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January 9, 1997

VIA OVERNIGHT MAIL

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

971055-TX

Re: *Application of Pacific Gateway Exchange, Inc. For Authority To Provide Local Exchange Service In Florida*

Dear Ms. Bayo:

Enclosed for filing on behalf of Pacific Gateway Exchange, Inc. ("PGE") please find an original and six (6) copies of the above-referenced application and a check for $250.00 to satisfy the filing fee. Please date stamp the enclosed extra copy and return it to the undersigned in the enclosed self-addressed, stamped envelope.

Should you have any questions concerning this filing, please do not hesitate to contact the undersigned.

Very truly yours,

Margaret M. Charles
Dalhi N. Myers

Enclosures

cc: Howard Neckowitz
Gail Granton
Steve Wood
Chuck Taylor
Andrew D. Lipman

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FPSC-RECORDS/REPORTING

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

APPLICATION FORM
for

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

INSTRUCTIONS

1. This form is used for an original application for a certificate and for approval of sale, assignment or transfer of an existing alternative local exchange certificate. In case of a sale, assignment or transfer, the information provided shall be for the purchaser, assignee or transferee.

2. Respond to each item requested in the application and appendices. If an item is not applicable, please explain why.

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

4. If you have questions about completing the form, contact:

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

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

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

(X) **Original authority** (new company)

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

( ) **Approval of assignment of existing certificate** (to a non-certificated company)
Example, a non-certificated company purchases an existing company and desires to retain the certificate of authority rather than apply for a new certificate.

( ) **Approval for transfer of control** (to another certificated company)
Example, a company purchases 51% of a certificated company. The Commission must approve the new controlling entity.

2. Name of applicant:

Pacific Gateway Exchange, Inc. ("PGE")

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

Pacific Gateway Exchange, Inc.
533 Airport Boulevard, Suite 505
Burlingame, California 94010
(415) 375-6700

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

PGE does not currently have a mailing address in Florida.

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

PGE does not currently have an office in Florida.

4. Structure of organization:

( ) Individual
(X) Foreign corporation
( ) General Partnership
( ) Joint Venture
( ) Corporation
( ) Foreign Partnership
( ) Limited Partnership
( ) Other, Please explain ______________

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

Corporate charter number(s): **PGE is in the process of obtaining authority to do business in Florida.**

6. Name under which the applicant will do business (d/b/a): **Pacific Gateway Exchange, Inc. ("PGE").**

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

Fictitious name registration number: **Not applicable.**

8. If applicant is an individual, partnership, or joint venture, please give name, title and address of each legal entity. **Not applicable.**

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

None of PGE's officers, directors, nor any of its ten largest stockholders, have previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime; nor are any such proceedings pending.

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

Ongoing liaison: Gail E. Granton, Vice President, Pacific Gateway Exchange, Inc., 533 Airport Boulevard, Suite 505, Burlingame, California 94010; Tel: (415) 375-6710; Fax: (415) 375-6799.

Liaison for Application: Margaret M. Charles, Esq., Dalhi N. Myers, Esq. Swidler & Berlin, Chartered, 3000 K Street, Suite 300, Washington, D.C. 20007-5116 Tel: (202) 945-7500; Fax: (202) 424-7647; Internet Address: DNMyers@Swidlaw.com.

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

PGE is authorized to provide resold interexchange service in California and is currently applying for authority to provide resold local exchange service within that

state. PGE also is applying for authority to provide resold interexchange and local exchange service in Arizona, Colorado, Connecticut, Delaware, Florida, Georgia, Maryland, Massachusetts, Michigan, Nevada, New Jersey, New York, Oklahoma, Oregon, Pennsylvania, Texas, Utah, Virginia, and Washington.

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

    No.

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

    No.

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

    PGE can be reached for customer complaints at 1-800-746-6743.

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

    A. Financial capability. **See Exhibit 1.**

    Regarding the showing of financial capability, the following applies:

    The application should contain the applicant's financial statements, including:

    1. the balance sheet

    2. income statement

    3. statement of retained earnings for the most recent 3 years.

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

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

B. Managerial capability. **See Exhibit 2.**

C. Technical capability. **See Exhibit 3.**

AFFIDAVIT

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

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

Official: Gail Granton
Signature

12/16/96
Date

Title: Executive Vice President

(415) 375-6710
Telephone Number

Address: Pacific Gateway Exchange, Inc.
533 Airport Boulevard, Suite 505
Burlingame, California 94010

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

EXHIBITS

EXHIBIT 1	**Financial Statements for PGE**
EXHIBIT 2	**Managerial Capability**
EXHIBIT 3	**Technical Capability**
EXHIBIT 4	**Verification**

EXHIBIT 1

Financial Statements for PGE

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
Pacific Gateway Exchange, Inc.:

We have audited the accompanying balance sheets of Pacific Gateway Exchange, Inc., as of December 31, 1994 and 1995, and the related statements of operations, cash flows, and changes in stockholders' equity for each of the three years in the period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Gateway Exchange, Inc., as of December 31, 1994 and 1995, and the results of their operations and cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

San Francisco, California
May 13, 1996

PACIFIC GATEWAY EXCHANGE, INC.

BALANCE SHEETS

ASSETS

	December 31, 1994	December 31, 1995	March 31, 1996 (Unaudited)
Current Assets:			
Cash and cash equivalents	$ 9,485	$ 1,792,202	$ 3,690,607
Accounts receivable, net of allowance for doubtful accounts of $137,038 in 1994, $824,337 in 1995 and $959,337 in 1996	4,683,257	12,804,008	18,992,096
Accounts receivable, related party	2,203,000	3,261,849	2,788,956
Advances receivable, related party	—	175,000	—
Income tax recoverable	54,868	—	—
Total current assets	6,950,610	18,033,059	25,471,659
Property and equipment:			
Undersea fiber optic cables	2,698,050	5,825,684	8,616,120
Long distance communications equipment	2,398,467	6,092,410	7,355,075
Office furniture and equipment	337,195	748,530	816,517
	5,433,712	12,666,624	16,787,712
Less accumulated depreciation	532,180	1,656,170	2,040,957
Total property and equipment, net	4,901,532	11,010,454	14,746,755
Notes receivable	223,834	149,669	148,865
Deferred income tax	53,309	148,247	177,743
Deposits and other assets	171,334	414,317	577,493
Total assets	$12,300,619	$29,755,746	$41,122,515

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31, 1994	December 31, 1995	March 31, 1996 (Unaudited)
Current Liabilities:			
Accounts payable	$ 6,636,730	$19,418,595	$27,837,134
Accrued liabilities	71,875	772,256	718,980
Income taxes payable	—	735,218	254,714
Revolving line of credit	—	3,000,000	3,000,000
Other liabilities	—	518,758	633,864
Total current liabilities	6,708,605	24,444,827	32,444,692
Revolving line of credit, related party	4,487,724	2,420,339	5,420,339
Total liabilities	11,196,329	26,865,166	37,865,031
Commitments and Contingencies (Note 9)			
Stockholders' Equity:			
Preferred stock, $.0001 par value, authorized 1,000,000 shares	—	—	—
Common stock, $.0001 par value, authorized 25,000,000 shares, issued and outstanding 14,100,000 shares	1,410	1,410	1,410
Additional paid-in capital	940,324	940,324	940,324
Retained earnings	162,556	1,948,846	2,315,750
Total stockholders' equity	1,104,290	2,890,580	3,257,484
Total liabilities and stockholders' equity	$12,300,619	$29,755,746	$41,122,515

See Accompanying Notes to Financial Statements.

PACIFIC GATEWAY EXCHANGE, INC.

STATEMENTS OF OPERATIONS

	Year Ended December 31,			Three Months Ended March 31,	
	1993	1994	1995	1995 (Unaudited)	1996 (Unaudited)
Revenues	$1,817,484	$11,702,041	$59,250,454	$ 8,364,265	$27,480,056
Revenues — related party	3,231,000	9,211,000	17,165,995	3,760,598	4,759,701
Total revenues	5,048,484	20,913,041	76,416,449	12,124,863	32,239,757
Cost of long distance services	4,035,847	17,195,516	66,346,356	10,041,528	29,130,061
Gross margin	1,012,637	3,717,525	10,070,093	2,083,335	3,109,696
Selling, general and administrative expenses	1,007,832	2,273,430	5,466,831	992,338	1,955,996
Depreciation	104,241	410,115	1,123,990	188,812	384,787
Total operating expenses	1,112,073	2,683,545	6,590,821	1,181,150	2,340,783
Operating income (loss)	(99,436)	1,033,980	3,479,272	902,185	768,913
Interest expense	11,891	192,979	537,982	110,773	152,009
Income (loss) before income taxes	(111,327)	841,001	2,941,290	791,412	616,904
Provision for income taxes	—	205,000	1,155,000	311,000	250,000
Net income (loss)	$ (111,327)	$ 636,001	$ 1,786,290	$ 480,412	$ 366,904
Net income (loss) per share	$ (0.01)	$ 0.04	$ 0.12	$ 0.03	$ 0.03
Weighted average number of common shares outstanding	14,300,000	14,300,000	14,300,000	14,300,000	14,300,000

See Accompanying Notes to Financial Statements.

PACIFIC GATEWAY EXCHANGE, INC.

STATEMENTS OF CASH FLOWS

	Year Ended December 31, 1993	Year Ended December 31, 1994	Year Ended December 31, 1995	Three Months Ended March 31, 1995 (Unaudited)	Three Months Ended March 31, 1996 (Unaudited)
Operating Activities:					
Net income (loss)	$ (111,327)	$ 636,001	$ 1,786,290	$ 480,412	$ 366,904
Adjustments to net income (loss):					
Depreciation	104,241	410,115	1,123,990	188,812	384,787
Change in provision for losses on bad debts	20,000	117,038	687,299	141,910	135,000
Provision for deferred income taxes	—	(53,309)	(94,938)	—	(29,496)
Change in accounts receivable	(505,588)	(3,978,408)	(9,510,050)	(5,317,295)	(6,323,088)
Change in accounts receivable, related party	(1,195,000)	(1,008,000)	(1,058,849)	(485,999)	472,893
Change in notes and advances receivable	(14,333)	195,172	(100,835)	—	175,804
Change in deposits and other assets	(55,907)	(106,407)	(242,983)	(4,099)	(163,176)
Change in accounts payable	2,516,204	3,692,828	12,781,865	5,712,915	8,418,539
Change in accrued liabilities	—	71,875	700,381	(8,375)	(53,276)
Change in other liabilities	—	—	518,758	34,761	115,106
Change in federal income taxes (recoverable) payable	—	(54,868)	790,086	120,001	(480,504)
Net cash provided by (used in) operating activities	758,290	(77,963)	7,381,014	863,043	3,019,493
Investing Activities:					
Purchase of property and equipment	(1,542,493)	(3,744,965)	(7,232,912)	(241,603)	(4,121,088)
Sale of stock (accepted as payment for accounts receivable) to related party	—	—	702,000	—	—
Net cash (used in) investing activities	(1,542,493)	(3,744,965)	(6,530,912)	(241,603)	(4,121,088)
Financing Activities:					
Borrowings on revolving lines of credit	717,919	3,929,308	4,000,000	—	3,000,000
Repayments on revolving lines of credit	—	(159,503)	(3,067,385)	—	—
Net cash provided by financing activities	717,919	3,769,805	932,615	—	3,000,000
Net increase (decrease) in cash	(66,284)	(53,123)	1,782,717	621,440	1,898,405
Cash at the beginning of the period	128,892	62,608	9,485	9,485	1,792,202
Cash at the end of the period	$ 62,608	$ 9,485	$ 1,792,202	$ 630,925	$ 3,690,607
Supplemental disclosure of cash flow information:					
Interest paid during the period	$ —	$ 102,810	$ 576,250	$ 76,012	$ 137,527
Income taxes paid during the period	$ —	$ 313,376	$ 682,999	$ —	$ 760,000
Non-Cash Activities:					
Stocks accepted as payment for accounts receivable	$ —	$ —	$ 702,000	$ —	$ —

See Accompanying Notes to Financial Statements

PACIFIC GATEWAY EXCHANGE, INC.

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Stock Committed To Be Issued	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings (Deficit)	Total
Balance January 1, 1993	$ 850,000	3,980	$ 40	$ 91,694	$ (362,118)	$ 579,616
Net loss	—	—	—	—	(111,327)	(111,327)
Balance December 31, 1993	850,000	3,980	40	91,694	(473,445)	468,289
Issuance of Common Stock	(850,000)	11,020	110	849,890	—	—
Net income	—	—	—	—	636,001	636,001
Balance December 31, 1994	—	15,000	150	941,584	162,556	1,104,290
940 to 1 stock split	—	14,085,000	1,260	(1,260)	—	—
Net income	—	—	—	—	1,786,290	1,786,290
Balance December 31, 1995	—	14,100,000	1,410	940,324	1,948,846	2,890,580
Net income (unaudited)	—	—	—	—	366,904	366,904
Balance March 31, 1996 (unaudited)	$ —	14,100,000	$1,410	$940,324	$2,315,750	$3,257,484

See Accompanying Notes to Financial Statements

PACIFIC GATEWAY EXCHANGE, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited with respect to the periods ended March 31, 1995 and 1996)

(1) The Company and Significant Accounting Policies

Description of Business and Organization:

Pacific Gateway Exchange, Inc. ("Pacific Gateway" or the "Company"), a Delaware corporation, owns and operates an international switched and domestic switched telecommunications network. The operations of Pacific Gateway have grown significantly as the result of entering into additional operating agreements with foreign partners and marketing to certain long distance companies in the United States which do not have their own international network.

For the periods ended March 31, 1995 and 1996, the Company believes that the financial statements include all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position and results of operations.

Cash and Cash Equivalents:

Cash equivalents consist primarily of money market accounts which are available on demand. The carrying amount reported in the accompanying balance sheet approximates fair value.

Fair Value of Financial Instruments:

The carrying amounts for accounts receivable and accounts payable approximate their fair value. The revolving lines of credit have an interest rate which varies with the prime rate and approximates the current interest rate for similar financial instruments. Therefore, the recorded amount of the revolving lines of credit approximates fair value.

Property and Equipment:

Property and equipment are stated at cost. Depreciation is provided for financial reporting purposes using the straight line method over the following estimated useful lives:

Undersea fiber optic cables	20 years
Long distance communications equipment	5-7 years
Office furniture and equipment	4-7 years

Maintenance and repairs are expensed as incurred. Replacements and betterments are capitalized. The cost and related accumulated depreciation of assets sold or retired are removed from the account balance, and any resulting gain or loss is reflected in results of operations.

Concentration of Credit Risk:

Financial instruments that potentially subject the Company to concentration of credit risk are accounts receivable. Seven of the Company's customers account for approximately 55% and 49% of gross accounts receivable as of December 31, 1995 and March 31, 1996, respectively. The Company performs ongoing credit evaluations of its customers but generally does not require collateral to support customer receivables. The Company's allowance for doubtful accounts is based on current market conditions. Losses on uncollectible accounts have consistently been within management's expectations.

Income Taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." SFAS 109 has as its basic objective the recognition of current and deferred income tax assets and liabilities based upon all events that have been recognized in the financial statements as measured by the provisions of the enacted tax laws.

Valuation allowances are established when necessary to reduce deferred tax assets to the estimated amount to be realized. Income tax expense represents the tax payable for the current period and the change during the period in the deferred tax assets and liabilities.

Revenue Recognition:

Revenues for telecommunication services provided to customers are recognized as services are rendered. Revenues for return traffic received according to the terms of the Company's operating agreements with its foreign partners are recognized as revenue as the return traffic is received.

Earnings Per Share:

Earnings per share are calculated based on the weighted average number of shares outstanding during the period plus the dilutive effect of stock committed to be issued and stock options determined using the treasury stock method. The earnings per share calculation has been adjusted for all periods presented to reflect the 940 to 1 stock split effected October 20, 1995. Additionally, this calculation treats stock options granted on September 30, 1995 as if they were common stock equivalents for all periods presented. See Notes 7 and 10.

Estimates in Financial Statements:

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

(2) Accounting for International Long Distance Traffic

The Company has entered into operating agreements with 25 telecommunications carriers in 19 foreign countries under which international long distance traffic is both delivered and received. Under these agreements, the foreign carriers are contractually obligated to adhere to the policy of the Federal Communications Commission (the "FCC"), whereby traffic from the foreign country is routed to international carriers, such as the Company, in the same proportion as traffic carried into the country. Mutually exchanged traffic between the Company and foreign carriers is settled through a formal settlement policy that generally extends over a six-month period at an agreed upon rate. The Company records the amount due to the foreign partner as an expense in the period the traffic is delivered. Of the 25 operating agreements the Company had at March 31, 1996, 10 agreements provided that the Company generally must wait up to six months before it actually receives the proportional return traffic. For these agreements, the Company recognizes a loss in the period in which it sells to a customer because the amount due to the foreign partner generally exceeds the amount the Company charges its customers. However, when the return traffic is received in the future period, the Company generally realizes a gross margin on the return traffic that, when combined with the prior period loss on the outbound traffic, results in a gross profit on the total transaction. Although the Company can reasonably estimate the revenue it will receive under the FCC's proportional share policy, there is no guarantee that there will be traffic delivered back to the United States or what impact changes in future settlement rates will have on net payments made and revenue received.

For the 10 agreements which provide for delayed return traffic, the Company had previously deferred a portion of the costs associated with the outbound call until the receipt of the proportional return traffic. The Company has restated its financial statements to adopt the accounting method described above. The impact of this restatement was to reduce income before income taxes, net income and income per share by $5,697,130, $3,473,431 and $0.25 in 1995 and $348,762, $211,282, and $0.02 in 1994, respectively.

(3) Income Taxes

The provision for income taxes is comprised of the following:

	Year Ended December 31,			Three Months Ended March 31,	
	1993	1994	1995	1995 (Unaudited)	1996 (Unaudited)
Current	—	$258,309	$1,249,938	$328,770	$279,496
Deferred	—	(53,309)	(94,938)	(17,770)	(29,496)
	—	$205,000	$1,155,000	$311,000	$250,000

The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate as follows:

	Year Ended December 31,			Three Months Ended March 31,	
	1993	1994	1995	1995 (Unaudited)	1996 (Unaudited)
Expected statutory amount	—	34.0%	34.0%	34.0%	34.0%
Release of valuation allowance	—	(15.1%)	—	—	—
State income taxes, net of federal benefit	—	5.5%	5.3%	5.3%	5.3%
Other	—	—	—	—	1.2%
	— %	24.4%	39.3%	39.3%	40.5%

As a result of operating losses in 1992 and 1993 and the fact that the Company had a limited operating history, a valuation allowance equal to the deferred tax asset was recorded at December 31, 1993 which resulted in no tax benefit being realized for the period. The Company was profitable for the first time in 1994 which allowed it to release the previously recorded deferred tax asset valuation allowance.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes and the impact of available net operating loss carryforwards.

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

	December 31,		March 31,
	1994	1995	1996 (Unaudited)
Deferred tax assets:			
Allowance for doubtful accounts	$ 54,040	$ 325,613	$ 378,938
Net operating loss carry forwards	61,412	42,185	35,805
Total gross deferred tax assets	115,452	367,798	414,743
Deferred tax liabilities:			
Depreciation	62,143	219,551	237,000
Net deferred tax (assets)	$(53,309)	$(148,247)	$(177,743)

At March 31, 1996, the Company has net operating loss carryforwards of approximately $80,000 which may be applied against future taxable income and which expire in 2008.

(4) Revolving Lines of Credit

At March 31, 1996, the Company had a $9,000,000 revolving line of credit with Ronald L. Jensen, a principal stockholder of the Company, having a maturity date that is the earlier of December 31, 1998, the closing of a public offering, or the date of a change in ownership of 50% of the outstanding common stock of the Company. Interest is payable monthly at prime (8.5% at March 31, 1996, 8.75% at December 31, 1995 and 9.0% at December 31, 1994) plus 2%. There was $3,579,661 available to be borrowed against the line of credit at March 31, 1996. The line of credit is collateralized by all the tangible and intangible assets of the Company other than accounts receivable and the terms prohibit the Company from disposing of any of such assets other than in the ordinary course of business. The amount outstanding under this line, which is subordinated to the amount due the commercial lender, was $4,487,724, $2,420,339 and $5,420,339 at December 31, 1994, December 31, 1995 and March 31, 1996, respectively.

In 1995, the Company entered into an additional revolving line of credit with a commercial lender under which it may borrow the lesser of $3,000,000 or 70% of certain of the Company's accounts receivable. The revolving credit facility is collateralized by all of the Company's accounts receivable and contains covenants with respect to, among other things, the profitability and current ratio of the Company and restrictions on the payment of dividends. Interest is payable monthly at the lender's prime rate plus .875%. The amount outstanding under this line was $3,000,000 at March 31, 1996. The line expires on September 30, 1996.

(5) Related Party Transactions

The Company provides certain domestic and international switched telecommunication services to Matrix Telecom, Inc. ("Matrix"), which is a switchless reseller. Ronald L. Jensen and his five adult children, as a group, own a controlling interest in Matrix and also own a significant, but not controlling interest in the Company. Revenues recorded from providing these services were $3,231,000, $9,211,000, and $17,165,995 for the years ended December 31, 1993, 1994, and 1995, respectively and $3,760,598 and $4,759,701 for the three months ended March 31, 1995 and 1996, respectively. Matrix also provided certain data processing services to the Company for which the Company incurred expenses of $35,000 and $166,000 in 1994 and 1995, respectively and $15,000 and $66,000 for the three months ended March 31, 1995 and 1996, respectively. The amount receivable from Matrix was $2,203,000, and $3,261,849 at December 31, 1994 and 1995, respectively and $2,788,956 at March 31, 1996.

In February 1995, the Company accepted certain shares of common stock, with a fair market value of approximately $702,000, of a customer as payment for accounts receivable totaling $702,000. The Company then sold this stock to Ronald L. Jensen for $702,000. Mr. Jensen subsequently sold the stock over a period of several months for a total of $730,000.

At December 31, 1995, the Company had advances receivable from the officers of the Company totaling $175,000. These advances were due on demand and were repaid in the first quarter of 1996.

PACIFIC GATEWAY EXCHANGE, INC.

NOTES TO FINANCIAL STATEMENTS — (Continued)
(Unaudited with respect to the periods ended March 31, 1995 and 1996)

(6) Segment Data

The Company classifies its operations into one industry segment, telecommunications services. Export sales were $694,000, $4,572,000, and $17,619,000 for the years ended December 31, 1993, 1994, and 1995, respectively and $2,815,000 and $8,836,000 for the three months ended March 31, 1995 and 1996, respectively. Export sales by geographic area were as follows:

	Year Ended December 31,			Three Months Ended March 31,	
	1993	1994	1995	1995 (Unaudited)	1996 (Unaudited)
Pacific Rim	$664,000	$2,908,000	$10,066,000	$1,666,000	$4,054,000
Europe	—	812,000	4,798,000	578,000	3,132,000
Canada	30,000	852,000	2,418,000	571,000	1,245,000
Other	—	—	337,000	—	405,000
	$694,000	$4,572,000	$17,619,000	$2,815,000	$8,836,000

To date, the Company's international operating agreements have been with entities operating in countries where management does not expect political or economic forces to cause disruption in telecommunications traffic to or from these countries.

The Company sells to the long distance companies in the United States which do not have their own international network and to its foreign partners. At March 31, 1996, the Company had 25 operating agreements and approximately 57 United States customers. Because it has a small number of large customers, 10% or more of the Company's revenues have been derived from the following customers.

	Year Ended December 31,			Three Months Ended March 31,	
	1993	1994	1995	1995 (Unaudited)	1996 (Unaudited)
Matrix Telecom, Inc. (see Note 5)	$3,231,000	$9,211,000	$17,165,995	$3,760,598	$4,759,701
Lightcom International, Inc.	600,000	(A)	(A)	(A)	(A)
Wiltel, Inc.	(A)	2,599,000	(A)	(A)	(A)
Optus Communications Pty Limited	(A)	2,209,000	(A)	(A)	(A)

(A) Sales were less than 10% of total revenues.

(7) Stock Option Plan

On September 30, 1995, the Company adopted a stock option plan. The plan provides for the granting of nonqualified and incentive stock options to purchase up to 1,200,000 shares of common stock. Options granted become exercisable over vesting periods of generally four years at exercise prices not less than the fair market value of the stock at the date of grant and generally must be exercised within five years. On September 30, 1995, options to purchase 509,170 shares were granted at an exercise price of $8.50 per share which the Board of Directors determined to be the fair market value of the stock at that time. The earnings per share calculation treats these options as if they were common stock equivalents for the periods presented, using the treasury stock method. In 1996, options to purchase 30,000 shares were granted at an exercise price of $11.50 per share.

(8) Employee Benefit Plans

In September 1995, the Company established an Employee Stock Purchase Plan (the "Purchase Plan") which is meant to qualify under section 423 of the Internal Revenue Code. The Purchase Plan will become effective immediately upon the successful completion of a public offering of the Company's common stock. Under the Purchase Plan, the Company reserved up to 400,000 shares of common stock for purchase by employees who meet certain eligibility requirements. Eligible employees may contribute up to 10% of their compensation to the Purchase Plan to purchase shares at 85% of the fair market value of the stock on the first or the last day of each six-month offering period as defined in the Purchase Plan.

(9) Commitments and Contingencies

Litigation

The Company is not currently subject to any legal proceedings that will have a material impact on the Company's financial position or results of operations.

Leases

The Company leases office space and equipment under noncancelable operating leases. Rental expenses for 1993, 1994, and 1995 was $52,000, $92,000, and $142,000, respectively and $38,000 and $30,000 for the three months ended March 31, 1995 and 1996, respectively. Future minimum lease payments under these leases as of March 31, 1996 are as follows:

1996	$126,000
1997	92,000
1998	15,000
Total minimum lease payments	$233,000

Employment Agreements

The Company has entered into employment agreements with each of Howard Neckowitz, President, Chief Executive Officer and Chairman of the Board, Gail Granton, Chief Financial Officer, Executive Vice President, International Business Development and Secretary, Ronald Anderson, Vice President, Operations and Engineering and Robert Craver, Senior Vice President, International Relations. The agreement with Mr. Neckowitz is for a term of four years, the agreements with Ms. Granton and Mr. Anderson are for a term of three years and the agreement with Mr. Craver is for a term of two years. The agreements provide for severance payments in an amount equal to base salary to the end of the term or, if greater, two years of base salary for Mr. Neckowitz and one year of base salary for Ms. Granton, Mr. Anderson and Mr. Craver in the event of termination without cause or termination following a change of control of the Company. In the event of a change of control, each of such employees would be entitled to severance following his or her resignation from the Company resulting from diminution of his or her duties. Should such an event occur, the Company's obligation for severance could range from $1,020,000 to $2,145,000. Upon any such payment of severance, the officer would also receive full vesting of any outstanding stock options.

Commitments

At March 31, 1996 the Company had outstanding commitments of $860,000 for the acquisition of additional ownership interests in digital undersea fiber optic cables.

(10) Capital Stock

In 1992, the Company entered into an agreement whereby it received $850,000 in cash and agreed to issue stock of the Company representing approximately 73% of the Company. In 1994, the Company issued 11,020 (pre-split) shares of its common stock to fulfill its commitment under this agreement. The earnings per share calculation treats these shares as common stock equivalents prior to the issuance of the shares for all periods presented.

On September 30, 1995, the Company's Board of Directors authorized management to file a registration statement with the Securities and Exchange Commission to permit the Company to sell shares of its common stock to the public. On September 30, 1995, the Company's Board of Directors authorized an amendment to the Certificate of Incorporation which was approved by the shareholders on the same date. The amendment effected a 940 to 1 split of the Company's Common Stock and adjusted the authorized shares to 25,000,000 shares of common stock, $.0001 par value per share, and 1,000,000 shares of Preferred Stock, $.0001 par value per share. The 940 to 1 split was effective October 20, 1995. The rights, preferences and limitations of the Preferred Stock may be designated by the Company's Board of Directors at any time.

(11) New Accounting Pronouncements

The Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 121, "*Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*," which is effective for fiscal years beginning after December 15, 1995. The Company adopted the standard on January 1, 1996 which did not have a material impact on its financial statements.

In October, 1995, the FASB issued SFAS No. 123, "*Accounting for Stock-Based Compensation*," which is effective for fiscal years beginning after December 31, 1995. SFAS 123 encourages entities to adopt a fair value based method of accounting for employee stock compensation plans; however, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting. Under the intrinsic value based method, companies do not recognize compensation cost for many of their stock compensation plans. Under the fair value based method, companies would recognize compensation costs for those same plans. The Company elects to continue to use the intrinsic value based method, and therefore does not expect the impact on its financial statements, if any, to be material.

EXHIBIT 2

Managerial Capability

PACIFIC GATEWAY EXCHANGE, INC.

Key Members of Management

Mr. Howard A. Neckowitz has served as President, Chief Executive Officer and Chairman of the Board of the Company since its inception in August 1991. Mr. Neckowitz previously served as a consultant to major U.S. and overseas telecommunications companies with respect to valuation and due diligence processes for the acquisition of ongoing foreign telecommunications operations and the start up of competitive carrier operations for international, long distance, local and cellular operations in various countries. Prior to his consulting experience, Mr. Neckowitz served from 1982 to 1986 as Director, International Services, at GTE Sprint, where he founded and developed GTE Sprint's international services operation. In this position, he was responsible for feasibility analyses supporting GTE Sprint's entrance into the international switched service market. From 1977 to 1982, Mr. Neckowitz worked at AT&T Corporation in its Overseas Department. Mr. Neckowitz serves as Chairman of the Board of Matrix Telecom, Inc. and as a director of Cam-Net Telecommunications, Inc., a provider of domestic telecommunication services in Canada, both of which are customers of the Company.

Ms. Gail E. Granton has served as Chief Financial Officer, Executive Vice President, International Business Development, Secretary and a member of the Board of Directors of the Company since its inception in August 1991. From 1986 to August 1991, Ms. Granton served as a consultant to major U.S. and overseas telecommunications companies, focusing on the valuation and due diligence process for the acquisition of ongoing foreign telecommunication operations and the start-up of competitive carrier operations for international, long distance, local and cellular operations in various countries. From 1982 to 1986, Ms. Granton worked in the International Department of GTE Sprint, as a Manager, International Business Development, reporting to Mr. Neckowitz.

Ms. Katherine A Chapman has served as Director, Customer Programs for the Company since April 1995. From 1989 to April 1995, Ms. Chapman served as Account Manager, Carrier Sales for Cable & Wireless of North America. While at Cable & Wireless, Ms. Chapman had various responsibilities including sales, marketing, and customer support for commercial customers, managing and maintaining a wholesale customer base, and developing the marketing strategy for dedicated access customers. Ms. Chapman has seven years of experience in the telecommunications industry.

Mr. Robert F. Craver has served as Vice President, International Relations of the Company since February 1994. Prior to joining the Company, Mr. Craver worked at GTE Hawaiian Telephone Co., Inc. from 1987 to 1994. While at GTE Hawaiian Telephone, Mr. Craver directed that company's international program as Director of International Services. Mr. Craver has also held international positions at Sprint and AT&T, for a total of more than 20 years of experience in the international telecommunications industry. Mr. Craver has extensive experience in international negotiations with foreign partners and has served as an officer of the Pacific Telecommunications Council.

Ms. Karen D. Martin has served as Controller of the Company since October 1995. From 1982 to 1995, Ms. Martin served as Tax Manager with Tab Products Co., an office products company. Ms. Martin is a member of the California Society of CPAs and the American Institute of Certified Public Accountants.

Ms. Joyce M. Raymond joined the Company in December 1992 as Vice President, Carrier Marketing, to develop a U.S. carrier marketing program for the Company. Prior to joining the Company, Ms. Raymond was Director, Carrier Services, at West Coast Communications, where she was responsible for carrier marketing from 1992 to 1993. Ms. Raymond was also Director, Carrier Services at Com System, Inc., a domestic long distance telecommunications company, where she was responsible for developing the carrier marketing program from 1982 to 1992. Ms. Raymond has more than 11 years of experience in the telecommunications industry.

EXHIBIT 3

Technical Capability

PGE is technically and managerially qualified to provide local exchange resale services within Florida. PGE is authorized to provide resold long distance telecommunications services on an intrastate basis in California pursuant to certification, registration, or (where appropriate) on a deregulated basis. The successful provision of telecommunications services throughout this state is proof in the first instance of PGE's technical qualifications.

EXHIBIT 4

Verification

VERIFICATION

I, Gail Granton, declare under penalty of perjury that I am Vice President and Counsel of Pacific Gateway Exchange, the Applicant in the subject proceeding; that I have read the foregoing Application and exhibits; and that the same are true and correct to the best of my knowledge, information, or belief. I have not previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime; nor are any such proceedings pending.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 16th day of December, 1996.

Gail Granton

Gail Granton, Vice President and Counsel

Sworn and Subscribed to before me
this 16th day of December, 1996.

Notary Public

My Commission Expires: Jan. 18, 2000

JULIE PHANICHKARN
Commission # 1083534
Notary Public — California
San Mateo County
My Comm Expires Jan 18, 2000