to employees of the Carrier.

SECTION 2 - REGULATIONS (Cont'd)

2.7 Taxes And Fees

Now, or at any future time, if a state or municipality possesses or acquires the legal right to impose an occupation tax, license tax, sales tax, gross receipts tax, permit fee, franchise fee or other similar charge upon NetLojix, and has imposed, or imposes the same by ordinance or otherwise, such taxes, fees or charges shall be billed to the customers receiving service within the territorial limits of such municipality. Such billing shall allocate the tax, fee or charge among customers uniformly on the basis of each customer's monthly charges for the types of service made subject to such tax, fee or charge.

If at any future time a county or other local taxing authority acquires the legal right to impose an occupation tax, license tax, sales tax, gross receipts tax, permit fee, franchise fee or other similar charge upon NetLojix, and has imposed, or imposes the same by ordinance or otherwise, such taxes, fees or charges shall be billed to the customers receiving service within the territorial limits of such municipality. Such billing shall allocate the tax, fee or charge among customers uniformly on the basis of each customer's monthly charges for the types of service made to such tax, fee or charge.

SECTION 3 - EXPLANATION OF RATES

3.1 Timing of Calls

The Customer's long distance usage charge is based on the actual usage of NetLojix's network. Usage begins when the called party picks up the receiver. When the called party picks up, is determined by hardware answer supervision in which the local telephone company sends a signal to the switch or the software utilizing audio tone detection. A call is terminated when either calling party hangs up.

3.2 Uncompleted Call Crediting

If A Customer receives a bill for an uncompleted call, NetLojix will reimburse the customer for the full amount.

3.3 Minimum Call Completion Rate

A Customer can expect a call completion rate (number of calls completed/number of calls attempted) of not less than 95% during peak use periods for all FGD services.

3.4 Rates Based Upon Calculation of Distance

Usage charges for all mileage sensitive products are based on the airline distance between rate centers associated with the originating and terminating points of the call.

The airline mileage between rate centers is determined by applying the formula below to the vertical and horizontal coordinates associated with the rate centers involved. The Company uses the rate centers that are produced by Bell Communications Research in the NPA-NXX V & H Coordinates Tape and Bell's NECA Tariff No. 4.

FORMULA:

The square root of: $$\frac{(V1 - V2)^2 + (HI - H2)^2}{10}$$

SECTION 4 - SERVICE OFFERINGS

4.1 Long Distance Service

Carrier's Long Distance Service (LDS) is a communications service which is available for use by customers twenty-four (24) hours a day. Customers may originate LDS from locations served by the Carrioer, and may terminate in all locations within the State of Florida.

The service is offered in Feature Group D (FGD) exchanges where the Customer's local telephone lines are presubscribed by the local exchange company to the Company's LDS service, such that "1+" interLATA calls are automatically routed to the Company's network.

4.2 Toll Free Service

Toll Free Service is an inbound communications service which permits calls to be completed at the Customer's location without charge to the calling party. Access to the service is gained by dialing a ten (10) digit telephone number (800+ NXX-XXXX) which will terminate at the Customer's location. Calls may originate from any location within the State of Florida and may terminate at the Customer's location.

Toll Free Service will be billed per call based on the duration of the call. Usage discounts apply to aggregate monthly interstate and intrastate usage.

Toll Free service calls are originated via normal shared use facilities and are terminated via the Customer's local exchange service access line.

SECTION 4 - SERVICE OFFERINGS (Cont'd)

4.3 Miscellaneous Services

RESERVED FOR FUTURE USE

SECTION 5 - RATES

5.1 Long Distance Service

	Rate Per Minute
24 hours a day, 7 days a week, 365 days a year	$.30

5.2 Toll Free Service

	Rate Per Minute
24 hours a day, 7 days a week, 365 days a year	$.30

5.3 Miscellaneous Services

RESERVED FOR FUTURE USE

SECTION 5 - RATES

5.4 Late Payment Charge

Interest charges of 1.5% per month will be assessed on all unpaid balances more than thirty days old.

5.5 Return Check Charge

A return check charge of $25.00 will be assessed for checks returned for insufficient funds.

5.6 Restoration of Service

A restoration fee of $25.00 per occurrence is charged when service is re-established for customers who had been disconnected for non-payment.

5.7 Directory Assistance Charge

Carrier will connect LDS Service Customers to Directory Assistance (DA) for a fee of $0.75 per occurrence.

5.8 Special Promotions

The Carrier will, from time to time, offer special promotions to its customers waiving certain charges. These promotions will be approved by the Commission with specific starting and ending dates.

5.9 Payphone Surcharge

A charge will apply to calls that originate from any payphone used to access Carrier's services.

Rate per Call: $0.24

SECTION 5 - RATES

5.10 Special Rates For The Handicapped

5.10.1 Directory Assistance

There shall be no charge for up to fifty (50) calls per billing cycle from lines or trunks serving individuals with disabilities. Carrier shall charge the prevailing tariff rates for every call in excess of fifty (50) calls within a billing cycle.

5.10.2 Hearing and Speech Impaired Persons

Intrastate toll message rates for TDD users shall be evening rates for daytime calls and night rates for evening and night calls.

5.10.3 Telecommunications Relay Service

The charge for intrastate toll calls received from the relay service, will be 50% percent off of the otherwise applicable rate for a voice nonrelay call except that where either the calling or called party indicates that either party is both hearing and visually impaired, the call shall be discounted 60 percent off of the otherwise applicable rate for a voice nonrelay call. The above discounts apply only to time-sensitive elements of a charge for the call and shall not apply to per call charges such as a credit card surcharge.

EXHIBIT 3

Financial Capability

As a wholly owned subsidiary of NetLojix Communications, Inc. ("NetLojix Communications"), NetLojix will rely upon the substantial financial resources of NetLojix Communications. Any and all financial resources needed to offer the proposed services will be furnished by its corporate parent. Therefore, NetLojix submits as Exhibit 2 the audited financial statements of its corporate parent, NetLojix Communications. [1]

As demonstrated by the attached documents, NetLojix has sufficient financial capability to provide the requested service in the geographic area proposed to be served, to maintain the requested service and to meet any of its lease or ownership obligations. For the period ending December 31, 1998, NetLojix Communications had total assets of $16 million, which exceeded total liabilities of $11.5 million, providing stockholders' equity of $4.5 million.

---

[1] NetLojix Communications, Inc. changed its name from AvTel Communications, Inc. The name change took effect September 15, 1999.

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For Fiscal Year Ended: December 31, 1998

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from to . Commission file number: 0-27580

AvTel Communications, Inc.

(Exact Name of Registrant in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**87-0378021** (I.R.S. Employer Identification No.)
501 Bath Street, Santa Barbara, CA (Address of Principal Executive Offices)	93101 (Zip Code)

(Issuer's Telephone Number, Including Area Code) (805) 884-6300

Securities registered under Section 12(b) of the Act: None.

Securities registered under Section 12(g) of the Act:

Common Stock Par Value $0.01

(Title of class)

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 in this form herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant was approximately $45,593,193, computed at the last sale price of such Common Stock on The Nasdaq SmallCap Market as of March 17, 1999.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

As of March 17, 1999, there were 10,539,123 shares of the Registrant's Common Stock, par value $0.01, issued and outstanding, excluding treasury stock.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III (Items 10, 11, 12 and 13) of Form 10-K is incorporated by reference to the Registrant's definitive Proxy Statement relating to its annual meeting of stockholders to be held on or about May 27, 1999, which will be filed with the Commission within 120 days after the end of the Registrant's fiscal year.

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

INTRODUCTORY STATEMENT

THIS ANNUAL REPORT ON FORM 10-K CONTAINS "FORWARD-LOOKING STATEMENTS" WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT") AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED (THE "EXCHANGE ACT"). FORWARD-LOOKING STATEMENTS ARE STATEMENTS OTHER THAN HISTORICAL INFORMATION OR STATEMENTS OF CURRENT CONDITION AND RELATE TO FUTURE EVENTS OR THE FUTURE FINANCIAL PERFORMANCE OF THE COMPANY. FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES, SUCH AS STATEMENTS OF THE COMPANY'S STRATEGIES, PLANS, OBJECTIVES, EXPECTATIONS, ESTIMATES AND INTENTIONS. SOME FORWARD-LOOKING STATEMENTS MAY BE IDENTIFIED BY USE OF SUCH TERMS AS "BELIEVES," "ANTICIPATES," "INTENDS" OR "EXPECTS." THE COMPANY'S ACTUAL RESULTS MAY DIFFER SIGNIFICANTLY FROM THE RESULTS DISCUSSED IN THE FORWARD-LOOKING STATEMENTS. THE COMPANY UNDERTAKES NO OBLIGATION TO PUBLICLY UPDATE OR REVISE ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE. THE CAUTIONARY STATEMENTS MADE IN THIS ANNUAL REPORT SHOULD BE READ AS BEING APPLICABLE TO ALL RELATED FORWARD-LOOKING STATEMENTS WHEREVER THEY APPEAR IN THIS ANNUAL REPORT.

BACKGROUND

General

AvTel Communications, Inc. (the "Company" or "AvTel") is a provider of broadband network services integrating voice, data and Internet solutions. The Company sells and markets a broad range of telecommunications and advanced network services through independent value added resellers, Affinity and agent organizations, and internal direct sales professionals. The Company targets mid-size corporations, small-office home-office professionals and select residential market segments.

The Company was formerly a Utah corporation. On December 1, 1997, the Company merged with and into its wholly-owned Delaware subsidiary, thus effecting the Company's reincorporation in Delaware (the "Reincorporation Merger"). The conversion of the Company's stock in the Reincorporation Merger resulted in an effective one-for-four reverse stock split, which was effective on December 1, 1997 (the "Reverse Stock Split"). All share and option numbers and prices set forth herein have been adjusted to reflect the Reverse Stock Split.

History

The Company was incorporated on October 31, 1981, but did not commence its current business until February, 1995. Prior to October 23, 1996, the Company conducted operations under the name "Hi, Tiger International, Inc.". The name change was effected in connection with the Company's acquisition of AvTel Holdings, Inc., a California corporation ("AHI") on that date. As a result of the acquisition of AHI, the Company implemented a complete change in its Board of Directors and executive management, began to pursue several acquisitions and strategic alliances and started development of a sales and operational strategy to position the Company as a telecommunications carrier providing a comprehensive array of broadband voice and data network services.

The acquisition of AHI was effected pursuant to the merger of a wholly-owned subsidiary of the Company with and into AHI (the "AHI Merger") as a result of which the Company acquired 100% of the issued and outstanding capital stock of AHI in exchange for 1,063,127 shares of the Company Common Stock, representing approximately 61% of the issued and outstanding Company Common Stock after giving effect to the AHI Merger, and 250,000 shares of newly authorized shares of the Company's Series A Convertible Preferred Stock. For accounting purposes, the acquisition was treated as a reverse acquisition with AHI as the acquirer.

In November, 1996, the Company acquired Silicon Beach Communications, Inc. ("SBC"), an Internet Service Provider ("ISP") and provider of software development services. In February, 1997, the Company acquired all of the issued and outstanding capital stock of WestNet Communications, Inc. ("WNI"), a Ventura, California ISP. Following completion of this acquisition, the Company began to integrate the customer bases, network facilities and other operations of SBC and WNI in order to achieve desired efficiencies and economies of scale.

On December 1, 1997, the Company acquired Matrix Telecom, Inc., a privately-held Texas corporation ("Matrix") by means of a share for share exchange (the "Share Exchange"). Matrix is a provider of long distance telephone services. See "Background—Acquisition of Matrix" below. The Reincorporation Merger and the Reverse Stock Split were conditions to the closing of the Share Exchange.

On September 25, 1998, the Company acquired all of the issued and outstanding capital stock of Digital Media International, Inc. ("DMI"), a privately-held corporation based in Santa Barbara, California, which develops software for educational, entertainment and other applications.

In November, 1998, the Company acquired all of the issued and outstanding capital stock of Remote Lojix/PCSI, Inc. ("RLI"), a privately-held corporation based in New York, which is a provider of system integration and local area network ("LAN") services to corporate customers in the eastern United States.

Acquisition of Matrix

AvTel and Matrix entered into a Stock Exchange Agreement dated April 29, 1997, and subsequently amended (the "Exchange Agreement"), pursuant to which the persons or entities who owned the issued and outstanding common stock of Matrix ("Matrix Stockholders") would transfer to AvTel all of their Matrix stock and, in exchange, AvTel would issue to the Matrix Stockholders shares of the Company's Common Stock (the "Share Exchange"). The Share Exchange was completed pursuant to the terms of the Exchange Agreement on December 1, 1997. For accounting purposes, the acquisition was treated as a reverse acquisition with Matrix as the acquirer.

In connection with the completion of the Share Exchange, the Matrix Stockholders and the Company entered into a Registration Rights and Lockup Agreement dated December 1, 1997 (the "Registration Rights and Lockup Agreement"). Pursuant to the Registration Rights and Lockup Agreement, certain persons and entities who held an aggregate of 85.2% of the outstanding Matrix Common Stock agreed, for a two-year period commencing on the closing of the Share Exchange, not to offer, pledge, sell, or otherwise dispose of any shares of the Company issued to them pursuant to the terms of the Exchange Agreement. As of March 17, 1999, this "lockup" provision relates to a total of 6,457,123 shares of AvTel stock held by the following shareholders: Ronald L. Jensen (329,321 shares), Gladys Jensen (731,847 shares), James J. Jensen (851,738 shares), Jami J. Jensen (851,738 shares), Janet Jensen Krieger (961,939 shares), Jeffrey J. Jensen (851,738 shares), Julie J. Jensen (851,738 shares), The RJ & GJ Foundation (329,692 shares), The Janet Foundation (24,124 shares), The OUI Foundation (24,124 shares), The Chasdrew Foundation (24,124 shares), John E. Allen (125,000 shares), Anthony E. Papa (250,000 shares) and James P. Pisani (250,000 shares)(together, the "Lockup Stockholders").

The Registration Rights and Lockup Agreement requires that the Company use its best efforts to file a shelf registration statement providing for the sale by the Lockup Stockholders of all securities issued to them in connection with the Exchange Agreement, subject to the two-year holding restriction imposed on the Lockup Stockholders described above. Under the Registration Rights and Lockup Agreement, the Company is obliged to use its reasonable efforts to keep the shelf registration statement effective on a continuous basis for a period described in the Registration Rights and Lockup Agreement. The Lockup Stockholders may also require the Company to undertake up to two additional demand registrations of their securities if the shelf registration is not in place. All costs and expenses of both shelf and demand registrations (excluding any underwriting discounts and fees of counsel to the Lockup Stockholders) will be borne by the Company.

BUSINESS OF THE COMPANY

The Company is a provider of broadband network services integrating voice, data and Internet solutions. The Company sells and markets a broad range of telecommunications and advanced network services through independent value added resellers and internal direct sales professionals. The Company targets mid-size corporations, small-office home-office professionals and select residential market segments through two primary business units; the Business Markets Group ("BMG") and the Channel Markets Group ("CMG").

Business Markets Group

BMG targets mid-size corporate customers for their broadband data, voice and Internet networking needs. Following this sales strategy, the Company's objective is to become the underlying telecommunications carrier for the transport of data, voice and Internet traffic. Through a value-added sales process, the Company designs, provisions and manages its customers' networks. The Company will provide a host of additional value added services assisting its customers to create enhanced intranet and extranet applications. The Company believes its strategy to focus on the corporate customer for enterprise-wide network services offers significant opportunity. BMG cross-markets to its customer base a variety of traditional telecommunications products and services such as long distance telephone service, executive calling cards and video/audio conferencing.

Industry. Information technology has fast become a driving force in telecommunications. The Company's BMG strategy is driven by corporate end users' needs for network connectivity as a result of new software applications and technology advancements developed in the information technology arena. This has become a critical element in the ability of businesses, professional and other organizations to improve productivity and lower costs. This can be accomplished through the use of a variety of telecommunications services, including branch office, remote office and telecommuter networking ("intranets") as well as providing network access to customers, vendors, suppliers ("extranets") and the Internet. While management expects these factors to continue to increase market demand for these services, there are no assurances regarding the size of such demand or that the Company will be selected to provide its services in response to such demand.

Internetworking. At an increasing rate, business, professional and other organizations are seeking to inter-network their LANs and WANs to share information and computing resources for applications such as e-mail, transaction processing, the sharing of databases, multi-site engineering and product development and electronic image transfer. The communications traffic of many organizations has grown steadily during the past two decades leading to enterprise-wide networks facilitating rapid and efficient data communications between work groups, departments and branch locations. Additionally, a shift to enterprise-wide remote access has occurred due to increased business mobility, increased telecommuting, reduced cost of WAN services and widespread adoption of remote access standards. Internet and remote access devices extend the organization network beyond the branch office, bringing remote users closer to the enterprise and permitting connection to the corporate LAN so users can work anywhere, any time. Users can access e-mail, databases and servers as if they were in the corporate office. The recent availability of reliable IP voice technology within an enterprise-wide data network has created additional cost-saving incentives for businesses to implement advanced network solutions.

The Company believes that, as a result of these shifts, internetworking, the method used for interconnecting networks, will continue to grow. This is reflected in the growth in sales and distribution of routers, remote access servers, intranet software and other various components that enable internetworking. As the computing paradigm continues to migrate to network-centric architectures, enterprise-wide networks allow those technologies to be implemented. The Company's strategy recognizes the opportunity to bridge the gap between telecom and computer providers and simplify networking complexities by becoming a single source for enterprise-wide services and support.

Connectivity and Bandwidth. The Company believes that communications requirements such as bandwidth availability and network design are replacing computer requirements such as processor speed, memory or operating systems as the delimiting factors for business applications. Video conferencing, remote patient diagnostics with medical imaging and telecommuting are all business applications in which the success of the deployment is defined by the available bandwidth. The ultimate realization of this trend is the Web and applications developed with Internet-specific tools. Web-based applications are computer platform and operating system independent but depend entirely upon connectivity and bandwidth for successful deployment and execution.

As a result, connectivity is becoming one of the most important factors in enhancing business productivity and customer service. Large corporations have historically created private wide area networks through leased dedicated data lines. However, dedicated point-to-point facilities have several deficiencies: leased lines are very expensive; remote offices and telecommuters are omitted; and leased lines are not suited for unscheduled and asynchronous communications. Accordingly, small and medium size companies that have sought the benefits of internetworking have been required to use modems and dial-up telephone lines which are generally too slow to handle today's applications.

Growing demands for high speed capabilities have given way to the emergence of new carrier-based data communication services to overcome the deficiencies of both dedicated leased and dial-up lines. WAN solutions vary substantially depending on an organization's size and communications needs. Traditionally, wideband digital transmission circuits (such as T1 and DS-1) were leased from public carriers to provide voice, fax and data communications links between larger offices and low speed leased lines (such as DS-O) for branch office connectivity. For some applications, however, this has proven expensive and inefficient because the entire bandwidth capacity is dedicated 24 hours per day, whether or not it is used.

Packet-based services were developed to address the issue of allocation and utilization. Today, "fast packet" networking technologies such as Frame Relay and Asynchronous Transfer Mode ("ATM") have emerged as an integrated, cost-effective, flexible WAN solution. These networks allow for "bandwidth on demand" between any two endpoints on a WAN.

Strategy. The implementation of the Company's BMG strategy involves the marketing of products and services integrated into enterprise-wide network solutions for business customers. These enterprise-wide solutions include network design, system integration and service, WAN connectivity, voice connectivity, Internet access and World-Wide Web ("Web") development. BMG's sales and marketing activities result in monthly, recurring revenues from networking customers under multi-year term agreements. The group's primary sales strategy includes in-house direct sales professionals and an agent program through which BMG distributes its services through value added resellers ("VARs") of information technology products. BMG leverages the existing customer relationships of these VARs gaining more immediate access to a wider group of prospective customers and greater credibility in the sales process. Additionally, this VAR channel becomes the service organization for the Company's business customers requiring on-site repair and maintenance visits.

Channel Markets Group

CMG markets domestic and international long distance telephone services, Internet access and related services through distribution companies, agents, resellers and affinity groups ("Channel Partners") that maintain access to large groups of individuals and small businesses through affinity relationships and niche marketing strategies. Channel Partners include non-profit organizations and for-profit distribution groups. The Company's Channel Partners generally require business-to-business account management, have a large and somewhat captive audience of members/customers and distribute information and services. Historically, telecommunications companies have leveraged third party organizations to sell long distance telephone service to their member/customers sharing a percentage of the revenues generated by the group.

The Company has recognized that the Internet explosion has created an "eBusiness Imperative" among these organizations that is generating new sales opportunities for the Company. The Company assists these organizations in designing and launching their Web presence and seeks to sell Internet access and additional telecom services to the organization's member/customer base. In turn, the Channel Partner participates in the revenue generated by their members' use of the Company's services. The Company believes that it is one of a few companies offering Channel Partners a turnkey-solution with private labeling and total technical, billing and customer service support.

CMG provides Internet access, long distance telephone and other services to customers in 49 states. The Company is fully certified or registered in all states where required and operates under Section 214 authority from the Federal Communications Commission ("FCC"). The Company, through a wholly owned subsidiary has a national-deployed Carrier Identification Code ("CIC"). The CIC provides the Company greater network flexibility and permits the Company to market to subscribers of other carriers by having the customer dial the CIC directly, a process, which is known in the industry as "casual calling." The Company maintains its own convergent billing platform, rating system and monitoring center.

The Company and various subsidiary companies market CMG's services under a variety of brands, which include AvTel™, Matrix Telecom®, MatrixInet™, Silicon Beach™, WestNet Communications™, Remote Lojix™, Addictive Media™ and Digital Meteor™. Channel Partners, at their expense, utilize a variety of marketing strategies which include direct mail, outbound telemarketing and direct sales. In November, 1998, the Company introduced its nationwide Internet access program for dial-up connectivity. This program is provided by the Company to the public under the MatrixInet™ brand, and is also available under a private label arrangement for certain Channel Partners.

Channel Partners generally market to niche consumer segments such as non-profit affinity membership groups, ethnic affinity groups and home based business professionals. These independent distributor groups are provided with a variety of value-added support services which include: an in-house multi-lingual Customer Service department open 24 hours a day, 7 days a week; direct electronic provisioning to local exchange carriers ("LECs"); and custom billing and management reports available in paper format or on line through the Company's eBill and NetAgent platforms. The Company believes that its agreements with Channel Partners provides highly-leveraged access to large, loyal groups of individuals. The Company also believes that accessing these individuals through its Channel Partners enables lower marketing expenditures, lower customer churn and a greater customer motivation to purchase additional services.

Operations and Support

Customer Service Center. The Company's inbound customer service center is designed to provide the Company's customer base with a high-level of service and support. Customer Service Representatives ("CSRs") are available 24 hours a day, 7 days a week in order to answer inquiries generated by the Company's marketing campaigns, as well as to support existing customers. CSRs are trained to answer a broad range of inquiries from prospective customers relating to service, pricing, and optional features. In addition to competitive rates and a wide variety of products, the Company is able to offer business customers a highly specialized direct bill summary package that includes call summaries by account code, department, employee, project, client, area code, country code, and time-of-day. Customer call management reports are available in a variety of media formats including electronic support via the Internet.

The Company's call center and technical support center are equipped with state-of-the-art computer and telecommunications technology. Incoming calls are managed with the help of an automatic call distributor and an automated attendant. Such a system allows for management of call queue time, the formation of distinct work groups for different projects, and on-line monitoring of customer service calls for quality assurance purposes. Bilingual CSRs are available during day and evening shifts.

Billing and Information Systems. The Company has dedicated substantial resources to its management information systems. The Company's information systems enable the Company to (1) monitor and respond to the evolving needs of its customers by developing new and customized services; (2) provide sophisticated billing information that can be tailored to meet the requirements of its customer base; (3) provide high quality customer service; (4) detect and minimize fraud; (5) verify payables to suppliers; and (6) integrate additions to its customer base. In addition, the Company has complete facilities for rating, formatting and distributing direct bills to its larger commercial subscribers. Small business customers and individuals may receive either a direct or a LEC bill, depending upon the services provided to the customer. The Company provides secure remote electronic access to certain activation, provision and billing information to its customers through the Internet.

The Company has invested in call rating, billing, and customer service infrastructure. In addition, the Company holds billing and collection agreements with LECs, including all of the Regional Bell Operating Companies ("RBOCs"), and independent local exchange companies ("ILECs"). These billing agreements permit the Company to include its billing on the customer's local telephone bill. The Company's billing information systems and services also allows it to provide direct bills to customers in a paper format and electronically through the Internet.

Strategic Alliances and Carrier Agreements. The Company has executed strategic agreements with Sprint for its underlying voice carrier services, Qwest and IXC for data carrier services and GST, GTE and PSINet for Internet access services. As noted above, the Company holds billing and collection agreements with all of the RBOCs and ILEC's. The Company developed with Prosoft I-Net Solutions a specialized training program designed to educate value-added resellers of the Company's services on the integration of data, voice and video products.

ACE Certified Engineer Training Program. On March 16, 1998 the Company announced the availability of its ACE Certified Engineering training program. The ACE program has been designed specifically for value added resellers in the telecommunications industry. The ACE program provides a complete curriculum over a broad range of courses. The program includes four tracks: 1) a general overview of the telecommunications industry and technologies; 2) voice equipment and network design; 3) data communications and network design; and 4) the integration of voice, video and data, traffic design and network engineering. Each track is a technical course focusing on how to use, engineer and integrate proven and leading-edge voice, video and data networking technologies. The complete program includes on-line and classroom training and course work requiring 128 hours of in-depth course work and labs.

Regulation

The services which the Company provides, either directly or through its subsidiaries, are subject to varying degrees of federal, state and local regulation. The FCC exercises jurisdiction over all facilities of, and services offered by, telecommunications common carriers to the extent that they involve the provision, origination or termination of jurisdictionally interstate or international communications. The state public service commissions ("PSCs") retain jurisdiction over jurisdictionally intrastate communications. The FCC and relevant PSCs have the authority to regulate interstate and intrastate rates, respectively, ownership of transmission facilities and the terms and conditions under which the Company's services are provided.

In general, neither the FCC nor the relevant state PSCs exercise direct oversight over cost justification for the Company's services or the Company's profit levels, but either or both may do so in the future. However, the Company is required by federal and state law and regulations to file tariffs listing the rates, terms and conditions of services provided. The Company generally is also required to obtain certification from the relevant state PSC prior to the initiation of certain intrastate service, and is required to maintain a certificate issued by the FCC in connection with the provision of certain international services. Any failure to maintain proper federal and state tariffs or certification or any difficulties or delays in obtaining required authorization could have a material adverse effect on the Company.

Competition

The telecommunications industry is highly competitive and affected by rapid regulatory and technological change. The Company believes that the principal competitive factors in its business include pricing, customer service, network quality, service offerings and the flexibility to adapt to changing market conditions. The Company's future success will depend in part upon its ability to compete with AT&T, MCI Worldcom, Sprint and other carriers (including the RBOCs when approved to enter the long distance market) and other long distance providers, and America On-Line and other national and local ISPs, many of which have considerably greater financial and other resources than the Company.

Intellectual Property

The Company has registered several trademarks for use in its marketing materials. The Matrix Telecom name and logo, used by the Company to market Internet access, long distance service, and calling card services is a registered trademark. The Company also uses several unregistered trademarks as part of its BMG and CMG businesses, including AvTel™, MatrixInet™, Silicon Beach™, Addictive Media™ and Digital Meteor™, which it may seek to register. While the Company believes these trademarks are important to its business, the Company does not believe that failure to register these trademarks poses any material risk of infringement on its rights to use such trademarks.

Employees

As of March 15, 1999, the Company, including its subsidiaries, had approximately 255 full-time employees. None of the employees of the Company are represented by a union. The Company supplements its work force from time to time with contractors, administrative personnel through employment agencies, and part time employees. The Company believes that it has good relations with its employees.

Executive Officers of the Registrant

Set forth below is information with respect to each executive officer of the Company:

Anthony E. Papa, age 36, has been the Chairman of the Board and Chief Executive Officer of the Company since October 1996. Mr. Papa was also President of the Company from October 1996 until February 1998. Prior to October, 1996, Mr. Papa had served as President of ICS Communications, Inc.("ICS"), Richardson, Texas, a national provider of cable television, wireless paging, local and long-distance telephone services from December 1992. Before joining ICS, Mr. Papa served as general manager for Spectradyne, Inc., the largest provider of pay-per-view entertainment and interactive services to the hospitality industry. Mr. Papa is a director of International School of Information Management, Inc., an accredited university and an electronic publisher and provider of electronic services, and a director of ABC-Clio, Inc., an international publisher of historical reference materials for institutions of higher education. Mr. Papa received a B.S. in Management from Iona College, in New Rochelle, New York.

James P. Pisani, age 34, has been the President of the Company since February 1998, and has served as Chief Operating Officer, Chief Financial Officer and Secretary of the Company since October 1996. Mr. Pisani has also served as Chief Accounting Officer of the Company since October 1998. From October 1996 to February 1998, Mr. Pisani was the Executive Vice President of the Company. Prior to October 1996, he served as Vice President of Sales and National Accounts for ICS. While at ICS, Mr. Pisani was responsible for that firm's business-to-business and consumer sales activities. Prior to joining ICS, from June 1989 to June 1994, Mr. Pisani served as Vice President of a national mortgage banking firm serving, primarily, institutional accounts. Mr. Pisani graduated from Princeton University in 1986, with a degree in Economics.

M. Scott Hall, age 40, was appointed Senior Vice President of the Company's Channel Markets Group in October 1998. From November 1994 to September 1998, Mr. Hall was Vice President of One Call Communications, Inc., a long-distance and Internet service provider. Prior to that time, Mr. Hall was Manager, Business Development for Transnational Communications. Mr. Hall graduated from the University of Hawaii in 1982, with a B.A. in Sociology.

Frank A. Leone, age 52, was appointed President of the Company's Business Markets Group in November 1998. From November 1996 to July 1998, Mr. Leone was Executive Vice President of Sales for First Image Management Company, a division of First Data Corporation. From November 1994 to November 1996, Mr. Leone was President of FAL Consultants, in which capacity he provided strategy and marketing consulting to corporations. Prior to that time, Mr. Leone held an executive management position with Recycled Paper Greetings, the fourth largest greeting card manufacturer in the U.S., and executive management positions with Baxter Healthcare Corporation and Xerox Corporation. Mr. Leone graduated from Gannon University, Erie, Pennsylvania, with a B.S. in Business Administration.

Joe Renteria, Jr., age 52, was appointed Vice President, Information Systems of AvTel on February 25, 1999. Prior to that time, he had been employed for more than five years by Matrix. During his tenure with Matrix, Mr. Renteria has served as Manager of Data Processing, Director of Information Services and was promoted to Vice President of Information Services in May of 1997. Prior to joining Matrix, Mr. Renteria held various information technology management positions, primarily in the manufacturing sector.

RECENT DEVELOPMENTS

Board of Directors

On December 17, 1998, Gregory T. Mutz resigned from the Company's Board of Directors. On April 9, 1999, the Board elected Anthony D. Martin to fill the vacancy created by the resignation of Gregory T. Mutz.

Stock Repurchase

In connection with a newly -established employee incentive plan, on January 29, 1999, AvTel commenced a small program to repurchase shares of its own Common Stock on The Nasdaq SmallCap Market. In connection with this program, AvTel spent approximately $77,400 to repurchase 11,075 shares of the Common Stock. These shares will be held in treasury.

Sale of Series B Convertible Preferred Stock

On April 13, 1999, the Company sold 1,500 shares of its newly -designated Series B Convertible Preferred Stock (the "Series B Stock") to AMRO International, S.A., an entity organized under the laws of Panama, Austinvest Anstalt Balzers, an entity organized under the laws of Liechtenstein, and Esquire Trade & Finance Inc., an entity organized under the laws of the British Virgin Islands (the "Series B Investors") for $1,500,000. The Series B Stock has a liquidation preference of $1,000 per share. The Series B Stock will be entitled to an annual dividend of $30 per share, payable in cash or Common Stock, at the Company's option. The annual dividend will increase to $60 per share if the Company ever ceases to be listed on The Nasdaq Stock Market or any national securities exchange. The Series B Stock is convertible into Common Stock at the option of the Series B Investors at any time. The number of shares of Common Stock to be received by a Series B Investor upon conversion will equal the liquidation preference of the amount converted, divided by the conversion price. The conversion price will be the lesser of (1) $6.875, or (2) 89% of the low closing bid price for the Common Stock on The Nasdaq SmallCap Market at the time of conversion. The conversion price will not be less than $3.00 for 180 days after the date of issuance of the Series B Stock. Thereafter the conversion price will not be less than $2.00 as long as certain revenue and EBITDA requirements are met. As a result, the Company could issue up to 750,000 shares of Common Stock upon conversion if all of the Series B Stock were converted at the lowest possible conversion price (assuming such revenue and EBITDA requirements continue to be met). Unless the Company shall have obtained the approval of its voting stockholders in accordance with the rules of The Nasdaq Stock Market, the Company will not issue shares of Common Stock upon conversion of any shares of Series B Stock if such issuance of Common Stock, when added to the number of shares of Common Stock previously issued by the Company upon conversion of or as dividends on shares of the Series B Stock, would exceed 19.9% of the number of shares of Common Stock which were issued and outstanding on the original issuance date of the Series B Stock. The Company will pay converting Series B Investors in cash for any excess over such amount.

The Company also issued the Series B Investors warrants to purchase up to 20,000 shares of Common Stock at a price of $8.60 per share. The warrants may be exercised beginning September 30, 1999, and terminate on March 31, 2002.

The Company and the Series B Investors entered into a Registration Rights Agreement that requires the Company to file, and obtain and maintain the effectiveness of, a Registration Statement with the Securities and Exchange Commission (the "Commission") in order to register the public resale of all shares of the Common Stock acquired by the Series B Investors (a) upon conversion of the Series B Stock, (b) in payment of dividends on the Series B Stock, and (c) upon exercise of the warrants. The Company will be subject to significant monetary penalties if it fails to obtain or maintain the effectiveness of such Registration Statement.

The Company paid Trinity Capital Advisors, Inc. $60,000 as compensation for arranging the placement of the Series B Stock.

RISK FACTORS

IN EVALUATING THE COMPANY, ITS BUSINESS, OPERATIONS AND FINANCIAL POSITION, THE FOLLOWING RISK FACTORS SHOULD BE CONSIDERED CAREFULLY, IN ADDITION TO THE OTHER INFORMATION CONTAINED IN THIS FORM 10-K. THE FOLLOWING FACTORS, AMONG OTHERS, COULD AFFECT THE COMPANY'S ACTUAL FUTURE OPERATING RESULTS AND COULD CAUSE SUCH RESULTS TO DIFFER FROM THE RESULTS DISCUSSED IN ANY FORWARD-LOOKING STATEMENTS MADE BY OR ON BEHALF OF THE COMPANY.

Losses; Operating Results Subject to Significant Fluctuations

The Company has had significant recurring losses in its last four fiscal quarters. The Company's future operating results are difficult to forecast with any degree of accuracy because a number of factors (including those described below) subject these results to significant fluctuations.

Factors Influencing Operating Results, Including Revenues, Costs and Margins

The Company's revenues, costs and expenses have fluctuated significantly in the past and are likely to continue to fluctuate significantly in the future as a result of numerous factors. The Company's revenues in any given period can vary due to factors such as call volume fluctuations; the addition or loss of major customers, whether through competition, merger, consolidation or otherwise; pricing pressure resulting from increased competition; and technical difficulties with or failures of portions of the network used by the Company that impact the Company's ability to provide service to or bill its customers. The Company's cost of services and operating expenses in any given period can vary due to factors such as fluctuations in rates charged by carriers to terminate the Company's traffic; increases in bad debt expense and reserves; compensation expense resulting from stock options granted by the Company; changes in the Company's sales incentive plans; and costs associated with changes in staffing levels of sales, marketing, technical support and administrative personnel. In addition, the Company's operating results can vary due to factors such as loss of favorable routing options; actions by regulatory entities; and general economic and political conditions.

Volatility of Stock Price

The Company's Common Stock has been traded on The Nasdaq SmallCap Market since May 28, 1998. Trading in the Company's stock was halted by Nasdaq after the close of trading on November 12, 1998, through the close of trading on November 13, 1998, as a result of an unusual upsurge in its stock price and trading volume. See "Legal Proceedings." The trading volume of the Common Stock has been variable, but generally low. As a result, relatively small trades may significantly affect the market price of the Common Stock. The market price of the shares of Common Stock has been highly volatile and may be significantly affected by factors such as actual or anticipated fluctuations in the Company's operating results, the announcement of potential acquisitions by the Company, changes in regulations, activities of the largest domestic providers, industry consolidation and mergers, conditions and trends in the telecommunications market, adoption of new accounting standards affecting the telecommunications industry, changes in recommendations and estimates by securities analysts, general market conditions and other factors. In addition, the stock market has from time to time experienced significant price and volume fluctuations that have particularly affected the market prices for the shares of emerging growth companies like the Company. These broad market fluctuations may adversely affect the market price of the Company's Common Stock.

Securities Class Action Litigation

As noted above, on November 12, 1998, the Company experienced an unusual upsurge in its stock price and trading volume. This unusual event has triggered the initiation of class action litigation under the federal securities laws. See "Legal Proceedings." The Company believes that these claims are without merit and intends to defend vigorously this litigation. However, it is not possible at this time for the Company to predict with certainty the outcome of this litigation. Even if the Company prevails in the litigation, the expenses of the defense could have a material adverse effect on the Company's operating results and financial condition.

Risks Inherent in Acquisition Strategy

An important component of the Company's past growth has been to develop its business through acquisitions. This growth strategy is dependent on the continued availability of suitable acquisition candidates and subjects the Company to a number of risks. Acquisitions may place significant demands on the Company's financial and management resources, as the process for integrating acquired operations presents a significant challenge to the Company's management and may lead to unanticipated costs or a diversion of management's attention from day-to-day operations. There can be no assurance that the Company will be able to successfully integrate any acquisitions made by the Company in the future into Company operations. Additionally, the Company may incur unknown liabilities despite management's efforts to investigate the operations of the acquired business.

Potential Adverse Effects of Government Regulation

The Company's business is subject to various federal and state laws, regulations, agency actions and court decisions. These laws, regulations, actions and decisions may impose prior certification, notification, registration and/or tariff requirements. Certificates of authority can generally be conditioned, modified or revoked by state regulatory authorities for failure to comply with state laws and regulations. Fines and other penalties, including revocation of a certificate of authority, may be imposed. In addition, future changes in any of these sources of regulation could have a material adverse effect on the Company's business, operating results and financial condition.

Dependence on Key Personnel

The Company's success depends to a significant degree upon the efforts of senior management personnel, in particular, Anthony E. Papa, the Company's Chairman and Chief Executive Officer, and James P. Pisani, the Company's President and Chief Operating Officer. The Company believes that its future success will depend in large part upon its continuing ability to attract and retain highly skilled personnel. Competition for qualified, high-level telecommunications personnel is intense and there can be no assurance that the Company will be successful in attracting and retaining such personnel. The loss of the services of one or more of the Company's key individuals, or the failure to attract and retain other key personnel, could materially adversely affect the Company's business, operating results and financial condition.

Significant Competition

The telecommunications industry is intensely competitive and subject to rapid change. The Company's competitors include facilities-based and non-facilities-based providers, many of which have substantially more resources than the Company. Providers compete on the basis of price, customer service, transmission quality, breadth of service offerings and value-added services. Additionally, the telecommunications industry is in a period of rapid technological evolution, marked by the introduction of competitive product and service offerings, such as the utilization of the Internet for international voice and data communications. The Company is unable to predict which technological development will challenge its competitive position or the amount of expenditures will be required to respond to a rapidly changing technological environment. The Company believes that competition will continue to increase, placing downward pressure on prices. Such pressure could adversely affect the Company's gross margins if the Company is not able to reduce its costs commensurate with such price reductions.

Need for Additional Capital

In the past, the Company's cash flow from operations, together with its secured borrowings, has been sufficient to meet its working capital and capital expenditure requirements. The Company does not expect to generate sufficient cash flow to fully implement its business strategy without raising additional capital. The Company is actively pursuing an equity line of credit through discussion with potential investors. If the Company is unable to obtain financing in a timely manner and on acceptable terms, management is developing and intends to implement a plan that would allow the Company to continue to operate through 1999. This plan would include reducing the Company's workforce, eliminating advertising expenditures, reducing professional services and reducing or eliminating other discretionary expenditures.

Year 2000 Computer Program Failure

A significant percentage of the software that runs most of the computers in the United States relies on two-digit date codes to perform computations and decision -making functions. Commencing on January 1, 2000, these computer programs may fail from an inability to interpret date codes properly, misinterpreting "00" as the year 1900 rather than 2000. In association with Electronic Data Systems Corporation (the Company's principal software vendor for such systems), the Company is in the process of upgrading the Company's billing, credit and call tracking systems to become Year 2000 compliant, at a cost to the Company of approximately $750,000. At the same time, a number of the computers of the Company's vendors that interface with the Company's systems may run on programs that have Year 2000 problems and may disrupt the Company's billing, credit and tracking systems. Failure of any of the computer programs integral to the Company's vendors could adversely affect the Company's business, operating results and financial condition. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Forward-looking Statements

Certain statements contained in this Form 10-K, including without limitation, statements containing the words "believes," "anticipates," "intends," "expects" and words of similar import, constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, those set forth above. GIVEN THESE UNCERTAINTIES, THE STOCKHOLDERS OF THE COMPANY ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON SUCH FORWARD-LOOKING STATEMENTS.

ITEM 2. PROPERTIES

The Company does not own any real property. The table below sets forth certain information with respect to the material properties leased by the Company, including the Company's executive offices in Santa Barbara, California. All of such properties consist of office space. The Company and its subsidiaries also operate points-of-presence for the purpose of creating local access points to its network backbone.

Location	Square feet	Expiration date(2)	Current monthly rent(1)
501 Bath Street Santa Barbara, CA	6,798	March 2003	$11,863
8721 Airport Freeway Fort Worth, TX	24,500	June 2000	$23,050
104 West Anapamu Suites C&D Santa Barbara, CA	3,441	November 2001	$ 4,800
70 West 36th St., Suite 605 New York, NY	2,500	December 2002	$ 4,800
38 East 32nd St., 8th Floor New York, NY	4,400	February 2004	$ 4,416
1600 Parkwood Circle Suite 603 Atlanta, GA	2,190	December 2001	$ 3,750
2333 Mill Creek Drive Suite 120 Laguna Hills, CA	1,446	February 2001	$ 3,370

(1) All amounts shown are on a "triple net" basis.

(2) Subject to certain renewal options held by the Company.

ITEM 3. LEGAL PROCEEDINGS

The Company is the defendant in a class action under the federal securities laws (*In re AvTel Securities Litigation,* Case No. 98-9236) currently pending in the United States District Court for the Central District of California.

This litigation is the consolidation of five separate class action suits that were filed against the Company and certain of its officers, alleging securities fraud. The plaintiffs are members of the class of investors who purchased shares of the Company's Common Stock on November 12, 1998. On that day, the trading price for the Common Stock on The Nasdaq SmallCap Market rose from $2.125 to $31 per share, with more than 3 million shares trading. The plaintiffs allege that a press release issued by the Company on November 12, 1998, announcing the launch of its subsidiaries' DSLink Service for high speed Internet access, and an interview with AvTel Chief Executive Officer Anthony E. Papa concerning that service, as reported by Bloomberg News, were misleading and caused a fraud on the market for the Company's publicly-traded securities.

This matter is still in the early stages of litigation. The plaintiffs filed a consolidated and amended complaint on March 15, 1999, and the Company is in the process of responding to that complaint. The plaintiffs have yet to state the amount of damages they seek.

The Company contends that its statements were not misleading, and intends to defend vigorously this securities litigation. However, it is not possible to predict at this time the likely outcome of this action or the cost the Company will incur in defending the action.

The Company is not aware of any proceedings against the Company contemplated by any governmental authority.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Since May 28, 1998, the Company's Common Stock has been traded on The Nasdaq SmallCap Market under the trading symbol "AVCO". Prior to its listing on The Nasdaq SmallCap Market, the Common Stock traded on the Electronic Bulletin Board. There is no established public trading market for the Company's Preferred Stock. The following table sets forth, for the indicated periods, high and low price information for the Company's Common Stock. High and low bid information is provided with respect to periods prior to May 28, 1998. High and low prices for periods after May 28, 1998, reflect high and low sales prices. Such information was provided by Nasdaq, various market makers and on-line quote reporting services. The quotations provided reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions. All prices have been adjusted to reflect the Reverse Stock Split.

Year ending December 31, 1997	High	Low
First Quarter	$ 3.50	$2.00
Second Quarter	$18.00	$3.13
Third Quarter	$19.00	$9.75
Fourth Quarter	$19.00	$7.00
Year ending December 31, 1998		
First Quarter	$ 8.63	$4.94
Second Quarter	$15.88	$7.67
Third Quarter	$ 8.00	$1.75
Fourth Quarter	$31.00	$2.00

The number of shareholders of record of the Company Common Stock as of March 17, 1999, was 396. At that date there were two record holders of the Company's Preferred Stock.

The Company has not paid any cash dividends on its Common Stock to date and does not anticipate paying dividends in the foreseeable future. It is the present intention of management to utilize all available funds for the development of the Company's business. The terms of the Company's Series A Convertible Preferred Stock prevent the payment of any dividend on the Company's Common Stock unless (1) all cumulative dividends on the Series A Convertible Preferred Stock have been fully paid, and (2) the holders of at least 50% of the outstanding shares of the Series A Convertible Preferred Stock have approved such dividend. The terms of the Company's Series B Convertible Preferred Stock also prohibit payment of any dividends on the Common Stock prior to the holder of the Series B Stock receiving their dividends. In addition, the terms of the Company's secured credit agreement provide that the Company cannot declare a dividend on any of its ownership interests without the secured lender's approval.

In July 1997, New Best Connections, Inc. ("Best"), a subsidiary of Matrix, issued options to purchase Matrix Common Stock to 41 individuals in recognition of their past services to Best, Matrix and related companies (and in satisfaction of certain obligations of Best to shareholders of Matrix who had contributed shares of Matrix stock to Best for this purpose). As a result of the Share Exchange, the shares of Matrix Common Stock subject to such options were converted into shares of the Company's Common Stock. The exercise price for such options was $1.50 per share. During the year ending December 31, 1998, (1) options were exercised for 107,250 shares, (2) options for 67,250 shares were cancelled in connection with the exercise of other options, and (3) options for 73,000 shares were forfeited or expired unexercised. At December 31, 1998, none of such options remained outstanding. No underwriters were used in connection with these option exercises and none of the shares issued upon exercise was issued publicly. The Company has relied on the exemptions from registration provided by Section 4(2) of the Securities Act and Rule 506 of Regulation D promulgated thereunder. The optionees are believed by the Company to possess the requisite level of financial sophistication and experience in order to qualify for such exemptions. The Company made available to the recipients of such Common Stock all material information with respect to the Company.

On November 19, 1998, the Company issued 650,000 shares of its Common Stock, which were not registered under the Securities Act, in connection with the acquisition of Remote Lojix/PCSI, Inc., a New York corporation ("RLI"). No underwriters were used in this transaction and none of such shares were issued publicly. The Company relied on the exemptions from registration provided by Section 4(2) of the Securities Act and Rule 506 of Regulation D promulgated thereunder. The persons receiving shares were the 20 shareholders of RLI. These persons are believed by the Company to possess the requisite level of financial sophistication and experience in order to qualify for such exemptions. The Company made available to the recipients of such Common Stock all material information with respect to the Company. Each such person signed a stock purchase agreement containing appropriate investment representations and covenants.

ITEM 6. SELECTED FINANCIAL DATA

For accounting purposes, the Share Exchange was treated as a reverse acquisition of AvTel by Matrix. Accordingly, the Company's results of operations reflect the operations of Matrix prior to December 1, 1997 and reflect the combined operations of AvTel and Matrix subsequent to December 1, 1997. The following selected operations data of the Company for the years ended December 31, 1998, 1997, 1996, 1995 and 1994 and balance sheet data as of December 31, 1998, 1997, 1996, 1995 and 1994 have been derived from the Company's (or Matrix's) audited financial statements. These selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included elsewhere herein.

Statement of Operations Data:

	Years Ended December 31,				
	1998	1997	1996	1995	1994
Revenues	$44,013,498	$ 51,389,080	$71,558,295	$64,289,718	$59,551,307
Operating income (loss)	(7,423,753)	(10,757,960)	4,091,034	2,422,393	604,109
Net income (loss)	(7,127,318)	(10,191,720)	2,566,734	(2,440,493)	643,200
Net loss per common share —basic and diluted	(0.74)	(1.23)	N/A	N/A	N/A
Cash dividends per common share	—	—	—	—	—

N/A—Not applicable

Balance Sheet Data:

	As of December 31,				
	1998	1997	1996	1995	1994
Working capital (deficit)	$(3,022,959)	$ 5,570,657	$ 6,066,620	$ 206,071	$ (140,741)
Total Assets	14,634,354	18,724,850	20,338,404	17,580,694	14,957,279
Long term borrowings	1,112,890	—	—	—	—
Stockholders' Equity	3,185,253	7,809,048	7,861,883	3,539,522	2,372,333

Notes to Selected Financial Data

(1) Matrix was originally formed May 29, 1990 as a Texas general partnership. The partners consisted of Matrix Communications, Limited ("MCL") a Texas limited liability partnership and Onward and Upward, Inc. ("OUI"). Effective January 1, 1994, the partnership was dissolved. Prior to the dissolution, cash distributions were made to OUI in satisfaction of its partnership interest. Concurrent with the dissolution, all remaining tangible and intangible assets and liabilities of Matrix then owned by MCL were transferred to Matrix Telecom, Inc., a Texas corporation. Effective June 30, 1995, MCL was liquidated and its sole asset (Matrix capital stock) was distributed to MCL's partners in proportion to their ownership interests.

(2) Matrix's original stock issuance consisted of 100 common shares. Effective December 31, 1994, a 10 for 1 stock split was declared. Concurrent with the dissolution of MCL on June 30, 1995, Matrix's then outstanding 1,000 shares of common stock were canceled and 100,000 shares were distributed to the prior MCL partners in proportion to the ownership interest in MCL. Effective March 10, 1997, an 18 for 1 stock split was declared resulting in 3,484,260 shares being then outstanding. On December 1, 1997, the Company effected the Reverse Stock Split as part of the Reincorporation Merger, and then acquired Matrix through the issuance of 9,582,493 shares of Common Stock (including 1,999,997 shares held as treasury stock after the Share Exchange which have subsequently been cancelled). All share amounts have been restated to reflect the stock splits and share exchanges.

(3) In October 1995, Matrix issued 2,405,499 shares of its common stock valued at $3,607,682 in exchange for all of the outstanding common stock of DNS Communications, Inc., a Houston based long distance reseller. Subsequent to the acquisition, the operations of DNS generated substantial losses. DNS's customer churn rate and bad debts as well as projected cash flows were evaluated as of December 31, 1995, and it was determined that the remaining investment in the DNS acquired customer base totaling approximately $4,462,000 should be written off.

(4) Per share amounts are not reflected for 1996, 1995 and 1994 due to the recapitalization of the Company as a result of the reverse acquisition in 1997.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

BACKGROUND

The following information should be read in connection with the consolidated financial statements of the Company and related notes included elsewhere in this report.

Share Exchange

As described above under "Business—Background—Acquisition of Matrix," on December 1, 1997, AvTel and Matrix completed the Share Exchange. For accounting purposes, the Share Exchange was treated as a reverse acquisition of AvTel by Matrix. AvTel was the legal acquirer and accordingly, the Share Exchange was effected by the issuance of AvTel Common Stock in exchange for all of the common stock then outstanding of Matrix. In addition, holders of Matrix outstanding stock options received non-qualified stock options of AvTel. The following discussion of results of operations reflects the operations of Matrix prior to December 1, 1997 and reflects the combined operations of AvTel and Matrix subsequent to December 1, 1997. Accordingly, references to the Company refer to operations of Matrix prior to the Share Exchange and the combined operations of Matrix and AvTel subsequent to the Share Exchange.

The reverse acquisition of AvTel by Matrix was accounted for using the purchase method of accounting. In order to value the consideration given in the Share Exchange, the market price of AvTel's Common Stock for a period immediately preceding the announcement of the Share Exchange was used. As of the date of acquisition, the Company determined the fair value of the net tangible and intangible assets and liabilities acquired. The underlying fair value of AvTel's net assets was substantially less than the indicated market value of AvTel's common and preferred stock. Accordingly, the Company recorded a charge to income of $9.1 million immediately subsequent to the reverse acquisition.

Acquisition of New Best Connections, Inc.

Effective July 1, 1997, Matrix acquired New Best Connections, Inc., a Texas corporation ("Best"), an affiliate of Matrix through substantially similar common ownership, by means of a share-for-share exchange. Best's primary assets were cash of $211,000, ownership of shares of Matrix common stock, and Best's relationships with the field force of sales agents. The assets and liabilities of Best were recorded at their historical cost, which approximated the fair value of such assets as of July 1, 1997.

Acquisition and Disposition of DNS Communications, Inc.

In October 1995, Matrix issued shares of its common stock valued at $3.6 million in exchange for all of the outstanding common stock of DNS Communications, Inc. ("DNS"), a Houston-based long distance reseller. The transaction was accounted for under the purchase method. The purchase price in excess of the book value of DNS net assets was pushed down to DNS and was allocated based upon the estimated fair value of the assets and liabilities acquired at the date of acquisition.

Subsequent to the acquisition, the operations of DNS generated substantial losses. DNS's customer churn rate and bad debts as well as projected cash flows were evaluated and as of December 31, 1995 it was determined that the remaining investment in the DNS acquired customer base totaling approximately $4.4 million should be written off.

In June 1996, Matrix sold the customer base acquired in the DNS acquisition in addition to certain blocks of customers acquired during 1995 and 1996 together with related assets to a former officer of Matrix and a former shareholder of DNS for approximately $5.2 million. Matrix recorded a gain on this sale of approximately $3.2 million.

Due to the timing of the acquisition and subsequent decision to sell the operations of DNS, Matrix has recorded its interest in DNS operations using the equity method of accounting.

RESULTS OF OPERATIONS

Year Ended December 31, 1998 compared with Year Ended December 31, 1997

Revenues

Revenues for the year ended December 31, 1998 decreased 14.4% or $7.4 million to $44.0 million from $51.4 million for the year ended December 31, 1997. The decrease in revenues resulted primarily from the reorganization and repositioning of the Company's Channel Markets Group ("CMG"). The focus of the Company is to be a provider of broadband network services integrating voice, data and internet solutions to mid-size corporations, small-office home-office professionals and select residential market segments. Historically, CMG has focused on selling retail long distance telephone service through telemarketing, direct mail, and distributors or agents. During the fourth quarter of 1998, CMG implemented a new strategy to sell Internet access and additional voice services exclusively through affinity groups, agents and distributors.

The primary source of revenues of the Company during 1998 continued to be voice distribution channels. Factors similar in nature to those affecting all resellers of long distance have continued to effect a decline in revenues. Due to pricing pressures within the industry and the competitive reductions by the first tier carriers, the Company similarly continued to reduce retail pricing of long distance products to meet consumer expectations, terminated the direct marketing of casual calling products and discontinued the telemarketing of residential customers. Long distance revenue, excluding discontinued sales channels, decreased 9.5% while the associated minutes of usage decreased only 3.8% for the year ended December 31, 1998 compared to the year ended December 31, 1997. Long distance revenue from affiliated companies was $4.6 million and $3.6 million for the years ended December 31, 1998 and December 31, 1997, respectively.

Decreases in revenues were additionally affected by a continued attrition and price reductions of a maturing customer. The effects of reduced revenue from discontinued sales channels is expected to be offset by increasing revenues from the Company's repositioning of CMG and the addition of new marketing organizations. The effects of competitive lower pricing as well as the decline of the customer base is expected to lessen dramatically as pricing decreases within the industry and reaches its floor, and the Company increases its focus on third party distributors, affinity groups and niche markets. Management additionally anticipates that the revenue decrease will stabilize as the continued integration of and revenue from the Business Markets Group ("BMG") targeting corporate data networking, voice and Internet service needs continues to expand and grow beyond the long distance portion.

Decreases in revenues resulting from the Share Exchange of AvTel and Matrix effective December 1, 1997 were anticipated by the Company beginning in the first quarter of 1998. At that time, the management team chose to discontinue and reduce certain unprofitable distribution channels. Management continued throughout 1998 to reduce the Company's dependence on low margin, high churn segments and to focus its resources in the business markets with higher average billing and retention rates, niche ethnic consumer markets, small office-home office distributors and agents, and internet service providers. For the year ended December 31, 1998, revenues generated from discontinued sales channels decreased 43.4% or $8.2 million to $10.7 million from $18.9 million for the year ended December 31, 1997. Long distance revenue generated from agents increased 3.5% or $665,000 to $19.5 million for the year ended December 31, 1998 from $18.9 million for the year ended December 31, 1997.

Data networking needs of the corporate customer and the Internet have continued to drive and change the telecom industry. The future focus of the Company continues to move toward incorporating voice and data networking solutions into the construction of corporate Intranets and Wide Area Networks which will decrease the Company's dependence on traditional long distance services of the residential consumer. The primary focus of the Company has been to move quickly and efficiently towards becoming a viable resource to the corporate world having few options in this new wave of technology. With the acquisition of RLI effective November 1, 1998, the Company recognized $1.0 million in technology systems integration and repair service revenues for the two months ended December 31, 1998.

Gross Margin

Gross margin decreased $3.0 million to $12.2 million for the year ended December 31, 1998 from $15.2 million for the year ended December 31, 1997. As a percentage of revenues, gross margin decreased by 1.9 percentage points to 27.6% for the year ended December 31, 1998 from 29.5% for the year ended December 31, 1997. The decrease in gross margin as a percentage of revenues primarily resulted from an increase in bad debt expenses, which was partially offset by decreases of network cost from renegotiated contracts and leased facilities, all of which are included in cost of sales.

Network cost as a percentage of revenues decreased by 1.3 percentage points to 65.2% for the year ended December 31, 1998 from 66.5% for year ended December 31, 1997. The primary factor that effected this decrease was significantly lower wholesale rates, which went into effect March and July of 1998, negotiated with the Company's major underlying carriers.

Bad debt expense as a percentage of revenues increased by 2.6 percentage points to 6.2% for the year ended December 31, 1998 compared to 3.6% for the year ended December 31, 1997. The increased bad debt expense primarily resulted from decreased collection percentages from the Local Exchange Carriers ("LECs") in certain geographical regions, primarily the northeastern portion of the United States. This related principally to the Company's now discontinued casual calling business. The majority of the Company's revenues are billed by the LECs and the Company's bad debt expense was affected by the lower collection percentages of the LECs. Collection policies and aggressiveness in collection procedures among the LECs vary. A significant amount of casual calling was experienced in the northeastern portion of the United States in which the LECs' collection percentages were considerably lower, and the

Company's bad debt expense as a percentage of revenues increased. The majority of new products being sold by the Company have been designed as direct billed or electronic internet billed products, and the bad debt percentages experienced by the Company's internal collection staff are significantly lower than those of the LECs. For the fourth quarter of 1998, the Company experienced an average bad debt percentage of 3.8% on direct billed products and 9.1% on LEC billed products. Therefore, as the number of customers being billed by the LEC decreases, and the Company implements its policy of moving away from the LEC billing services, bad debt expense as a percentage of revenue is anticipated to decrease. As of December 31, 1998, 58% of the Company's revenue was direct billed compared to 23% as of December 31, 1997.

Selling, General, and Administrative Costs

Selling, general, and administrative costs increased $2.4 million to $18.5 million for the year ended December 31, 1998 from $16.1 million for the year ended December 31, 1997. As a percentage of revenues, selling, general, and administrative costs increased by 10.6 percentage points to 42.0% for the year ended December 31, 1998 from 31.4% for the year ended December 31, 1997.

The primary reason for the increase to selling, general, and administrative costs was the expanded sales force and related expenses including general office expense, rent, utilities and travel expenditures. The remaining increase in cost was attributable to the purchase of RLI by the Company, effective November 1, 1998. As of December 31, 1998, the Company had three primary business locations, eight additional sales locations throughout the United States and 47 sales and marketing related employees compared to two primary business locations, two remote sales locations and 21 sales and marketing related employees as of December 31, 1997.

The decrease in revenue as explained above resulted in a decrease in selling expenses of $1.6 million for the year ended December 31, 1998. Stock compensation expense for the year ended December 31, 1998 was $477,000 compared to $749,000 for the year ended December 31, 1997. The change was due primarily to two circumstances. First, during 1998, the Company caused certain options previously granted to accelerate (and to expire if not exercised before December 13, 1998). As a result, fewer of such options were exercised than contemplated in 1997, and the stock price used to calculate stock compensation expense for such options was considerably lower than in 1997. The resulting decrease in stock compensation expense was partially offset by additional expense recognized in connection with the early vesting of a restricted stock grant to a departing director. Certain non-employee agents were granted options for participation in the generation of new business for the Company. Accordingly, stock compensation was expensed under the requirements of SFAS No. 123.

Depreciation and Amortization

Depreciation and amortization increased $427,000 to $1,107,000 for the year ended December 31, 1998 from $680,000 for the year ended December 31, 1997. The increase primarily resulted from amortization of the acquired customer base associated with the Share Exchange of AvTel and Matrix effective December 1, 1997. The customer base is amortized on a straight-line basis over five years. Similarly, the acquisition and consolidation of assets related to the Share Exchange resulted in some increases in depreciation expense. As a result of the acquisitions of DMI and RLI in the fourth quarter of 1998, the company recognized goodwill in the amount of $4.5 million. Goodwill is amortized on a straight-line basis over fifteen years. RLI comprised $4.4 million of goodwill. Goodwill was determined by the purchase price in excess of net liabilities assumed. RLI provides service and installation of local area networks. Their name and reputation in their existing geographical area is strong and facilitates RLI's entry into other geographical markets. The service provided is generally recurring and RLI's clientele is comprised of large, stable companies that are loyal to their product and level of service provided.

Interest Expense and Other Income, Net

Interest expense and other income net of other expenses decreased $195,000 to $95,000 for the year ended December 31, 1998 from $290,000 for the year ended December 31, 1997. Interest expense increased $74,000 to $86,000 for the year ended December 31, 1998 from $12,000 for the year ended December 31, 1997 due to interest on the Coast Business Credit line of credit and leased equipment acquired as the result of the Share Exchange of AvTel and Matrix. Other income decreased $121,000 to $181,000 for the year ended December 31, 1998 from $302,000 for the year ended December 31, 1997 primarily due to the decrease of interest earned from cash investments.

Income Taxes

The Company recognized a tax benefit of $202,000 for the year ended December 31, 1998 compared to $276,000 for the year ended December 31, 1997. The tax benefit in 1998 resulted from the loss from operations. As of December 31, 1998, the Company has net operating loss carryforwards for federal tax purposes of approximately $9.1 million which are available on a limited basis to offset future federal taxable income, if any, through 2018.

Year Ended December 31, 1997 compared with Year Ended December 31, 1996

Revenue

Revenue for the year ended December 31, 1997, decreased 28.1% or $20.2 million to $51.4 million from $71.6 million for the year ended December 31, 1996. The decrease in revenue resulted primarily from decreases in sales from three significant sales channels, all of which were affiliated with the Company through substantially common ownership prior to the Share Exchange of AvTel and Matrix effective December 1, 1997. These sales channels were a distributor selling via telemarketing, a distributor focusing on the casual or dial-around customer, and a DNS distributor of long distance services. The relationship with the DNS distributor was terminated resulting from the sale of the DNS customer bases in June of 1996.

The Company in 1997 chose to reduce its focus on the promotion of the dial-around customer due to the significant costs of direct mailing and bad debt associated with this product. Reduced sales from the telemarketing distributor resulted from the erosion of the retail pricing in the market for the residential consumer. Pricing continued to decline during 1997, and attrition from a maturing customer base resulted in losing customers on higher gross margin products. Attrition rates associated with long distance products are a normal industry occurrence; however, methods of calculation differ within the industry.

The Company sought to reduce its risk from reliance on a small group of distributors, and refocused to obtain multiple revenue sources external to the Company. New distributors significantly contributed to the mix in 1997. 1997 sales from sources other than the Company's primary 1996 distributors increased more than 20%.

Gross margin

Gross margin decreased $8.7 million in 1997, to $15.2 million for the year ended December 31, 1997 from $23.9 million for the year ended December 31, 1996. As a percentage of net sales gross margin decreased 3.9 percentage points to 29.5% for the year ended December 31, 1997 from 33.4% for the year ended December 31, 1996. Two primary factors contributed to the decrease in gross margin in 1997.

First, due to increasing competitive market demands, the Company was forced to continue decreasing its retail rates in 1997 to meet the competitive rate reductions; however, the underlying carrier costs to the Company did not change due to contractual commitments. Accordingly, cost of network as a percentage of revenue increased reflecting a lower gross margin in 1997 over 1996.

Second, bad debt as a percentage of revenue increased approximately 2% in 1997, primarily resulting from increased bad debt associated with the casual or dial-around product. The majority of the Company's revenues were billed and collected from the Local Exchange Carriers ("LECs"), with which the Company has agreements. Collection policies and aggressiveness in collection procedures differ among the LECs. The Company experienced significant sales growth in a geographical location in which the LECs bad debt percentages were significantly higher than other LECs.

Selling, general, and administrative costs

The Company's selling, general, and administrative costs decreased $2.7 million in 1997 from 1996. As a percentage of revenue, such costs increased 5.1 percentage points to 31.4% for the year ended December 31, 1997 compared to 26.3% for the year ended December 31, 1996. This increase resulted primarily from the decrease in revenues causing the expense as a percentage of revenue to increase. Certain changes are more fully described below.

Certain selling, general, and administrative costs related to the addition of AvTel operations to Matrix subsequent to the effective date of the Share Exchange, December 1, 1997, amounted to approximately $286,000, accounting for .56% of the increase as a percentage of revenues in 1997 over 1996. Selling costs related to direct mailing to the casual or dial-around customer (which were absorbed by the sales distributor in 1996) were approximately $605,000 in 1997, accounting for 1.18% of the increase as a percentage of revenues in 1997 over 1996. Salary expenses increased approximately $651,000 between the years, or 3.76% as a percentage of revenues in 1997 over 1996, resulting primarily from integration of AvTel employees subsequent to the Share Exchange and the addition of certain sales and marketing personnel in 1997.

Billing and collection fees and distributor commissions decreased approximately $3.9 million, or 1.82% as a percentage of revenues. Most of the new products sold in 1997 were direct billed. As the percentage of direct billed customers increased, billing and collection fees have decreased. Similarly, as sales of certain products having a higher commission structure have declined, commission expense has also declined.

Certain regulatory and professional services increased approximately $266,000, or 1.22% as a percentage of revenues in 1997 over 1996. Carrier fees specific to telecommunication providers upon reaching certain thresholds of customers were met in the last half of the year in 1996; therefore, increased fees in 1997 resulted from being charged the lower volume based fees for a full year. Professional fees increased in 1997 over 1996 for two primary reasons. First, due to increased market demands for information systems programmers, the Company was forced to secure external contractors. Second, certain telemarketing and verification costs associated with the sales process increased in 1997 primarily resulting from the sales distributor absorbing these costs in 1996. Other selling, general and administrative costs decreased approximately $213,000 in 1997. As a percentage of revenue, these costs increased .81% in 1997 over 1996 due to decreasing revenues.

Acquisition-related writeoff

The $9.1 million write off relates to the Share Exchange and is discussed under "Background" above.

Depreciation and Amortization

Depreciation and amortization expense decreased approximately $314,000 for the year ended December 31, 1997, compared to the year ended December 31, 1996, resulting primarily from older assets becoming fully depreciated.

Interest expense and other income, net

Interest expense decreased $219,000 to $12,000 for the year ended December 31, 1997 from $231,000 for the year ended December 31, 1996. The decrease resulted from reduced borrowings in 1997 compared to 1996. The Company had sufficient cash from operations to meet operating expenses and capital expenditures. Other income net of other expenses increased more than 11% for 1997 over 1996 primarily resulting from increases in interest earned from cash investments.

Income taxes

The Company recognized a tax benefit of $276,000 for the year ended December 31, 1997 compared to a tax expense of $1.7 million for the year ended December 31, 1996. The tax benefit in 1997 resulted from the loss from operations for the year 1997.

LIQUIDITY AND CAPITAL RESOURCES

The Company's consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the consolidated financial statements during the years ended December 31, 1998 and 1997, the Company reported net losses of $7,127,318 and $10,191,720, respectively. In addition, as of December 31, 1998, the Company had a working capital deficit of $3,022,959, and for the year ended December 31, 1998, net cash used in operations totaled $5,978,797.

As a result, as of December 31, 1998, unless the Company effects substantial changes in its operating methods, the Company does not have sufficient resources to meet its anticipated operating requirements during 1999 without obtaining additional financing. The Company is actively pursuing an equity line of credit through discussion with potential investors. If the Company is unable to obtain financing in a timely manner and on acceptable terms, management is developing and intends to implement a plan that would allow the Company to continue to operate through 1999. This plan would include significantly reducing the Company's workforce, eliminating advertising expenditures, reducing professional services and reducing or eliminating other discretionary expenditures.

On October 2, 1998, the Company entered into a secured credit facility with Coast Business Credit. This credit facility consists of a line of credit of up to $7.5 million. Under the line of credit, the Company may borrow up to 75% of eligible receivables (as defined). In addition, the line of credit may be utilized in connection with certain acquisitions and equipment purchases as well as to provide a facility for issuing letters of credit. Borrowings under the line of credit bear interest, payable monthly, based upon the prime rate of Bank of America NT & SA plus 2% (9.75% at December 31, 1998). As of December 31, 1998, borrowing outstanding under the credit facility amounted to $1,113,000 with approximately $1,634,000 available for future borrowings. Borrowings under the credit facility are secured by substantially all of the assets of the Company. The credit facility expires on October 31, 2000.

Subsequent to the end of the year, the Company sold $1,500,000 of its Series B Convertible Preferred Stock in a private placement. The Company is also actively pursuing a private equity line of credit arrangement with potential investors which may enable the Company to raise additional capital through subsequent sales of its Common Stock. See "Business—Recent Developments."

The primary sources of operating cash flow for the Company are (1) revenues derived from the sale of information technology and telecommunications services to individuals and business, and (2) its secured credit facility. Minor sources of revenues are received for the provision of back office support to affiliated and non-affiliated companies and for earnings from investment income. The primary uses of cash are payments to underlying network vendors for provisioning telecommunications facilities, to sales distributors for soliciting long distance sales, and to the major LECs for billing and collecting directly from the end user. Net cash used in operations totaled $6.0 million for the year ended December 31, 1998, and net cash provided by operations was $1.7 million for the year ended December 31, 1997, and $1.0 million for the year ended December 31, 1996.

As of December 31, 1998, the Company had a working capital deficit of $3.0 million. The Company's accounts receivable decreased to $4.8 million at December 31, 1998 from $7.0 million at December 31, 1997. The decrease was primarily due to a corresponding decrease in sales described elsewhere in this discussion. Current liabilities increased to $10.2 million as of December 31, 1998 from $9.8 million as of December 31, 1997. The increase in current liabilities is due to the additional liabilities acquired with the purchase of RLI, offset by the decrease in accrued liabilities due to a corresponding decrease in sales. Sales and excise taxes included in current liabilities increased to $1.4 million for the year ended December 31, 1998 from $736,000 for the year ended December 31, 1997, as a result of the tax liabilities assumed with the purchase of RLI. Due to affiliates decreased to $324,000 for the year ended December 31, 1998 from $2.7 million for the year ended December 31, 1997. In 1998, Pacific Gateway Exchange ("PGE") was no longer affiliated with the Company. As of December 31, 1997, $2.3 million was included in due to affiliates associated with PGE.

Prior to the Share Exchange, the Company loaned $2.0 million to an affiliated company, Core Marketing, LLC, during 1997. Of such amount, $201,000 was repaid prior to December 31, 1997, and the remainder was repaid in 1998.

The Company has been able to finance its capital expenditures, which have consisted primarily of property and equipment, from funds generated from operations and, commencing in the last quarter of 1998, with the proceeds of its secured credit facility. An important component of the Company's past growth has been to develop its business through acquisitions, including the Share Exchange and the acquisitions of RLI and DMI. The Company intends to continue this strategy. In appropriate circumstances, the Company may utilize its capital stock for acquisitions in addition to debt and equity financing.

Year 2000 Compliance

The Year 2000 issue concerns the inability of computer systems and certain other equipment to properly recognize and process data that uses two digits rather than four to designate particular years. The Company has initiated a Year 2000 Project Plan ("the Plan") to assess whether its systems that process date sensitive information will perform satisfactorily leading up to and beyond January 1, 2000. The goal of the Plan is to correct, prior to January 1, 2000, any Year 2000-related problem with critical systems, the failure of which could have a material adverse effect on the Company's operations. The Plan includes steps to (1) identify each critical system element that requires date code remediation, (2) establish a plan to remediate such systems, (3) implement all required remediations and (4) selectively test the remediated systems.

Thus far, the identification phase has identified Year 2000 issues in the following critical Company-owned and leased systems: rating and billing systems used by the Company to process and prepare billing data for its customer base. In addition, the Company receives critical services from providers of utilities and other services to facilities that house employees and equipment. The Company is also critically reliant upon the systems of other telecommunications providers on which the Company depends to deliver services and invoices to its customers. The identification and planning phases of the Plan are materially complete as they relate to Company-owned systems. As they relate to third party vendors and other telecommunications carriers, the identification and planning phases are on-going and are expected to be materially complete during second quarter 1999.

Based on work completed under the Plan to date, the Company currently intends to take the following additional steps under its Plan with respect to Company-owned systems, third-party vendors and other telecommunications carriers:

- The Company generally plans to remediate Company-owned rating, billing and collection systems through the revision or replacement of current system components. Necessary changes to Company-owned systems are in process and are expected to be completed by third quarter 1999. The selective testing and verification of such changes are expected to be completed in the third quarter of 1999. Due to the large number of system components requiring remediation, the Company does not intend to test every remediated system but will rely upon the results of testing of the critical components of such systems to determine the effectiveness of remediation efforts. Components not tested are not considered critical to the Company's business.
- With respect to critical services provided by utilities and other third parties, the Company is in the process of contacting all such suppliers. Thus far, a majority of those suppliers who have responded have indicated that their systems and service delivery mechanisms are Year 2000 compliant or can be made so through currently available modifications. The Company plans to continue monitoring all third-party remediation efforts and to develop contingency plans for the delivery of such services as necessary.
- The Year 2000 compliance status of other telecommunications providers with which the Company's systems interact is not yet known. The Company is making inquiries of these providers to determine their compliance status and expects to obtain the results of compliance tests during second quarter 1999, although there can be no assurance that providers will supply this information.

While the Company currently believes that it will be able to remediate and selectively test Company-owned systems in time to minimize any detrimental effect on its operations, there can be no assurance that such steps will be successful. Failure by the Company to timely and effectively remediate its systems, or the failure of critical vendors and suppliers and other telecommunications carriers to remediate affected systems, could have a material adverse impact on the Company's business, financial condition, results of operations and prospects. Because the impact of Year 2000 issues on the Company is materially dependent on the mitigation efforts of parties outside the Company's control, the Company cannot assess with certainty the magnitude of any such potential adverse impact. However, based upon risk assessment work conducted thus far, the Company believes that the worst case scenario of the failure by the Company, its suppliers or other telecommunications carriers with which the Company interacts to resolve Year 2000 issues would be an inability by the Company to timely and accurately process service requests and to timely and accurately bill its customers. In addition to lost earnings, these failures could also result in loss of customers due to service interruptions and billing errors, substantial claims by customers and increased expenses associated with stabilizing operations and executing mitigation plans.

Contingency planning to maintain and restore service in the event of natural disasters, power failures and systems-related problems is a routine part of the Company's operations. The Company believes that such contingency plans will assist the Company in responding to the failure by outside service providers to successfully address Year 2000 issues. In addition, the Company is currently identifying and considering various Year 2000-specific contingency plans, including identification of alternate vendors and service providers and manual alternatives to system operations. These Year 2000-specific contingency plans are expected to be materially completed during the second quarter of 1999, but their review and development will continue throughout 1999.

Although the total costs to implement the Plan cannot be precisely estimated, the Company incurred minimal costs during 1998 (none of which was related to hardware costs) and anticipates spending an aggregate of approximately $750,000 during 1999 (which includes $250,000 of hardware costs). These costs will be expensed as incurred, unless new systems or equipment are purchased that should be capitalized in accordance with generally accepted accounting principles. Some of the costs represent ongoing investment in systems upgrades, the timing of which is being accelerated in order to facilitate Year 2000 compliance. In some instances, such upgrades will position the Company to provide more and better-quality services to its customers than they currently receive. The Company expects to fund these costs with a combination of financing provided by the hardware vendor, cash provided by operations, and other debt or equity financing. Cost estimates and statements of the Company's plans discussed above are forward-looking statements that are derived using numerous assumptions of future events, many of which are outside the Company's control, including the availability and future cost of trained personnel and various other resources, third party modification plans, the absence of systems requiring remediation that have not yet been discovered, and other factors.

INFLATION

The Company does not believe that the relatively moderate rates of inflation over the past three years have had a significant effect on its net sales or its profitability.

RECENTLY-ISSUED ACCOUNTING PRONOUNCEMENTS

On January 1, 1998, the Company adopted SFAS No. 130, Reporting Comprehensive Income. SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. Comprehensive income consists of net income and net unrealized gains (losses) on securities and is presented in the consolidated statements of stockholders' equity and comprehensive income. The statement requires only additional disclosures in the consolidated financial statements; it does not affect the Company's financial position or results of operations. Comprehensive income (loss) for the years ended December 31, 1998, 1997 and 1996 is equal to net income (loss) reported for such periods.

In 1998, the Company adopted the provisions of SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. SFAS No. 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas and major customers. This statement supersedes SFAS No. 14, Financial Reporting for Segments of a Business Enterprise, but retains the requirement to report information about major customers. See Note 11 of the Notes To Consolidated Financial Statements for segment disclosures.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. This statement is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999. Management does not anticipate that this statement will have a material impact on the Company's consolidated financial statements.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is not exposed to material future earnings or cash flow fluctuations, from changes in interest rates on its long-term debt at December 31, 1998. A hypothetical increase of 97 basis points in interest rate (ten percent of the Company's overall borrowing rate) would not result in a material fluctuation in future earnings or cash flow. The Company had not entered into any derivative financial instruments to manage interest rate risk or for speculative purposes and is currently not evaluating the future use of such financial instruments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements of the Company and supplementary data are included beginning immediately following the signature page to this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item will be contained in the Company's definitive Proxy Statement for its 1999 Annual Meeting of Stockholders under the captions "Election of Directors" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934."

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item will be contained in the Company's definitive Proxy Statement for its 1999 Annual Meeting of Stockholders under the caption "Executive Compensation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item will be contained in the Company's definitive Proxy Statement for its 1999 Annual Meeting of Stockholders under the captions "Stock Ownership" and "Principal Shareholders."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item will be contained in the Company's definitive Proxy Statement for its 1999 Annual Meeting of Stockholders under the captions "Certain Relationships and Transactions."

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) The index to the financial statements and financial statement schedules filed as part of this report is set forth immediately following the signature page.

(b) The Company did not file any Current Reports on Form 8-K during the quarter ending December 31, 1998.

(c) The index to the exhibits filed as part of this report is set forth immediately following the financial statements.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant has caused this report to be signed on it behalf by the undersigned, thereunto duly authorized.

AVTEL COMMUNICATIONS, INC.

Dated: April 14, 1999

By /s/ ANTHONY E. PAPA

Anthony E. Papa,
Chairman of the Board and
Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on this 13th day of April, 1999.

AVTEL COMMUNICATIONS, INC.

By /s/ ANTHONY E. PAPA

Anthony E. Papa,
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

By /s/ JAMES P. PISANI

James P. Pisani,
President, Chief Operating Officer and
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)

By /s/ JOHN E. ALLEN

John E. Allen
Director

By /s/ JEFFREY J. JENSEN

Jeffrey J. Jensen
Director

By ______________________

Anthony D. Martin
Director

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

The Board of Directors
AvTel Communications, Inc.:

We have audited the accompanying consolidated balance sheets of AvTel Communications, Inc. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1998. In connection with our audits of the consolidated financial statements, we also have audited the accompanying financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of AvTel Communications, Inc. and subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

Dallas, Texas
April 14, 1999

AVTEL COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 1998 and 1997

	1998	1997
ASSETS		
Current assets:		
Cash and cash equivalents	$ 911,179	4,807,441
Accounts receivable, net	4,804,532	6,961,953
Due from affiliates	501,858	2,127,771
Federal and state income tax receivable	—	598,970
Other current assets	921,435	861,950
Total current assets	7,139,004	15,358,085
Property and equipment, net	1,684,707	1,791,682
Goodwill, net	4,463,747	—
Other assets, net	1,346,896	1,575,083
Total assets	$14,634,354	18,724,850
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and other accrued expenses	$ 2,643,761	1,546,762
Accrued network service costs	4,217,206	4,319,198
Sales and excise taxes payable	1,433,483	736,012
Unearned revenue	954,101	—
Due to affiliates	324,020	2,719,417
Other current liabilities	589,392	466,039
Total current liabilities	10,161,963	9,787,428
Deferred income taxes	—	498,712
Long term borrowings	1,112,890	—
Other liabilities	5,381	50,782
Common stock subject to put option (note 4)	168,867	578,880
Total liabilities	11,449,101	10,915,802
Stockholders' equity:		
Preferred stock, authorized 750,000 shares, $0.01 par value.	—	—
Series A convertible preferred stock, authorized 250,000 shares, $0.01 par value, cumulative as to 8% dividends, 147,700 and 207,700 shares issued and outstanding at December 31, 1998 and 1997 respectively. (Liquidation preference of $704,032 December 31, 1998 including dividends in arrears.)	1,477	2,077
Common stock, Authorized 20,000,000 shares, $0.01 par value; issued 10,409,473 and 11,437,056 shares at December 31, 1998 and 1997 respectively, including 112,578 and 385,920 shares subject to put options on December 31, 1998 and 1997 respectively.	102,969	110,511
Additional paid in capital	19,630,404	17,138,739
Accumulated deficit	(16,549,597)	(9,422,279)
Treasury stock, none at December 31, 1998 and 1,999,997 common shares at December 31, 1997.	—	(20,000)
Total stockholders' equity	3,185,253	7,809,048
Commitments and contingencies		
Total liabilities and stockholders' equity	$14,634,354	18,724,850

See accompanying notes to consolidated financial statements.

AVTEL COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
Years ended December 31, 1998, 1997 and 1996

	1998	1997	1996
Revenues (note 6)	$44,013,498	51,389,080	71,558,295
Cost of revenues (note 6)	31,849,354	36,227,507	47,674,396
Gross margin	12,164,144	15,161,573	23,883,899
Operating expenses:			
Selling, general and administrative (note 6)	18,480,576	16,141,132	18,798,925
Acquisition related write off (note 2)	—	9,098,545	—
Depreciation and amortization	1,107,321	679,856	993,940
	19,587,897	25,919,533	19,792,865
Operating income (loss)	(7,423,753)	(10,757,960)	4,091,034
Interest expense (note 6)	(86,251)	(11,692)	(230,922)
Other income, net	181,107	301,580	393,498
Income (loss) before income tax expense	(7,328,897)	(10,468,072)	4,253,610
Income tax expense (benefit)	(201,579)	(276,352)	1,686,876
Net income (loss)	$(7,127,318)	(10,191,720)	2,566,734
Net loss per common share—basic and diluted (note 8)	$ (0.74)	(1.23)	
Weighted average number of common shares	9,633,474	8,267,296	

See accompanying notes to consolidated financial statements.

AVTEL COMMUNICATIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

Years ended December 31, 1998, 1997 and 1996

	Preferred Stock		Common Stock		Additional Paid in Capital	Retained Earnings (accumulated deficit)	Treasury Stock		Total
	Shares	Amount	Shares	Amount			Shares	Amount	
Balances at December 31, 1995	—	—	6,872,883	5,336,815	—	(1,797,293)	—	—	3,539,522
Purchase of common stock	—	—	—	—	—	—	(171,548)	(439,584)	(439,584)
Issuance of common stock	—	—	1,463,771	2,195,211	—	—	—	—	2,195,211
Net income	—	—	—	—	—	2,566,734	—	—	2,566,734
Balances at December 31, 1996	—	—	8,336,654	7,532,026	—	769,441	(171,548)	(439,584)	7,861,883
Acquisition of Best (note 2)	—	—	934,987	3,361,208	—	—	(1,999,997)	(3,317,940)	43,268
Share for share exchange between AvTel and Matrix (note 2):									
Reverse acquisition of AvTel	207,700	2,077	1,839,563	18,396	9,129,040	—	—	—	9,149,513
Reflect new capitalization of Company	—	—	(171,548)	(10,802,234)	7,064,710	—	171,548	3,737,524	—
Issuance of common stock for exercise of options	—	—	15,000	150	52,350	—	—	—	52,500
Expired put options (note 4)	—	—	96,480	965	143,755	—	—	—	144,720
Stock compensation earned (note 7)	—	—	—	—	748,884	—	—	—	748,884
Net loss	—	—	—	—	—	(10,191,720)	—	—	(10,191,720)
Balances at December 31, 1997	207,700	$2,077	11,051,136	$ 110,511	17,138,739	(9,422,279)	(1,999,997)	$ (20,000)	7,809,048
Conversion of preferred stock (note 4)	(60,000)	(600)	60,000	600	—	—	—	—	—
Issuance of common stock for exercise of options and restricted common stock	—	—	473,326	4,733	512,879	—	—	—	517,612
Issuance of common stock for acquisitions (note 2)	—	—	680,000	6,800	1,526,950	—	—	—	1,533,750
Expired put options (note 4)	—	—	48,187	482	36,770	—	—	—	37,252
Exercised put options (note 6)	—	—	185,847	1,859	372,918	—	(201,604)	(2,016)	372,761
Purchase of officer notes receivable (note 6)	—	—	—	—	(435,000)	—	—	—	(435,000)
Stock compensation earned (note 7)	—	—	—	—	477,148	—	—	—	477,148
Retirement of treasury stock	—	—	(2,201,601)	(22,016)	—	—	2,201,601	22,016	—
Net loss	—	—	—	—	—	(7,127,318)	—	—	(7,127,318)
Balances at December 31, 1998	147,700	$1,477	10,296,895	$ 102,969	19,630,404	(16,549,597)	—	$ —	3,185,253

See accompanying notes to consolidated financial statements.

AVTEL COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 1998, 1997 and 1996

	1998	1997	1996
Cash flows from operating activities:			
Net income (loss)	$(7,127,318)	$(10,191,720)	2,566,734
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,107,321	679,856	993,940
Amortization of advanced commissions	220,928	1,355,492	618,791
Acquisition related write off	—	9,098,545	—
Gain on disposition of assets	(83,139)	—	—
Provision for bad debts	2,727,803	1,829,770	1,461,471
Deferred income taxes	(498,712)	(80,377)	(321,678)
Stock compensation earned	477,148	748,884	—
Equity in income of DNS	—	—	(122,327)
Changes in certain operating assets and liabilities:			
Accounts receivable	374,477	1,969,332	(1,971,970)
Due from affiliates	(106,071)	(915,357)	345,336
Federal and state income tax receivable	583,906	(598,970)	—
Other current assets	(224,820)	1,787,672	(393,781)
Accounts payable and accrued liabilities	(1,034,923)	(2,876,789)	(1,397,160)
Due to affiliates	(2,395,397)	(1,138,568)	(742,663)
Net cash provided by (used in) operating activities	(5,978,797)	1,667,770	1,036,693
Cash flows from investing activities:			
Cash received (paid) in acquisitions (note 2)	(474,082)	477,643	—
Loans to affiliate	—	(2,000,000)	—
Payments received on loans to affiliates	1,798,889	201,111	—
Purchase of property and equipment	(473,089)	(212,421)	(701,718)
Repayments from DNS, net	—	—	1,577,432
Proceeds from sale of property and equipment	94,370	2,749	(14,482)
Net cash provided by (used in) investing activities	946,088	(1,530,918)	861,232
Cash flows from financing activities:			
Principal payments on capital leases	(59,055)	(4,306)	—
Issuance of common stock for exercise of options	517,612	52,500	—
Borrowings on line of credit	9,753,467	—	—
Amounts paid on line of credit	(8,640,577)	—	—
Purchase of officer notes receivable	(435,000)	—	—
Purchase of common stock for treasury	—	—	(439,583)
Net cash provided by (used in) financing activities	1,136,447	48,194	(439,583)
Net increase (decrease) in cash and cash equivalents	(3,896,262)	185,046	1,458,342
Cash and cash equivalents at beginning of year	4,807,441	4,622,395	3,164,053
Cash and cash equivalents at end of year	$ 911,179	$ 4,807,441	4,622,395
Cash paid (received) during the year for:			
Interest	$ 86,121	11,594	212,404
Income taxes, net of refunds	$ (487,007)	925,161	1,482,103
Noncash financing activities:			
Common stock issued for advanced commissions	$ —	—	2,195,211
Common stock issued for receivable from major shareholder	$ —	—	723,600
Common stock issued for Best acquisition	$ —	3,361,208	—
Treasury stock acquired with Best acquisition	$ —	(3,317,940)	—
Common and preferred stock issued in AvTel reverse acquisition	$ —	9,149,513	—
Common stock issued for DMI acquisition	$ 30,000	—	—
Common stock issued for RLI acquisition	$ 650,000	—	—

See accompanying notes to consolidated financial statements.

AVTEL COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1998, 1997, and 1996

(1) Summary of Significant Accounting Policies

(a) Business and Background

On December 1, 1997, AvTel Communications, Inc. ("AvTel") and Matrix Telecom, Inc. ("Matrix") completed a share for share exchange pursuant to a stock exchange agreement dated April 29, 1997 as subsequently amended ("Share Exchange"). For accounting purposes, the Share Exchange was treated as a reverse acquisition of AvTel by Matrix. AvTel was the legal acquirer and accordingly, the Share Exchange was effected by the issuance by AvTel of 9,582,493 shares of common stock in exchange for all of the common stock then outstanding of Matrix. In addition, holders of outstanding Matrix stock options received 22,338 non-qualified stock options of AvTel. The purchase method of accounting was used, with Matrix being treated as the acquirer for accounting purposes. The results of operations reported in the accompanying consolidated financial statements reflect the operations of Matrix prior to December 1, 1997 and the combined operations of AvTel and Matrix subsequent to December 1, 1997. References to the "Company" refer to operations of Matrix prior to the Share Exchange and the combined operations of Matrix and AvTel subsequent to the Share Exchange. As a result of the Share Exchange, Matrix became a wholly owned subsidiary of AvTel. (See note 2).

The Share Exchange provided that each Matrix shareholder would receive 2.4819 AvTel common shares for each common share of Matrix then issued including treasury shares held by Matrix. For periods prior to the December 1, 1997 Share Exchange, all share amounts have been restated to reflect the Share Exchange as a 2.4819 for one stock split. In addition, on March 10, 1997 Matrix declared an 18 for one stock split. All share amounts have also been restated to reflect this stock split.

AvTel was formed to be a provider of broadband network services integrating voice, data and Internet solutions for individuals and corporate customers. The Company sells and markets a broad range of telecommunications and advanced network services through independent value added resellers, third party marketing organizations and internal direct sales professionals. The Company targets mid-size corporations, small-office home-office professionals and select residential market segments through two primary business units, its Business Markets Group ("BMG") and Channel Markets Group ("CMG").

BMG targets mid-size corporate customers for their broadband data, voice and Internet networking needs. Following this sales strategy, the Company's objective is to become the underlying telecommunications carrier for the transport of data, voice and Internet traffic. Through a value-added sales process, the Company designs, provisions and manages its customers' networks. The Company will provide a host of additional value-added services assisting its customers to create enhanced intranet and extranet applications. Additionally, BMG markets to its customer base a variety of traditional communications products and services such as long distance telephone service, executive calling cards and video/audio conferencing.

CMG targets and markets to distribution companies, agents, resellers and affinity groups that maintain access to large groups of individuals and small businesses through affinity relationships and niche marketing strategies. CMG provides Internet access, long distance telephone and other services to customers in 49 states. The Company is fully certified or registered in all states where required and operates under Section 214 authority from the Federal Communications Commission ("FCC"). The Company, through a wholly owned subsidiary, has a national-deployed Carrier Identification Code ("CIC"). The Company maintains its own convergent billing platform, rating system and monitoring center.

(1) Summary of Significant Accounting Policies (Continued)

(b) Liquidity

The Company's consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the consolidated financial statements during the years ended December 31, 1998 and 1997, the Company reported net losses of $7,127,318 and $10,191,720, respectively. In addition, as of December 31, 1998, the Company had a working capital deficit of $3,022,959, and for the year ended December 31, 1998, net cash used in operations totaled $5,978,797.

As a result, as of December 31, 1998, unless the Company effects substantial changes in its operating methods, the Company does not have sufficient resources to meet its anticipated operating requirements during 1999 without obtaining additional financing. The Company is actively pursuing an equity line of credit through discussion with potential investors. If the Company is unable to obtain financing in a timely manner and on acceptable terms, management is developing and intends to implement a plan that would allow the Company to continue to operate through 1999. This plan would include significantly reducing the Company's workforce, eliminating advertising expenditures, reducing professional services and reducing or eliminating other discretionary expenditures.

(c) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

(d) Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all demand deposits, time deposits, and other highly liquid investments with a remaining maturity at date of purchase of less than ninety days to be cash equivalents.

(e) Commissions

Commissions to sales agents are paid and expensed based on a percentage of billings as incurred.

Commissions paid in advance of $221,000 as of December 31, 1997, included in other current assets, were expensed over a period of eighteen months based on estimated billings of the customers for which the commissions were paid. The above advances were fully expensed during 1998 and no additional advance commission payments were made.

(f) Revenue Recognition

Long distance, frame relay, Internet, systems integration and repair service revenues are recognized as service is provided. Amounts paid in advance are recorded as unearned revenue and recognized as services are provided.

(g) Property and Equipment

Property and equipment are recorded at cost. Maintenance and repairs are charged against income as incurred, while renewals and major replacements are capitalized. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts, and any resulting gain or loss is

(1) Summary of Significant Accounting Policies (Continued)

reflected in operations. The Company provides depreciation on fixed assets using the straight-line method over the estimated useful lives of the respective assets.

(h) Goodwill

Goodwill of $4.5 million, which is net of amortization of $19,000 as of December 31, 1998, represents the excess of purchase price over fair value of net assets acquired in the DMI and RLI acquisitions and is amortized on a straight-line basis over fifteen years. The Company assesses the recoverability of this intangible asset by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future cash flows of the acquired operation. The amount of goodwill impairment, if any, is measured based on expected undiscounted future operating cash flows expected to be generated by the acquired business. The assessment of the recoverability of goodwill will be impacted if estimated future operating cash flows are not achieved.

(i) Income Taxes

The Company utilizes the asset and liability method for accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(j) Use of Estimates

Management of the Company has made a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(k) Concentrations of Credit Risk

The Company's subscribers are primarily small business owners and residential subscribers and are not concentrated in any specific geographic region of the United States. The Company has agreements with Local Exchange Companies, which provide billing and collection services to the majority of the Company's subscribers. A significant portion of the Company's accounts receivable is due from these companies.

(l) Accounts Receivable

Accounts receivable are net of allowances for doubtful accounts and other provisions of $935,000 and $982,000 as of December 31, 1998 and 1997, respectively. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of subscribers, historical trends and other information.

(1) Summary of Significant Accounting Policies (Continued)

(m) Financial Instruments

The Company's financial instruments include cash, receivables, payables, and accrued expenses. The carrying amount of such financial instruments approximates fair value because of the short maturity of these instruments.

(n) Acquired Customer Base

Acquired customer base of $1,240,000, which is net of accumulated amortization of $343,000 at December 31, 1998, included in other assets, is being amortized on a straight-line basis over five years. The Company assesses the recoverability of this intangible asset by determining whether the acquired customer base balance can be recovered through undiscounted future operating cash flows of the acquired operations. The amount of impairment, if any, is measured based on projected discounted cash flows. The assessment of the recoverability of the acquired customer base will be impacted if estimated future operating cash flows are not achieved.

(o) Impairment of Long-Lived Assets

In January, 1996, the Company adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS No. 121"). SFAS No. 121 requires that long-lived assets and certain intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the net asset exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(p) Comprehensive Income

In 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"). SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. Comprehensive income includes net income and other comprehensive income, which is generally composed of changes in the fair value of available-for-sale marketable securities, foreign currency translation adjustments and adjustments to recognize additional minimum pension liabilities. The statement requires additional disclosures in the consolidated financial statements; it does not affect the Company's financial position or results of operations. Comprehensive income (loss) for the years ended December 31, 1998, 1997 and 1996 is equal to net income (loss) reported for such periods.

(q) Segment Reporting

In 1998, the Company adopted the provisions of Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" (SFAS No. 131"). SFAS No. 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas and major customers. (See Note 11).

(1) Summary of Significant Accounting Policies (Continued)

(r) Reclassifications

Certain reclassifications have been made to prior period amounts in order to conform to current year presentation.

(2) Acquisitions

Matrix Telecom, Inc.— On December 1, 1997, AvTel and Matrix completed the Share Exchange. For accounting purposes the Share Exchange was treated as a reverse acquisition of AvTel by Matrix. AvTel was the legal acquirer and, accordingly, the Share Exchange was effected by the issuance of AvTel common stock in exchange for all of the common stock then outstanding of Matrix. In addition, holders of outstanding Matrix stock options received non-qualified stock options of the Company. Immediately after the Share Exchange the former shareholders of Matrix held approximately 84% of the then outstanding common stock of the Company.

The consummation of the Share Exchange was subject to the satisfaction of several conditions by AvTel. These included the reincorporation of AvTel (then a Utah corporation; "AvTel Utah") in Delaware by way of a merger (the "Reincorporation Merger") with and into AvTel Communications, Inc., a Delaware corporation, a wholly-owned subsidiary formed for the sole purpose of this merger. As part of the merger, AvTel (the surviving Delaware corporation) issued to its stockholders one share of new Delaware Common Stock for each four shares of AvTel-Utah's Common Stock outstanding immediately prior to the Reincorporation Merger. AvTel's Series A Convertible Preferred Stock and its outstanding options were similarly adjusted. Accordingly, the Reincorporation Merger essentially effected a one for four reverse stock split of AvTel's shares.

The reverse acquisition of AvTel by Matrix was accounted for using the purchase method of accounting. In order to value the consideration given in the Share Exchange the market price of AvTel's common stock for a period immediately preceding the announcement of the Share Exchange was used. As of the date of acquisition, the Company determined the fair value of the net tangible and intangible assets acquired and liabilities assumed. Concurrently, the Company determined that the carrying amount of recorded goodwill was not recoverable. Accordingly, the Company recorded a charge to income of $9,098,545 immediately subsequent to the reverse acquisition.

In connection with the completion of the Share Exchange, the Company entered into a Registration Rights and Lockup Agreement dated December 1, 1997 (the "Registration Rights and Lockup Agreement"). The Registration Rights and Lockup Agreement requires that the Company use its best efforts to file a shelf registration statement providing for the sale by certain stockholders of all securities issued to them in connection with the Exchange Agreement, subject to a two-year holding restriction imposed on such stockholders. Under the Registration Rights and Lockup Agreement, the Company is obliged to use its reasonable efforts to keep the shelf registration statement effective on a continuous basis for a period described in the Registration Rights and Lockup Agreement. Such stockholders may also require the Company to undertake up to two additional demand registrations of their securities if the shelf registration is not in place. As of April 14, 1999, this registration obligation related to 6,457,123 shares held by 14 stockholders.

Best Connections, Inc. ("Best")— Effective July 1, 1997, shareholders of Best, an affiliate of Matrix through substantially common ownership, contributed their ownership of Best to Matrix in exchange for

(2) Acquisitions (Continued)

934,987 shares of Matrix common stock. Best's primary assets were 1,999,997 shares of Matrix common stock and cash of $211,000. The assets and liabilities of Best were recorded at their historical cost which approximated the fair value of such assets as of July 1, 1997. As a result of the combination, Matrix assumed the obligation to grant up to 1,999,997 stock options to agents of Best and certain employees of affiliated companies. Such option grants relate to services, including sales promotion activities, to be performed by the recipients on behalf of the Company. Accordingly, the fair value of such options is being charged to expense by the Company as the related services are provided.

Digital Media, Inc. ("DMI")— Effective September 25, 1998, the Company acquired all of the capital stock of DMI, a California based developer of multimedia software. The Company exchanged 30,000 shares of its common stock valued at $71,250 for all of the outstanding common stock of DMI. The transaction was accounted for under the purchase method of accounting. The assets and liabilities of DMI were recorded at their historical cost which approximated their fair value at September 25, 1998. The Company recorded goodwill of approximately $117,000, which represents the excess of the purchase price over the fair value of the net assets received. The goodwill is being amortized on a straight-line basis over fifteen years.

Remote Lojix/PCSI, Inc. ("RLI")— Effective November 1, 1998, the Company acquired all of the capital stock of RLI, a New York based provider of information technology services to corporate customers. The Company exchanged 650,000 shares of its common stock valued at $1,462,500 and the outstanding balance of a $500,000 loan from the Company for all of the outstanding common stock of RLI. The transaction was accounted for under the purchase method of accounting. The assets and liabilities of RLI were recorded at their historical cost which approximated the fair value at November 1, 1998. The Company recorded goodwill of approximately $4.4 million, which represents the excess of the purchase price over the fair value of the assets received. The goodwill is being amortized on a straight-line basis over fifteen years.

Unaudited pro forma results of operations of the Company as if the share exchange of Matrix and the acquisitions of Best, DMI and RLI had occurred as of the beginning of the periods presented is as follows:

	Year Ended December 31	
	1998	1997
Revenue	$ 49,711,440	$ 58,967,268
Loss from operations	(8,909,490)	(12,749,469)
Net loss	(9,124,180)	(12,378,014)
Proforma net loss per share	$ (0.89)	$ (1.02)

The pro forma financial information has been prepared for comparative purposes only and does not purport to indicate the results of operations that would have occurred had the acquisition been made at the beginning of the period indicated, or which may occur in the future.

(2) Acquisitions (Continued)

As of the date of acquisitions, the fair market value of the assets acquired and liabilities assumed included the following:

	1998		
	DMI	RLI	Total
Current assets other than cash	$ 50,105	1,034,803	1,084,908
Property and equipment	44,313	132,169	176,482
Goodwill	117,169	4,375,191	4,492,360
Current liabilities	(166,255)	(3,579,663)	(3,745,918)
Common stock issued	(71,250)	(1,462,500)	(1,533,750)
Cash acquired (paid)	$ 25,918	(500,000)	(474,082)

	1997		
	Matrix	Best	Total
Current assets other than cash	$ 258,041	—	258,041
Property and equipment	577,836	15,137	592,973
Customer base	1,583,000	—	1,583,000
Goodwill	9,098,545	—	9,098,545
Current liabilities	(1,945,526)	(183,041)	(2,128,567)
Long-term liabilities	(688,854)	—	(688,854)
Common and preferred stock issued	(9,149,513)	(3,361,208)	(12,510,721)
Treasury stock acquired	—	3,317,940	3,317,940
Cash acquired	$ 266,471	211,172	477,643

(3) Property and Equipment

Property and equipment consisted of the following:

	Estimated Useful Life	December 31 1998	December 31 1997
Communications system	2-5 years	$ 1,318,326	$ 1,318,326
Office furniture and equipment	1-7 years	3,420,773	2,945,795
Leasehold improvements	lease term	521,319	416,220
Total property and equipment		5,260,418	4,680,341
Accumulated depreciation and amortization		(3,575,711)	(2,888,659)
Property and equipment, net		$ 1,684,707	$ 1,791,682

Depreciation expense was $737,000, $632,000 and $877,000 for 1998, 1997 and 1996, respectively.

(4) Stockholders' Equity

The Series A convertible preferred shareholders are entitled to receive cumulative annual dividends at a rate of 8% and are entitled to a preference in liquidation in the amount of $4 per share plus unpaid dividends. There were $137,000 cumulative Series A convertible preferred stock dividends in arrears at December 31, 1998. The Series A preferred stock is convertible, on a one-for-one basis, into shares of Company common stock. During 1998, a total of 60,000 shares of the Company's Series A convertible preferred stock was converted to 60,000 shares of the Company's common stock.

In December 1998, the Company retired all of its outstanding treasury stock.

In December 1996, the Company issued 1,463,771 shares of common stock for future commissions due to affiliates as of October 31, 1996. A value of $1.50 per share was used in determining the number of shares to issue in settlement of the $2,195,211 obligation. Of this amount, $221,000, $1,355,000 and $619,000 was expensed as commission expense in 1998, 1997 and 1996, respectively.

During 1996, the Company sold to certain employees 482,400 shares of common stock at $1.50 per share. As of December 31, 1996, the Company had recorded a $723,600 receivable for such shares, which was subsequently collected. Proceeds used to repay the $723,600 receivable were loaned to the employees by a major shareholder of the Company. As of December 31, 1998 and 1997, the shares subject to this agreement could be put to the Company at the option of the employee at approximately $1.50 per share ($168,867 and $578,880), respectively. Such amounts have been included in other liabilities. Under certain circumstances (e.g. employee termination) the Company has a call at the same amounts. The call and put rights vest over a period of five years. As of December 31, 1998, these rights were forty percent vested. Activity in common stock outstanding related to shares subject to put follows:

	Shares	Amount
Sale of common shares subject to put	482,400	$ 723,600
Increase in share value subject to put charged to expense	—	172,400
Balance, December 31, 1996	482,400	896,000
Decrease in share value subject to put recorded as a reduction to expense	—	(172,400)
Vested shares no longer subject to put	(96,480)	(144,720)
Balance, December 31, 1997	385,920	578,880
Vested shares no longer subject to put	(48,187)	(37,253)
Called shares subject to put	(225,155)	(372,760)
Balance, December 31, 1998	112,578	$ 168,867

During May 1996, the Company purchased 171,548 shares of its common stock as treasury stock for $439,584. As further discussed in note 8 in connection with the Best and Matrix combination effective July 1, 1997, Matrix acquired an additional 1,999,997 shares of its common stock as treasury stock. As a part of the recapitalization done in connection with the AvTel reverse acquisition, Matrix retired the 171,548 shares of its common stock discussed above and the Company recorded the remaining treasury stock at par value.

(5) Federal and State Income Taxes

The provision for income taxes consisted of the following:

	1998	1997	1996
Current tax expense (benefit):			
Federal	$ —	$(234,899)	$1,751,047
State and local	7,531	(41,453)	257,507
	7,531	(276,352)	2,008,554
Deferred tax expense (benefit):			
Federal	(209,110)	—	(254,350)
State and local	—	—	(67,328)
	(209,110)	—	(321,678)
	$(201,579)	$(276,352)	$1,686,876

Income tax expense differs from the amounts computed by applying the U.S. federal income tax rate of 34 percent to pretax income as a result of the following:

	1998	1997	1996
Computed "expected" tax expense (benefit)	$(2,491,825)	$(3,559,144)	$1,404,637
State and local taxes, net of federal income tax effect	(135,961)	(27,359)	125,518
Other nondeductible items	22,539	3,093,522	—
Losses not providing tax benefit	2,594,289	330,190	—
Other	(190,621)	(113,561)	156,721
	$ (201,579)	$ (276,352)	$1,686,876

Deferred income taxes as of December 31, 1998 and 1997 reflect the impact of temporary differences between financial statement carrying amounts and tax bases of assets and liabilities. The tax effects of

(5) Federal and State Income Taxes (Continued)

temporary differences that give rise to significant portions of the net deferred tax assets at December 31, 1998 and 1997 are presented below:

	December 31	
	1998	1997
Deferred tax assets		
Net operating loss carryovers	$ 3,494,634	$ 814,425
Compensation related items	480,137	299,554
Contingent liabilities and other	268,340	204,978
Gross deferred tax asset	4,243,111	1,318,957
Less valuation allowance	(3,778,958)	(1,184,669)
Net deferred tax asset	464,153	134,288
Deferred tax liabilities:		
Customer base intangible	(464,153)	(633,000)
Net deferred tax liability	$ —	$ (498,712)

The valuation allowance for deferred tax assets increased $2,594,289 and $1,184,669 during 1998 and 1997, respectively.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and prior taxes paid in making this assessment. Based upon its evaluation of these factors, management believes that it is more likely than not that the Company will realize the benefits of these deductible differences, net of the valuation allowance, at December 31, 1998. At December 31, 1998, the Company has net operating loss carryforwards for federal tax purposes of approximately $9,153,822 which are available on a limited basis to offset future federal taxable income, if any, through 2018. When realized, such benefit will first be utilized to reduce intangible assets recorded in the reverse acquisition of AvTel by Matrix.

(6) Related Party Transactions

The Company has had transactions in the normal course of business with various companies which are affiliated with shareholders of the Company. Pacific Gateway Exchange, Inc. ("PGE") provides the Company with significant domestic and international transmission services. As of January 1, 1998, PGE was no longer affiliated with the Company. During 1998, a director and several significant holders of the Company's common stock divested themselves of a substantial portion of their holdings of PGE common stock; they have advised the Company that they no longer could be deemed to be in control of PGE. A significant number of the Company's employees were leased from United Group Service Center, an affiliate, which provides such services to a number of affiliated companies. This lease agreement was terminated on December 31, 1998, at which time these individuals became employees of the Company. The Company provides long distance and data network service to a number of affiliated companies.

(6) Related Party Transactions (Continued)

Balances with affiliates related to operating activities are settled monthly. In addition, the Company has made both interest bearing and non-interest bearing advances to affiliated companies.

Due from affiliates consists of the following:

	December 31	
	1998	1997
Core Marketing—note receivable due September 1, 1998	$ —	$1,798,889
UICI Administrators (long distance services)	308,346	94,417
Interactive Media Works (IMW) (long distance services)	6,214	25,263
Core Marketing (long distance services)	82,695	111,280
AMLI Management Co. (long distance services)	10,695	—
Other receivables from various affiliates	93,908	97,922
	$501,858	$2,127,771

Due to affiliates consists of the following:

	1998	1997
PGE (not considered an affiliate in 1998)	$ —	2,335,787
Group Association (UGA) and Core Marketing (commissions)	5,339	134,618
Other payables to various affiliates	318,681	249,012
	$324,020	2,719,417

(6) Related Party Transactions (Continued)

Significant services and transactions incurred in the normal course of operations with affiliated companies are summarized as follows:

	1998	1997	1996
Revenues include the following:			
U.S. Telco-billing and collection services, customer service and accounting services	$ —	$ 200,370	$ —
Long distance revenues from affiliates: UGA, UICI, IMW, Core Marketing, and AMLI	4,592,040	3,351,375	5,445,903
	$4,592,040	$3,551,745	$ 5,445,903
Cost of revenues includes the following:			
Network transmission services—PGE (not considered an affiliate in 1998)	$ —	15,917,688	20,527,236
Selling, general and administrative expenses include the following:			
Expenses paid on behalf of PGE (not considered an affiliate in 1998) for access services, for which the Company was reimbursed	$ —	3,534,154	5,040,051
Expenses incurred for leasing employees from United Group Service Center	5,581,428	4,395,820	4,542,007
Sales commissions to affiliates:			
Core Marketing, UICI, UGA, Best Connections and AMLI	140,187	990,533	5,335,233
Overhead expenses reimbursed to/from UGA Divisions	241,810	110,761	77,231
Core Marketing—casual mailings and telemarketing	21,425	603,742	—
	$5,984,850	$9,635,010	$14,994,522
Interest expense includes the following:			
Interest paid to shareholder	$ —	$ —	$ 173,380

During 1997, the Company loaned $2,000,000 to an affiliated company, Core Marketing, LLC. Of such amount, $201,000 was repaid in 1997 and the remainder was repaid in 1998.

In July 1998, the Company purchased notes receivable from one of the Company's significant shareholders at a discount. The notes receivable evidenced loans made by the significant shareholder in 1996 to Matrix employees to finance their purchases of Matrix common stock (which was subsequently converted to shares of the Company's common stock). Each of the employees who delivered a note receivable also entered into a Buyback Agreement dated October 6, 1996 (the "Buyback Agreement"), pursuant to which the Company has the option (but no obligation) to repurchase a portion of such employee's stock upon the termination of his or her employment. The original notes, plus accrued interest, at the date of purchase by the Company was $573,000. The Company purchased these notes for $435,000.

(6) Related Party Transactions

In connection with the purchase of the notes receivable above, the Company repurchased 240,912 shares of its common stock subject to the Buyback Agreement from terminated employees. The Company exercised its right to repurchase 225,154 of such shares at a price range of $1.51 to $1.70 per share, and the former employees used the $373,081 in proceeds to reduce the amount of their notes. The Company repurchased an additional 15,758 shares in satisfaction of the remaining balance of $116,085 on the former employees' notes.

(7) Stock Compensation

AvTel options—Prior to the Share Exchange AvTel adopted a 1997 Incentive Stock Option Plan (the "AvTel 1997 Plan") for option grants to officers and key employees. The AvTel 1997 Plan authorizes grants of options to purchase up to 250,000 shares of authorized but unissued common stock and 125,000 shares of restricted common stock. Stock options are to be granted with an exercise price greater than or equal to the stock's fair market value at the date of grant. Options generally vest 25% after one year and 25% each year thereafter until fully vested. Such options typically expire after ten years. In addition, AvTel had other options which had been granted prior to the adoption of the AvTel 1997 Plan. After the Share Exchange all outstanding options became obligations of the Company.

On January 1, 1998, the Company granted options to purchase 75,000 shares of the Company's common stock at an exercise price of $1.50 per share. On March 1, 1998 the Company granted options to purchase 100,000 shares of the Company's common stock at an exercise price of $1.50 per share. These options become exercisable based on qualified billings of long distance customers generated by the optionees from the respective dates of grant through December 31, 2000. As of December 31, 1998, 27,316 options are exercisable.

On February 24, 1998, the Company's Board of Directors approved the grant of a total of 120,000 shares of restricted common stock to two board members pursuant to the Company's 1997 Stock Incentive Plan. The restricted stock provisions will lapse over four years or fully lapse in the event of death or permanent disability of the grantees. During 1998 one of the board members resigned from the board and his 60,000 shares were vested immediately. As of December 31, 1998, only those 60,000 shares of restricted common stock are vested.

During 1998, the Company adopted the 1998 Stock Incentive Plan (the "AvTel 1998 Plan"), which provides for the issuance of up to 1,500,000 shares of AvTel common stock pursuant to stock options and issuances of restricted stock, as well as for the grant of stock appreciation rights. Stock options are to be granted with an exercise price greater than or equal to the stock's fair market value at the date of grant. Options generally vest 25% after one year and 25% each year thereafter until fully vested. Such options typically expire after ten years. As of December 31, 1998, the Company granted 671,000 options under the AvTel 1998 Plan. Exercise prices range from $2.375 to $4.00 per share.

Matrix options—Prior to the Share Exchange, the Board of Directors of Matrix approved stock options for certain officers and employees. Stock option transactions of Matrix are included in the table below. At the time of the Share Exchange, Matrix had 22,338 options outstanding to purchase its common stock. In connection with the Share Exchange, the Company reissued these stock options and they vested immediately. These reissued options expire in December 2002.

(7) Stock Compensation (Continued)

The Company applies APB Opinion No. 25 in accounting for the AvTel 1997 Plan, 1998 Stock Incentive Plan and the Matrix options discussed above; and, accordingly, no compensation cost has been recognized for its stock options issued to employees in the financial statements. For stock options granted to non-employees, the Company accounts for such options in accordance with the requirements of SFAS No. 123. Had the Company determined compensation cost based on the fair value at the grant date for stock options issued to employees under SFAS No. 123, the Company's net loss in 1998 and 1997 would not have materially changed.

Best Connections, Inc. options—As discussed in Note 2, as a result of the Matrix combination with Best, Matrix assumed the obligation to issue stock options to Best's agents under Best's 1997 Option Plan. Effective as of the date of combination, July 1, 1997, 1,292,000 options to purchase Matrix common shares were granted to Best agents at $1.50 per share, which will result in aggregate commission expense of approximately $764,000 over the vesting period. The option price per share was $1.50. The agents' options become exercisable no later than December 31, 1999 and may be exercised earlier based on qualified billings of long distance customers generated by the agents during six month measurement periods. After the Share Exchange such options became obligations of the Company. As of December 31, 1998, 641,532 options have been earned and 172,120 exercised under the Plan and the Company recorded expense totaling approximately $132,000 and $249,000 related to such options based on qualified billings for 1998 and 1997, respectively. Options generally expire two years from the date they become exercisable or sixty days subsequent to termination of employment.

The per share weighted average fair value of stock options granted on July 1, 1997 was $.59 on the date of the grant using the Black-Scholes option—pricing model with the following weighted-average assumptions: expected volatility of 30%, risk-free interest rate of 6.0%, and an expected life of 3.5 years.

Best Connections, Inc. options and restricted stock agreements—As discussed in Note 2 as a result of the Matrix combination with Best, Matrix assumed the obligation to issue stock options, consisting of Matrix common shares owned by Best, to employees of affiliated companies. Effective July 15, 1997, the Company issued 247,500 options to purchase an equal number of shares of its common stock, at $1.50 per share subject to the provisions of a Restricted Stock Agreement. The Restricted Stock Agreement includes a call provision by the Company that lapses 10 percent each six months beginning December 15, 1997 through June 15, 2002 or fully lapses in the event of death or permanent disability of the option holder. The call price is equal to the initial purchase price of $1.50 plus the aggregate amount of net income or less the aggregate amount of net losses per share for each fiscal quarter beginning after December 15, 1997; provided that the call price could not be less than $1.50 per share. During 1998 AvTel relinquished its right to call the shares which caused the options to vest immediately and to expire if not exercised before December 13, 1998. AvTel provided the holders the option of a "cashless" exercise by purchasing up to one half the shares issuable at $3.00 The Company recognized expense over the life of the options in accordance with the provisions of SFAS No. 123 and recorded expense of $500,000 in 1997 and a reduction of expense of $170,000 in 1998. At December 31, 1998, 107,250 options had been exercised, 67,250 were used for the cashless exercise, 45,500 expired, and 27,500 were cancelled.

(7) Stock Compensation (Continued)

Stock option activity is as follows:

	Options	Weighted average Exercise Price
Outstanding at December 31, 1995	53,607	$2.24
Canceled	(31,269)	2.24
Outstanding at December 31, 1996	22,338	2.24
AvTel options outstanding at time of Share Exchange	255,109	4.52
Granted	1,539,500	1.50
Exercised	(15,000)	3.50
Outstanding at December 31, 1997	1,801,947	1.78
Granted	1,024,500	3.31
Expired	(46,750)	1.54
Forfeited	(106,999)	1.91
Exercised	(353,327)	1.81
Outstanding at December 31, 1998	2,319,371	2.45
Exercisable at December 31, 1995	—	$ —
Exercisable at December 31, 1996	3,574	2.24
Exercisable at December 31, 1997	349,972	2.21
Exercisable at December 31, 1998	524,849	2.16

Total expense recorded for stock based awards during 1998 and 1997 was $477,148 and $748,884, respectively.

The following table summarizes certain information about the Company's stock options at December 31, 1998.

	Options Outstanding			Options Exercisable	
Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$ 1.50 - 2.25	1,427,218	2.5 years	$ 1.57	462,334	$ 1.54
2.38 - 3.30	303,749	8.5	2.92	26,736	2.93
4.00 - 6.00	555,112	9.9	4.02	2,487	4.00
6.75 - 8.00	17,093	8.9	7.47	17,093	7.47
12.00 - 14.00	16,199	8.1	12.77	16,199	12.77
	2,319,371	5.1	2.45	524,849	2.16

(8) Earnings Per Common Share

The Company adopted the provisions of Statement of Financial Accounting Standards No. 128, *Earnings per Share* ("SFAS 128") in the fourth quarter of 1997, which required companies to present basic earnings per share and diluted earnings per share.

	1998	1997
Numerator:		
Net loss	$(7,127,318)	(10,191,720)
Less preferred dividends	47,264	5,540
Loss applicable to common shareholders	$(7,174,582)	(10,197,260)
Denominator:		
Weighted average number of common shares used in basic and diluted loss per common share	9,633,474	8,267,296
Basic and diluted loss per common share	$ (0.74)	(1.23)

Per share amounts are not reflected for 1996 due to the recapitalization of the Company as a result of the reverse acquisition in 1997.

(9) Leasing Activities and Other Commitments

The Company leases office space and various equipment under operating leases expiring in various years through 2004. In the normal course of business, operating leases are generally renewed or replaced by other leases. Total rental expenses were $546,000 in 1998, $245,000 in 1997, and $325,000 in 1996. Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 1998 are: 1999—$731,000; 2000—$688,000; 2001—$426,000; 2002—$307,000; and 2003—$101,224.

Substantially all of the Company's switching and transmission facilities have been provided by two suppliers under negotiated contractual agreements. The Company purchases long distance services at certain per-minute rates, which vary depending on the time and type of call. At December 31, 1998, there are outstanding contractual agreements committing the Company to $18,570,000 minimum usage through February 15, 2000.

(10) Revolving Line of Credit

In 1998, the Company entered into a Loan and Security Agreement with a bank, which provides for an asset-based revolving credit line with a floating interest rate of prime plus 2% (9.75% at December 31, 1998), payable monthly. The credit limit is the lesser of $7,500,000 or a percentage of the amount of the Company's eligible receivables and other items. Borrowings are secured by substantially all of the assets of the Company. The agreement also calls for a minimum borrowing of $1,500,000 with a two-year term. At December 31, 1998, there was $1,112,890 outstanding under the agreement, and an additional $1,655,000 was eligible for borrowing under the revolving credit line.

The Loan and Security Agreement contains restrictions on net worth, future acquisitions and other transactions.

(11) Segment Reporting

In June 1997, the Financial Accounting Standards Board issued Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*, which the Company adopted in 1998. The Company identifies such segments based on management responsibility. The Company's two primary business segments are Business Markets Group ("BMG") and Channel Markets Group ("CMG").

BMG targets mid-size corporate customers for their broadband data, voice and Internet networking needs. Through a value-added sales process, the Company designs, provisions and manages its customers' networks. The Company provides a host of additional value-added services assisting its customers to create enhanced intranet and extranet applications. Additionally, BMG markets to its customer base a variety of traditional communications products and services such as long distance telephone service, executive calling cards and wireless paging.

CMG targets and markets to distribution companies, agents, resellers and affinity groups ("Channel Partners") that maintain access to large groups of individuals and small businesses through affinity relationships and niche marketing strategies. Channel Partners include non-profit organizations and for-profit distribution groups. CMG provides Internet access, long distance telephone and other services to customers in 49 states.

During 1998, the Company measured and monitored the progress of BMG and CMG based on revenues from external customers and gross margin. The results for the year ended December 31, 1998 are as follows:

	Year Ended December 31, 1998		
	BMG	CMG	Total
Revenue from external customers	$6,338,114	37,675,384	44,013,498
Gross margin	1,846,895	10,317,249	12,164,144
Total assets	8,079,998	6,554,356	14,634,354

	Year Ended December 31, 1997		
	BMG	CMG	Total
Revenue from external customers	$5,791,993	45,597,087	51,389,080
Gross margin	1,715,205	13,446,368	15,161,573
Total assets	2,241,825	16,483,025	18,724,850

	Year Ended December 31, 1996		
	BMG	CMG	Total
Revenue from external customers	$6,368,460	65,189,835	71,558,295
Gross margin	2,135,461	21,748,438	23,883,899
Total assets	705,964	19,632,440	20,338,404

(12) Contingencies

The Company's common stock has been traded on The Nasdaq SmallCap Market since May 28, 1998. Trading in the Company's stock was halted by Nasdaq after the close of trading on November 12, 1998,

(12) Contingencies (Continued)

through the close of trading on November 13, 1998, as a result of an unusual upsurge in its stock price and trading volume. This unusual event has triggered the initiation of class action litigation under the federal securities laws. The Company believes that these claims are without merit and intends to defend vigorously this litigation. However, it is not possible at this time for the Company to predict with certainty the outcome of this litigation. Even if the Company prevails in the litigation, the expenses of the defense could have a material adverse effect on the Company's operating results and financial condition.

The Company presently has other contingent liabilities relating to various lawsuits and other matters related to the conduct of its business. On the basis of information furnished by counsel and others, management believes these contingencies upon resolution will not materially affect the financial condition or results of operations of the Company.

(13) Subsequent Events

On April 13, 1999, the Company sold 1,500 shares of its newly-designated Series B Convertible Preferred Stock (the "Series B Stock") to AMRO International, S.A., an entity organized under the laws of Panama, Austinvest Anstalt Balzers, an entity organized under the laws of Liechtenstein, and Esquire Trade & Finance Inc., an entity organized under the laws of the British Virgin Islands (the "Series B Investors") for $1,500,000. The Series B Stock has a liquidation preference of $1,000 per share. The Series B Stock will be entitled to an annual dividend of $30 per share, payable in cash or Common Stock, at the Company's option. The annual dividend will increase to $60 per share if the Company ever ceases to be listed on The Nasdaq Stock Market or any national securities exchange. The Series B Stock is convertible into Common Stock at the option of the Series B Investors at any time. The number of shares of Common Stock to be received by a Series B Investor upon conversion will equal the liquidation preference of the amount converted, divided by the conversion price. The conversion price will be the lesser of (1) $6.875, or (2) 89% of the low closing bid price for the Common Stock on The Nasdaq SmallCap Market at the time of conversion. The conversion price will not be less than $3.00 for 180 days after the date of issuance of the Series B Stock. Thereafter the conversion price will not be less than $2.00 as long as certain revenue and EBITDA requirements are met. As a result, the Company could issue up to 750,000 shares of Common Stock upon conversion if all of the Series B Stock were converted at the lowest possible conversion price (assuming such revenue and EBITDA requirements continue to be met). Unless the Company shall have obtained the approval of its voting stockholders in accordance with the rules of The Nasdaq Stock Market, the Company will not issue shares of Common Stock upon conversion of any shares of Series B Stock if such issuance of Common Stock, when added to the number of shares of Common Stock previously issued by the Company upon conversion of or as dividends on shares of the Series B Stock, would exceed 19.9% of the number of shares of Common Stock which were issued and outstanding on the original issuance date of the Series B Stock. The Company will pay converting Series B Investors in cash for any excess over such amount.

The Company also issued the Series B Investors warrants to purchase up to 20,000 shares of Common Stock at a price of $8.60 per share. The warrants may be exercised beginning September 30, 1999, and terminate on March 31, 2002.

The Company and the Series B Investors entered into a Registration Rights Agreement that requires the Company to file, and obtain and maintain the effectiveness of, a Registration Statement with the Securities and Exchange Commission (the "Commission") in order to register the public resale of all

(13) Subsequent Events (Continued)

shares of the Common Stock acquired by the Series B Investors (a) upon conversion of the Series B Stock, (b) in payment of dividends on the Series B Stock, and (c) upon exercise of the warrants. The Company will be subject to significant monetary penalties if it fails to obtain or maintain the effectiveness of such Registration Statement.

The Company paid Trinity Capital Advisors, Inc. $60,000 as compensation for arranging the placement of the Series B Stock.

AVTEL COMMUNICATIONS, INC. AND SUBSIDIARIES

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

Years ended December 31, 1998, 1997, and 1996

Description	Balance at beginning of period	Additions	Deductions	Balance at end of period
Allowance for doubtful Accounts and other Provisions—years ended:				
December 31, 1998	$ 982,000	2,728,000(a)	2,775,000(b)	935,000
December 31, 1997	$ 627,000	1,830,000(a)	1,475,000(b)	982,000
December 31, 1996	$ 730,000	1,461,000(a)	1,564,000(b)	627,000
Valuation allowance for deferred tax assets:				
December 31, 1998	$1,185,000	2,594,000(c)	—	3,779,000
December 31, 1997	$ —	1,185,000(c)	—	1,185,000
December 31, 1996	$ —	—	—	—

(a) Charged to cost of revenues.

(b) Amounts written off.

(c) Recognized as a component of deferred tax assets.

EXHIBIT INDEX

Exhibit Number	Title of Document	Page Number
2.1	Acquisition Agreement, dated as of August 30, 1996, by and among Hi-Tiger International, Inc., a Utah corporation, AvTel Communications, Inc., a Utah corporation, and AvTel Holdings, Inc., a California corporation. (Incorporated by reference to Exhibit A to Registrant's Information Statement on Schedule 14C dated October 2, 1996).	
2.2	Amendment No. 1 to Acquisition Agreement, dated October 22, 1996, among Hi-Tiger International, Inc., AvTel Communications, Inc. and AvTel Holdings, Inc. (Incorporated by reference to Exhibit 2.2 to Registrant's Current Report on Form 8-K dated October 23, 1996).	
2.3	Stock Exchange Agreement, dated as of April 29, 1997, by and between the Registrant and Matrix Telecom, Inc. (Incorporated by reference to Exhibit 2 to Registrant's Current Report on Form 8-K dated April 30, 1997).	
2.4	Amendment to Stock Exchange Agreement, dated as of August 25, 1997, by and between the Registrant and Matrix Telecom, Inc. (Incorporated by reference to Exhibit 2 to Registrant's Current Report on Form 8-K dated August 25, 1997).	
2.5	Agreement and Plan of Merger, dated as of October 3, 1997, between AvTel Communications, Inc., a Delaware corporation and AvTel Communications, Inc., a Utah corporation. (Incorporated by reference to Exhibit 2.7 to Registrant's Annual Report on Form 10-KSB for the year ended September 30, 1997).	
2.6	Stock Purchase Agreement, dated as of July 22, 1998, among the Registrant and the shareholders of Remote Lojix/PCSI, Inc.	
2.7	First Amendment to Stock Purchase Agreement, dated as of August 18, 1998, among the Registrant and the shareholders of Remote Lojix/PCSI, Inc.	
2.8	Earnout Agreement, dated as of October 30, 1998, among the Registrant and certain shareholders of Remote Lojix/PCSI, Inc.	
3.1	Certificate of Incorporation of the Registrant. (Incorporated by reference to Exhibit 3.1 to Registrant's Annual Report on Form 10-KSB for the year ended September 30, 1997).	
3.2	Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock.	
3.3	Bylaws of the Registrant. (Incorporated by reference to Exhibit 3.2 to Registrant's Annual Report on Form 10-KSB for the year ended September 30, 1997).	
10.1	Rights Agreements dated October 23, 1996, between the Registrant and holders of the Registrant's Series A Convertible Preferred Stock. (Incorporated by reference to Exhibit 4.2 to Registrant's Current Report on Form 8-K dated October 23, 1996).	
10.2	1997 Stock Incentive Plan. (Incorporated by reference to Exhibit A to the Registrant's definitive Proxy Statement on Schedule 14A dated January 8, 1997.)	

Exhibit Number	Title of Document	Page Number
10.3	1998 Stock Incentive Plan. (Incorporated by reference to Exhibit A to Registrant's definitive Proxy Statement on Schedule 14A dated April 28, 1998).	
10.4	New Best Connections, Inc. Amended and Restated 1997 Option Plan. (Incorporated by reference to Exhibit 4.2 to Registrant's Registration Statement on Form S-8 dated May 22, 1998).	
10.5	First Amendment to New Best Connections, Inc. Amended and Restated 1997 Option Plan.	
10.6	Registration Rights and Lockup Agreement dated December 1, 1997, between the Registrant and Matrix Telecom, Inc., on behalf of the stockholders of Matrix, (Incorporated by reference to Exhibit 4 to Registrant's Current Report on Form 8-K dated December 1, 1997).	
10.7	Triple Net Real Property Lease (Multi-Tenant Building) dated as of February 16, 1998, by and between Bath Street Partners, a California limited partnership and the Company. (Incorporated by reference to Exhibit 10.8 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1997).	
10.8	Commercial Lease Agreement dated February 28, 1995, Matrix Telecom, Inc. and Ameritas Life Insurance Corp., as amended by Lease Modification Agreement dated March 2, 1995. (Incorporated by reference to Exhibit 10.9 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1997).	
10.9	Resale Solutions Switched Services Agreement dated March 12, 1998, between Matrix Telecom, Inc. and Sprint Communications Company L.P. (Incorporated by reference to Exhibit 10.10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1997).	
10.10	Amendment to Carrier Transport Switched Services Agreement dated October 15, 1998, between Matrix Telecom and Sprint Communications Company L.P. (Incorporated by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1998).	
10.11	Loan and Security Agreement dated October 2, 1998, among Registrant, Matrix Telecom, Inc. and Coast Business Credit. (Incorporated by reference to Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1998).	
10.12	License Agreement dated as of March 1, 1999, between Matrix Telecom, Inc. and Electronic Data Systems Corporation.	
10.13	Convertible Preferred Stock and Warrants Purchase Agreement dated as of April 5, 1999, among Registrant, AMRO International, S.A., Austinvest Anstalt Balzers, and Esquire Trade & Finance Inc.	
10.14	Registration Rights Agreement dated as of April 5, 1999, among Registrant, AMRO International, S.A., Austinvest Anstalt Balzers, and Esquire Trade & Finance Inc.	
10.15	Stock Purchase Warrants granted by Registrant to AMRO International, S.A., Austinvest Anstalt Balzers, and Esquire Trade & Finance Inc.	
21	List of Subsidiaries.	

Exhibit Number	Title of Document	Page Number
23	Consent of KPMG LLP.	
27	Financial Data Schedule.	

EXHIBIT 4

Managerial and Technical Capabilities

Managerial and Technical Capabilities of
Key Personnel for Applicant

Anthony E. Papa has been the **Chairman of the Board and Chief Executive Officer of the Company** since October 1996. Mr. Papa was also President of the Company from October 1996 until February 1998. Prior to October, 1996, Mr. Papa had served as President of ICS Communications, Inc. ("ICS"), Richardson, Texas, a national provider of cable television, wireless paging, local and long distance telephone services from December 1992. Before joining ICS, Mr. Papa served as general manager for Spectradyne, Inc., the largest provider of pay-per-view entertainment and interactive services to the hospitality industry. Mr. Papa is a director of International School of Information Management, Inc., an accredited university and an electronic publisher and provider of electronic services, and a director of ABS-Clio, Inc., an international publisher of historical reference materials for institutions of higher education. Mr. Papa received a B.S. in Management from Iona College, in New Rochelle, New York.

James P. Pisani has been the **President** of the Company since February 1998, and has served as Chief Operating Officer, Chief Financial Officer and Secretary of the company since October 1996. Mr. Pisani has also served as Chief Accounting Officer of the Company since October 1998. From October 1996 to February 1998, Mr. Pisani was the Executive Vice President of the Company. Prior to October 1996, he served as Vice President of Sales and National Accounts for ICS. While at ICS, Mr. Pisani was responsible for that firm's business-to-business and consumer sales activities. Prior to joining ICS, from June 1989 to June 1994, Mr. Pisani served as Vice President of a national mortgage banking firm serving, primarily, institutional accounts. Mr. Pisani graduated from Princeton University in 1986, with a degree in Economics.

Michael D. Ussery is the **Chief Financial Officer** and **Chief Accounting Officer**. As the C.F.O. and the C.A.O. of NetLojix Telecom, Inc., Mr. Ussery is responsible for the preparation of financial statements, cash management and regulatory compliance of the company. Mr. Ussery has been a Certified Public Accountant since 1986. He has also worked in public accounting since 1981. Mr. Ussery is a member of the AICPA and FEI. He has written for and lectured to Certified Public Accountant groups on various accounting topics, including SEC reporting, foreign GAAP and accounting principles.