

**LCI International®**  
**Worldwide Telecommunications**

February 14, 1996

VIA OVERNIGHT DELIVERY

Mr. Rick Moses  
Division of Communications  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399-0866

DEPOSIT TREAS REC DATE  
D267 FEB 16 1996

960187-TX

RE: Application for Alternative Local Exchange Service Authority

Dear Mr. Moses:

Enclosed for filing please find an original and six (6) copies of the Application for Alternative Local Exchange Service Authority of LCI International Telecom Corp. Also enclosed is a check in the amount \$250.00 as payment of the application fee for this filing.

I have enclosed a duplicate of this letter. Please date-stamp the duplicate and return it to me in the enclosed self-addressed stamped envelope.

Should you have any questions regarding this matter, please contact me at (703) 848-4466.

Sincerely,

  
Scott McMahon  
Regulatory Attorney

Enclosures

# LCI International<sup>®</sup>

Worldwide Telecommunications

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Sincerely,

*Scott McMahon*  
Scott McMahon  
Regulatory Attorney

Enclosures

SCOTT M. McMAHON  
(703) 917-0796  
7600 Tremayne Place, No. 107  
McLean, Va 22102

825

2/14/96

Pay to the order of FLORIDA PUBLIC SVC. COMM. \$250.00

~~FIVE HUNDRED AND FIFTY 2/00/00~~

Washington telephone  
Federal credit union  
111 University Boulevard West  
Washington, MD 20895

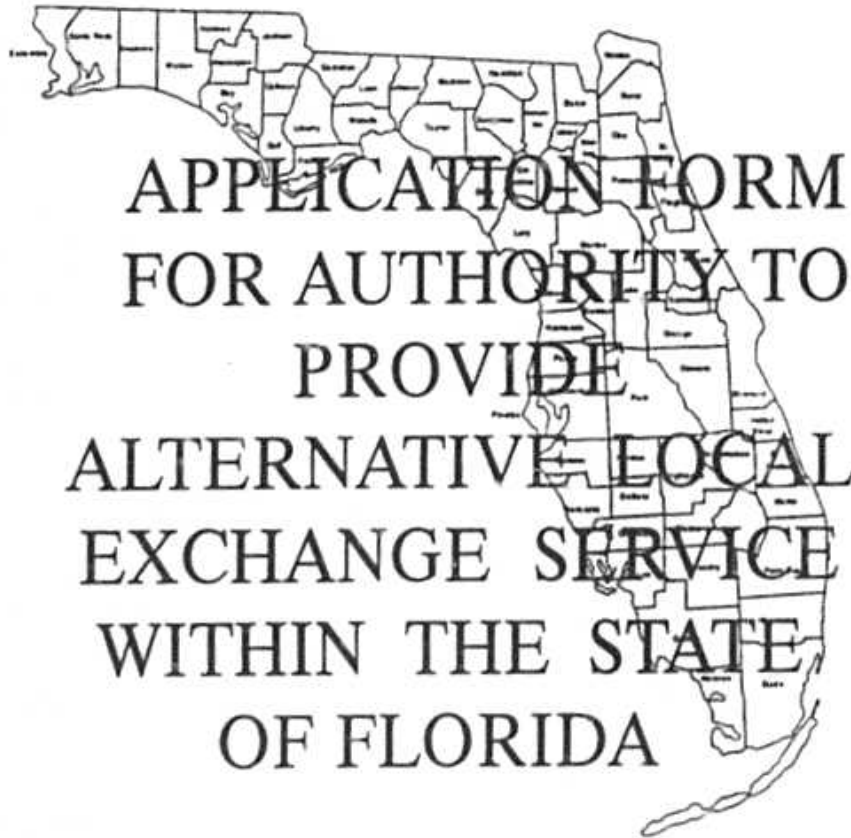
LCI APPLICATION

DOCUMENT NUMBER-DATE  
01843 FEB 16 96  
FPSC-RECORDS/REPORTING

960187-TX

APPLICANT: LCI INTERNATIONAL TELECOM CORP.

DATE: FEBRUARY 13, 1996



DOCUMENT NUMBER-DATE

01813 FEB 16 96

FPSC-RECORDS/REPORTING

Application of LCI International Telecom Corp.  
for  
Authority to Provide Alternative Local Exchange Service  
Within The State of Florida

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 noncertificated company)

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

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

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

2. Name of applicant:

LCI International Telecom Corp. ("LCI" or the "Company")

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

LCI International Telecom Corp.  
6180 Greensboro Drive, Suite 800  
McLean, VA 22102  
(703) 442-0220

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

LCI International Telecom Corp.  
c/o CT Corporation System  
8751 West Broward Blvd.  
Plantation, FL 33324  
Phone: (954) 473-5503

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

Same as stated in immediately preceding response in 3.B.

4. Structure of organization:

- |   |  |
|---|--|
| <input type="checkbox"/> Individual   | <input type="checkbox"/> Corporation           |
| <input checked="" type="checkbox"/> Foreign Corporation<br>(incorporated in DE) | <input type="checkbox"/> Foreign Partnership   |
| <input type="checkbox"/> General Partnership                                    | <input type="checkbox"/> Limited Partnership   |
| <input type="checkbox"/> Joint Venture  | <input type="checkbox"/> Other, Please explain |

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

Corporate charter number: 393A00142481

(Attached hereto as Exhibit A is a copy of documentation indicating that LCI has been granted authority to operate as a Foreign Corporation in Florida.)

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

N/A

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

N/A

Fictitious name registration number: N/A

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

N/A

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.

N/A

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.

Scott McMahon, Regulatory Attorney  
LCI International Telecom Corp.  
8180 Greensboro Drive  
McLean, VA 22101  
Phone: (703) 848-4466  
Fax: (703) 848-4404  
Internet Address: N/A

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

LCI has applied for and been granted local service or alternative local exchange service authority in Illinois, Texas and New York. LCI has applied for, but not yet received, authority to operate as a reseller of local exchange service in Michigan, Maryland and California.

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

LCI has not been denied certification in any state.

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

No penalties have been imposed against LCI in any state.

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

LCI's customer service representatives are available to assist the Company's customers 24 hours per day, seven days per week. Residential customers can contact LCI's Customer Services Department by calling (800) 860-2255; business customers may call (800) 860-1020. Customers wishing to communicate with an LCI customer service representative in writing can write to LCI at:

LCI International  
ATTN: Customer Services  
4650 Lakehurst Court  
Dublin, OH 43017

LCI's customer service representatives are prepared to respond to a broad range of service matters, including consumer inquiries regarding: the types of services offered by the Company and the rates associated with such services; monthly billing statements; problems or concerns pertaining to a customer's current service; and general telecommunications matters.

For purposes of this application, customer service matters may be directed to:

Sherri Ronnebaum  
LCI International  
4650 Lakehurst Court  
Dublin, OH 43017  
(614) 798-6813

15. Please complete and file a tariff in accordance with draft Commission Rule 25-24.830 and rules 25-9.001 through 25-9.010.

Should its application be approved, LCI will file the requisite tariff with the Commission prior to offering service.<sup>1</sup>

---

<sup>1</sup> LCI has discussed this matter with Commission Staff ("Staff") and Staff has advised LCI that, rather than filing its tariff with this application, LCI may file at a later date, so long as the tariff is filed prior to the offering of service.

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

- A. Financial capability.
- B. Managerial capability.
- C. Technical capability.

LCI has been providing interexchange service since 1984. In 1989, this Commission granted LCI authority to operate as a provider of interexchange service. Thus, LCI has previously demonstrated to the Commission that it possesses the requisite technical, financial and managerial capabilities to operate as an interexchange carrier ("IXC"). Since then, LCI has grown substantially, thereby improving upon its already considerable these capabilities.

LCI is not only among the nation's largest interexchange carriers, but it is also one of the fastest growing in the industry. LCI's robust growth is primarily due to its innovative marketing strategies, as developed by the Company's experienced and highly skilled management team. As a result of its unique marketing approach, LCI has achieved substantial increases in traffic volume, as measured in minutes of use ("MOU"). LCI's MOU growth has resulted in substantial revenue growth. In 1994, LCI's gross operating revenue grew over 30 percent, increasing to \$453



million.<sup>2</sup> In conjunction with effective financial and operational measures, LCI's net income has also grown significantly, increasing to over \$17 million in 1994. This strong performance clearly indicates that LCI possesses both the financial and managerial qualifications required to operate as a reseller of local exchange resale service.<sup>3</sup>

LCI has also demonstrated that it possesses the technical capability to provide local service on a resale basis. LCI currently offers a wide range of interexchange services on a statewide basis in Florida. LCI has been providing consistently high quality service to both residential and business customers in Florida for nearly seven years. Further, LCI presently provides this same high quality service to consumers in all 50 states.

LCI's interexchange network is entirely digital. LCI meets or exceeds all federal guidelines regarding service quality. LCI is deploying Signaling System 7 ("SS7") across the United States and anticipates that deployment will exceed 90 percent by the end

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<sup>2</sup> LCI's financial statements for the calendar year 1995 have not yet been released. The Company's 1994 financial statements are attached hereto as Exhibit B.

<sup>3</sup> Detailed information regarding LCI's officers and directors, as well as information pertaining to the strong performance of LCI, and LCI International, Inc. ("LCII"), its corporate parent, is contained in LCII's 1994 Annual Report to Shareholders, 1994 SEC Form 10-K, and 1994 Proxy Statement, attached hereto as C, D and E, respectively. LCI's financials are not externally reported; instead, this information is incorporated into the financials of LCII.

of 1996. As a result of SS7 deployment, interexchange calls are completing within five seconds after dialing is completed.

Moreover, LCI proposes to operate as a reseller of local exchange service. LCI's local traffic will be routed entirely over the networks of its underlying local carriers. Consequently, the quality of service that LCI's local exchange customers receive will be equivalent to that provided by the incumbent LECs.

As the foregoing illustrates, LCI possesses considerable technical, financial and managerial capabilities. The Company has demonstrated its expertise in the provision of interexchange and toll services and in providing the customer service associated with these services. Accordingly, LCI is well-qualified to provide alternative local exchange telecommunications service in Florida.

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.

Official:

Lee M. Weiner  
Signature

2/13/96  
Date

Lee M. Weiner  
Vice President & General Counsel  
LCI International Telecom Corp.  
8180 Greensboro Drive, Suite 800  
McLean, VA 22102  
(703) 848-4446

FILING OF LCI INTERNATIONAL TELECOM CORP. FOR ALTERNATIVE LOCAL  
SERVICE AUTHORITY IN THE STATE OF FLORIDA

LIST OF EXHIBITS

- EXHIBIT A     Documentation indicating that LCI International  
Telecom Corp. ("LCI") has been granted authority  
to operate as a Foreign Corporation in Florida.
- EXHIBIT B     1994 Financial Statements of LCI.
- EXHIBIT C     1994 Annual Report to Shareholders of LCI  
International, Inc. ("LCII").
- EXHIBIT D     1994 SEC Form 10-K of LCII.
- EXHIBIT E     1994 Proxy Statement of LCII.



SEP 26 1993

FLORIDA DEPARTMENT OF STATE

Jim Smith  
Secretary of State

December 20, 1993

C T CORPORATION SYSTEM  
TALLAHASSEE, FL

**LCI International**  
Worldwide Telecommunications  
8180 Greensboro Drive · Suite 800 · McLean, VA · 22102

LOCAL SERVICE APPLICATION  
EXHIBIT A

Re: Document Number P23340

The Amendment to the Application of a Foreign Corporation for LITEL TELECOMMUNICATIONS CORPORATION which changed its name to LCI INTERNATIONAL TELECOM CORP., a Delaware corporation authorized to transact business in Florida, was filed on December 20, 1993.

Should you have any questions regarding this matter, please telephone (904) 487-6050, the Amendment Filing Section.

Kelley Shank  
Corporate Specialist  
Division of Corporation

Letter Number: 393A00142481

Division of Corporations - P.O. BOX 6327 - Tallahassee, Florida 32314

APPLICATION BY FOREIGN CORPORATION TO FILE AMENDMENT TO  
APPLICATION FOR AUTHORIZATION TO TRANSACT BUSINESS IN  
FLORIDA

SECTION I (1-3 must be completed)

1. Litel Telecommunications Corporation  
Name of corporation as it appears within the records of the Department of State.
2. Incorporated under laws of: Delaware
3. Date authorized to do business in Florida: March 9, 1989

SECTION II (4-7 complete only the applicable changes)

4. If the amendment changes the name of the corporation, when was the change effected under the laws of its jurisdiction of incorporation?

August 10, 1993

5. Name of corporation after the amendment, adding suffix "corporation," "company," "incorporated", or appropriate abbreviation, if not contained in new name of the corporation:

LCI INTERNATIONAL TELECOM CORP.

6. If the amendment changes the period of duration, indicate new period of duration

No Change

7. If the amendment changes the jurisdiction of incorporation, indicate new jurisdiction

No Change

J/L

Signature  
Name and Title

James D. Heflinger, Vice President

December 15, 1993  
Date



Florida Department of State, [Redacted], Secretary of State

**APPLICATION BY FOREIGN CORPORATION FOR  
AUTHORIZATION TO TRANSACT BUSINESS IN FLORIDA**

FILED  
1987 MAR -3 11:11:04  
SECRETARY OF STATE  
TALLAHASSEE, FLORIDA

*File Log # P23340*

1. LITEL TELECOMMUNICATIONS CORPORATION  
(Name of corporation adding the word "INCORPORATED" or "CORPORATION" if not so contained in the name at present).
2. Delaware  
(Incorporated Under the Laws of)
3. December 7, 1983  
(Date of Incorporation)
4. Upon qualification  
(Date first transacted business in Florida)
5. 200 Old Wilson Bridge Rd., Worthington, Ohio 43085  
(Address of Principal Office)
6. C T CORPORATION SYSTEM  
(Name of Florida Registered Agent)  
c/o C T CORPORATION SYSTEM, 8751 WEST BROWARD BLVD.  
(Street Address in Florida of Registered Agent)  
PLANTATION FLORIDA 33324  
(City) (State Florida) (Zip Code)
7. To engage in any lawful act or activity for which foreign corporations may engage in this state.  
(Nature of Business to be Transacted in Florida)

**8. NAME OF OFFICERS**

**SPECIFIC ADDRESSES**

- |                                 |     |       |
|---------------------------------|-----|-------|
| <u>(SEE ATTACHED EXHIBIT B)</u> | (P) | _____ |
| _____                           | (V) | _____ |
| _____                           | (S) | _____ |
| _____                           | (T) | _____ |

**NAME OF DIRECTORS**

**SPECIFIC ADDRESSES**

- |                                 |     |       |
|---------------------------------|-----|-------|
| <u>(SEE ATTACHED EXHIBIT A)</u> | (D) | _____ |
| _____                           | (D) | _____ |
| _____                           | (D) | _____ |
| _____                           | (D) | _____ |

9. I am familiar with and accept the obligations provided for in s. 607.325.

Acceptance by the Registered Agent: \_\_\_\_\_

*G. L. Hatfield*  
Agent must sign on this line  
G. L. Hatfield, Assistant Secretary

10. 1,000, Common, No par value  
(Total Authorized Shares (itemized by Class), Par Value of Shares, & without Par Value)

Two officers must sign this application

*[Handwritten Signature]*

Secretary or Assistant Secretary

James D. Heflinger, Assistant Secretary

*[Handwritten Signature]*

President or Vice President

Larry E. Wolfe, Senior Vice President

State of Ohio County of Franklin

The foreign instrument was acknowledged before me this 7<sup>th</sup> day

of March, 19 89, By Larry E. Wolfe  
(Name of Officer)

Senior Vice President of LITEL TELECOMMUNICATIONS CORPORATION  
(Title of Officer) (Name of Corporation)

~~xxxx~~ Delaware Corporation, on behalf of the Corporation.  
(State or Country)

(Seal)

*[Handwritten Signature]*  
Notary Public



KATHLEEN J. MERRILL  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MARCH 16, 1992



LITEL TELECOMMUNICATIONS CORPORATION  
BOARD OF DIRECTORS

<u>Name and Address</u>	<u>Home Address</u>
James T. Bartlett Managing Partner PRIMUS VENTURE PARTNERS 1375 East Ninth Street Suite 2140, Cleveland Ctr. Cleveland, Ohio 44114	22401 McCauley Road Shaker Heights, Ohio 44122
Stephen W. Fillo Managing Director E. M. WARBURG, PINCUS & CO. 466 Lexington Avenue New York, New York 10017-3147	10 West 66th St., Apt. 24F New York, New York 10023
Lawrence A. McLernon Chief Executive Officer LCI COMMUNICATIONS, INC. 200 Old Wilson Bridge Road Worthington, Ohio 43085	3489 Glenalmond Court Dublin, Ohio 43017
Adam Solomon Managing Director E. M. WARBURG, PINCUS & CO. 466 Lexington Avenue New York, New York 10017-3147	19 Kenilworth Drive Short Hills, New Jersey 07078

## LITEL TELECOMMUNICATIONS CORPORATION

## OFFICERS

<u>Name and Address</u>	<u>Home Address</u>
Lawrence A. McLernon Chief Executive Officer LITEL TELECOMMUNICATIONS CORPORATION 200 Old Wilson Bridge Road Worthington, Ohio 43085	3489 Glenalmond Court Dublin, Ohio 43017
Thomas J. Byrnes President and Chief Operating Officer LITEL TELECOMMUNICATIONS CORPORATION 200 Old Wilson Bridge Road Worthington, Ohio 43085	4379 Tuttle Road Dublin, Ohio 43017
Larry E. Wolfe Senior Vice President - Finance and Administration, Chief Financial Officer, Secretary and Treasurer LITEL TELECOMMUNICATIONS CORPORATION 200 Old Wilson Bridge Road Worthington, Ohio 43085	278 Glen Village Court Powell, Ohio 43065
Michael R. McCoy Senior Vice President - Business Development LITEL TELECOMMUNICATIONS CORPORATION 200 Old Wilson Bridge Road Worthington, Ohio 43085	7292 Chaparral Drive Worthington, Ohio 43235
James D. Heflinger Vice President and Assistant Secretary LITEL TELECOMMUNICATIONS CORPORATION 200 Old Wilson Bridge Road Worthington, Ohio 43085	5801 Berkshire Court Dublin, Ohio 43017
Robert H. Rice Assistant Treasurer LITEL TELECOMMUNICATIONS CORPORATION 200 Old Wilson Bridge Road Worthington, Ohio 43085	404 Pittsfield Drive Worthington, Ohio 43085
Patrick S. Miller Assistant Secretary LITEL TELECOMMUNICATIONS CORPORATION 200 Old Wilson Bridge Road Worthington, Ohio 43085	179 Baranof East Westerville, Ohio 43081

**LCI International.**  
**Worldwide Telecommunications**

8180 Greensboro Drive • Suite 800 • McLean, VA • 22102



LOCAL SERVICE APPLICATION  
EXHIBIT E

5

March 30, 1995

Dear Stockholder:

You are cordially invited to attend the annual meeting of stockholders of LCI International, Inc. which will be held at the Hyatt Regency Reston, 1800 Presidents Street, Reston, Virginia, on Tuesday, May 16, 1995, at 10:30 a.m.

The Notice and Proxy Statement on the following pages contain details concerning the business to come before the meeting. Management will report on current operations and there will be an opportunity for discussion concerning the Company and its activities. Please sign and return your proxy card in the enclosed envelope to ensure that your shares will be represented and voted at the meeting if you cannot attend. You are urged to sign and return the enclosed proxy card even if you plan to attend the meeting.

I hope you can make it and look forward to personally meeting you if you can attend.

Sincerely,

H. BRIAN THOMPSON  
*Chairman and Chief Executive Officer*



## LCI INTERNATIONAL, INC.

### NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held May 16, 1995

To the Stockholders of  
LCI INTERNATIONAL, INC.:

NOTICE IS HEREBY GIVEN that the annual meeting of the stockholders (the "Meeting") of LCI International, Inc. (the "Company") will be held at the Hyatt Regency Reston, 1800 Presidents Street, Reston, Virginia, on Tuesday, May 16, 1995, at 10:30 a.m. (local time), with registration beginning at 9:30 a.m., for the following purposes:

1. To elect three directors to serve as Class II directors for a three-year term until the 1998 Annual Meeting of Stockholders.
2. To approve the 1995/1996 LCI International, Inc. Stock Option Plan, the 1995 Executive Incentive Compensation Plan, and the Amended and Restated Employee Stock Purchase Plan.
3. To ratify the selection by the Board of Directors of Arthur Andersen LLP as the independent certified public accountants of the Company.
4. To transact such other business as may properly come before the Meeting.

The Board of Directors has fixed the close of business on March 20, 1995 as the record date for the purpose of determining stockholders entitled to notice of and to vote at the Meeting or any postponement or adjournment thereof.

In order to assure a quorum, it is important that the stockholders who do not expect to attend the Meeting in person complete, sign, date and return the enclosed proxy in the accompanying envelope.

By Order of the Board of Directors,

A handwritten signature in cursive script that reads "James D. Hefflinger".

JAMES D. HEFLINGER  
*Secretary*

McLean, Virginia  
March 30, 1995

# LCI INTERNATIONAL, INC.

8180 Greensboro Drive, Suite 800  
McLean, Virginia 22102

---

## PROXY STATEMENT

---

The enclosed proxy is solicited by the Board of Directors of LCI International, Inc. (the "Company") for use at the 1995 annual meeting of stockholders (the "Meeting") to be held at the Hyatt Regency Reston, 1800 Presidents Street, Reston, Virginia, on Tuesday, May 16, 1995, at 10:30 a.m. (local time), and at any postponement or adjournment thereof. The enclosed proxy, properly executed and received by the Secretary of the Company prior to the Meeting, and not revoked, will be voted in accordance with the directions thereon. If no directions are indicated, the persons named in the proxy solicited by the Board of Directors of the Company intend to vote: (i) for each nominee for election as a director, (ii) for approval of the 1995/1996 LCI International, Inc. Stock Option Plan, the 1995 Executive Incentive Compensation Plan, and the Amended and Restated Employee Stock Purchase Plan, and (iii) for approval of the selection of Arthur Andersen LLP as the independent accountants for the Company for 1995.

If any other matter should be presented at the Meeting upon which a vote properly may be taken, the shares represented by the proxy will be voted with respect thereto at the discretion of the person or persons holding such proxy. Proxies may be revoked by stockholders at any time prior to the voting of the proxy by written notice to the Secretary of the Company, by submitting a new proxy to the Secretary of the Company, or by personal ballot at the Meeting. Attendance at the meeting shall not have the effect of revoking a proxy unless the stockholder so attending shall, in writing, so notify the Secretary of the Meeting at any time prior to the voting of the proxy.

As of the close of business on March 20, 1995, the record date for determining stockholders entitled to vote at the Meeting, the Company had issued and outstanding 29,672,645 shares of its Common Stock (the "Common Shares") and 4,599,800 shares of its 5% Cumulative Convertible Exchangeable Preferred Stock (the "Preferred Shares"). Each Common Share is entitled to one vote at the Meeting. The Preferred Shares are not entitled to vote at the Meeting. The first date on which this proxy statement and the enclosed form of proxy are being sent to the Company's stockholders is on or about March 30, 1995.

Commencing December 29, 1994, the Common Shares and Preferred Shares began trading on the New York Stock Exchange, Inc. ("NYSE"). Through December 28, 1994, the Common Shares and Preferred Shares were traded on the NASDAQ-National Market System ("NASDAQ"). All information in this proxy statement concerning the Common Shares reflects the two-for-one stock split effective July 6, 1994.

### PROPOSAL NUMBER ONE

#### ELECTION OF DIRECTORS

The Board of Directors of the Company presently consists of eight members. At the Meeting, three directors will be elected as Class II directors to hold office for a three-year term until the 1998 annual meeting of stockholders, and until their successors have been elected and qualified. If any nominee shall, prior to the Meeting, become unavailable for election as a director, the persons named in the accompanying form of proxy will vote for such nominee, if any, in their discretion as may be recommended by the Board of Directors, or the Board of Directors may reduce the number of directors to eliminate the vacancy. The presence, in person or by proxy, of a majority of the outstanding Common Shares is required for a quorum for the election of directors at the Meeting, but if a quorum should not be present, the Meeting may be adjourned from time to time until a quorum is obtained.

WP, and serve on the Company's Board of Directors as nominees of Warburg. As such, each of Messrs. Vogelstein and Karp may be deemed to be the beneficial owner (within the meaning of Rule 16a-1 under the Securities Exchange Act of 1934) of an indeterminate portion of the stock of the Company owned by Warburg.

<sup>2</sup> Includes (i) 2,579,278 Common Shares issuable upon the exercise of currently exercisable warrants to purchase Common Shares which warrants are exercisable through April 1, 2000 at an exercise price of \$5.67 per share ("Warrants"), (ii) 161,762 Common Shares issuable pursuant to currently exercisable employee stock options held by Messrs. Thompson, Wynne and Hanno which Warburg has an option to acquire.

<sup>3</sup> On February 13, 1995, FMR Corp. ("FMR") notified the Company by means of a Statement on Schedule 13G that certain of its subsidiaries or voluntary affiliates exercised investment discretion over various investment accounts which as of December 31, 1994, held 2,315,146 shares including 48,684 Common Shares from the assumed conversion of 37,000 Preferred Shares. Fidelity Management & Research Company, a wholly owned subsidiary of FMR, is the beneficial owner of 2,213,080 shares including 13,158 Common Shares from the assumed conversion of 10,000 Preferred Shares. Fidelity Management Trust Company, a wholly owned subsidiary of FMR and a bank, is the beneficial owner of 102,066 shares including 35,526 Common Shares from the assumed conversion of 27,000 Preferred Shares.

<sup>4</sup> Includes shares issuable pursuant to currently exercisable employee stock options which Warburg has an option to acquire.

<sup>5</sup> Includes 26,316 shares issuable upon conversion of Preferred Shares owned by Mr. Thompson or trusts for the benefit of his children.

<sup>6</sup> Includes Common Shares which the directors and executive officers had the right to acquire through the exercise of options as of March 15, 1995 as follows: James T. Bartlett — 8,000; Stephen W. Fillo — 4,000; DuWayne J. Peterson — 8,000; George M. Perrin — 4,000; H. Brian Thompson — 597,539; Thomas J. Wynne — 171,029; Joseph A. Lawrence — 67,167; and Marshall W. Hanno — 73,487. Also includes Common Shares which the executive officers have the right to acquire through the exercise of options within 60 days of March 15, 1995 as follows: H. Brian Thompson — 12,225; Thomas J. Wynne — 6,268; Joseph A. Lawrence — 8,668; and Marshall W. Hanno — 3,113.

<sup>7</sup> Includes 33,170 Common Shares as to which Mr. Bartlett shares voting and investment power with his wife. Primus Capital Fund Limited Partnership ("Primus") and Primus Capital Fund II Limited Partnership ("Primus II") are Ohio limited partnerships engaged in making venture capital and related investments. Primus Management I, an Ohio general partnership, is the general partner of Primus and Primus Management II, an Ohio general partnership, is the general partner of Primus II. Mr. Bartlett is a general partner of Primus Management I and Primus Management II. Primus beneficially owns 39,626 Common Shares and Primus II beneficially owns 34,984 Common Shares issuable upon the exercise of currently exercisable Warrants held by Primus II, all of which shares Mr. Bartlett disclaims beneficial ownership.

<sup>8</sup> Includes or excludes, as the case may be, Common Shares set forth in the preceding footnotes.

### **Executive Compensation and Related Information**

The information below is provided with respect to the compensation of the Chief Executive Officer and the four other executive officers serving in 1994, which would include H. Brian Thompson as the Company's Chairman and Chief Executive Officer, Thomas J. Wynne, President and Chief Operating Officer, Joseph A. Lawrence, Senior Vice President-Finance and Development and Chief Financial Officer, Larry E. Wolfe, Chief Accounting and Administrative Officer, and Marshall W. Hanno, Senior Vice President-Sales. Mr. Wolfe and the Company's wholly-owned subsidiary, LCI International Management Services, Inc. ("LCIM"), agreed to the termination of Mr. Wolfe's employment agreement effective September 16, 1994, and the position of Chief Accounting and Administrative Officer was eliminated at that time.

### **Compensation Committee Report on Executive Compensation**

#### **Organization and Guiding Principles**

The Compensation Committee of the Board of Directors consists of three non-employee directors. The Compensation Committee evaluates and sets the base salaries for the Chief Executive Officer ("CEO"), President and Chief Operating Officer ("COO"), Senior Vice President-Finance and Development and Chief Financial Officer ("CFO"), and the Senior Vice President-Sales ("Senior VP"), and, while the position existed, the Chief Accounting and Administrative Officer ("CAA"). The Compensation Committee also administers the 1994 Executive Incentive Compensation Plan ("Incentive Plan") for all executive officers including the CEO. The members of the Compensation Committee also constitute the committees which administer the Company's stock option plans.

# LCI INTERNATIONAL, INC.

8180 Greensboro Drive, Suite 800  
McLean, Virginia 22102

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## PROXY STATEMENT

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The enclosed proxy is solicited by the Board of Directors of LCI International, Inc. (the "Company") for use at the 1995 annual meeting of stockholders (the "Meeting") to be held at the Hyatt Regency Reston, 1800 Presidents Street, Reston, Virginia, on Tuesday, May 16, 1995, at 10:30 a.m. (local time), and at any postponement or adjournment thereof. The enclosed proxy, properly executed and received by the Secretary of the Company prior to the Meeting, and not revoked, will be voted in accordance with the directions thereon. If no directions are indicated, the persons named in the proxy solicited by the Board of Directors of the Company intend to vote: (i) for each nominee for election as a director, (ii) for approval of the 1995/1996 LCI International, Inc. Stock Option Plan, the 1995 Executive Incentive Compensation Plan, and the Amended and Restated Employee Stock Purchase Plan, and (iii) for approval of the selection of Arthur Andersen LLP as the independent accountants for the Company for 1995.

If any other matter should be presented at the Meeting upon which a vote properly may be taken, the shares represented by the proxy will be voted with respect thereto at the discretion of the person or persons holding such proxy. Proxies may be revoked by stockholders at any time prior to the voting of the proxy by written notice to the Secretary of the Company, by submitting a new proxy to the Secretary of the Company, or by personal ballot at the Meeting. Attendance at the meeting shall not have the effect of revoking a proxy unless the stockholder so attending shall, in writing, so notify the Secretary of the Meeting at any time prior to the voting of the proxy.

As of the close of business on March 20, 1995, the record date for determining stockholders entitled to vote at the Meeting, the Company had issued and outstanding 29,672,645 shares of its Common Stock (the "Common Shares") and 4,599,800 shares of its 5% Cumulative Convertible Exchangeable Preferred Stock (the "Preferred Shares"). Each Common Share is entitled to one vote at the Meeting. The Preferred Shares are not entitled to vote at the Meeting. The first date on which this proxy statement and the enclosed form of proxy are being sent to the Company's stockholders is on or about March 30, 1995.

Commencing December 29, 1994, the Common Shares and Preferred Shares began trading on the New York Stock Exchange, Inc. ("NYSE"). Through December 28, 1994, the Common Shares and Preferred Shares were traded on the NASDAQ-National Market System ("NASDAQ"). All information in this proxy statement concerning the Common Shares reflects the two-for-one stock split effective July 6, 1994.

### PROPOSAL NUMBER ONE

#### ELECTION OF DIRECTORS

The Board of Directors of the Company presently consists of eight members. At the Meeting, three directors will be elected as Class II directors to hold office for a three-year term until the 1998 annual meeting of stockholders, and until their successors have been elected and qualified. If any nominee shall, prior to the Meeting, become unavailable for election as a director, the persons named in the accompanying form of proxy will vote for such nominee, if any, in their discretion as may be recommended by the Board of Directors, or the Board of Directors may reduce the number of directors to eliminate the vacancy. The presence, in person or by proxy, of a majority of the outstanding Common Shares is required for a quorum for the election of directors at the Meeting, but if a quorum should not be present, the Meeting may be adjourned from time to time until a quorum is obtained.

### Information As To Nominees For Election As Class II Directors

The respective ages, positions with the Company, business experience and directorships in other companies of the nominees for election as Class II directors are set forth below, which information has been furnished by such directors to the Company.

*George M. Perrin, 49*, has been Chairman of the Board of Paging Network, Inc. ("PageNet"), a wireless messaging company in the United States, since 1993. From 1981 until 1992, Mr. Perrin served as President and Chief Executive Officer of PageNet. Prior to founding PageNet, Mr. Perrin was the President of Zip-Call, Inc., and held executive positions with Genecom, Inc. and Telocator Network of America. Mr. Perrin has been a director of the Company since July 1994.

*John L. Vogelstein, 60*, is presently Vice Chairman and President of E.M. Warburg, Pincus & Co., Inc. ("Warburg, Pincus") which provides specialized financial advisory and counseling services. Prior thereto, he was an officer and a director of Warburg, Pincus & Co., Inc. and its affiliates for more than five years. Mr. Vogelstein has been a director of the Company since August 1994. Mr. Vogelstein serves on the Board of Directors as a nominee of Warburg, Pincus Capital Company, L.P. ("Warburg"), a principal stockholder of the Company. Mr. Vogelstein is a director of ADVO, Inc., Aegis Group plc, Magma Copper Co., Mattel, Inc., and Value Health, Inc.

*Thomas J. Wynne, 55*, has been President and Chief Operating Officer of the Company's subsidiaries since July 1991 and President and Chief Operating Officer of the Company since April 1993. From 1977 to 1991, Mr. Wynne held several executive positions with MCI Communications Corporation ("MCI"), including President of the West Division, Vice President of Sales and Marketing for the Mid-Atlantic Division, and Vice President for the Midwest Region. Mr. Wynne has been a director of the Company since December 1991.

### Information As To Directors Continuing In Office

The respective ages, positions with the Company, business experience and directorships in other companies of the directors of the Company continuing in office are set forth below, which information has been furnished by such directors to the Company.

*James T. Bartlett, 58*, has been a Managing Director of Primus Venture Partners Inc., a venture capital firm, since April 1986. From August 1983 to March 1986, Mr. Bartlett was President and Chief Operating Officer of Acme-Cleveland Corporation. Mr. Bartlett has been a director of the Company since November 1988. Mr. Bartlett is a director of Keithley Instruments, Inc., Wastequip, Inc. and ITC Corporation.

*Stephen W. Fillo, 57*, has been President of Fillo & Company, Inc., a consulting firm, since January 1, 1991. From January 1991 through December 1993, Mr. Fillo was a consultant to Warburg, Pincus; and from January 1981 through December 1990, Mr. Fillo was a Managing Director of Warburg, Pincus. Formerly, Mr. Fillo was President and General Partner of the Quidnet Venture Capital Funds. Mr. Fillo has been a director of the Company since November 1988.

*H. Brian Thompson, 56*, has been Chairman of the Board of Directors and Chief Executive Officer of the Company and its subsidiaries since July 1991. Mr. Thompson previously served as Executive Vice President of MCI where he was responsible for all eight of MCI's operating divisions and held various other senior management positions from 1981 to 1991. These positions included Executive Vice President responsible for all staff functions, Divisional President and Senior Vice President responsible for strategic development and corporate planning. Mr. Thompson is a director of Microdyne Corporation, STN Incorporated, and Comcast UK Cable Partners Limited.

*Douglas M. Karp, 39*, has been a Managing Director of Warburg, Pincus since May 1991. Prior to joining Warburg, Pincus, Mr. Karp held several positions at Salomon Brothers Inc., including Managing Director from January 1990 through May 1991, Director from January 1989 through December 1989 and Vice President from October 1986 through December 1988. Mr. Karp serves on the Board of Directors as a nominee of Warburg. Mr. Karp has been a director of the Company since February 1993. Mr. Karp is a Director of STN Incorporated.



*DuWayne J. Peterson, 62*, has been President of DuWayne Peterson Associates, a consulting firm, since June 1991. From June 1986 to June 1991, Mr. Peterson was an Executive Vice President, Operations, Systems and Telecommunications at Merrill Lynch & Co., Inc. Prior thereto, Mr. Peterson was an Executive Vice President of Security Pacific Corporation and Chairman and Chief Executive Officer of Security Pacific Automation Company. Mr. Peterson has been a director of the Company since June 1993. Mr. Peterson is a director of Network Equipment Technologies, Inc.

Messrs. Karp and Thompson are classified as Class III directors and were elected for a term that expires at the annual meeting of stockholders in 1996. Messrs. Bartlett, Fillo and Peterson are classified as Class I directors and were elected for a term that expires at the annual meeting of stockholders in 1997. All directors will serve until successors have been duly elected and qualified. Vacancies may be filled by appointment through a majority vote of the remaining directors.

As a result of his prior employment as a Managing Director of Warburg, Pincus, Mr. Fillo currently has a right to a portion of any profits realized by Warburg, Pincus from its investment in the Company. Mr. Fillo has no right, however, to cause the disposition of any shares of stock of the Company beneficially owned by Warburg, Pincus.

Directors shall be elected by a plurality of the votes of the Common Shares represented at the Meeting and entitled to vote on the election of directors. An abstention from voting will be tabulated as a vote withheld in the election, but will be included in computing the number of shares present for purposes of determining the presence of a quorum for the Meeting.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE ELECTION OF THE THREE DIRECTORS NAMED ABOVE. UNLESS INDICATED OTHERWISE ON THE PROXY, THE SHARES WILL BE VOTED FOR THIS PROPOSAL.**

#### **Board Of Directors' Meetings, Committees And Fees**

In 1994, the Board of Directors had Audit and Compensation Committees. The current members of the Audit Committee are Messrs. Perrin and Peterson. The current members of the Compensation Committee are Messrs. Bartlett, Karp and Peterson. The Board of Directors does not have a Nominating Committee.

The Audit Committee recommends to the Board of Directors the engagement of the independent accountants of the Company and reviews with the independent accountants the scope and results of the Company's audits. The Audit Committee meets with management and with the Company's independent accountants to review matters relating to the quality of financial reporting and internal accounting control, including the nature, extent and results of their audits, and otherwise maintains communications between the Company's independent accountants and the Board of Directors. The Audit Committee met four times during 1994.

The Compensation Committee reviews the performance of corporate officers, establishes overall employee compensation policies and recommends to the Board of Directors major compensation programs. The Compensation Committee also reviews and approves salary arrangements and other remuneration for executive officers of the Company and is responsible for review of certain employee benefit plans. The Compensation Committee met seven times during 1994.

The Board of Directors met seven times during 1994. During 1994, each director attended at least 75% of the aggregate of (i) all Board meetings, during the time he was a member of the Board, and (ii) all Committee meetings of which he was a member.

Directors are reimbursed for expenses incurred in attending meetings of the Board of Directors. In addition, directors qualifying as "Outside Directors" are paid \$1,000 for each meeting of the Board of Directors attended in person, \$500 for each Board of Directors meeting participated in by conference call and \$100 for each Board Committee meeting attended in person or participated in by conference call. An Outside Director is a director who is neither (i) an employee of the Company or any of its subsidiaries nor (ii) a person who, through an employment relationship, by ownership of stock or partnership interest, or through contractual relationships, is affiliated with any persons or entities who or which in the aggregate is or are

beneficial owner(s) of 4% or more of any class of the Company's equity securities; provided, however, that Stephen W. Fillo, for as long as he serves as a director of the Company, shall be deemed an Outside Director. Currently, Messrs. Bartlett, Fillo, Perrin, and Peterson qualify as Outside Directors.

Under the Nonqualified Stock Option Plan for Directors (the "Director Option Plan") each Outside Director will be granted an option to purchase 4,000 Common Shares at the time of becoming a director. In addition, after each annual meeting of the stockholders, each Outside Director automatically will be granted an option to purchase 4,000 Common Shares. As of the date of this Proxy Statement, Messrs. Fillo and Perrin have been granted an option to purchase 4,000 Common Shares, and Messrs. Peterson and Bartlett have been granted options to purchase 8,000 Common Shares. Options to purchase a total of up to 200,000 Common Shares are authorized for grant under the Director Option Plan. The options granted under the Director Option Plan vest immediately on the date of grant and the option price per share is the fair market value per share of Common Shares determined as of the date of grant. The options granted under the Director Option Plan expire ten years from the date of grant.

### Security Ownership Of Management And Others

The following table sets forth certain information regarding the ownership of the Common Shares of the Company as of March 15, 1995 by (i) each person known by the Company to be the beneficial owner of more than 5% of the outstanding Common Shares, (ii) each of the executive officers named in the "Summary Compensation Table," (iii) each director of the Company and (iv) all directors and executive officers of the Company as a group. Except as otherwise noted, the named beneficial owner has sole voting and investment power, and none of the shares is known by the Company to be shares with respect to which such beneficial owner has the right to acquire beneficial ownership.

Name	Shares Beneficially Owned	Percentage of Total
Warburg, Pincus Capital Company, L.P. <sup>1</sup> 466 Lexington Avenue New York, New York 10017	15,713,370 <sup>2</sup>	48.5%
FMR Corp. <sup>3</sup> 82 Devonshire Street Boston, Massachusetts 02109-3614	2,315,146	7.8%
James T. Bartlett	115,780 <sup>6,7</sup>	•
Stephen W. Fillo	4,000 <sup>6</sup>	•
John L. Vogelstein <sup>1</sup>	15,713,370 <sup>2</sup>	48.5%
Douglas M. Karp <sup>1</sup>	15,713,370 <sup>2</sup>	48.5%
DuWayne J. Peterson	8,000 <sup>6</sup>	•
George M. Perrin	9,000 <sup>6</sup>	•
H. Brian Thompson	647,379 <sup>4,5,6</sup>	2.1%
Thomas J. Wynne	185,908 <sup>4,6</sup>	•
Joseph A. Lawrence	76,350 <sup>6</sup>	•
Marshall W. Hanno	83,379 <sup>4,6</sup>	•
Larry E. Wolfe	39,707	•
All executive officers and directors as a group (11 persons)	16,882,873 <sup>8</sup>	50.5%

• Less than one percent.

<sup>1</sup> Warburg, Pincus Capital Company, L.P. ("Warburg") is a Delaware limited partnership engaged in making venture capital and related investments. The sole general partner of Warburg is Warburg, Pincus & Co., a New York general partnership ("WP"). Lionel I. Pincus is the managing partner of WP and may be deemed to control it. Warburg, Pincus, through a wholly owned subsidiary, manages Warburg. WP owns all of the outstanding stock of Warburg. Pincus and, as sole general partner of Warburg, has a 20% interest in the profits of Warburg. Warburg, Pincus owns less than 1% of the limited partnership interest in Warburg. Messrs. Vogelstein and Karp are officers of Warburg, Pincus and partners in

WP, and serve on the Company's Board of Directors as nominees of Warburg. As such, each of Messrs. Vogelstein and Karp may be deemed to be the beneficial owner (within the meaning of Rule 16a-1 under the Securities Exchange Act of 1934) of an indeterminate portion of the stock of the Company owned by Warburg.

- <sup>2</sup> Includes (i) 2,579,278 Common Shares issuable upon the exercise of currently exercisable warrants to purchase Common Shares which warrants are exercisable through April 1, 2000 at an exercise price of \$5.67 per share ("Warrants"), (ii) 161,762 Common Shares issuable pursuant to currently exercisable employee stock options held by Messrs. Thompson, Wynne and Hanno which Warburg has an option to acquire.
- <sup>3</sup> On February 13, 1995, FMR Corp. ("FMR") notified the Company by means of a Statement on Schedule 13G that certain of its subsidiaries or voluntary affiliates exercised investment discretion over various investment accounts which as of December 31, 1994, held 2,315,146 shares including 48,684 Common Shares from the assumed conversion of 37,000 Preferred Shares. Fidelity Management & Research Company, a wholly owned subsidiary of FMR, is the beneficial owner of 2,213,080 shares including 13,158 Common Shares from the assumed conversion of 10,000 Preferred Shares. Fidelity Management Trust Company, a wholly owned subsidiary of FMR and a bank, is the beneficial owner of 102,066 shares including 35,526 Common Shares from the assumed conversion of 27,000 Preferred Shares.
- <sup>4</sup> Includes shares issuable pursuant to currently exercisable employee stock options which Warburg has an option to acquire.
- <sup>5</sup> Includes 26,316 shares issuable upon conversion of Preferred Shares owned by Mr. Thompson or trusts for the benefit of his children.
- <sup>6</sup> Includes Common Shares which the directors and executive officers had the right to acquire through the exercise of options as of March 15, 1995 as follows: James T. Bartlett — 8,000; Stephen W. Fillo — 4,000; DuWayne J. Peterson — 8,000; George M. Perrin — 4,000; H. Brian Thompson — 597,539; Thomas J. Wynne — 171,029; Joseph A. Lawrence — 67,167; and Marshall W. Hanno — 73,487. Also includes Common Shares which the executive officers have the right to acquire through the exercise of options within 60 days of March 15, 1995 as follows: H. Brian Thompson — 12,225; Thomas J. Wynne — 6,268; Joseph A. Lawrence — 8,668; and Marshall W. Hanno — 3,113.
- <sup>7</sup> Includes 33,170 Common Shares as to which Mr. Bartlett shares voting and investment power with his wife. Primus Capital Fund Limited Partnership ("Primus") and Primus Capital Fund II Limited Partnership ("Primus II") are Ohio limited partnerships engaged in making venture capital and related investments. Primus Management I, an Ohio general partnership, is the general partner of Primus and Primus Management II, an Ohio general partnership, is the general partner of Primus II. Mr. Bartlett is a general partner of Primus Management I and Primus Management II. Primus beneficially owns 39,626 Common Shares and Primus II beneficially owns 34,984 Common Shares issuable upon the exercise of currently exercisable Warrants held by Primus II, all of which shares Mr. Bartlett disclaims beneficial ownership.
- <sup>8</sup> Includes or excludes, as the case may be, Common Shares set forth in the preceding footnotes.

### **Executive Compensation and Related Information**

The information below is provided with respect to the compensation of the Chief Executive Officer and the four other executive officers serving in 1994, which would include H. Brian Thompson as the Company's Chairman and Chief Executive Officer, Thomas J. Wynne, President and Chief Operating Officer, Joseph A. Lawrence, Senior Vice President-Finance and Development and Chief Financial Officer, Larry E. Wolfe, Chief Accounting and Administrative Officer, and Marshall W. Hanno, Senior Vice President-Sales. Mr. Wolfe and the Company's wholly-owned subsidiary, LCI International Management Services, Inc. ("LCIM"), agreed to the termination of Mr. Wolfe's employment agreement effective September 16, 1994, and the position of Chief Accounting and Administrative Officer was eliminated at that time.

#### ***Compensation Committee Report on Executive Compensation***

##### ***Organization and Guiding Principles***

The Compensation Committee of the Board of Directors consists of three non-employee directors. The Compensation Committee evaluates and sets the base salaries for the Chief Executive Officer ("CEO"), President and Chief Operating Officer ("COO"), Senior Vice President-Finance and Development and Chief Financial Officer ("CFO"), and the Senior Vice President-Sales ("Senior VP"), and, while the position existed, the Chief Accounting and Administrative Officer ("CAA"). The Compensation Committee also administers the 1994 Executive Incentive Compensation Plan ("Incentive Plan") for all executive officers including the CEO. The members of the Compensation Committee also constitute the committees which administer the Company's stock option plans.

The principles which guide the Compensation Committee are:

- A. Compensation should be competitive with the market in order to attract and retain high-quality executives;
- B. Compensation should be performance based; a significant portion of compensation should be tied to achievement of the Company's financial performance targets; and
- C. Compensation should include significant ownership of Common Shares in order to focus executive objectives on maximizing shareholder value.

#### *Compensation and Company Performance*

Base salaries for the executive officers are set annually, subject to adjustment during the year, by the Compensation Committee. Factors in the determination of the base salaries for the CEO, COO, CFO, CAA and Senior VP include the Compensation Committee's knowledge of salaries for executives in comparably situated positions, as well as information provided by the Company's Human Resources staff and external compensation consultants relative to salaries paid by peer companies for comparable jobs. For the COO, CFO, CAA, and Senior VP, the Compensation Committee also considers the officer's contribution to the Company's performance and reviews the performance of the particular aspects of the Company for which the executive officer is responsible.

When determining the base salary for the CEO, the Compensation Committee compares the performance of the Company as a whole to its goals and objectives, including effectiveness in completing strategic objectives such as expansion into new geographic markets and new market segments; growth in revenue; growth in earnings before depreciation, interest and taxes ("EBDIT"); and improvement in recurring profitability. In its base salary evaluation of the CEO for 1994, the Compensation Committee noted the Company's successful expansion into many domestic and international markets, the development of several new services, and the growth in revenue and EBDIT and the improvement in recurring earnings per share.

In 1994, incentive compensation for all executive officers, including the CEO, was determined pursuant to the Company's Executive Incentive Plan, which was approved by the shareholders on May 10, 1994. Under the Executive Incentive Plan the Compensation Committee of the Board of Directors established pre-determined financial performance goals related to revenue growth; EBDIT; selling, general and administrative expenses; and earnings per share.

Each executive officer was assigned an individual incentive target, which represented the amount that would be payable to the officer if the pre-determined performance goals were met.<sup>1</sup> The incentive target for the CFO, CAA and the Senior VP was set at 60% of base salary and the incentive targets for the COO and CEO were set at 70% and 80% of base salary, respectively. The individual awards that were payable under the plan ranged from 0% to 200% depending on the actual financial performance of the Company relative to the pre-determined financial performance goals.

Based on an incentive target of 80% of base salary and the actual financial performance of the Company relative to the pre-determined financial performance goals, Mr. Thompson received quarterly Incentive Plan payments totaling 80% of his base salary for 1994.

The Company believes that employee ownership of Common Shares is a critical element to the Company's success. The Compensation Committee periodically grants stock options to executive officers and other key employees. Options are generally granted at 100% of market value. Generally, 20% of the options are exercisable on the first anniversary of the grant and 1.66% are exercisable each month thereafter, provided employment continues. The Compensation Committee believes the stock option grants are made at levels consistent with other executive compensation plans in the industry.

<sup>1</sup> As part of his agreement to join the Company, for four quarters ended in October 1994, the CFO received the greater of the amount payable under the Incentive Plan or 30% of his base salary.

During 1994, 120,000, 60,000, 70,000, 30,000 and 30,000 in stock options were granted to the CEO, COO, CFO, CAA and Senior VP, respectively. The grants of stock options were the result of the Committee's continuing interest into focusing the executive's objectives on maximizing shareholder value as well as a reflection of the Company's continuing growth in revenue and EBDIT and the improvement in recurring earnings per share.

*Compliance With Internal Revenue Code Section 162(m)*

Section 162(m) of the Internal Revenue Code, enacted in 1993, generally disallows a tax deduction to public companies for compensation over \$1 million paid to the corporation's Chief Executive Officer and the four other most highly compensated executive officers. Qualifying performance-based compensation and compensation paid pursuant to plans adopted prior to a company's initial public offering of securities will not be subject to the deduction limit if certain requirements are met. The Company currently intends to structure the compensation of its executive officers in a manner that complies with the exceptions from the deduction limits of Section 162(m).

*THE COMPENSATION COMMITTEE*

*James T. Bartlett  
Douglas M. Karp  
DuWayne J. Peterson*

### Summary Compensation Table

The table below sets forth all compensation paid by the Company to each of Messrs. Thompson, Wynne, Lawrence, Wolfe and Hanno for the last three fiscal years.

Name and Principal Position	Year	Annual Compensation			Long Term Compensation Awards	All Other Compensation(\$)
		Salary(\$)	Bonus(\$)	Other Annual Compensation(\$) <sup>1</sup>	Securities Underlying Options/SARs	
H. Brian Thompson Chairman & Chief Executive Officer	1994	460,000	368,460	33,479	120,000	16,700 <sup>4,5</sup>
	1993	440,000	215,600	31,094	186,742	21,000 <sup>4</sup>
	1992	400,000	45,000	22,421	642,992 <sup>3</sup>	21,000 <sup>4</sup>
Thomas J. Wynne President & Chief Operating Officer	1994	287,500	201,502	25,035	60,000	6,163 <sup>7,8</sup>
	1993	275,000	118,038	24,338	98,034	6,303 <sup>7,8</sup>
	1992	250,000	27,350	23,160	229,642 <sup>3</sup>	6,212 <sup>7,8</sup>
Joseph A. Lawrence Senior Vice President-Finance and Development, and Chief Financial Officer	1994	215,500	129,384	21,423	70,000	5,480 <sup>9</sup>
	1993	39,600 <sup>2</sup>	41,630 <sup>9</sup>	4,139	150,000	24,232 <sup>9</sup>
	1992					
Larry E. Wolfe Chief Accounting & Administrative Officer and Secretary	1994	149,815	61,808	15,716	30,000 <sup>11</sup>	450,771 <sup>6,10</sup>
	1993	205,000	75,775	20,910	40,000 <sup>11</sup>	1,890 <sup>9</sup>
	1992	192,500	15,600	20,285	18,000 <sup>11</sup>	476 <sup>9</sup>
Marshall W. Hanno Senior Vice President- Sales	1994	180,000	108,158	18,750	30,000	3,597 <sup>8</sup>
	1993	166,250	57,363	15,944	48,400	556 <sup>7</sup>
	1992	153,692	13,780	16,615	110,228 <sup>3</sup>	1,698 <sup>7</sup>

<sup>1</sup> Includes perquisites and automobile allowance.

<sup>2</sup> Represents partial year; Mr. Lawrence joined the Company as an executive officer in October 1993.

<sup>3</sup> Warburg has the right to acquire certain of the stock options granted to Messrs. Thompson, Wynne and Hanno under the 1992 Stock Option Plan. See "Certain Relationships and Related Transactions — Options Granted to Warburg."

<sup>4</sup> Includes premiums of \$21,000, \$21,000 and \$12,100 in 1992, 1993, and 1994, respectively, paid by the Company on a split dollar life insurance policy, the proceeds of which are payable to designated beneficiaries of Mr. Thompson.

<sup>5</sup> Includes \$5,500 in 1992, 1993 and 1994 for premiums paid by the Company on a term life insurance policy, the proceeds of which are payable to designated beneficiaries of Mr. Wynne.

<sup>6</sup> Includes the following matching contributions made to officers' accounts in the Company's 401(k) Plan: \$4,600 in 1994 for Mr. Thompson; \$712 in 1992, \$803 in 1993, and \$663 in 1994 for Mr. Wynne; \$3,597 in 1994 for Mr. Hanno; and \$476 in 1992, \$1,890 in 1993, and \$3,713 in 1994 for Mr. Wolfe of which all matching contributions were required to be forfeited upon his termination from the Company.

<sup>7</sup> Represents compensation imputed on an interest-free loan with a principal amount of \$7,807 made by the Company in connection with Mr. Hanno's relocation. Compensation was imputed for the period from January 1 through December 31, 1993 at the applicable federal rate of 4.43% per annum.

<sup>8</sup> Represents premiums in 1993 and 1994 and buy-out amounts in 1993 paid by the Company on a split dollar life insurance policy, the proceeds of which are payable to designated beneficiaries of Mr. Lawrence.

<sup>9</sup> Includes a bonus of \$20,000 paid upon commencement of employment.

<sup>10</sup> Includes severance of \$447,058 paid to Mr. Wolfe upon termination of his employment effective September 16, 1994.

<sup>11</sup> All options granted to Mr. Wolfe in 1994 and 1993, and 12,000 of the options granted in 1992 were surrendered upon his termination.

The following table contains information concerning the grant of options under the Company's 1994/1995 Stock Option Plan to each of the named executive officers of the Company during the year ended December 31, 1994. No stock appreciation rights ("SARs") were granted in 1994.

#### Option Grants In 1994

Name	Individual Grants				Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation for Option Term(s) <sup>1</sup>	
	Number of Securities Underlying Options Granted (#)	% of Total Options Granted To Employees in Fiscal Year	Exercise Price (\$/Sh)	Expiration Date	5%	10%
H. Brian Thompson	120,000 <sup>1</sup>	14.1%	\$17.8125	2/16/04	\$1,344,262	\$3,406,625
Thomas J. Wynne	60,000 <sup>1</sup>	7.0	\$17.8125	2/16/04	\$ 672,131	\$1,703,312
Joseph A. Lawrence	40,000 <sup>1</sup>	4.7	\$17.8125	2/16/04	\$ 448,087	\$1,135,541
	30,000 <sup>2</sup>	3.5	\$16.8800	7/26/04	\$ 318,472	\$ 807,071
Total:	70,000	8.2			\$ 766,559	\$1,942,612
Larry E. Wolfe	30,000 <sup>4</sup>	3.5	\$17.8125	2/16/04	\$ — <sup>4</sup>	\$ — <sup>4</sup>
Marshall W. Hanno	30,000 <sup>1</sup>	3.5	\$17.8125	2/16/04	\$ 336,065	\$ 851,657

<sup>1</sup> 20% of these options became exercisable on February 16, 1995 and 1.66% become exercisable each month thereafter for 48 months. Options were granted at the fair market value of the Common Shares on the date of grant and expire ten years from the date of grant.

<sup>2</sup> 20% of these options become exercisable on July 26, 1995 and 1.66% become exercisable each month thereafter for 48 months.

<sup>3</sup> The potential realizable value represents the estimated future gain in the value of the options over their exercise price which may exist immediately prior to the scheduled expiration date of the options. The calculation assumes the specified compounded rates of appreciation in the per share price of the Common Shares starting on the date of the grant and further assumes that the options will be exercised on their expiration date. The actual value, if any, which may be realized will depend upon the market price of the Common Shares on the date the option is exercised. There is no assurance that the actual value, if any, which may be realized will be at, or near, the value estimated by the calculations above. The market price of the Common Shares at December 31, 1994 was \$26.75 per share.

<sup>4</sup> All options granted to Mr. Wolfe in 1994 were surrendered upon his termination.

On January 13, 1995, Messrs. Thompson, Wynne, Lawrence and Hanno were granted options of 150,000, 100,000, 80,000 and 70,000 Common Shares, respectively, under the 1994/1995 Stock Option Plan. These options were granted at the fair market value of the Common Shares on the date of grant as defined under the plan and expire ten years from the date of grant. Twenty percent (20%) of these options become exercisable on January 13, 1996 and 1.66% become exercisable each month thereafter for 48 months.

The following table contains information concerning the grant of options under the Company's 1994/1995 Stock Option Plan to each of the named executive officers of the Company during the year ended December 31, 1994. No stock appreciation rights ("SARs") were granted in 1994.

#### Option Grants In 1994

Name	Individual Grants				Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation for Option Term(s) <sup>1</sup>	
	Number of Securities Underlying Options Granted (#)	% of Total Options Granted To Employees in Fiscal Year	Exercise Price (\$/Sh)	Expiration Date	5%	10%
H. Brian Thompson .....	120,000 <sup>1</sup>	14.1%	\$17.8125	2/16/04	\$1,344,262	\$3,406,625
Thomas J. Wynne .....	60,000 <sup>1</sup>	7.0	\$17.8125	2/16/04	\$ 672,131	\$1,703,312
Joseph A. Lawrence .....	40,000 <sup>1</sup>	4.7	\$17.8125	2/16/04	\$ 448,087	\$1,135,541
	30,000 <sup>2</sup>	3.5	\$16.8800	7/26/04	\$ 318,472	\$ 807,071
Total: .....	70,000	8.2			\$ 766,559	\$1,942,612
Larry E. Wolfe .....	30,000 <sup>4</sup>	3.5	\$17.8125	2/16/04	\$ — <sup>4</sup>	\$ — <sup>4</sup>
Marshall W. Hanno .....	30,000 <sup>1</sup>	3.5	\$17.8125	2/16/04	\$ 336,065	\$ 851,657

<sup>1</sup> 20% of these options became exercisable on February 16, 1995 and 1.66% become exercisable each month thereafter for 48 months. Options were granted at the fair market value of the Common Shares on the date of grant and expire ten years from the date of grant.

<sup>2</sup> 20% of these options become exercisable on July 26, 1995 and 1.66% become exercisable each month thereafter for 48 months.

<sup>3</sup> The potential realizable value represents the estimated future gain in the value of the options over their exercise price which may exist immediately prior to the scheduled expiration date of the options. The calculation assumes the specified compounded rates of appreciation in the per share price of the Common Shares starting on the date of the grant and further assumes that the options will be exercised on their expiration date. The actual value, if any, which may be realized will depend upon the market price of the Common Shares on the date the option is exercised. There is no assurance that the actual value, if any, which may be realized will be at, or near, the value estimated by the calculations above. The market price of the Common Shares at December 31, 1994 was \$26.75 per share.

<sup>4</sup> All options granted to Mr. Wolfe in 1994 were surrendered upon his termination.

On January 13, 1995, Messrs. Thompson, Wynne, Lawrence and Hanno were granted options of 150,000, 100,000, 80,000 and 70,000 Common Shares, respectively, under the 1994/1995 Stock Option Plan. These options were granted at the fair market value of the Common Shares on the date of grant as defined under the plan and expire ten years from the date of grant. Twenty percent (20%) of these options become exercisable on January 13, 1996 and 1.66% become exercisable each month thereafter for 48 months.



The following table sets forth information with respect to the exercise of options during 1994 and the options held as of December 31, 1994 by each of the named executive officers. As of December 31, 1994, no SARs were outstanding.

Shares Acquired on Exercise (#)	Value Realized (\$) <sup>1</sup>	Aggregated Option/SAR Exercises in last Fiscal Year And Fiscal Year-End Option/SAR Values				
		Number of Securities Underlying Unexercised Options/SARs At FY-End (#)		Values Of Unexercised In-The-Money Options/SARs at FY-End (\$) <sup>2</sup>		
		Exercisable	Unexercisable	Exercisable	Unexercisable	
H. Brian Thompson .....	—	564,198 <sup>3</sup>	385,536	\$13,415,179	\$5,681,521	
Thomas J. Wynne .....	10,000	\$203,750	154,127 <sup>3</sup>	223,549	\$ 3,611,614	\$3,408,401
Joseph A. Lawrence .....	—	—	53,334	166,666	\$ 409,797	\$1,446,928
Larry E. Wolfe .....	6,000	\$ 80,010	—	—	—	—
Marshall W. Hanno .....	14,090	\$254,875	65,067 <sup>3</sup>	109,561	\$ 1,504,380	\$1,657,658

<sup>1</sup> Represents the difference between the closing market price of the Common Shares at December 31, 1994 of \$26.75 per share and the exercise price of in-the-money options multiplied by the number of shares underlying the in-the-money options.

<sup>2</sup> Warburg has the right to acquire certain of the stock options granted to Messrs. Thompson, Wynne and Hanno under the 1992 Stock Option Plan. See "Certain Relationships and Related Transactions - Options Granted to Warburg."

<sup>3</sup> The value realized is calculated by subtracting the exercise or base price from the fair market value of the Common Shares as of the exercise date or December 31, 1994, as appropriate.

## Stock Based Plans

### I. 1993 Stock Option Plan

Pursuant to the 1993 Stock Option Plan, the Company may grant to its employees "incentive stock options" ("ISOs") or stock options which are not intended to be ISOs ("Non-qualified Options"). There are 993,244 Common Shares eligible to be granted under the 1993 Stock Option Plan, of which amount options to purchase 993,176 shares previously have been granted. The 1993 Stock Option Plan is administered by the Option Committee which consists of three members of the Board of Directors. The Option Committee determines whom, at what times, the number of shares for individual grants, the purchase price and whether such options are ISO's or Non-qualified Options. No stock option granted under the 1993 Stock Option Plan may be exercised after the expiration of ten years from the date of its grant.

### II. 1994/1995 Stock Option Plan

Pursuant to the 1994/1995 Stock Option Plan, the Company may grant to its employees ISOs or Non-qualified Options. There are 2,000,000 Common Shares eligible to be granted under the 1994/1995 Stock Option Plan, of which amount options to purchase 1,917,200 shares previously have been granted. The 1994/1995 Stock Option Plan is administered by the Option Committee which consists of three members of the Board of Directors. The Option Committee determines whom, at what times, the number of shares for individual grants, the purchase price and whether such options are ISO's or Non-qualified Options. No stock option granted under the 1994/1995 Stock Option Plan may be exercised after the expiration of ten years from the date of its grant.

The 1993 Stock Option Plan and 1994/1995 Stock Option Plan (the "Plans") will terminate ten years from the date of adoption by the Board of Directors. The Plans may from time to time be terminated, modified or amended by the affirmative vote of stockholders. The Board of Directors may at any time terminate the Plans or make such modifications or amendments it deems advisable, provided, that the Board may not, without stockholder approval, increase the maximum number of Common Shares as to which options may be granted under the Plans (except certain adjustments upon changes in capitalization) or change the class of persons eligible to receive options.

### **III. Stock Purchase Plan**

The Stock Purchase Plan reserves Common Shares for purchase by employees and is an "employee stock purchase plan" qualifying under Section 423 of the Internal Revenue Code of 1986 ("Code"). For a discussion of the Stock Purchase Plan, see Proposal Number Two included in this Proxy Statement.

#### **Employment Contracts And Termination Of Employment And Change-In-Control Arrangements**

Effective April 19, 1993, the Company and LCIM entered into employment agreements with each of Messrs. Thompson, Wynne and Hanno, pursuant to which Mr. Thompson has agreed to serve full time in his present position until December 1995 and Messrs. Wynne and Hanno have agreed to serve full time in their present positions until July 1995. Effective in October 1993, the Company and LCIM entered into an Employment Agreement with Mr. Lawrence, pursuant to which Mr. Lawrence agreed to serve full time as Chief Financial Officer until October 1995. The term of each employment agreement will automatically extend for successive two-year periods except that any party may, at the end of the initial term, or at the end of any successive term, terminate the agreement by giving written notice no later than 90 days prior to the end of such term. The annual base salary under such agreements for Messrs. Thompson, Wynne, Lawrence and Hanno will be set by the Board of Directors, but cannot be less than \$400,000, \$250,000, \$206,000 and \$150,000, respectively. In addition, each of these executives will be eligible to receive quarterly bonus payments in amounts determined by the Board of Directors.

Pursuant to these employment agreements, if the executive is terminated for cause (as defined in the agreements) or the executive voluntarily terminates his employment, he receives his base salary plus any amounts due under a benefit plan or otherwise through the date of termination. If the executive's employment is terminated without cause, he receives (i) his base salary plus any amounts due under a benefit plan or otherwise through the date of termination, (ii) a severance payment in an amount equal to the executive's annual base salary, and (iii) bi-weekly payments in an amount equal to the last such payment received by the executive prior to the date of termination for up to one year after the termination of employment (the "Termination Payments"). If there is a material change in an executive's position or his duties (and in the case of Mr. Lawrence, compensation or benefits) without his consent, and the executive thereafter terminates his employment, such termination shall be deemed to be without cause and the executive will be entitled to the rights of an executive terminated without cause. Mr. Lawrence is entitled to receive the Termination Payments if he resigns as a result of any material breach by the Company of his employment agreement or his office being moved to a location other than Dublin, Ohio or McLean, Virginia.

The employment agreements further provide that if there is a "change in control" of the Company, all options granted to these executives will vest and become immediately exercisable. "Change of control" is defined under the employment agreements as the acquisition by any person, entity or group (within the meaning of Section 13(d)(3) of 14(d)(2) of the Securities Exchange Act of 1934) other than Warburg or its affiliate, of more than 50% of the then outstanding voting securities of the Company.

Pursuant to an employment agreement entered into in November 1989 between LCIM and Mr. Wolfe, Mr. Wolfe agreed to serve full time in an executive position through November 1994. The parties agreed to terminate the employment agreement effective September 16, 1994. Mr. Wolfe's minimum base salary under such agreement was set by the Board of Directors but could not be less than \$175,000. Mr. Wolfe was also eligible to participate in any bonus plans and employee benefit plans developed for key employees and to receive such awards as were determined by the Board of Directors.

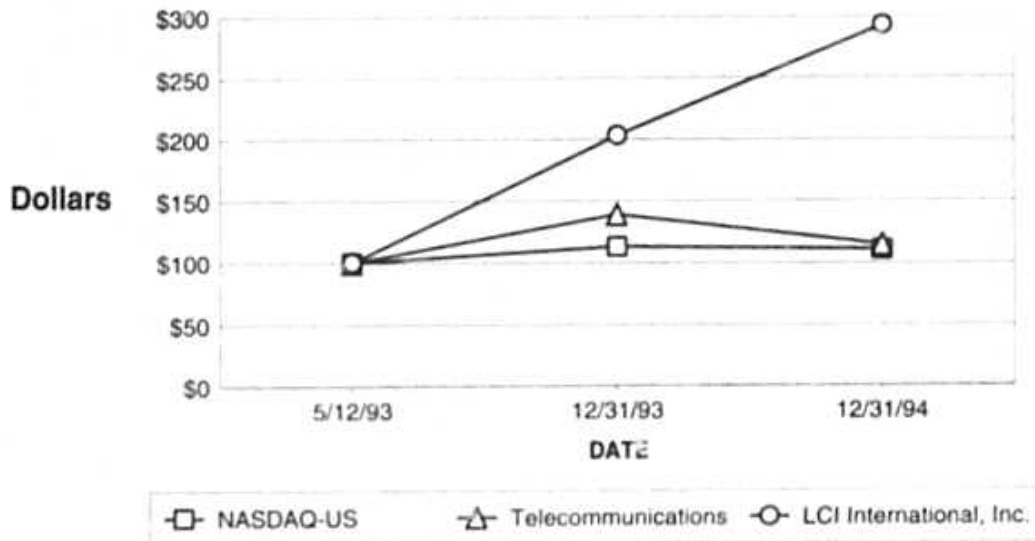
#### **Compensation Committee Interlocks And Insider Participation**

The members of the Compensation Committee in 1994 were Messrs. Bartlett, Karp and Peterson. Mr. Bartlett served as a member of the Compensation Committee of the Company during the last fiscal year and served as vice president of the Company from August 1988 through September 1991 at which time he resigned as an officer. No executive officer of the Company served on any board of directors or compensation committee of any entity other than the Company with which any member of the Compensation Committee is affiliated.

### Performance Graph

The graph set forth below compares the cumulative total return on the Common Shares for the period commencing with the initial issuance of the Common Shares on May 12, 1993, and ending on December 31, 1994, as compared with the Total Return Index for the Nasdaq Stock Market (U.S.) and The Total Return Index for Nasdaq Telecommunications Stocks prepared by the Center for Research in Security Prices ("CRSP") at the University of Chicago. The graph assumes that \$100 was invested on May 12, 1993. The Company's Common Shares were traded on NASDAQ until December 29, 1994 when both the Company's Common Shares and Preferred Shares began trading on the NYSE. For purposes of the Performance Graph, the CRSP Total Return for Nasdaq-US and Telecommunications has been used through December 30, 1994, the last trading day of 1994.

**Comparison of Total Return Among LCI International, Inc. and CRSP Total Return Indexes for NASDAQ - US and Telecommunications**  
(Assuming \$100 Invested on May 12, 1993)



	5/12/93	12/31/93	12/31/94
NASDAQ-US	\$100	\$113	\$111
Telecommunications	100	139	115
LCI International, Inc.	100	203	293

### Compliance with Section 16(a) of the Securities Exchange Act of 1934

Section 16(a) of the Exchange Act requires the Company's directors and executive officers, and persons who own more than 10% of the Company's Common Shares, to file with the Securities and Exchange Commission (the "SEC") and the NYSE initial reports of beneficial ownership and changes in beneficial ownership of the Company's Common Shares. Such persons are also required by regulation to furnish the Company with copies of all Section 16(a) forms they file. To the Company's knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations as to transactions for which reports are required, all Section 16(a) filing requirements applicable to such individuals were complied with in 1994.

### Certain Relationships And Related Transactions

The following is a summary of certain transactions among the Company and its directors, executive officers and certain of its current stockholders and related persons:

**Stockholder Loans.** Warburg, directly and indirectly through a wholly owned subsidiary, loaned the Company \$29.0 million in 1992 and \$8.5 million in 1991. In 1991, Primus II loaned the Company \$500,000. The Company used the proceeds of these loans for working capital and general corporate purposes. In 1993, Warburg and Primus II exchanged this indebtedness for the Company's Senior Floating Rate Convertible Notes due March 31, 2003 ("Convertible Notes") and Warrants (as previously defined). In 1993, Convertible Notes held by Warburg and a wholly owned subsidiary were converted into 2,921,794 Common Shares and the remaining portion of the Convertible Notes was redeemed for approximately \$12.9 million, including interest. In addition, in 1993, a portion of the Convertible Notes held by Primus II were converted into 39,626 Common Shares and the remaining portion was redeemed for \$175,431, including interest.

**Registration Rights.** Pursuant to certain agreements between Warburg and the Company, and such other parties thereto, the Company has granted to Warburg certain demand and "piggyback" registration rights. In connection therewith, the Company has agreed to pay certain expenses of Warburg in connection with such registration and has agreed to indemnify Warburg against certain civil liabilities, including liability under the Securities Act of 1933.

**Options Granted to Warburg.** Pursuant to agreements with Warburg, dated February 9, 1993, Messrs. Thompson, Wynne and Hanno granted Warburg the right to purchase from them certain stock options granted under the Company's 1992 Stock Option Plan. Currently, Warburg has the right to acquire options to purchase up to 93,102 Common Shares from Mr. Thompson at an exercise price of \$1.76 per share, 46,390 Common Shares from Mr. Wynne at an exercise price of \$1.50 per share and 22,270 Common Shares from Mr. Hanno at an exercise price of \$1.50 per share. The amount of options which Warburg has the right to acquire decreases each year. Warburg's right to acquire options from Mr. Thompson expires on July 31, 1995 and its right to acquire options from Messrs. Wynne and Hanno expires on July 31, 1996.

## PROPOSAL NUMBER TWO

### APPROVAL OF THE 1995/1996 LCI INTERNATIONAL, INC. STOCK OPTION PLAN, THE 1995 EXECUTIVE INCENTIVE COMPENSATION PLAN, AND THE AMENDED AND RESTATED EMPLOYEE STOCK PURCHASE PLAN

#### I. The 1995/1996 LCI International, Inc. Stock Option Plan

On March 2, 1995, the Board of Directors adopted and recommended for stockholder approval the 1995/1996 LCI International, Inc. Stock Option Plan ("1995/1996 Stock Option Plan") pursuant to which the Company may grant ISOs or Non-Qualified Options. A copy of the 1995/1996 Stock Option Plan is attached hereto as Appendix A. The following description of this plan is qualified in its entirety by reference to Appendix A which is hereby incorporated herein by reference as if fully set forth herein.

#### Plan Administration

The 1995/1996 Stock Option Plan will be administered by the 1995/1996 Stock Option Committee of the Board of Directors which consists of Messrs. Bartlett, Karp and Peterson, and will have the full authority to administer the plan and prescribe, amend or rescind rules and regulations related thereto. In making such determinations, the 1995/1996 Stock Option Committee may consider the nature of the services rendered by such individuals, their present and potential contributions to the Company's success, and such other factors deemed relevant by the 1995/1996 Stock Option Committee. No stock option granted under the 1995/1996 Stock Option Plan shall be exercisable after the expiration of ten years from the date of its grant.

#### Material Provisions

The total number of Common Shares subject to stock options granted under the 1995/1996 Stock Option Plan shall not exceed 2,000,000, subject to certain potential adjustments. Stock options may be granted under the 1995/1996 Stock Option Plan only to employees of the Company or any of its subsidiaries within the meaning of Section 424(f) of the Code. In addition, no individual participant may be granted options under the plan for more than 500,000 Common Shares during any calendar year for which the plan is in effect. In the case of ISOs and options granted to executives whose compensation is subject to Section 162(m) of the Code, the exercise price of options will not be less than the Fair Market Value, as defined in the plan, of the Common Shares on the date the options are granted. As of March 15, 1995, there were 1,144 employees eligible to participate in the 1995/1996 Stock Option Plan.

#### Termination, Modification and Amendment

The 1995/1996 Stock Option Plan shall terminate ten years from the date of its adoption by the Board of Directors. The plan may from time to time be terminated, modified or amended by the affirmative vote of stockholders. Additionally, the Board may at any time terminate the plan or from time to time make such modifications or amendments of the plan as it deems advisable; provided, that the Board may not, without stockholder approval, increase the maximum number of Common Shares as to which options may be granted under the plan (except certain adjustments upon changes in capitalization) or change the class of persons eligible to receive options.

#### Federal Income Tax Effects Of Plan Participation

Options granted under the plan to an employee of the Company will constitute either an ISO within the meaning of Section 422 of the Code, or Non-Qualified Options, as determined by the 1995/1996 Stock Option Committee on the date of grant in accordance with the Code.

**Incentive Stock Options.** Neither the grant nor the exercise of an ISO will result in taxable income to the optionee or any income tax deduction to the Company. However, the excess, if any, of the Fair Market Value of the Common Shares acquired pursuant to such exercise over their option price is an adjustment for the

purpose of computing the alternative minimum tax, unless such shares are disposed of in a "disqualifying disposition" (as defined below) in the year of exercise. However, the alternative minimum tax applies only if it is greater than a taxpayer's regular tax liability.

If an optionee makes no disposition of the Common Shares acquired on the exercise of an ISO within the period ending the later of two years after the date of grant of such option or one year plus one day after the date of transfer of such shares to such optionee pursuant to such exercise, then upon disposition of such shares:

- (a) the amount, if any, realized in excess of the option price of such shares will be treated as long-term capital gain; or
- (b) the amount, if any, by which such option price of such shares will be treated as long-term capital loss; and in either event
- (c) the Company will not be allowed any deduction for federal income tax purposes with respect to the exercise of such option.

If an optionee disposes of Common Shares acquired on the exercise of an ISO within the period described above (any disposition by the optionee within such period being hereinafter called a "disqualifying disposition"), then upon disposition of such shares:

- (a) if the amount realized upon such disposition is equal to or greater than the Fair Market Value of such shares at the date of exercise:
  - (i) the amount, if any, by which such Fair Market Value exceeds the option price of such shares will be treated as compensation taxable as ordinary income to such optionee in the year of disposition; and
  - (ii) the amount, if any, realized in excess of such Fair Market Value will be treated as long-term capital gain if such shares were held for more than twelve months after the date of exercise and as a short-term capital gain if such shares were held for a lesser period;
- (b) if the amount realized upon a disqualifying disposition is less than such Fair Market Value but not less than such option price, the excess of the amount realized over such option price will be treated as compensation taxable as ordinary income to such optionee in the year of such disposition, unless such disposition is a transaction (such as a sale between certain related parties) in which any loss sustained would not have been recognized under the Code, in which case the difference between such Fair Market Value and such option price will be treated as compensation taxable as ordinary income;
- (c) if the amount realized upon a disqualifying disposition is less than such option price, the excess of such option price over the amount realized will be treated as a long-term capital loss if such shares were held for more than twelve months after the date of exercise and as short-term capital loss if such shares were held for a lesser period, unless such disposition is a transaction (such as a sale between certain related parties) in which any loss sustained would not have been recognized under the Code, in which case the difference between such Fair Market Value and such option price will be treated as compensation taxable as ordinary income to such optionee in the year of such disposition; or
- (d) if a disqualifying disposition is a gift, the difference between such Fair Market Value and such option price will be treated as compensation taxable as ordinary income to such optionee in the year of such disposition.

The Company generally will be allowed a deduction for federal income tax purposes in the year of any disqualifying disposition to the extent, if any, that an optionee recognized compensation taxable as ordinary income. Any amount that an optionee recognizes as compensation taxable as ordinary income will be subject to income tax withholding by the Company.

**Non-Qualified Stock Options.** An optionee will not recognize any income upon the grant of a Non-Qualified option, but the exercise of a Non-Qualified option will have the following tax consequences:

- (a) On the date of such exercise an optionee who at the time of exercise is not an officer or director of the Company will recognize compensation taxable as ordinary income with respect to Common Shares

acquired pursuant to such exercise, in an amount equal to the excess, if any, of the Fair Market Value of such shares on the date of exercise over the option price, and the holding period for such shares will commence on such date.

(b) An optionee who at the time of exercise is an officer or director of the Company will recognize compensation taxable as ordinary income with respect to Common Shares acquired pursuant to such exercise on the expiration date of the period during which such optionee is subject to suit under Section 16(b) of the Exchange Act, in an amount equal to the excess, if any, of the Fair Market Value of such shares on the date on which such income is recognized over the option price, and the holding period for such shares will commence on such date. However, such an optionee may elect to recognize any compensation resulting from the exercise of a Non-Qualified option on the date of exercise and have such compensation computed by reference to the Fair Market Value of the Common Shares acquired pursuant to such exercise on such date (and thus to have the holding period for such shares commence on such date) by filing an election with the IRS within 30 days after exercise. If the optionee makes such an election and later is required to forfeit the excess of the Fair Market Value of the shares over the purchase price, pursuant to Section 16(b) of the Exchange Act, no deduction will be allowed to the optionee as a result of such forfeiture.

(c) An optionee will not recognize any additional income by reason of delivery of shares, rather than cash, as payment for shares acquired by exercise of Non-Qualified options. Under current IRS rulings, the number of shares acquired by exercise equal to the number of shares so delivered will have a carryover basis equal to the optionee's basis in the shares so delivered. The basis of any remaining shares will be equal to the amount of income recognized by the optionee upon the exercise of the option.

The amount which an optionee, who at the time of exercise is also an employee, recognizes as compensation taxable as ordinary income will be subject to income tax withholding by the Company. The Company will be allowed a deduction for federal income tax purposes in the year and in the amount that an optionee recognizes compensation taxable as ordinary income.

The tax basis of Common Shares acquired by the exercise of a Non-Qualified option with cash will be equal to the option price, increased by the amount, if any, that an optionee recognizes as compensation taxable as ordinary income. Upon the disposition of the Common Shares acquired on the exercise of a Non-Qualified option, an optionee will realize long-term capital gain or loss if such shares were held for more than 12 months and short-term capital gain or loss if such shares were held for a lesser period.

## **II. 1995 Executive Incentive Compensation Plan**

On February 22, 1995, the Compensation Committee of the Board of Directors approved and recommended for stockholder approval the 1995 Executive Incentive Compensation Plan (the "1995 Plan"). The plan provides quarterly incentive awards to executive officers of the Company, contingent upon the financial performance of the Company, to motivate individual and corporate performance that will inure to the benefit of the Company's shareholders. The 1995 Plan is being submitted for stockholder approval in order to comply with the requirements of Section 162(m) of the Code. In general, Section 162(m) disallows deductions for compensation paid to a public corporation's top five executives, unless the compensation is based on performance and approved by stockholders. In the event stockholder approval of the 1995 Plan is not obtained, no compensation will be paid under the plan and the Compensation Committee will consider other alternatives.

### **Plan Administration**

The 1995 Plan is administered by the Compensation Committee of the Board of Directors and all decisions and all actions thereof shall be conclusive and binding. The Compensation Committee establishes the performance goals which must be met before awards are payable under the plan, administers the plan in accordance with terms and conditions of the plan, and certifies prior to payment of any awards that the performance goals for which awards are payable were in fact met.

### **Effective Date and Eligibility**

The 1995 Plan is effective January 1, 1995 and will end on December 31, 1995. The fiscal quarters to which the plan applies are the three-month periods ending March 31, 1995; June 30, 1995; September 30, 1995; and December 31, 1995. The Chairman and CEO, the President and COO, the Senior Vice President and CFO, and the Senior Vice President-Sales are eligible to participate in the 1995 Executive Incentive Compensation Plan.

### **Calculation Of Awards**

Each eligible participant is assigned an Individual Incentive Target for the purpose of calculating awards under the 1995 Plan. The targets are based on the participant's base compensation rate. For purposes of the 1995 Plan, neither the Individual Incentive Targets nor the base compensation rates used for the CEO may be increased during 1995. The Individual Incentive Target represents the amount a participant would receive as an award under the plan adjusted by a percentage ranging from 0% to 200% depending on actual Company financial performance during the quarter for which the award is calculated. Accordingly, the maximum compensation that can be paid to a participant for any fiscal quarter is 200% of the participant's Individual Incentive Target for that quarter. The Individual Incentive Targets for each of the four fiscal quarters included in 1995 are \$125,000, \$76,250, \$58,750, and \$48,750 for the Chairman and CEO, President and COO, Senior Vice President and CFO, and Senior Vice President-Sales, respectively. The maximum dollar amounts payable under the 1995 Plan for each of the four fiscal quarters included in 1995 are \$200,000, \$152,500, \$117,500, and \$97,500 for the Chairman and CEO, President and COO, Senior Vice President and CFO, and Senior Vice President-Sales, respectively.

### **Financial Performance Criteria**

Company financial performance is measured by comparing actual financial results for a given quarter against the financial performance goals established by the Compensation Committee prior to March 31, 1995. The specific financial elements used in this comparison are: Revenue Growth; Selling, General and Administrative Expense Controls; EBDIT; and Earnings Per Share. The Compensation Committee authorizes the payment of incentive awards following the end of each quarter through a certification that the performance targets for which incentives are payable have been met. The Compensation Committee has the discretion to adjust the performance goals in the event of an acquisition, disposition, corporate restructuring, recapitalization, or other unusual event. In no event may such adjustment increase the compensation that would otherwise be due upon attainment of the goal. The Compensation Committee reserves the right to reduce the level of incentives payable, at its sole discretion.

### **Federal Income Tax Consequences Of Plan Participation**

Compensation payable under the 1995 Executive Incentive Compensation Plan will be taxable to participants as ordinary income (compensation) at the time of payment. The Company will generally be entitled to a corresponding compensation deduction, provided that the payments comply with the requirements of Section 162(m) of the Code.

### **III. Amended and Restated Employee Stock Purchase Plan**

On December 20, 1994, the Board of Directors of the Company approved the Amended and Restated Employee Stock Purchase Plan which amended the Stock Purchase Plan in effect since May 8, 1993 (the "Stock Purchase Plan"). The Stock Purchase Plan reserves 900,000 Common Shares for purchase by employees and is an "employee stock purchase plan" qualifying under Section 423 of the Code. Eligible employees with the Company or any subsidiary corporation within the meaning of Section 424(f) of the Code, may purchase shares by authorizing payroll deductions of up to 15% of salary, subject to a maximum deduction per employee of \$25,000 per year, to be applied to the purchase of shares. The purchase price for shares under the plan will equal 85% of the Fair Market Value of the Common Shares as established at intervals from time to time subject to the discretion of the Committee administering the Stock Purchase Plan.



No individual participant may acquire more than 10,000 shares in any Offer as defined pursuant to the Stock Purchase Plan. The Stock Purchase Plan was amended to (i) reduce the eligibility requirement from six months of employment to 90 days; (ii) change the automatic purchase price reset mechanism to be discretionary on the part of the Stock Purchase Plan Committee; (iii) increase the contribution limit from 10% of compensation to 15%; and (iv) increase the number of authorized shares from 600,000 to 900,000 shares. With the exception of the amendment reducing the eligibility requirement from six months to 90 days, which was effective on January 1, 1995, all other amendments shall be effective on the next offering date under the plan scheduled for August 13, 1995. As of March 15, 1995 there were 1,056 employees eligible to participate in the Stock Purchase Plan.

#### **Plan Administration**

The Stock Purchase Plan is administered by a Stock Purchase Plan Committee designated by the Board of Directors, which currently consists of members of the Board of Directors, Messrs. Bartlett, Karp, and Peterson. The Stock Purchase Plan Committee has the sole responsibility for the administration of the Stock Purchase Plan and has the exclusive right to interpret the provisions thereof.

#### **Termination Date**

The Stock Purchase Plan and all rights to participants will terminate (i) on the date as of which participants have exercised options to purchase a number of shares equal to or greater than the number of shares then subject to the plan or (ii) if earlier, the date as of which the Stock Purchase Plan Committee or the Board of Directors terminates the plan.

#### **Amendment**

The Board of Directors may amend the plan at any time, except that the Board may not amend the plan without stockholder approval if such amendment would increase the number of Common Shares that are reserved for issuance under the plan. The Board may at any time amend the plan to cause the plan to comply with the requirements of Rule 16b-3 promulgated by the SEC under the Exchange Act.

#### **Federal Income Tax Effects Of Plan Participation**

The Stock Purchase Plan is not qualified under Section 401 (a) of the Code. Participants' contributions to the plan through payroll deductions are not tax deductible but will constitute part of the cost basis of the Common Shares purchased under the plan.

No tax liability results from the grant of an option or purchase of Common Shares under the plan. The employee participant becomes liable for federal income tax on the disposition of the Common Shares. In addition, in order to avail themselves of the beneficial treatment provided under Section 423 of the Code, employees must hold the Common Shares for two years from the date the option is granted, or one year from the date of purchase, whichever is later.

When the Common Shares are disposed of after the required holding period, the employee participant realizes ordinary income (compensation) to the extent of the lesser of (i) the amount by which the Fair Market Value of the Common Shares at the time the option was granted exceeded the option price and (ii) the amount by which the Fair Market Value of the Common Shares at the time of disposition of the Common Shares exceeded the price paid. Any further gain is taxed as capital gain. The Company is not entitled to tax deductions for any portion of the income or gain recognized by the employee meeting the holding period requirements.

If the sales price is less than the option price, there is no ordinary income and the employee has a long-term capital loss for this difference. Where an employee sells the Common Shares before the expiration of the required holding period, such employee realizes ordinary income (compensation) to the extent of the

difference between the option price and the Fair Market Value of the Common Shares at the date the option was exercised. The Company will generally be allowed a corresponding tax deduction.

Any dividends and other distributions made with respect to Common Shares held in an employee participant's account would be deemed gross income to the participant. Any gain or loss from the sale of any rights or other property distributed with respect to a share of Common Shares held on behalf of a participant is gain or loss to the participant.

**New Plan Benefits Under the 1995/1996 Stock Option Plan,  
the 1995 Executive Incentive Compensation Plan  
and the Stock Purchase Plan**

As of the date of this Proxy statement, no options have been granted under the 1995/1996 Stock Option Plan. Accordingly, no description has been provided of the dollar value of benefits or number of shares underlying the options. The dollar value of benefits under the 1995 Plan is based on the future performance of the Company and therefore not readily ascertainable. However, see "1995 Executive Incentive Plan — Calculation of Awards" for target and maximum amounts payable to the named executive officers. No description of benefits under the Stock Purchase Plan is included because such plan is an ongoing securities purchase plan open to participation by full-time employees. Participation in the plan and levels of participation are voluntary. Accordingly, the Company cannot determine the dollar value of benefits or the number of shares that will be purchased by participants. Each of Messrs. Thompson, Wynne, Lawrence and Hanno is entitled to participate in the 1995/1996 Stock Option Plan, the 1995 Executive Incentive Compensation Plan, and the Stock Purchase Plan. No current non-executive director is entitled to participate in these plans. All employees of the Company and its subsidiaries are eligible to participate in the 1995/1996 Stock Option Plan and the Stock Purchase Plan. The 1995 Executive Incentive Compensation Plan is limited to executive officers.

The affirmative vote of a majority of the Common Shares represented at the Meeting and entitled to vote is required for approval of each element of the proposal. An abstention from voting will be tabulated as a vote withheld, but will be included in computing the number of shares present for purposes of determining the presence of a quorum. Under stock exchange and NASDAQ rules, brokers may be precluded from voting stock they hold for others on the foregoing proposal, except in accordance with instruction from the beneficial owners thereof. In addition, under applicable Delaware law, a broker non-vote will not be considered present and entitled to vote, but will be included in computing the number of shares present for purposes of determining the presence of a quorum.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" APPROVAL OF THE 1995/1996 LCI INTERNATIONAL, INC. STOCK OPTION PLAN, THE 1995 EXECUTIVE INCENTIVE COMPENSATION PLAN, AND THE AMENDED AND RESTATED EMPLOYEE STOCK PURCHASE PLAN. UNLESS INDICATED OTHERWISE ON THE PROXY, THE SHARES WILL BE VOTED FOR EACH ELEMENT OF THIS PROPOSAL.**

## PROPOSAL NUMBER THREE

### RATIFICATION OF THE SELECTION OF INDEPENDENT ACCOUNTANTS

Upon recommendation of the Audit Committee, the Board of Directors proposes and recommends that the stockholders ratify the selection of the firm of Arthur Andersen LLP to serve as independent accountants of the Company for 1995. Unless otherwise directed by the stockholders, proxies will be voted for approval of the selection of Arthur Andersen LLP as the independent accountants of the Company for 1995. A representative of Arthur Andersen LLP will attend the Meeting, and will have an opportunity to make a statement if he so desires and to respond to appropriate questions.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE RATIFICATION OF THE SELECTION OF ARTHUR ANDERSEN LLP AS THE COMPANY'S INDEPENDENT ACCOUNTANTS FOR 1995. UNLESS INDICATED OTHERWISE ON THE PROXY, THE SHARES WILL BE VOTED FOR THIS PROPOSAL.**

### DATE FOR SUBMISSION OF STOCKHOLDER PROPOSAL

Appropriate proposals from stockholders intending to be present at the 1996 annual meeting must be received by the Company for inclusion in the Company's proxy statement and form of proxy relating to that meeting on or before December 1, 1995.

### MISCELLANEOUS

The Company will bear all of the costs of the solicitation of proxies for use at the Meeting. In addition to the use of the mails, proxies may be solicited by a personal interview, telephone and telegram by directors, officers and employees of the Company, who will undertake such activities without additional compensation. Banks, brokerage houses and other institutions, nominees or fiduciaries will be requested to forward the proxy materials to the beneficial owners of the Common Shares held of record by such persons and entities and will be reimbursed for their reasonable expenses incurred in connection with forwarding such material.

Stockholders who do not expect to attend in person are urged to sign, date and return the enclosed proxy in the envelope provided. In order to avoid unnecessary expense, we ask your cooperation in mailing your proxy promptly, no matter how large or how small your holdings may be.

As of the date of this Proxy Statement, management had no knowledge of any business, other than that described herein, which will be presented for consideration at the Meeting. In the event any other business is properly presented at the Meeting, it is intended that the persons named in the enclosed proxy will have authority to vote such proxy in accordance with their judgment on such business.

By Order of the Board of Directors  
JAMES D. HEFLINGER  
*Secretary*

## APPENDIX A

### 1995/1996 LCI INTERNATIONAL, INC. STOCK OPTION PLAN

#### 1. Purposes.

The 1995/1996 LCI International, Inc. Stock Option Plan (the "Plan") is intended to attract and retain the best available personnel for positions of substantial responsibility with LCI International, Inc., a Delaware corporation (the "Company"), LCI International Management Services, Inc. ("LCI"), or any other subsidiary corporations of the Company, and to provide additional incentive to such persons to exert their maximum efforts toward the success of the Company and its subsidiary corporations. The above aims will be effectuated through the granting of certain stock options ("Options"). Under the Plan, the Company may grant "incentive stock options" ("ISOs") within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, or Options which are not intended to be ISOs ("Non-Qualified Options").

#### 2. Administration of the Plan.

The Plan shall be administered by a committee (the "Committee") consisting of at least three persons, appointed by the Board of Directors of the Company (the "Board of Directors"), each of whom shall be a "disinterested person" within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934 (the "Exchange Act"). The Committee may exercise the power and authority vested in the Board of Directors under the Plan. In administering the Plan, the Committee shall follow any general guidelines not inconsistent with the Plan established by the Board of Directors and may adopt rules and regulations for carrying out the Plan. Within the limits of the express provisions of the Plan, the Committee shall have the authority, in its discretion, to take the following actions under the Plan:

(a) to determine the individuals to whom, and the time or times at which, Options to purchase the Company's shares of common stock, par value \$.01 per share ("Common Shares"), shall be granted, the number of Common Shares to be subject to each Option and whether such Options shall be ISOs or Non-Qualified Options;

(b) to interpret the Plan;

(c) to prescribe, amend and rescind rules and regulations relating to the Plan;

(d) to determine the terms and provisions of the respective stock option agreements granting Options, including the date or dates upon which Options shall become exercisable, which terms need not be identical;

(e) to accelerate the vesting of any outstanding Options; and

(f) to make all other determinations and take all other actions necessary or advisable for the administration of the Plan. In making such determinations, the Committee may take into account the nature of the services rendered by such individuals, their present and potential contributions to the Company's success, and such other factors as the Committee, in its discretion, shall deem relevant. An individual to whom an option has been granted under the Plan is referred to herein as an "Optionee." The Committee's determinations on the matters referred to in this Section 2 shall be conclusive.

#### 3. Shares Subject to the Plan.

The total number of Common Shares which shall be subject to Options granted under the Plan shall not exceed 2,000,000 subject to adjustment as provided in Section 7 hereof. The Company shall at all times while the Plan is in force reserve such number of Common Shares as will be sufficient to satisfy the requirements of outstanding Options. The Common Shares to be issued upon exercise of Options shall be authorized and unissued or reacquired Common Shares held in treasury. The unexercised portion of any expired, terminated or canceled Option shall again be available for the grant of Options under the Plan. In addition, in no event shall any one person be granted options for more than 500,000 Common Shares during any calendar year for which the Plan is in effect.

#### 4. Eligibility.

(a) Options may be granted under the Plan only to employees of the Company, LCI or to employees of any other "subsidiary corporation" (a "Subsidiary") of the Company within the meaning of Section 424(f) of the Code. The term "Company," when used in context of an Optionee's employment, shall be deemed to include Subsidiaries of the Company.

(b) Nothing contained in the Plan shall be construed to limit the right of the Company to grant stock options otherwise than under the Plan for proper corporate purposes.

#### 5. Terms of Options.

The terms of each Option granted under the Plan shall be determined by the Committee consistent with the provisions of the Plan, including the following:

(a) The purchase price of the Common Shares subject to each Option shall be fixed by the Committee, in its discretion, at the time such Option is granted. Except in the case of ISOs, such purchase price may be less than the Fair Market Value (as determined in accordance with Section 5(g) hereof) of the Common Shares as of the date of grant.

(b) The dates on which each Option (or portion thereof) shall be exercisable shall be fixed by the Committee, in its discretion, at the time such Option is granted.

(c) The expiration of each Option shall be fixed by the Committee, in its discretion, at the time such Option is granted. No Option shall be exercisable after the expiration of ten (10) years from the date of its grant and each Option shall be subject to earlier termination as determined by the Committee, in its discretion, at the time such Option is granted.

(d) The exercise period following death, disability and termination of employment shall be determined by the Committee, in its discretion, at the time the option is granted.

(e) Options shall be exercised by the delivery to the Company at its principal office or at such other address as may be established by the Committee (Attention: Corporate Treasurer) of written notice of the number of Common Shares with respect to which the Option is being exercised accompanied by payment in full of the purchase price of such shares. Unless otherwise determined by the Committee at the time of grant, payment for such shares may be made (i) in cash, (ii) by certified check or bank cashier's check payable to the order of the Company in the amount of such purchase price, (iii) by delivery to the Company of Common Shares having a Fair Market Value equal to such purchase price, (iv) by irrevocable instructions to a broker to deliver promptly to the Company the amount of sale or loan proceeds necessary to pay such purchase price and to sell the Common Shares to be issued upon exercise of the Option and deliver the cash proceeds less commissions and brokerage fees to the Optionee or to deliver the remaining Common Shares to the Optionee, or (v) by any combination of the methods or payment described in (i) through (iv) above.

(f) An Optionee shall not have any of the rights of a shareholder with respect to the Common Shares subject to his or her Option until such shares are issued to him or her upon the exercise of his or her Option.

(g) Options shall not be transferable, except by will or the laws of descent and distribution or pursuant to a qualified domestic relations order as defined by the Internal Revenue Code of 1986, as amended, and may be exercised during the lifetime of the Optionee only by him or her. No Option granted under the Plan shall be subject to execution, attachment or other process.

(h) For purposes of the Plan, the Fair Market Value of Common Shares as of any date shall be deemed to be the mean between the highest and lowest sale prices reported on the New York Stock Exchange ("NYSE"), the National Association of Securities Dealers Automated Quotation System - National Market System ("NASDAQ-NMS") or the principal national securities exchange on which such Common Shares are listed and traded on the immediately preceding date, or, if there is no such sale on that date, then on the last preceding date on which such a sale was reported. If the Common Shares are not quoted on the NYSE, the NASDAQ-NMS or listed on an exchange, or representative quotes are not otherwise available, the Fair Market Value of the Common Shares shall mean the amount determined by the Committee to be the Fair Market Value based upon a good faith attempt to value the Common Shares accurately.

## **6. Special Provisions Applicable to ISOs.**

The following special provisions shall be applicable to ISOs granted under the Plan.

(a) No ISOs shall be granted under the Plan after ten (10) years from the earlier of (i) the date the Plan is adopted, or (ii) the date the Plan is approved by the shareholders of the Company.

(b) The purchase price per share with respect to Common Shares subject to any ISO granted under the Plan may not be less than the Fair Market Value of a Common Share at the time such ISO is granted, as determined by the Committee.

(c) ISOs may not be granted to a person who owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company, any of its Subsidiaries, or any "parent corporation" (a "Parent") of the Company within the meaning of Section 424(e) of the Code.

(d) If the aggregate Fair Market Value of the Common Shares with respect to which ISOs are exercisable for the first time by any Optionee during a calendar year (under all plans of the Company and its Parents and Subsidiaries) exceeds \$100,000, such ISOs shall be treated, to the extent of such excess, as Non-Qualified Options. For purposes of the preceding sentence, the Fair Market Value of the Common Shares shall be determined at the time the ISOs covering such shares were granted.

(e) Without prior written notice to the Company, no Common Shares acquired by an Optionee upon exercise of an ISO granted hereunder may be disposed of by the Optionee within two (2) years from the date such ISO was granted, nor within one (1) year after the transfer of such Common Shares to the Optionee; provided, however, that a transfer to a trustee, receiver, or other fiduciary in any insolvent proceeding, as described in Section 422(c)(3) of the Internal Revenue Code of 1986, shall not be deemed to be such a disposition. If Section 422 of the Internal Revenue Code of 1986 is amended during the term of this Plan, the Committee may modify this Plan consistently with such amendment.

## **7. Adjustment upon Changes in Capitalization.**

(a) In the event that the outstanding Common Shares are changed by reason of any reorganization, merger, consolidation, recapitalization, reclassification, stock split-up, combination or exchange of shares and the like, or dividends payable in Common Shares, an appropriate adjustment shall be made by the Committee in the aggregate number of shares available under the Plan and in the number of shares and price per share subject to outstanding Options. If the Company shall be reorganized, consolidated, or merged with another corporation, or if all or substantially all of the assets of the Company shall be sold or exchanged, an Optionee shall at the time of issuance of the stock under such corporate event be entitled to receive upon the exercise of his Option the same number and kind of shares of stock or the same amount of property, cash or securities as he would have been entitled to receive upon the occurrence of any such corporate event as if he had been, immediately prior to such event, the holder of the number of Common Shares covered by his Option.

(b) Any adjustment under this Section 7 in the number of Common Shares subject to Options shall apply proportionately to only the unexercised portion of any Option granted hereunder. If fractions of a share would result from any such adjustment, the adjustment shall be revised to the next lower whole number of shares.

## **8. Further Conditions of Exercise.**

(a) Unless prior to the exercise of an Option, the Common Shares issuable upon such exercise are the subject of a registration statement filed with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended (the "Securities Act"), and there is then in effect a prospectus meeting the requirements of Section 10(a)(3) of the Securities Act, the notice of exercise with respect to such Option shall be accompanied by a representation or agreement of the Optionee to the Company to the effect that such shares are being acquired for investment only and not with a view to the resale or distribution thereof, or such other documentation as may be required by the Company, unless, in the opinion of counsel to the Company, such representation, agreement or documentation is not necessary to comply with the Securities Act.

(b) Anything in subparagraph (a) of this Section 8 to the contrary notwithstanding, the Company shall not be obligated to issue or sell any Common Shares until they have been listed on each securities exchange on which the Common Shares may then be listed and until and unless, in the opinion of counsel to the Company, the Company may issue such shares pursuant to the qualification of an effective registration statement, or an exemption from registration, under such state and federal laws, rules or regulations as such counsel may deem applicable. The Company shall use reasonable efforts to effect such listing, qualification and registration, as the case may be.

#### **9. Termination, Modification and Amendment.**

(a) The Plan (but not Options previously granted under the Plan) shall terminate ten (10) years from the date of its adoption by the Board of Directors, and no Option shall be granted after termination of the Plan. Any Option outstanding at the termination date shall remain outstanding until it either has expired or been exercised.

(b) The Plan may from time to time be terminated, modified or amended by the affirmative vote of the holders of a majority of the outstanding shares of the capital stock of the Company entitled to vote thereon.

(c) The Board of Directors of the Company may at any time terminate the Plan or from time to time make such modifications or amendments of the Plan as it may deem advisable; provided, however, that the Board of Directors shall not, without approval by the affirmative vote of the holders of a majority of the outstanding shares of the capital stock of the Company entitled to vote thereon, increase (except as provided in Section 7) the maximum number of Common Shares as to which Options may be granted under the Plan or change the class of persons eligible to receive Options under the Plan.

(d) No termination, modification or amendment of the Plan may adversely affect the rights conferred by any Options without consent of the affected Optionee.

#### **10. Effectiveness of the Plan.**

The Plan shall become effective upon adoption by the Board of Directors of the Company, subject to the approval by the shareholders of the Company. Options may be granted under the Plan prior to receipt of such approval, provided that, in the event such approval is not obtained, the Plan and all Options granted under the Plan shall be null and void and of no force and effect.

#### **11. Not a Contract of Employment.**

Nothing contained in the Plan or in any stock option agreement executed pursuant hereto shall be deemed to confer upon any Optionee any right to remain in the employ of the Company or subsidiary corporation.

#### **12. Governing Law.**

The Plan shall be governed by the laws of the State of Delaware without reference to principles of conflict of law.

#### **13. Withholding.**

As a condition to the exercise of any Option, the Committee may require that an Optionee satisfy, through withholding from other compensation or otherwise, the full amount of all federal, state and local income and other taxes required to be withheld in connection with such exercise.

#### **14. Approved Leaves of Absence.**

In the case of an Optionee on an approved leave of absence, the Committee may, if it determines that to do so would be in the best interests of the Company, provide in a specific case for continuation of the Options held by such Optionee during such leave of absence; such continuation to be in such terms and conditions as the Committee determines to be appropriate, except that in no event shall an option be exercisable after ten (10) years from the date it is granted.

**APPENDIX B**  
**LCI INTERNATIONAL, INC.**  
**AMENDED AND RESTATED**  
**EMPLOYEE STOCK PURCHASE PLAN**

This is an Amendment and Restatement of the LiTel Communications, Inc. 1993 Employee Stock Purchase Plan, now referred to as the Amended and Restated LCI International and Subsidiaries Employee Stock Purchase Plan (the "Plan").

**1. Purpose of Plan.**

The purpose of the Plan is to provide eligible employees who wish to become stockholders of LCI International, Inc. (the "Company"), or who wish to increase their stockholdings in the Company, with an opportunity to purchase shares of the Company's common stock, par value \$0.01 per share ("Common Stock") which is both convenient and on a basis more favorable than would otherwise be available. It is believed that employee participation in ownership of the Company on this basis will be to the mutual benefit of both the employees and the Company. It is intended that the Plan constitute an "employee stock purchase plan" (a "Stock Purchase Plan") within the meaning of Section 423 of the Internal Revenue Code of 1986, as amended (the "Code").

**2. Employees Eligible To Participate.**

a) Any employee who has been continuously employed for a period of ninety (90) days or more by the Company, LCI International Management Services, Inc., or any "parent corporation" of the Company within the meaning of Section 424(e) of the Code (a "Parent"), or "subsidiary corporation" of the Company within the meaning of Section 424(f) of the Code (a "Subsidiary") which adopts the Plan with the consent of the Company (an "Employing Corporation") is eligible to participate in the Plan. Notwithstanding the foregoing and to the extent permitted by Section 423 of the Code and any rules or regulations promulgated thereunder, an employee whose customary employment with the Employing Corporation is for twenty (20) hours or less per week or for not more than five (5) months in any calendar year shall not be eligible to participate in the Plan. Upon reemployment of a former participant whose employment with the Company or a participating subsidiary is terminated, the former participant will be required to fulfill the eligibility requirements set forth in this paragraph anew. The term "employee" shall not include a member of the Board of Directors of an Employing Corporation who is not an employee of an Employing Corporation.

b) Notwithstanding the prior paragraph, any employee subject to Rule 16(b) of the Securities Exchange Act of 1934, must be continuously employed for a period of six (6) months to be eligible to participate in the Plan. However, once the provisions of paragraph 2(a) have been approved by the shareholders, any person subject to Rule 16(b) of the Securities Act of 1934 and hired after the date of shareholder approval shall be subject to the provisions of paragraph 2(a).

**3. Eligible Compensation.**

Compensation eligible for payroll deductions shall be base salary and, to the extent allowed by the Stock Purchase Plan Committee (the "Committee"), commissions (if any) paid in each payroll period. Eligible compensation does not include overtime, bonuses, severance pay, incentive pay, shift premium differentials, pay in lieu of vacation, imputed income for income tax purposes, patent and award fees, awards and prizes, back pay awards, reimbursement of expenses and living allowances, educational allowances, expense allowances and reimbursements, disability benefits under any insurance program, fringe benefits, deferred compensation, compensation under the Company's stock plans, amounts paid for services as an independent contractor, or any other compensation excluded by the Committee in its discretion. The preceding sentence notwithstanding, compensation shall be determined before giving effect to any salary reduction agreement pursuant to a qualified cash or deferred arrangement within the meaning of Section 401(k) of the Code or to



any similar reduction agreement pursuant to any cafeteria plan (within the meaning of Section 125 of the Code).

#### **4. Terms of Offers.**

##### *(a) Offer Dates.*

The Committee shall determine the date or dates upon which one (1) or more offers ("Offer"/"Offers") shall be made under the Plan, provided that, (i) in no event shall any Offer have a term of more than twenty-seven (27) months, and (ii) the first Offer made under the Plan shall have a term of twenty-seven (27) months and shall commence on the date upon which the Securities and Exchange Commission ("SEC") declares effective the Company's Registration Statement on Form S-1 relating to shares of the Company's Common Stock (File No. 33-60558).

##### *(b) Elections to Participate.*

In order to participate in an Offer, an eligible employee must sign and forward to the Committee a payroll deduction authorization form authorizing regular payroll deductions in any full percentage of his eligible compensation, which may not exceed the maximum percentage of the employee's eligible compensation per pay period, to be applied toward the purchase of Common Stock pursuant to the Offer. The "maximum percentage" means the percent of eligible compensation available for payroll deductions which shall be specified by the Committee at the beginning of the term of each Offer, and which shall not exceed fifteen percent (15%). The payroll deduction authorization form must be submitted to the Committee at least ten (10) days prior to the effective date of the Offer, or such other number of days as the Committee may prescribe from time to time.

#### **5. Participation.**

##### *(a) In General.*

On the effective date of an Offer, each then eligible employee who has elected to participate in the Offer as provided in Section 4 hereof will be granted an option to purchase, through payroll deductions, as many full and partial shares of Common Stock, subject to the terms of the Plan and the limitations hereinafter set forth, as may be purchased with the percentage of eligible compensation authorized by him to be applied toward the purchase of Common Stock during the term of the Offer.

##### *(b) Newly Eligible Employees.*

Each employee who is not eligible to participate in the Plan on the effective date of an Offer but who becomes eligible to participate during the term of the Offer will, as of the first trading day of the month which begins at least ten (10) days after the date on which such employee became eligible, be granted an option to purchase, through payroll deductions, as many full shares of Common Stock, subject to the terms of the Plan and the limitations hereinafter set forth, as may be purchased with the percentage of eligible compensation authorized by him to be applied toward the purchase of Common Stock during the remainder of the term of the Offer. In such cases, the employee's payroll deduction authorization form must be submitted to the Committee at least ten (10) days prior to the first trading day of such month.

##### *(c) Enrollment During an Offer.*

Any employee who does not elect to participate within the period for initial enrollment in a particular Offer may subsequently elect to participate in such Offer, but such employee shall have a Base Option Price (as defined herein) determined as if he had elected to participate within the initial enrollment period for such Offer, withdrawn from participation, and then elected to recommence participation pursuant to paragraph 11. In such cases, the employee's payroll deduction authorization form must be submitted to the Committee at least ten (10) days prior to the first trading day of the first month in the Offer to which such election relates.

(d) *Notice of Dispositions.*

Each participant in an Offer shall agree to notify the Company of any disposition of shares of Common Stock purchased pursuant to the Plan prior to the expiration of the holding periods set forth in Section 423(a) of the Code.

(e) *Equivalent Rights.*

All employees granted options under the Plan shall have the same rights and privileges under the Plan except that the number of shares each participant may purchase will bear a uniform relationship to his eligible compensation and will depend upon the percentage of payroll deduction he authorizes.

(f) *Trading Day.*

For purposes of the Plan, a "trading day" is a day on which shares of Common Stock are traded in the over-the-counter market or, if the Common Stock is then listed or admitted to trading on a national securities exchange, on the principal national securities exchange on which the Common Stock is then listed or admitted to trading.

**6. Participation Limitations.**

(a) *Five Percent Owners.*

Notwithstanding anything herein to the contrary, no employee shall be granted an option to purchase any shares under the Plan if the employee, immediately after the option is granted, owns or would own shares (including all shares which may be purchased under outstanding options under the Plan) possessing five percent (5%) or more of the total combined voting power or value of all classes of shares of capital stock of the Employing Corporation or any Parent or Subsidiary. For purposes of the foregoing limitation, the rules of Section 424(d) (relating to attribution of stock ownership) of the Code shall apply in determining share ownership, and stock which the employee may purchase under outstanding options shall be treated as stock owned by such employee.

(b) *\$25,000 Value Limitation.*

If pursuant to the terms of the Plan, an employee would be granted one or more options that violate Section 423(b)(8) of the Code, such options shall not be granted and in its place the employee shall be granted options to purchase shares which permit his rights to purchase shares under all Stock Purchase Plans of the Employing Corporation and its Parents and Subsidiaries to accrue at a rate which does not exceed twenty-five thousand dollars (\$25,000) of the Fair Market Value of such shares (determined at the time such options were granted) for each calendar year in which such options are outstanding at any time. In determining this limitation, the rules of Section 423(b)(8) of the Code and the regulations thereunder shall apply.

(c) *Fair Market Value.*

For purposes of the Plan, the "Fair Market Value" of the Common Stock on any date shall mean the closing price of a share of Common Stock on the New York Stock Exchange on such date (the "Fair Market Value"). If the Common Stock is no longer traded on the New York Stock Exchange, the Board of Directors shall determine, in good faith, the Fair Market Value.

(d) *Maximum Number of Shares.*

The maximum number of shares which an employee will be permitted to purchase pursuant to any one (1) Offer will be 10,000 shares. When the foregoing participation limitation is reached, payroll deductions shall cease, and any amount of excess funds as of the date that the participation limitation has been reached shall be returned to the employee.

## 7. Option Price.

### (a) *In General.*

Subject to the provisions of paragraph 11 with regard to recommencement of participation, the price at which shares of Common Stock may be purchased with respect to any Offer made under the Plan shall be determined by the Committee, but may not be less than the lesser of (i) eighty-five percent (85%) of the Fair Market Value of a share of Common Stock on the effective date of such Offer (the "Base Option Price") or (ii) eighty-five percent (85%) of the Fair Market Value of a share of Common Stock on the date such Common Stock is purchased through options granted in connection with such Offer (the "Alternative Option Price").

### (b) *Adjustments.*

In the event that an Offer shall have a term of more than fifteen (15) months, the Base Option Price may be subject to adjustment on the date (the "Revaluation Date") which falls at the midpoint of the interval between the effective date of the Offer and the end of the term of the Offer. This adjustment may be made at the discretion of the Committee. If eighty-five percent (85%) of the average of the Fair Market Value of a share of Common Stock during a period of twenty (20) trading days ending one (1) month before the Revaluation Date is an amount different than the then applicable Base Option Price, then the applicable Base Option Price shall be adjusted to such different amount which shall be and continue to be the then applicable Base Option Price; provided, however, that if such adjustment would result in the adjusted Base Option Price being lower than the initial Base Option Price for any participant, the initial Base Option Price shall remain unchanged.

## 8. Exercise of Options.

### (a) *Purchase of Common Stock.*

At the end of each payroll period, each participant shall have deducted from his pay the amount authorized pursuant to paragraphs 4 or 5 hereof, as applicable. This amount shall be held for the credit of the participant by the Company as part of its general funds and shall not accrue any interest. On the last trading day of each full month during the term of the Offer, a participant will be deemed to have exercised his option to purchase, at the lower of the then applicable Base Option Price or the Alternative Option Price, that number of full and partial shares of Common Stock which may be purchased with the amount deducted from the participant's compensation during that month and excess funds from the preceding month, if any.

### (b) *Custodian.*

Each month, the Plan custodian designated by the Committee shall receive from the Company, at the applicable option price, as many full shares of Common Stock as may be purchased with the funds received from each participant for that month. Upon receipt of the Common Stock so purchased, the custodian will allocate to the credit of each participant the number of full shares of Common Stock, and the amount of any partial shares, to which that participant is entitled. Subject to any limitations imposed by the Committee from time to time, a certificate representing the number of shares of Common Stock to which a participant is entitled will be issued to the participant upon written request. Unless otherwise requested by the participant, Common Stock purchased under the Plan will be held by and in the name of, or in the name of a nominee of, the custodian for the benefit of each participant, who shall thereafter be a beneficial stockholder of the Company.

### (c) *Rights as a Stockholder.*

A participant's rights as a stockholder of record of the Company shall begin when the custodian makes a purchase of Common Stock on behalf of the participant. Shares of Common Stock issued to participants shall be transferable in accordance with applicable securities laws.

#### **9. Number of Shares To Be Offered.**

The maximum number of shares of Common Stock that may be purchased under the Plan is 900,000. Such shares may be treasury shares, or authorized and unissued shares, as the Board and Directors of the Company (the "Board") may determine in its discretion.

#### **10. Administration of the Plan.**

The Plan shall be administered by the Committee. The members of the Committee shall be designated by the Board. The Committee shall have the sole responsibility for the administration of the Plan, and, except as herein expressly provided, the Committee shall have the exclusive right to interpret the provisions of the Plan and to determine any questions arising hereunder or in connection with the administration of the Plan, including the remedying of any omission, inconsistency, or ambiguity, and the determination of benefits, eligibility and interpretation of Plan provisions. The Committee's decisions, determinations, interpretations or other actions in respect thereof shall be conclusive and binding upon all participants, former participants, beneficiaries, heirs, executors, assigns, and all other parties.

#### **11. Withdrawal from Participation.**

A participant may, at any time and for any reason, by giving written notice to the Committee, elect to withdraw from any further participation in an Offer. The participant withdrawing will, as soon as practicable, but only after stockholder approval of the Plan, receive a certificate representing the number of full shares of Common Stock credited to the participant's account as of the date of withdrawal and a check for any funds not applied toward the purchase of full shares as of that date. During the remainder of the term of an Offer, the participant may elect to recommence his participation in that Offer by executing and delivering to the Committee a new payroll deduction authorization form at least (10) days prior to the first trading day of the first month in the Offer to which such election relates. The Base Option Price applicable to a recommencing participant shall be the greater of (i) the Base Option Price applicable to that participant had he not withdrawn from participation during the Offer, or (ii) eighty-five percent (85%) of the Fair Market Value of a share of Common Stock on the recommencement date. A participant may withdraw from participation and recommence participation as provided in this paragraph 11 only once during the term of an Offer and, after the second such withdrawal, shall not be allowed to recommence participation during the remainder of the term of the Offer.

#### **12. Rights Not Transferable.**

Options granted under the Plan shall not be transferable by a participant otherwise than by will or the laws of descent and distribution, and shall be exercisable, during a participant's lifetime, only by him.

#### **13. Termination of Employment.**

In the event of a participant's retirement, death, or other termination of employment, no payroll deductions will be made from any compensation then due and owing to such employee at such time, and a certificate representing the number of full shares of Common Stock then credited to the participant's account and a check for any amount of excess funds contributed as of that date (and not eligible for the purchase of shares) will be issued and delivered to the participant or his representative.

#### **14. Periods of Inactive Employment.**

During periods of inactive employment of a participant due to disability or an approved leave of absence, which are less than ninety days and so long as the participant remains an employee of the Company, the participant will not be considered as withdrawing from the Plan.

During the inactive status, the participant may continue to make payroll deductions under the Plan during the first ninety (90) days from the effective date of the inactive status, provided the participant continues to receive "eligible compensation" from the Company as defined in Section 3. However, the

participant may elect to discontinue the payroll deduction during the inactive status. Any such election shall constitute a withdrawal from the Plan.

If the participant does not receive eligible compensation from the Company, during the inactive status, and returns within ninety (90) days, the participant's payroll deductions will resume and the participant's base option price will not be impacted by the leave.

If the inactive status extends beyond ninety (90) days, on the ninety first day, payroll deductions, if any will cease. As soon as is practicable, a certificate representing the number of full shares of Common Stock then credited to the participant's account and a check for any amount of excess funds contributed and partial shares credited to such account as of that date (and not eligible for the purchase of shares) will be issued and delivered to the participant.

#### **15. Reorganization.**

In the event of a reorganization, recapitalization, stock split, stock dividend, combination of shares, merger, consolidation, offering of rights, or any other change in the structure of Common Stock, the Committee may make such adjustments, if any, as it may deem appropriate in the number, kind, and price of shares available for purchase under the Plan, and in the minimum and maximum number of shares which a participant is entitled to purchase.

#### **16. Approval of Stockholders.**

No shares of Common Stock will be issued pursuant to the Plan prior to the approval of the Plan by the Company's stockholders.

#### **17. Amendments.**

The Board may amend the Plan at any time without obtaining the approval of the stockholders of the Company, provided, however, that the Board shall not amend the Plan without approval of the stockholders of the Company if such amendment (i) increases the number of shares of Common Stock that are reserved for issuance under the Plan; (ii) extends the duration of the Plan; (iii) increases the maximum term of the options; (iv) changes the option price; or (v) changes the Eligible Class of Employees. Furthermore, the Board may not amend the Plan in any manner which would materially and adversely affect an option previously granted to a participant without the consent of such participant; provided, however, that the Board may at any time make such amendments as it may deem necessary to cause the Plan to comply with the requirements of Rule 16b-3 promulgated by the SEC under the Securities Exchange Act of 1934, as amended.

#### **18. Termination of Plan.**

The Plan and all rights of participants will terminate (i) on the date as of which participants have exercised options to purchase a number of shares equal to or greater than the number of shares then subject to the Plan or (ii) if earlier, the date as of which the Committee or the Board terminates the Plan. Upon termination, all payroll deductions shall cease and all amounts credited to participants' accounts shall be equitably applied to the purchase of the shares then available under the Plan, and all funds accumulated under the Plan not utilized to purchase Common Stock will be refunded.

#### **19. Required Governmental Approvals.**

The Plan, and all options granted under and other rights inherent in the Plan, are subject to stockholder approval as provided in paragraph 16 and to receipt by the Company of all necessary approvals or consents of governmental agencies which the Company, in its sole discretion, shall deem necessary or advisable. Notwithstanding any other provision of the Plan, all options granted under the Plan and all other rights inherent in the Plan are subject to such termination and/or modification as may be required or advisable in order to obtain any such approval or consent, or which, as a result of consequences attaching to any such approval or consent, may be required or advisable in the judgment of the Committee in order to avoid adverse impact on the Company's overall wage and salary policy.

**20. No Employment Rights.**

The Plan does not, directly or indirectly, create in any employee or class of employees any right with respect to continuation of employment by the Employing Corporation, and it shall not be deemed to interfere in any way with the Employing Corporation's right to terminate, or otherwise modify, an employee's employment at any time with or without cause.

**21. Gender.**

Pronouns shall be deemed to include both the masculine and feminine gender, and words used in the singular shall be deemed to include both the singular and the plural, unless the context indicates otherwise.

**22. Expenses.**

Expenses of administering the Plan, including any expenses incurred in connection with the purchase by the Company of shares for sale to participating employees, shall be borne by the Employing Corporations.

**23. Governing Law.**

All rights and obligations under the Plan shall be construed and interpreted in accordance with the laws of the State of Ohio, without giving effect to principles of conflict of laws.

**24. Effective Date.**

The Plan, as amended and restated herein, shall become effective on August 13, 1995 provided the stockholders approve the Plan within twelve (12) months from that date.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SF  
OF 1934 [FEE REQUIRED]

For the fiscal year ended December 31, 1994



8180 Greensboro Drive · Suite 800 · McLean, VA · 22102

TRANSITION REPORT PURSUANT TO  
ACT OF 1934 [NO FEE REQUIRED]

LOCAL SERVICE APPLICATION

EXHIBIT D

For the transition period from \_\_\_\_\_

Commission file number 33-60558

**LCI INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

DELAWARE  
(State of Incorporation)

13-3498232  
(I.R.S. Employer Identification Number)

8180 GREENSBORO DRIVE, SUITE 800  
McLEAN, VA  
(Address of principal executive offices)

22102  
(Zip Code)

Registrant's telephone number, including area code: 1-800-555-2124

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$.01 par value  
(title of class)

5% Cumulative Convertible Exchangeable  
Preferred Stock, \$.01 par value  
(title of class)

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

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

The aggregate market value of the voting stock held by non-affiliates of LCI International, Inc. was \$353,161,100 at March 1, 1995.

As of March 1, 1995, there were 29,669,831 shares of LCI International, Inc. Common Stock (par value \$.01 per share) outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 1994 Annual Report to Shareowners - Part II  
Portions of the Proxy Statement for the 1995 Annual Meeting of Shareowners - Part III

## **Part I**

### **Item 1. Business**

LCI International, Inc. ("LCI" or "the Company") is a facilities-based long distance telecommunications carrier that provides a broad array of domestic and international voice and data services to commercial and residential customers. The Company serves its customers primarily through leased and owned digital fiber optic facilities spanning the U.S. and more than 200 countries. LCI's network also includes eight switches in Columbus, Cleveland, Chicago, Jersey City, Washington DC, Atlanta, Charlotte and Los Angeles - connecting LCI to metropolitan areas that account for 95% of U.S. call volume.

LCI, a Delaware corporation, was incorporated in 1988 and is a holding company. The Company's operations are conducted through LCI's directly wholly owned subsidiary, LCI International Management Services, Inc. ("LCI Management Services"), and indirectly wholly owned subsidiaries, LCI International Telecom Corp. ("LTC") and LCI Telecom South, Inc.

As used in this Annual Report on Form 10-K, references to "LCI" and the "Company" refer to LCI and its direct and indirect subsidiaries, unless otherwise indicated or the context otherwise requires.

### **Industry Background**

The \$70 billion U.S. long distance telecommunications industry is dominated by the nation's three largest long distance providers, AT&T Corp. (AT&T), MCI Communications Corporation (MCI) and Sprint Corporation (Sprint), which together generated approximately 85% of the aggregate revenues of all U.S. long distance interexchange carriers. Fewer than ten other interexchange carriers, including the Company, have annual revenues exceeding \$200 million each. The balance of the industry comprises several hundred smaller inter-exchange carriers.

Today's long distance telecommunications marketplace was principally shaped by the 1984 court-ordered divestiture by AT&T of its 22 Bell Operating Companies, known as "BOCs." As part of the AT&T Divestiture Decree, the United States was divided into geographic areas known as Local Access Transport Areas or "LATAs." The local exchange carriers, known as "LECs," which include the Bell Operating Companies and independent local exchange carriers, provide local telephone service, local access services and short-haul toll service. Interexchange carriers known as "IXCs," including the Company, and certain independent local exchange carriers provide long distance service between LATAs (interLATA traffic) and within LATAs. Under the AT&T Divestiture Decree, the Bell Operating Companies are currently permitted only to provide local telephone service, local access services and toll service that both originates and terminates within the same LATA (intraLATA traffic). The Bell Operating Companies are generally prohibited from entering the interLATA long distance market although independent local exchange carriers are not so limited. Several Regional Bell Operating Companies (RBOCs) have petitioned the Department of Justice seeking waivers from the AT&T Divestiture Decree in order to remove the interLATA restriction. There are also several pending legislative initiatives that would allow the RBOCs to provide interLATA services (see Business - Regulation). The Company is unable to predict the outcome of these pending matters.



## Telecommunications Services

The Company provides a broad array of long distance telecommunications services to its customers, which include residential, small, medium-sized and large businesses, national accounts, other carriers, government agencies and academic institutions. The Company's switched services include basic long distance or measured toll service (MTS), accessible via "1 plus" dialing or dialing a five digit access code, and a variety of wide area telecommunications service (WATS) available through switched or dedicated lines. Due to the almost universal use of high quality digital transmission facilities, the Company believes that quality of transmission is no longer a substantial competitive advantage. The Company therefore seeks to attract and retain a wide range of commercial and residential customers through frequent introduction of new services, as well as continued provision of high quality service at competitive prices. Although the Company provides long distance services to a wide range of market segments, the Company does not seek to compete with every service offered by the Company's competitors.

Residential customers and small and medium-sized businesses primarily purchase switched services, while carriers and large commercial customers typically purchase both switched and dedicated access services. Switched services are telecommunication services provided to each customer through switching and transmission facilities that are charged on a usage-sensitive basis. Dedicated services are telecommunications services charged on a fixed price basis for which transmission capacity is reserved for that customer's traffic.

**Commercial Services.** In 1994 and 1993, commercial long distance customers (other than wholesale) accounted for 66.2% and 67.7% of the Company's minutes of use and 64.6% and 66.3%, respectively, of its revenues. The Company has expanded its marketing efforts from primarily small to medium-sized businesses in the Midwest to include the full range of large and small businesses throughout the United States. The Company has also expanded its marketing efforts in business international services in order to take full advantage of opportunities in the global telecommunications market. As a result, revenue from business international services grew by 63% and 49% in 1993 and 1994, respectively.

Revenues from the Company's Integrity<sup>TM</sup> product line, a full range of voice and data options for large accounts, grew by over 150% in 1994. Integrity offers term and volume discounts that are more generous than many competing programs with rates that are guaranteed for the life of the contract. All tariffed services count in cross-product discounting. Additional use of LCI's services can increase volume discounts, thereby encouraging customers to use LCI for all of their long distance needs.

In addition to services for large business accounts, revenues from the Company's Simply Business<sup>SM</sup> product, launched in mid-1994 for small businesses, increased on average 30% per month since its introduction. Simply Business<sup>SM</sup> rounds to six seconds intervals in all situations for all calls and offers a simple flat rate that improves with minimum volume and length of contract.

**Residential Services.** Within the past two years the Company has implemented marketing and service development efforts intended to expand its share of the U.S. residential long distance market. The Company now offers residential customers low, simplified rates, direct dialing for nationwide and international calls, 24-hour customer service, combined billing from the local exchange carrier and optional special features such as World Card Plus, a calling card option. As a result, the Company's residential revenue has grown at 119% and 116% in 1994 and 1993, respectively, and represented approximately 16% of the Company's revenues by the end of 1994. This compares with approximately 5% of the Company's revenues at the end of 1993.

Residential services growth rates were accomplished primarily through LCI's All America Plan product that bills customers based on time of day, not distance. Customers are billed in six second increments after the first thirty seconds.

**LCI International, Inc.**  
**1994 Annual Report on Form 10-K**

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**Wholesale and Reseller Services.** Another important source of revenue for the Company is the sale of transmission capacity and services to other long distance wholesalers and to resellers of long distance service. Switched minutes of use purchased by such customers accounted for 23.7% and 25.7% of the Company's total switched minutes of use in 1994 and 1993, respectively. Overall, revenues from such customers represented 10.2% and 10.9% of the Company's total revenues in 1994 and 1993, respectively. Although gross margins on sales to such customers are generally lower than the Company's average, the Company believes that the operating margins on sales to wholesale and reseller customers are approximately equivalent to those on sales to other customers because of the lower sales and service expenses associated with these revenues.

**Point to Point Services.** The Company also offers dedicated telecommunications services to its commercial and wholesale customers. Point to point services are interexchange facilities dedicated exclusively for a single customer's use, connected to customer's locations on both ends with dedicated access facilities. Revenues from point to point services were 13.1% and 15.3% of total revenues for 1994 and 1993, respectively. Historically gross margins on sales of these services have been higher than the Company's average due to fixed transmission facilities in place to handle these services.

### **Facilities**

The Company operates a network that consists of owned digital fiber optic transmission facilities and switches and leased digital transmission facilities. The Company also has entered into arrangements to provide its customers with international services.

The Company's network utilizes transmission equipment consisting of digital fiber optic transmission circuits to complete long distance calls. Within the central Midwest region of the United States, the Company provides services primarily through the operation of its 1,400 mile owned network, which includes digital fiber optic transmission facilities owned by the Company and transmission facilities leased by the Company under capitalized leases. Nationwide, the Company provides long distance telecommunications services primarily through its entire network, which includes the owned network and leased digital fiber optic transmission facilities spanning the continental United States.

In an effort to expand its connections in the New York metropolitan and Southern markets, the Company added network facilities in Jersey City, New Jersey and Atlanta, Georgia in 1994. The Company also expanded to network facilities in the western United States with the acquisition of T.M. Sepulveda Inc. and Premium Access, Inc. (collectively TMS), a Los Angeles-based telecommunications company. Network facilities in North Carolina, South Carolina and Tennessee were acquired through the acquisition of Teledial America of North Carolina, Inc.

During the fourth quarter of 1994, the Company completed negotiations with an interexchange carrier to consolidate a substantial amount of its leased line and interexchange services for a fixed contract period in return for reduced service costs, increased service availability and access to new technologies. The Company's minimum annual billing commitment under this contract is approximately \$48 million beginning in August of 1995 with increasing annual minimums until July 2000. The cumulative annual commitments under this contract are subject to an underutilization charge of 25% of the shortfall calculated under the contract provisions.

### **Competition**

The long distance telecommunications market is highly competitive. The principal competitive factors affecting the Company's market share are pricing, customer services and diversity of services and features. The Company's ability to compete effectively will depend on its continued ability to maintain high quality, market-driven services at prices generally equal to or below those charged by its competitors.

Several of the Company's competitors are substantially larger and have substantially greater financial, technical and marketing resources. As the Company grows, it expects to face increased competition, particularly from AT&T, MCI and Sprint. The Company also competes with regional interexchange carriers and resellers for interLATA long distance services and with local exchange carriers for intraLATA long distance services. Although recent market conditions have reduced the price differential between the Company and its competition, the Company's pricing strategy is to keep its rates generally below those of AT&T and competitive with those of MCI and Sprint.

Price competition in the long distance telecommunications industry has increased in recent years and the Company believes that its customers are very price conscious. The Federal communications Commission (FCC) has, on several occasions since 1984, approved or required price decreases by AT&T. To maintain its competitive posture, the Company believes that it must be in a position to reduce its prices in order to meet rate reductions by AT&T.

### **Regulation**

Although in the past the FCC had extensively regulated interstate communications, the trend during the 1980s was toward lessened regulation for both the Company and its competitors. As a nondominant interexchange carrier, the Company was not required by the FCC to maintain a certificate of public convenience and necessity or file tariffs with the FCC other than with respect to international calls and except for informational tariffs, which must be filed with respect to operator services. Over this period of time, the FCC had retained general regulatory jurisdiction over the sale of interstate telecommunications services by interexchange carriers, including the requirement that service be provided on a nondiscriminatory, just and reasonable basis. As discussed below, as a result of certain judicial determinations, all interexchange carriers must now submit tariffs for the provision of basic telecommunications services.

*Tariffs.* On November 13, 1992, the United States Court of Appeals for the District of Columbia Circuit (Court of Appeals) ruled that the FCC lacks statutory authority to waive the requirement that nondominant interexchange carriers file tariffs. The Court of Appeals reversed the FCC's "forbearance policy" under which nondominant interexchange carriers were not required to file tariffs. As a result of a number of related proceedings, the legality of the FCC's forbearance policy was reviewed by the United States Supreme Court. On June 17, 1994, the Supreme Court issued a ruling upholding the Court of Appeals' decision reversing the FCC's forbearance policy. There is a possibility that the aftermath of the Supreme Court's ruling may affect the Company's pricing practices.

As a consequence of the FCC's forbearance policy being overturned, the FCC promulgated new tariff filing rules for nondominant interexchange carriers to give substantial pricing flexibility to the Company and similarly situated competitors. The new rules permitted nondominant domestic carriers to file a "range" of prices, thereby avoiding the need to identify specifically the rates being offered to customers or to have all price differences reflected in tariff filings at the FCC. AT&T challenged the legality of the FCC's rules allowing nondominant carriers to file tariffs containing a range of prices in lieu of specific rates. On January 20, 1995, the Court of Appeals issued a ruling reversing the FCC's range of rates policy.

As a consequence of the FCC's forbearance policy being declared unlawful and notwithstanding all nondominant carriers' reliance on this policy, the Company could be subject to complaints seeking damages, assessment of monetary forfeitures and/or injunctive relief filed by any party claiming to be injured by the Company's failure to file tariffs. The Court of Appeals' decision suggests that reliance on the forbearance policy may not excuse past failure to file tariffs, because the Court ruled that the forbearance policy itself was unlawful. The Court of Appeals' decision does not, however, require the FCC to assess forfeitures or damages or take any other specific enforcement action against those carriers who relied upon its policy. In February 1993, AT&T filed lawsuits in federal court against MCI, Sprint and WorldTel for alleged failure to file proper tariffs and requested lost profits based on a purported loss of \$1 billion in sales. On November 9, 1993, the district court dismissed the complaints against MCI and Sprint, but stayed AT&T's action against WorldTel pending resolution of related matters.

before the FCC. WorldTel responded by filing a lawsuit against AT&T alleging various counts of illegal activity, and similar complaints filed by MCI and Sprint have been pending at the FCC for several years. AT&T has also indicated that it may institute similar suits against other interexchange carriers. To date, AT&T has not filed any additional suits. MCI has filed a petition for declaratory ruling with the FCC to declare that it and other interexchange carriers cannot be held liable for good faith reliance on the FCC's now reversed forbearance policy. At this time, the Company cannot predict the likelihood of the filing of complaints against it or the potential liability relative to the reversal of the FCC's forbearance policy. However, with regard to the court's reversal of the FCC's range of rates policy, the Company does not foresee any adverse impact because the Company has filed discernible rates for each of its services on file with the FCC.

*Potential Increased Competition.* In 1984, pursuant to a consent decree (referred to as the Modified Final Judgment or MFJ) approved by the United States District Court for the District of Columbia (District Court), AT&T divested its 22 wholly owned Bell Operating Companies. In 1987, as part of the triennial review of the MFJ, the district court denied the BOCs petition to enter, among other things, the interLATA long distance telecommunications business. The district court's ruling was appealed to the Court of Appeals, which, in 1990, affirmed the district court's decision to retain the interLATA prohibition for the BOCs. There are currently a variety of petitions pending before the District Court and the United States Department of Justice (DOJ), which seek relief from the MFJ. On July 6, 1994, four BOCs, including BellSouth Corporation, Bell Atlantic Corporation, SBC Corporation, and NYNEX Corporation, filed a petition with the District Court seeking to vacate the MFJ. Subsequently, Bell Atlantic Corporation has withdrawn as a party to the proceeding. On August 25, 1994, NYNEX Corporation filed a separate petition seeking waiver of the MFJ's interLATA long distance restriction for its services originating in the state of New York. LCI has filed comments with DOJ opposing these petitions and no action has been taken by the court to date. In March 1993, Ameritech Corporation filed a plan with the DOJ and the FCC proposing to restructure its interconnection arrangements with other telecommunications carriers' networks. In exchange, Ameritech Corporation sought FCC approval for additional price deregulation and the FCC's recommendation to the District Court that Ameritech be permitted to provide interLATA services. The FCC and DOJ have solicited public comments on the proposal but no action has been taken to date. LCI has submitted written comments to the DOJ, setting forth LCI's opposition to the Ameritech proposal as well as the safeguards that LCI believes would be necessary if DOJ would ultimately recommend approval of Ameritech's plan. The BOCs can be expected to continue to pursue removal of the interLATA prohibition by future petitions in court or through the legislative process. If the BOCs ultimately are permitted to provide interLATA long distance telecommunications services, the Company would face substantial additional competition.

*Legislation.* On November 23, 1993, House Bill 3626 was introduced into the House of Representatives by Congressman John Dingell. The proposed legislation would have allowed the BOCs into the interLATA long distance market. In June 1994, H.R. 3626 was passed by the House of Representatives by a margin of 423-5. As adopted, the bill would have allowed the BOCs to seek permission to provide interLATA services by applying to both DOJ and the FCC, both of whom would have had to approve the application. To make their entry into interLATA services, the BOCs would have needed only to prove, by a preponderance of the evidence, that they could not impede competition in the interLATA long distance market. The bill would also have permitted the state public service commissions to allow BOCs entry into intrastate interLATA services on a state-by-state basis. The Senate's companion bill, S. 1822, imposed stricter entry requirements on the BOCs including the need to satisfy certain preconditions and obtain regulatory approvals. S. 1822 was approved by the Senate Commerce and Transportation Committee on August 11, 1994, on a vote of 18-2. On September 23, 1994, however, Senator Hollings withdrew the bill from consideration by the full Senate.

The make up of the 104th Congress is considerably different than that of the 103rd Congress, with Republicans now controlling both the Senate and the House of Representatives. The following members of Congress will chair committees with telecommunications oversight during the 104th Congress: Congressman Thomas Bliley (R-VA) and Congressman Jack Fields (R-TX) will be the Chairmen of the House Committee on Commerce and Subcommittee on Telecommunications and Finance, respectively. Senator Larry Pressler (R-SD), and Senator Bob Packwood (R-OR) will be the Chairmen of the Senate Commerce Committee and Telecommunications Subcommittee, respectively.

In the House of Representatives, Congressman Jack Fields is currently urging the long distance industry and local exchange carriers to reach a compromise on what would be considered acceptable telecommunications legislation. Congressman Fields is expected to begin discussions with his subcommittee members as to what potential telecommunications legislation should include and is expected to introduce telecommunications legislation regardless of whether industry parties can reach a compromise. Additionally, Congressman John Dingell (D-MI), has introduced House Bill 411 that is substantially the same as House Bill 3626 (described above) with one significant change: House Bill 411 would eliminate DOJ review of BOC petitions for interLATA authority.

In the Senate, Senator Larry Pressler has proposed legislation that would establish various requirements that the BOCs would have to meet prior to entry into the long distance market. However, Senator Pressler's proposal would also establish a "date certain" of three years for BOC entry. Under the "date certain" environment, the BOCs would be permitted to begin offering interLATA long distance services at the end of the three years regardless of whether effective competition has emerged in the local exchange and local access markets. Under Senator Pressler's proposal, a BOC could receive authority to provide interLATA services prior to the end of the three years upon a showing that it has complied with the requirements set forth in the proposed legislation. This remains a dynamic situation and Democratic members of the Senate Telecommunications Subcommittee are expected to propose legislation that is similar to S.1822 (described above).

*Access charges.* Access charges are charges paid by interexchange carriers to local exchange carriers for the origination and termination of long distance transmission services. Access charges are regulated by both the FCC and the state regulatory commissions as part of the agencies' review of local exchange carriers' interstate and intrastate tariffs. Interstate and intrastate access charges currently constitute over 58% of the Company's cost of service. The FCC announced interim changes to certain interstate access charges, called local transport charges, that took effect December 30, 1993.

Previously, local transport charges were assessed on a usage basis for all carriers, whether the traffic was carried entirely on facilities dedicated to a particular interexchange carrier or was carried partially or wholly over facilities used in common by a number of interexchange carriers. The previous rate structure was required by a provision of the MFJ with the intent and effect of minimizing AT&T's historical advantages. The new interim changes adopted and implemented by the FCC allow the largest long distance carriers to pay flat-rate transport charges to the local telephone companies for the use of local facilities to originate and terminate long distance calls.

The new interim transport charge rate structure has resulted in varying increases and decreases on access prices for interexchange carriers throughout the country. The impact of the new transport structure upon LCI has been an overall rate decrease based on LCI's current traffic distribution. Inasmuch as LCI does not know how the interim transport rate structure has affected each of its competitors, this impact does not imply that LCI's competitive position has improved as a result of such decrease. Additionally, this impact could change as a result of the Company expanding service into new regions of the country. The FCC's interim transport structure is scheduled to expire October 30, 1995. There is currently no indication as to whether the FCC will retain the existing interim structure or develop a new transport structure as the permanent structure. The potential impact of any future access structure adopted by the FCC upon the Company is currently unknown.

The Competitive Telecommunications Association (CompTel), of which LCI is a member, has filed a complaint against BellSouth Corporation at the Department of Justice. CompTel's complaint alleges that BellSouth's switched access rates for local transport violate the MFJ because they are set in a manner that is unrelated to the underlying costs of providing those services to long distance carriers.

In addition, the FCC has adopted and implemented policies to increase the ability of competitive access providers to offer interstate switched and special access service to long distance carriers. These policies have resulted in local exchange carriers facing actual or potential competition for certain services in certain geographic areas. Congress is also considering legislation in this area. Over the long term, the introduction of competition in these services is expected to exert downward pressures on access charge rates.

*Regulation of AT&T.* The Company has historically been subject to less regulation than AT&T. The difference in the level of regulation between AT&T and its competitors, however, has recently been narrowed. The general trend of the FCC is to treat AT&T interexchange business services as competitive and lessen regulation of virtually all of AT&T's business services. On January 12, 1995, the FCC issued an order removing AT&T's domestic business commercial services (except analog private line & 800 directory assistance) from price cap regulation and allowed streamlined regulation for those services. This further streamlined regulation with respect to AT&T's domestic business services could result in more aggressive pricing policies by AT&T, thereby affecting the Company's pricing policies and gross margins.

*State Regulation.* The Company's intrastate long distance telecommunications operations are subject to various state laws and regulations including, in many jurisdictions, certification and stringent tariffing requirements. Generally, the Company must obtain and maintain certificates of public convenience and necessity from regulatory authorities in most states in which it offers intrastate long distance services. Most state regulatory agencies also require carriers to file tariffs that set forth their rates and conditions of service. Those states that permit the offering of intrastate/intraLATA service by interexchange carriers generally require that end users desiring to use such services dial special access codes. This puts the Company at a competitive disadvantage compared with local exchange carriers whose customers can make intrastate/intraLATA calls simply by dialing 1+ the desired number. If a long distance carrier's customer attempts to make an intraLATA call by simply dialing 1+ the desired number, the call will be intercepted and completed by the local exchange company.

During 1994, regulatory agencies in the states of Florida, Michigan, New York, Minnesota, and Kentucky issued decisions that would permit the Company and other interexchange carriers to provide intraLATA calling on a 1+ basis, identical to the dialing sequence that local exchange carriers currently use to complete such calls today. Implementation of these state decisions is expected to occur between 1995 and 1998. The Company expects to benefit from the ability to offer 1+ intraLATA services in states that allow this type of dialing parity.

## **Employees**

At December 31, 1994, the Company had 1,136 full-time employees, none of whom were subject to any collective bargaining agreement. The Company believes it has good relations with its employees.

## **Item 2. Properties**

The Company corporate headquarters are located in McLean, Virginia, where LCI leases space for general and administrative functions as well as a sales office under a lease expiring in January 2003 at a monthly base rent of approximately \$24,430 and increasing 2.5% each year thereafter. In addition, the Company leases office space in Dublin, Ohio, a suburb of Columbus, Ohio, for the principal, administrative and marketing offices of LCI Management Services and LTC under a capitalized lease expiring in 2005 for which annual lease payments (including interest) amounted to approximately \$2.2 million in 1994. The Company leases approximately 80 properties for its offices, switching and other facilities. The annual lease payments for these leases and other rentals (excluding the Company's Dublin, Ohio office and the McLean, Virginia office) amounted to \$3.1 million in 1994. The Company believes that such properties are adequate and suitable for its current operations.

To construct and operate the owned network, the Company has obtained a variety of franchises, licenses, leases, easements and encroachment permits (collectively, "Rights of Way") from various public and quasi-public authorities and private parties. Aggregate annual payments for the Rights of Way amount to approximately \$1.4 million. Most Rights of Way are for 20 to 30 year time periods with renewal options.

The Company has entered into alternative compensation agreements with several providers of Rights of Way pursuant to which the Rights of Way have been obtained in exchange for reduced rents plus the provision of service on the network. By using this compensation strategy, the Company believes that it is able to preserve cash and give providers of Rights of Way additional incentive to ensure the security of the fiber optic cable and other facilities maintained along their Rights of Way.

#### **Legal Proceedings**

*Thomas J. Byrnes and Richard C. Otto v. LCI Communications Holdings Co. et al.* was filed on June 28, 1991 in Common Pleas Court, Franklin County, Ohio naming LCI, LCI Management Services and LTC as defendants. The Complaint, by two former employees of the Company's management, alleged age discrimination, among other things and sought \$42.8 million in compensatory and punitive damages. During 1993, a jury returned a verdict in favor of the former employees and the Court awarded approximately \$8.1 million in damages and attorney's fees.

Both the Plaintiffs and the Company have appealed this matter. Plaintiffs appealed the trial court's decisions which rejected Plaintiffs' claim of approximately \$5 million in connection with certain unvested stock rights; denied a requested award of approximately \$0.1 million for pre-judgment interest; and denied Plaintiffs' request for approximately \$2 million in additional attorney's fees.

In its appeal, LCI has argued that certain evidence was wrongfully admitted; the evidence was legally insufficient to support the jury's finding; the trial court erred in awarding additional damages for Plaintiffs' unvested stock; the award of certain damages was legally invalid and punitive damages were improperly awarded.

No decision has been rendered on the appeals.

The Company has also been named as a defendant in various other litigation matters. Management intends to vigorously defend these outstanding claims. The Company believes it has adequate accrued loss contingencies and that current pending or threatened litigation matters will not have a material adverse impact on the Company's results of operations or financial condition.

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

None



### Executive Officers of the Company

The following table sets forth the executive officers of LCI as of March 1, 1995:

<u>Name</u>	<u>Age</u>	<u>Position</u>
H. Brian Thompson	56	Chairman of the Board of Directors and Chief Executive Officer
Thomas J. Wynne	55	President and Chief Operating Officer
Joseph A. Lawrence	45	Senior Vice President Finance and Development and Chief Financial Officer
Marshall Hanno	49	Senior Vice President - Sales

*Mr. Thompson* has been Chairman of the Board of Directors and Chief Executive Officer of LCI and its subsidiaries since July 1991. Mr. Thompson previously served as executive vice president of MCI Communications Corporation where he was responsible for all eight of MCI's operating divisions and various other senior management capacities from 1981 to 1991. These capacities included vice president responsible for all staff functions, Divisional president and Senior Vice President responsible for strategic development and corporate planning. Mr. Thompson is a director of Microdyne Corporation, STN Incorporated, and Comcast UK Cable Partners Limited.

*Mr. Wynne* has been President and Chief Operating Officer of the Company's subsidiaries since July 1991 and President and Chief Operating Officer of the Company since April 1993. From 1977 to 1991, Mr. Wynne held several executive positions with MCI Communications Corporation, including President of the West Division, Vice President of Sales and Marketing for the Mid-Atlantic Division, and Vice President in the Midwest Division. Mr. Wynne has been a Director of the Company since December 1991.

*Mr. Lawrence* has been Senior Vice President Finance and Development and Chief Financial Officer, of LCI and its subsidiaries since October 1993. From January 1985 through October 1993, Mr. Lawrence held several executive positions at MCI, including Senior Vice President-Finance and Vice President Finance and Administration for the Consumer Division and Vice President Finance for the Mid-Atlantic Division. Mr. Lawrence is a director of STN Incorporated.

*Mr. Hanno* has been Senior Vice President-Sales of LCI since June 1993 and was Vice President of Sales of LCI Management Services since July 1991. From 1987 to July 1991, Mr. Hanno was Vice President of Sales of MCI Communications Corporation and prior thereto was Vice President of Sales and Marketing with Allnet Communications.

## **Part II**

### **Item 5. Market for the Company's Equity and Related Shareowner Matters**

From the initial public offering of its Common Stock on May 12, 1993 to December 29, 1994, LCI's Common Stock has traded on the Nasdaq National Market under the symbol "LCII." On December 30, 1994, LCI's Common Stock began trading on the New York Stock Exchange under the symbol "LCI". The following table sets forth, on a per share basis, the range of the high and low closing sale price information of shares of the Common Stock as reported by the Nasdaq National Market and New York Stock Exchange.

	Market Price Per Share					
	1994			1993		
	High *	Low *	End of Period *	High *	Low *	End of Period *
First Quarter	\$ 21	\$ 17 1/2	\$ 19 1/8	\$ -	\$ -	\$ -
Second Quarter	22 3/4	15	16	12 1/2	10	11 3/8
Third Quarter	21 5/8	13 1/2	19 7/16	18 3/8	11 3/8	17 3/4
Fourth Quarter	26 3/4	18 1/4	26 3/4	21 1/8	15 1/2	18 1/2

\* Adjusted to reflect the 2-for-1 stock split effective in the form of a stock dividend in July 1994.

At March 1, 1995, there were 29,669,831 shares of Common Stock outstanding held by 1,013 shareowners of record.

LCI has not declared or paid any cash dividends on its Common Stock since its inception and does not currently anticipate paying any cash dividends on its Common Stock in the foreseeable future. LCI is a holding company which conducts substantially all of its operations through its subsidiaries. The Company is restricted from paying dividends under the terms of certain of its financing documents.

### **Item 6. Selected Financial Data**

Incorporated by reference to page 14 of the 1994 Annual Report.

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

Incorporated by reference to pages 15 through 21, inclusive, of the 1994 Annual Report.

### **Item 8. Financial Statements and Supplementary Data**

The financial statements appearing on pages 23 to 39, inclusive, of the 1994 Annual Report together with the report thereon of Arthur Andersen LLP dated February 14, 1995, appearing on page 22 thereof are incorporated by reference in this Annual Report on Form 10-K. With the exceptions of the aforementioned information and the additional information incorporated by reference in Part II hereof, the 1994 Annual Report is not to be deemed filed as part of this report.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

## **Part III**

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

Information with respect to executive officers of the Company is set forth in Part I of this Annual Report on Form 10-K.

Information with respect to directors of the company is incorporated by reference to the information under the caption "Information As to Nominees For Election As Class II Directors" and "Information As to Directors Continuing In Office" in LCI's Proxy Statement for its 1995 Annual Meeting of Shareholders (the "1995 Proxy Statement").

### **Item 11. Executive Compensation**

Incorporated by reference to the captions "Board of Directors' Meetings Committees and Fees" and "Executive Compensation and Related Information" including "Summary Compensation Table," "Option Grants in 1994," "Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Option/SAR Values," "Stock Based Plans," "Employment Contracts and Termination of Employment and Change-In-Control Arrangements," and "Compensation Committee Interlocks and Insider Participation" but not including "Compensation Committee Report on Executive Compensation" and "Performance Graph" in the 1995 Proxy Statement.

### **Item 12. Security Ownership of Certain Beneficial Owners and Mangement**

Incorporated by reference to "Security Ownership of Management and Others" in the 1995 Proxy Statement.

### **Item 13. Certain Relationships and Related Transactions**

Incorporated by reference to information under the caption "Certain Relationships and Related Transactions" in the 1995 Proxy Statement.

## Part IV

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

(a) Documents filed as part of this report:

(1) Financial Statements:

	Pages in 1994 Annual Report
Report of Independent Public Accountants	22
Consolidated Statements of Operations	23
Consolidated Balance Sheets	24
Consolidated Statements of Shareowners' Equity	26
Consolidated Statements of Cash Flows	27
Notes to Consolidated Financial Statements	28-38

(2) Financial Statement Schedules

All supporting schedules other than those listed below have been omitted because they are not required or the information to be set forth therein is included in the financial statements or in the notes thereto. The following additional financial data should be read in conjunction with the financial statements incorporated by reference herein.

Report of Independent Public Accountants on Financial Statement Schedule

Schedule VIII - Valuation and Qualifying Accounts

(3) Exhibits.

The exhibits filed or incorporated by reference as part of this report are set forth in the Index of Exhibits on page E-1 of this Annual Report.

(b) Reports on Form 8-K

No reports on Form 8-K were filed in the fourth quarter of 1994.

(c) See Item 14(a)(3) above.

(d) See Item 14(a)(2) above.

## INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
3(i)(a)	- Amended and Restated Certificate of Incorporation of LCI International, Inc. <sup>1</sup>
3(i)(b)	- Certificate of Designation. <sup>2</sup>
3(ii)	- Amended and Restated By-laws of LCI International, Inc. <sup>1</sup>
4(a)(i)	- Specimen Preferred Stock Certificate. <sup>2</sup>
4(a)(ii)	- Specimen Common Stock Certificate. <sup>1</sup>
4(b)	- Registration Rights Agreement, effective as of November 15, 1988, among LCI Communications Holdings Co., LCI Communications, Inc., Warburg, Pincus Capital Company, L.P., Primus Capital Fund and Primus Capital Fund II, L.P. <sup>1</sup>
4(c)	- Credit Agreement, dated as of December 30, 1993, by and among LCI International, Inc., First Union National Bank of North Carolina and Nationsbank of Texas, N.A. <sup>5</sup>
4(c)(i)	- First Amendment and Confirmation, dated as of March 3, 1994, by and among LCI International, Inc., LCI International Management Services, Inc., LCI International of New Hampshire, Inc., 1056974 Ontario Inc., First Union National Bank of North Carolina and Nationsbank of Texas, N.A. <sup>5</sup>
4(c)(ii)	- Unconditional Guaranty Agreement, dated as of January 19, 1994, by and between LCI International Management Services, Inc. and First Union National Bank of North Carolina. <sup>5</sup>
4(c)(iii)	- Unconditional Guaranty Agreement, dated as of January 19, 1994, by and between LCI International of New Hampshire, Inc. and First Union National Bank of North Carolina. <sup>5</sup>
4(c)(iv)	- Unconditional Guaranty Agreement, dated as of January 19, 1994, by and between 1056974 Ontario Inc. and First Union National Bank of North Carolina. <sup>5</sup>
4(c)(v)	- Pledge Agreement, dated as of December 30, 1993, by and between LCI International, Inc. and First Union National Bank of North Carolina. <sup>5</sup>
4(c)(vi)	- Pledge Agreement, dated as of January 19, 1994, by and between LCI International Management Services, Inc. and First Union National Bank of North Carolina. <sup>5</sup>
4(c)(vii)	- Pledge Agreement, dated as of January 19, 1994, by and between LCI International, Inc. and First Union National Bank of North Carolina. <sup>5</sup>
4(c)(viii)	- Second Amendment, dated April 7, 1994, to the Credit Agreement, dated December 30, 1993 by and among LCI International, Inc., First Union National Bank of North Carolina and Nationsbank of Texas, N.A. <sup>6</sup>
4(c)(ix)	- Third Amendment, dated September 28, 1994, to the Credit Agreement, dated December 30, 1993 by and among LCI International, Inc., First Union Bank of North Carolina and Nationsbank of Texas, N.A. <sup>8</sup>
4(c)(x)	- Unconditional Guaranty Agreement, dated as of September 1, 1994, by and between LCI Telecom South, Inc. and First Union National Bank of North Carolina. <sup>8</sup>
4(c)(xi)	- Unconditional Guaranty Agreement, dated as of September 1, 1994, by and between LCI International Telecom Corp., and First Union National Bank of North Carolina. <sup>8</sup>
4(c)(xii)	- Fourth Amendment, dated October 21, 1994, to the Credit Agreement, dated December 30, 1993 by and among LCI International, Inc., First Union Bank of North Carolina and Nationsbank of Texas, N.A.
4(d)	- Registration Rights Agreement, dated as of November 15, 1988, by and among LCI Communications Holdings Co., Warburg, Pincus Capital Company, L.P., APT Holdings Corporation and Creditanstalt-Bankverein. <sup>1</sup>

- 4(e) – Registration Rights Agreement, dated as of December 30, 1988, by and among LCI Communications Holdings Co., Warburg, Pincus Capital Company, L.P., PNC Venture Corp. and PNC Venture Group I, L.P. <sup>1</sup>
- 4(f) – Registration Rights Agreement, dated as of January 16, 1989, by and among LCI Communications Holdings Co., Warburg, Pincus Capital Company, L.P., and Trustees of General Electric Pension Trust. <sup>1</sup>
- 4(g) – \$64,262,707 Subordinated Term Note, dated June 17, 1993, issued by LiTel Communications, Inc. <sup>2</sup>
- 10(a)(i) – License Agreement, dated November 19, 1984, between the Ohio Turnpike Commission and Litel Telecommunications Corporation. <sup>1</sup>
- 10(a)(ii) – Right-of-Way Agreement, dated October 31, 1984, among Grand Trunk Western Railroad Company and Litel Telecommunications Corporation. <sup>1</sup>
- 10(a)(iii) – Right-of-Way Agreement, dated May 14, 1985, between Indiana Department of Highways Toll Road Division and Litel Telecommunications Corporation. <sup>1</sup>
- 10(b) – Lease Agreement, dated September 27, 1984, by and between Terminal Management Inc. and LiTel, Inc. <sup>1</sup>
- 10(c) – Indenture of Lease and License Agreement, dated November 1985, by and between Drytraub of Illinois, Inc., Drytraub Office Management, Inc. and Litel Telecommunications Corporation, as amended. <sup>1</sup>
- 10(d) – Lease Agreement, dated March 3, 1989, by and between The Equitable Life Assurance Society (successor in interest to 180 East Broad Partnership) and Litel Telecommunications Corporation, as amended. <sup>1</sup>
- 10(e) – Lease Agreement, dated August 14, 1989, by and between Duke Associates No. 70 Limited Partnership and LCI Management Services, Inc., as amended. <sup>1</sup>
- 10(f) – Agreement Regarding Additional Space, dated August 14, 1989, among Duke Associates No. 70 Limited Partnership and LCI Management Services, Inc., as amended. <sup>1</sup>
- 10(g) – Lease Agreement, dated as of October 11, 1993, by and between Eighty-One Eighty Greensboro Associates Limited Partnership and LCI International, Inc. <sup>4</sup>
- 10(g)(i) – Lease, dated May 19, 1986, by and between 13th and L Associates and Long Distance Services of Washington, Inc. <sup>2</sup>
- 10(g)(ii) – Amendment No. 1 to Lease, dated December 20, 1988, by and between 13th and L Associates and Long Distance Service of Washington, Inc. <sup>4</sup>
- 10(g)(iii) – Second Amendment to Retail Lease, dated June 6, 1991, by and between 13th and L Associates and Long Distance Service of Washington, Inc. <sup>4</sup>
- 10(h) – Master License and Services Agreement, dated as of March 1, 1993, among LiTel Communications, Inc. and the Subsidiaries named in Schedule I thereto. <sup>1</sup>
- 10(h)(i) – First Amendment to Master License and Services Agreement, dated as of April 29, 1993, among LiTel Communications, Inc., Litel Telecommunications Corporation, Afford-A-Call Corp. and LDS Telecommunications Corp. f/k/a New Cable Inc. <sup>1</sup>
- 10(h)(ii) – Management Services Agreement dated as of April 1, 1993, between LCI International, Inc. and LiTel Communications, Inc. <sup>1</sup>
- 10(i) – Agreement for Purchase of Assets between LiTel Communications, Inc. and Long Distance Service of Washington, Inc. and Richard J. Rice, dated February 1, 1993. <sup>1</sup>
- 10(j)(i) – Interim Loan Agreement, dated as of October 15, 1993, between LCI International, Inc. and STN Incorporated. <sup>3</sup>
- 10(j)(ii) – Secured Demand Note, dated as of October 15, 1993, between LCI International, Inc. and STN Incorporated. <sup>3</sup>

- 10(j)(iii) – Note Pledge Agreement, dated as of October 15, 1993, between LCI International, Inc. and STN Incorporated.<sup>3</sup>
- 10(j)(iv) – Debenture Purchase Agreement, dated as of October 15, 1993, between LCI International, Inc. and STN Incorporated.<sup>3</sup>
- 10(j)(v) – Option Agreement, dated as of October 15, 1993, between LCI International, Inc. and STN Incorporated.<sup>3</sup>
- 10(j)(vi) – Share Purchase Agreement, dated as of October 15, 1993, by and among LCI International, Inc. and certain shareholders of STN Incorporated named on the signature page thereof.<sup>3</sup>
- 10(j)(vii) – Share Deposit Agreement, dated as of October 15, 1993, by and among LCI International, Inc. and certain shareholders of STN Incorporated named on the signature page thereof.<sup>3</sup>
- 10(j)(viii) – TransPrairie Option Agreement, dated as of October 15, 1993, by and among LCI International, Inc., TransPrairie Energy Management Partnership and certain persons named on the signature pages thereof.<sup>3</sup>
- 10(j)(ix) – Services Agreement and License, dated as of October 26, 1993, between LCI International Management Services, Inc. and STN Incorporated.<sup>3</sup>
- 10(j)(x) – Traffic Exchange Agreement, dated as of October 26, 1993, between LCI International Telecom Corp. and STN Incorporated.<sup>3</sup>
- 10(j)(xi) – Not used
- 10(j)(xii) – Promissory note dated April 29, 1994 between LCI International Telecom Corp. and STN Incorporated.<sup>6</sup>
- 10(j)(xiii) – Promissory Note dated May 12, 1994 between LCI International Telecom Corp. and STN Incorporated.<sup>6</sup>
- 10(j)(xiv) – Debenture Purchase Agreement Amendment, dated as of June 1, 1994, between LCI International, Inc., and STN Incorporated.<sup>7</sup>
- 10(j)(xv) – Loan Agreement, dated June 1, 1994, between STN Incorporated and LCI International, Inc.<sup>7</sup>
- 10(j)(xvi) – Option Agreement, dated June 1, 1994, between STN Incorporated and LCI International, Inc. - Purchase of up to 400,000 Common Shares of STN Incorporated.<sup>7</sup>
- 10(j)(xvii) – Option Agreement, dated June 1, 1994, between STN Incorporated and LCI International, Inc. - Purchase of up to one-half the difference between 5,300,000 and number of Common Shares held by depositing shareholders of STN Incorporated who have executed the Second Share Deposit Agreement.<sup>7</sup>
- 10(j)(xviii) – Form of Share Deposit Agreement, dated May 27, 1994, between LCI International, Inc. and "Principal Shareholders" of STN Incorporated.<sup>7</sup>
- 10(j)(xix) – Form of Share Option Agreement, dated May 31, 1994, between LCI International, Inc. and Robey Company Limited, Vanier Company Limited and Yarker Company Limited.<sup>7</sup>
- 10(j)(xx) – Debenture Purchase Agreement Second Amendment, dated July 7, 1994, between LCI International, Inc. and Stn Incorporated.<sup>7</sup>
- 10(j)(xxi) – Debenture Purchase Agreement Third Amendment, dated July 22, 1994, between LCI International, Inc. and STN Incorporated.<sup>7</sup>
- 10(j)(xxii) – Loan Agreement Amendment, dated July 7, 1994, between LCI International, Inc. and STN Incorporated.<sup>7</sup>
- 10(j)(xxiii) – Loan Agreement Second Amendment, dated July 22, 1994, between LCI International, Inc. and STN Incorporated.<sup>7</sup>
- 10(j)(xxiv) – LCI Treasury Option Agreement Amendment between LCI International, Inc. and STN Incorporated.<sup>7</sup>
- 10(j)(xxv) – LCI Treasury Additional Option Agreement Amendment between LCI International, Inc. and STN Incorporated.<sup>7</sup>

- 10(j)(xxvi) – Promissory Note dated June 30, 1994 between LCI International, Inc. and STN Incorporated.<sup>7</sup>
- 10(j)(xxvii) – Agreement of Purchase and Sale of Assets dated as of March 31, 1994 by and among LCI International Management Services, Inc., T.M. Sepulveda, Inc. and Gene Elmore.<sup>10</sup>
- 10(j)(xxviii) – Agreement of Purchase and Sale of Assets dated as of March 31, 1994 by and among LCI International Management Services, Inc., Premium Acces, Inc. and Gene Elmore.<sup>10</sup>
- 10(j)(xxvix) – Amendment No. 1 dated July 11, 1994 to Agreement of Purchase and Sale of Assets Glendale Gene, Inc. (formerly known as T.M. Sepulveda, Inc.).<sup>10</sup>
- 10(j)(xxx) – Amendment No. 1 dated July 11, 1994 to Agreement of Purchase and Sale of Assets Glendale Access International, Inc. (formerly known as Premium Acces, Inc.).<sup>10</sup>
- 10(j)(xxxix) – Assignment of T.M. Sepulveda, Inc. Agreement of Purchase and Sale of Assets from LCI International Management Services, Inc. to LCI International Telecom Corp. dated April 4, 1994.<sup>10</sup>
- 10(j)(xxxix) – Assignment of Premium Acces, Inc. Agreement of Purchase and Sale of Assets from LCI International Management Services, Inc. to LCI International Telecom Corp. dated April 4, 1994.<sup>10</sup>
- 10(j)(xxxix) – Consulting Agreement dated July 11, 1994 between LCI International Telecom Corp. and Gene Elmore.<sup>10</sup>
- 10(j)(xxxix) – Promissory Note of STN Incorporated, dated as of December 21, 1994, for Cnd. \$6,951,500.
- 10(j)(xxxix) – General Security Agreement, dated as of December 21, 1994, between STN Incorporated and LCI International, Inc. relating to the Promissory Note.
- 10(j)(xxxix) – Form of Acknowledgment and Promise to Pay, by STN Incorporated, to be dated as of December 21, 1994, evidencing amount owed to LCI International Management Services, Inc. for certain services rendered prior to October 1, 1994.
- 10(j)(xxxix) – Form of General Security Agreement, to be dated as of December 21, 1994, relating to Acknowledgment and Promise to Pay.
- 10(j)(xxxix) – Indemnification Agreement, dated as of January 6, 1995, between STN Incorporated and LCI International, Inc.
- 10(j)(xxxix) – General Security Agreement, dated as of January 6, 1995 between STN Incorporated and LCI International, Inc., relating to the Indemnification Agreement.
- 10(k)(i) – Letter Agreement, dated February 9, 1993, between H. Brian Thompson and Warburg, Pincus Capital Company, L.P.<sup>1\*</sup>
- 10(k)(ii) – Letter Agreement, dated February 9, 1993, between Thomas J. Wynne and Warburg, Pincus Capital Company, L.P.<sup>1\*</sup>
- 10(k)(iii) – Letter Agreement, dated February 9, 1993, between Marshall W. Hanno and Warburg, Pincus Capital Company, L.P.<sup>1\*</sup>
- 10(l)(i) – Employment Agreement, dated as of April 19, 1993, between LiTel Communications, Inc. and H. Brian Thompson to which LCI International, Inc. also is a party.<sup>1\*</sup>
- 10(l)(ii) – Employment Agreement, dated as of April 19, 1993, between LiTel Communications, Inc. and Thomas J. Wynne to which LCI International, Inc. also is a party.<sup>1\*</sup>
- 10(l)(iii) – Employment Agreement, dated as of April 19, 1993, between LiTel Communications, Inc. and Marshall W. Hanno to which LCI International, Inc. also is a party.<sup>1\*</sup>
- 10(l)(iv) – Employment Agreement, dated November 15, 1989, between LCI International Management Services, Inc. and Larry E. Wolfe.<sup>1\*</sup>
- 10(l)(v) – Employment Agreement, dated as of October 18, 1993, between LCI International Management Services, Inc. and Joseph A. Lawrence.\*
- 10(l)(vi) – Form of LCI International, Inc. 1994 Executive Perquisite Program.<sup>5\*</sup>
- 10(l)(vii) – LCI International, Inc. 1992 Stock Option Plan.<sup>1\*</sup>



- 10(l)(viii) - LiTel Communications, Inc. 1993 Stock Option Plan. <sup>1</sup> \*
- 10(l)(ix) - LCI International, Inc. 1994/1995 Stock Option Plan. <sup>5</sup> \*
- 10(l)(x) - LiTel Communications, Inc. Stock Purchase Plan. <sup>1</sup> \*
- 10(l)(xi) - LCI International, Inc. and Subsidiaries Nonqualified Stock Option Plan for Directors. <sup>2</sup> \*
- 10(l)(xii) - LCI International, Inc. 1995/1996 Stock Option. <sup>9</sup> \*
- 10(l)(xiii) - LCI International, Inc. Amended and Restated Employee Stock Purchase Plan. <sup>9</sup> \*
- 10(l)(xiv) - Employment Agreement, dated as of March 20, 1994, between LCI International, Inc. and H. Brian Thompson. \*
- 10(l)(xv) - Employment Agreement, dated as of March 20, 1994, between LCI International, Inc. and Thomas J. Wynne. \*
- 10(l)(xvi) - Form of Employment Agreement, dated as of March 20, 1994, between LCI International, Inc. and Marshall W. Hanno. \*
- 10(m) - Lease Agreement dated as of July 1, 1994 by and between LCI International Management Services, Inc. and Bank Building Limited Partnership. <sup>6</sup>
- 10(n) - Lease Agreement dated April 14, 1994 by and between LCI International Management Services, Inc. and RFG Co., LTD. <sup>6</sup>
- 10(o) - Forth Amendment to Lease and Consent to Assignment dated as of June 28, 1994 by and between LCI International Telecom Corp. and One Wilshire Arcade Imperial, LTD. <sup>8</sup>
- 10(p) - Network Services Agreement dated December 22, 1994 between MCI Telecommunications Corporation and LCI International Telecom Corp. <sup>11</sup>
- 11 - Statement re computation of per share earnings.
- 13 - LCI International, Inc. 1994 Annual Report to Shareowners
- 21 - Subsidiaries of LCI International, Inc.
- 23 - Consent of Arthur Andersen LLP

<sup>1</sup> Incorporated by reference to the Company's Registration Statement No. 33-60558.

<sup>2</sup> Incorporated by reference to the Company's Registration Statement No. 33-67368.

<sup>3</sup> Incorporated by reference to the Company's Form 8-K dated October 17, 1993.

<sup>4</sup> Incorporated by reference to the Company's Registration Statement No. 33-71500.

<sup>5</sup> Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1993.

<sup>6</sup> Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1994.

<sup>7</sup> Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994.

<sup>8</sup> Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994.

<sup>9</sup> Incorporated by reference to the Company's Proxy Statement for the 1995 Annual Meeting of Shareowners.

<sup>10</sup> Incorporated by reference to the Company's Form 8-K dated July 11, 1994.

<sup>11</sup> Confidential treatment has been requested for portions of this exhibit.

\* Indicates a management contract or compensatory plan or arrangement required to be filed pursuant to Item 14(c) of Form 10-K.



Report of Independent Public Accountants

To the Board of Directors and Shareowners of LCI International, Inc.

We have audited in accordance with generally accepted auditing standards, the consolidated financial statements included in LCI International, Inc.'s Annual Report to shareowners incorporated by reference in this Form 10-K, and have issued our report thereon dated February 14, 1995. Our audits were made for the purpose of forming an opinion on those statements taken as a whole. The schedule listed in the index is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Columbus, Ohio  
February 14, 1995.

LCI INTERNATIONAL, INC.

SCHEDULE VIII - VALUATION AND QUALIFYING ACCOUNTS  
(dollars in thousands)

Column A	Column B	Column C	Column D	Column E	Column F
Description	Balance at Beginning of Period	Additions		Deductions - Describe	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts - Describe		
Reflected as reductions to the related assets:					
Provision for uncollectible accounts (deductions from trade accounts receivable)					
Year ended December 31, 1992	\$ 2,023	\$ 3,173	\$ 4,459 (a)	\$ (5,670) (b)	\$ 3,985
Year ended December 31, 1993	3,985	3,914	6,820 (a)	(8,699) (b)	6,020
Year ended December 31, 1994	6,020	5,791	9,610 (a)	(14,966) (b)	6,455

- (a) Represents accrued credits, recoveries of amounts previously written off and balances recorded from acquisitions.
- (b) Represents amounts written off as uncollectible and credits issued.

LCLINTERNATIONAL, INC.

SCHEDULE VIII - VALUATION AND QUALIFYING ACCOUNTS  
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**LCI International**

**Worldwide Telecommunications**

**8180 Greensboro Drive · Suite 800 · McLean, VA · 22102**

**LOCAL SERVICE APPLICATION**

**EXHIBIT C**

# different

## because

- We're growing faster than any of the nation's major long distance carriers
- We've taken the confusion out of long distance service.
- We're a mid-sized company with big company leadership.
- We're a fast-growing company backed by a sound financial structure.
- We're a "second tier" company competing across all segments of the market.
- We don't measure our strength by our technology, but by how well we respond to our customers' real needs.
- We're the place to be for people who want to help write the telecommunications industry's next chapter.

LCI International today is a half-billion dollar facilities-based long distance communications company that provides voice and data services to residential and business customers throughout the U.S. and to more than 200 international locations.

With headquarters in McLean, Virginia, LCI maintains its Network Control Center and National Customer Service Center in Dublin, Ohio, and has sales and operations offices in over 55 U.S. locations.

LCI International is listed on the New York Stock Exchange under the symbol "LCI" for its common shares and "LCIPR" for its preferred shares.



H. Brian Thompson  
Chairman and  
Chief Executive Officer

# a very different long distance company

**To Our Shareowners** ECI is a different kind of

company in the long distance industry.

The services we offer are simple, fair and inexpensive — a

marked contrast to the discounts, hidden costs and small print

confusion in the market today.

We're a unique combination of size and control —

powerful enough to meet the needs of large multi-national busi-

ness accounts, but small enough to be responsive, flexible and

cost-efficient.

We're different in how we *apply* our technology. We are

continually improving our owned and leased global network

with the best technology from suppliers around the world.

And, perhaps most importantly to you, the shareowner,

we're different in our financial performance. Some of the

financial highlights in 1994 were:

- Internal revenue growth — not including acquisitions — exceeded 55%

- Our minutes of use (MOU's), the standard industry

measure of volume, jumped from 2.5 billion in 1993

to 3.5 billion, a 45% growth rate.

- Earnings earnings on common stock for the year

climbed to \$52.8 million, paced by strength across all

segments, as we turned the corner to profitability.

- Performance momentum accelerated throughout the

year, with year-over-year revenue growth reaching

40% in the fourth quarter of 1994.

- Shareholder return was equally strong: our stock price

was up nearly 45% for the year, versus an average

decline of 14% for the rest of the industry.

We were pleased during the year to welcome two experi-

enced executives to our Board of Directors. George Ferrin,

chairman and founder of Fajing Network, Inc. (FajingNet), brings

over 20 years experience in the telecommunications and pub-

lishing industries. John L. Vogelsheim, vice chairman and president

of E.M. Warburg, Pincus & Co., Inc., one of the nation's leading

venture banking firms, brings to our board more than 10 years

of experience in the investment business.

## Ending confusion

Our difference — and our performance — are based on the

belief that the vast majority of customers want three things in

telecommunications: a quality connection in order to commu-

cate a fair price; and an understanding of what they're paying for.

For ECI, *simple* means we charge flat rates by time of day.

not location. We don't use fine print or build in hidden charges.

*Fair* means we've blown the whistle on the industry's secret

we charge in six second increments instead of rounding.

charges up to the next full minute. And *transparent* means just

what it says. We tell our customers to look at their bill. Not

only are our services of high quality, but the total charge to ECI

customers almost always saves them money.

## Driving growth

The growth strategy that drives our market approach centers

on three points: geographic expansion in sales offices and net-

work operating facilities; offering new services to each market

segment; and selective acquisitions.

We're attacking the wide-open opportunity of a \$70 billion

industry, growing at an estimated 7% a year across all fronts —

residential, small business and large accounts. That means

there's over \$4 billion in new business up for grabs in 1995.

and we remain excited about ECI's potential to capture a good

piece of that growth.

We're quickly building the technology and service base to

accelerate growth. Though we serve customers nationwide, we

have added to efficiencies and effectiveness by establishing

five sales offices in key markets across the country in 1994, and

by adding three new network switching centers to serve the

southern, Northeast and Western markets. Two additional

increased our presence in the South and West, adding to our

base of operations in the Midwest and Mid-Atlantic states.

In addition to the 200 countries we already reach through

leased networks, we received approval from the FCC in 1994



**Thomas J. Wyznie**  
President and Chief Operating Officer

**Joseph A. Lawrence**  
Senior Vice President, Finance  
and Development and  
Chief Financial Officer

**Marshall Hando**  
Senior Vice President, Sales

to seek agreements for direct connections with many of the world's top calling markets. And a joint international agreement now enables LCL to offer its customers high speed data services through connections to over 57 countries, more than any other LCL long-distance carrier.

In the fourth quarter, we decided to take a one-time non-recurring charge related to probable losses on LCL's investments in STN Incorporated of Canada (STN). While this was not an easy decision, we took a hard look at developments in the Canadian marketplace and determined that this charge was the most prudent action for LCL. We remain hopeful that Canadian authorities will take the actions necessary to nurture a truly competitive long distance industry for Canadian consumers. Fortunately, to date these actions have not been forthcoming. We are hopeful that the regulatory and business environment will improve over time, and that real competition will flourish in Canada to the benefit of all concerned.

We've added more than 20 new services in the last two years in all key markets — ranging from one of the first domestic prepaid calling cards to new services for small and large accounts businesses. In 1994, we also began to spread our simple, fair and inexpensive message in a series of highly effective national cable television advertisements that began airing during the summer. Finally, our acquisition strategy for the future is opportunistic, but focused. We're not in the market to simply acquire customer lists. Any company we add must bring something to the table in terms of technology, location and talent, and must manifest a clear cut ability to become an integral part of LCL.

### **Increasing financial flexibility**

Backing our growth strategies is a sound financial structure. We have come a long way from a company that just four years ago was experiencing financial difficulties. Building on our successful public offerings in 1993, LCL's financial flexibility was further supported in 1994 by an increased \$200 million revolving credit agreement extended to LCL by a consortium of banks led by Nationsbank and First Union.

Our new financial flexibility is clear in our debt-to-equity ratio which has changed from \$250 million in debt and negative equity of \$38 million in 1992, to \$145 million in debt and \$202 million in equity in 1994. Even as our earnings rose, our net interest payments have dropped from a high of nearly \$55 million two years ago to \$9 million in 1994.

### **Running lean**

Managing our rapid growth is number one on the agenda of management challenges. We lead the industry in key productivity measures. We keep a firm hand on our selling, general and administrative (SG&A) costs — we're a company that lives each industry analysis project that in 1994, SG&A as a percent of revenue for our three largest competitors ranged from 25% to more than 28%. We came in at 22.1% for 1994.

We have successfully leveraged our buying power for the network services we buy from other carriers. This approach allows us to effectively continue the reduction of our network costs for each call in turn providing the freedom to price the service competitively. It also offers important flexibility in the expansion of our network reach.

### **Promoting fair competition**

New telecommunications legislation would be of course a major factor in our future. Our position is clear. We welcome open competition — LCL already competes successfully with three of the world's largest and most aggressive marketers, and we believe competition benefits all consumers. What we cannot accept is less than fair competition. We have been active on Capitol Hill to ensure that appropriate safeguards are in place and that there is effective competition in local service markets before the bell-ringing companies are allowed to enter the long distance market. We're happy to compete with anyone on service, as long as potential competitors cannot use their monopoly power to impede competition.

### **Outlook**

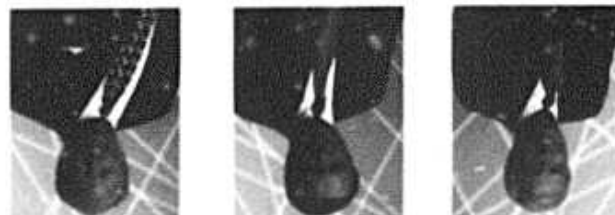
When we began the company turnaround in 1991, we said we would be a \$100-500 million company by 1994. We are a \$1 billion company by 1997. Looking ahead, we have every reason to believe that our market position, technology, people, strategies and balance sheet strength will continue to make us one of the industry's outstanding success stories.

Sincerely,



**Brian Thompson**

Chairman and Chief Executive Officer



## Key Services, Major Markets, Worldwide

We've executed the core mobile strategy of adding smaller carriers, choosing instead to grow in all market segments — residential, small business, large accounts, international, and nationwide services for other telecom municipalities carriers.

We believe that speed and results are essential to our growth goals. And while we do not intend to compete in every product line in all markets, long customer service demands a full range of key services and connections to the world.

In taking this broad approach to the market, we're leveraging a number of strengths.

First is the experience of our senior management of being "network" companies. As the largest telecommunications company ever, we know what it takes to play in that arena.

We understand the advantage of a technologically advanced network. In addition to the 100,000 miles and capacity in key markets of the Midwest, we've created partnerships and ventures with many companies to harness the most sophisticated technology in support of the array of services offered to LCI customers.

Acquisitions will continue to be a factor. However, we're not simply acquiring size. We're looking for companies that add to the base from which we can continue to build an enterprise and enter new markets.

- AT&T revenues grew 8% in 1994. MCI revenues grew 12%. And Sprint revenues grew 11%. LCI revenues grew at 36% — 33% of that from our base and 3% from acquisitions.
- Our residential business grew by over 100%, while our international business increased approximately 50%. LCI's traditional core — small and large business — increased nearly 30%.
- We launched new services across all our markets. Revenues from Integrity<sup>SM</sup>, a full range of voice and data options for large accounts, grew by over 150%. And revenues from Simply Business<sup>SM</sup>, launched in mid-1994 for small businesses, increased on average nearly 30% per month. We also added programs for smaller long distance carriers whom we serve, a series of successful calling cards, and one of the industry's first debit cards for business travelers.
- We added network facilities in Jersey City, New Jersey and Atlanta, Georgia that expand our connections in the important New York metropolitan and Southern markets. We also added our first network facility in the West with our acquisition of T. M. Sepulveda, a Los Angeles-based telecommunications company. And we expanded in North and South Carolina and Tennessee through the acquisition of Teledial America of North Carolina. These additions follow last year's acquisition of LDS in Washington, DC, which established LCI in the Mid-Atlantic states.
- We were granted FCC approval in 1994 to seek agreements overseas allowing direct connections to over 40 countries, positioning LCI to become one of the few U.S. telecommunications firms to offer "facilities-based" international service.

1994 Revenue Growth vs. Big 3  
(Percentage)



Acquisitions accounted for 3% of our 1994 revenue growth, as we continue our selective addition of companies that are a strategic and technological fit.

Attacking all segments of the telecommunications market with new services and a simple, fair and inexpensive approach has provided 1994 base revenue growth of 33%.

different

because of our

**36%**

growth

rate

\*Based on interview notes in effect 1/1/78

- Most customers don't know it, but the big three major carriers round up their billing to the next minute — meaning, for example, that residential customers who talk for one minute and a few seconds are billed for the full two minutes. Estimates are that every year more than \$2 billion goes to carriers for "phantom" service, and customers are charged for services that they do not use.
- LCI bills in six-second increments, meaning our customers pay only for the time they use.
- Our All America<sup>SM</sup> residential service rounds to six seconds after the first 30 seconds. And rates are inexpensive for most callers because the \$ .19, \$ .14 and \$ .12 flat rates do not depend on call distance.
- Simply Business<sup>SM</sup> is fair and inexpensive because it rounds to six seconds in all situations for all calls and offers a simple flat rate that improves with minimum volume and length of contract.
- Integrity<sup>SM</sup> offers the most competitive large account rates in the industry. Term and volume discounts are also more generous than many competing programs, and rates are guaranteed for the life of the contract. All tariffed services count in cross-product discounting. Every additional program improves the customer's price, thereby encouraging customers to use LCI for all their long distance needs.
- Fair and inexpensive is more than a marketing position. It's central to how we run the business. Offering competitive rates and forgoing the subsidy that rounding provides our competitors takes clear product focus and tough cost management. We don't carry low-margin services just to fill out our competitive menu. And we're holding our overhead among the industry's lowest at 2.7% of revenue, while continually reducing our network and local access costs through the better use of technology and innovative joint ventures and partnerships.

**A Growing List  
of Large Customers**

We offer large business rate options to our customers. And a growing list of customers is discovering that sophisticated service does not have to be purchased with a high response and complex contracts. Simple, fair and inexpensive service is being offered for large, growing companies in manufacturing, transportation, banking, government, education and other services and a range of other industries.

Among our large organization customers are:

American Express Corp.  
 Thyssen Corp.  
 The Republic of Ireland  
 Little Boat Inn  
 Key-Off  
 Newcastle International  
 British Telecom  
 State of Kentucky  
 State of Oregon  
 The Atlantic Corp.  
 The Bank of New York Corp.  
 The Ohio State University  
 University of Michigan  
 and the list is growing by the day.



## Network Reach

*Today the globe is crisscrossed in more than 1 million miles of fiber optic cable. And new generations of intelligent network software have increased the speed and capacity of that fiber. At the same time, transmission costs have been cut to a fraction of what they were when the networks were built. The result: far more capacity than there is traffic to fill it. And the gap is growing.*

*As world-class telecommunication service no longer depends on the amount of fiber it carries on its customers aren't as concerned with how service is provided as they are that it is provided reliably, flexibly, and at the right price. Simply put, a telecommunication company no longer has to own a global network than an airline has to own the airports it delivers passengers to around the world.*

*ICI is taking full advantage of this capacity in a dual approach to our network services. We have over 1,000 miles of owned fiber mainly in the Midwest. But we also lease capacity that allows us to provide service around the world. Our*

*Network Control Center monitors our customers' worldwide traffic, whether the traffic is owned, leased, or leased network.*

*We believe this approach gives us the best of both worlds. Ownership of our core network allows us to work directly with the latest technologies, making us a more effective manager of supplies and giving us a better line of sight to the interplay of technology and service.*

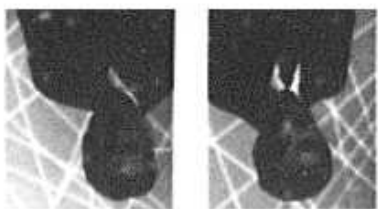
- Our global network consists of more than 600 million circuit miles spanning the U.S. and more than 200 countries. It includes eight switches in Columbus, Cleveland, Chicago, New Jersey, Washington, DC, Atlanta, Charlotte, and Los Angeles — connecting us to metropolitan areas that account for 95% of U.S. call volume.
- Our switch architecture is among the most advanced and feature-rich service platforms available — allowing us to offer international switching, customized service packages, enhanced billing, virtual private networking and a growing list of advanced network features.
- Working with systems and software partners like Northern Telecom Ltd., Newbridge Networks Corporation, Oracle Systems Corp., Hewlett Packard Co., DSC Communications Corp., Forte Software, Inc., Powersoft Corporation, Tellabs Operations, Inc., and others, we're creating a network architecture that offers one of the best customer information systems in the industry. Our order entry and billing technology platforms support ICI's ability to offer industry-leading cross discounting for major accounts and tailored billing for individual customers.
- Another illustration of the efficiency of leasing versus buying, we are now able to offer the world's largest frame relay network to customers. We developed the system, FramePlus<sup>SM</sup>, in partnership with Newbridge Networks. Through an agreement with Scitor, we now offer ICI's frame relay data service to more international destinations than any other U.S. long distance carrier. Scitor's parent company, SITA, operates the world's largest global data network, which carries the traffic of more than 600 air transport companies and other multinational corporations in over 220 countries.

# different because of our people

- Simple, fair and inexpensive telecommunications service is part of technology and part strategy, but the third critical part of the mix is the people who bring strategy and technology together to create opportunity. Testimony to the power of people is standard fare in annual reports, but at LCI — an enterprise still in its formative years — the kind of people we're attracting is absolutely critical to our future.

- Our senior management team has an average of nearly 20 years of experience in the telecommunications business. Many of them were on the front lines in the fight to open the industry to competition in the U.S. and in forcing the boundaries outward to the far corners of the globe. They know the competitive telecommunications industry because they helped create it.
- Do different kinds of companies attract different kinds of people? Absolutely. Some are more comfortable in a settled and predictable environment. But the people knocking on our door tend to have an entrepreneurial streak.

- We're a company currently growing at over 35% a year. That's exciting. And people want to be part of it. They like not having to stand in line for challenge and recognition. They like change and a company where opportunity is a function of ability. Simply put, we're different because of the people we attract, and the people we attract make us different.



**Selected Consolidated Financial Data**

*In Thousands, Except Revenue Per MOU and Earnings Per Common Share*

	1994	1993(A)	1992(A)	1991(A)	1990
<b>Statement of Operations Data</b>					
Revenues	\$ 463,941	\$ 341,220	\$ 260,494	\$ 228,034	\$ 260,183
Operating Expenses	413,079	320,067	267,033	221,078	234,521
Operating Income	50,862	21,173	(6,539)	6,956	25,662
Net Income (Loss) Before Extraordinary Items	6,803	(2,570)	(41,721)	(27,392)	(4,441)
Net Income (Loss)	6,803	(10,915)	(41,721)	(27,392)	(4,441)
Income (Loss) on Common	\$ 1,053	\$ (13,039)	\$ (46,948)	\$ (32,158)	\$ (8,902)
<b>Operating Data</b>					
Minutes of Use (MOU's)	3,288,386	2,270,354	1,677,189	1,325,372	1,413,322
Revenue Per MOU	\$ 0.1426	\$ 0.1273	\$ 0.1263	\$ 0.1358	\$ 0.1447
EBITDA <sup>(B)</sup>	\$ 86,975	\$ 67,623	\$ 50,332	\$ 44,850	\$ 53,220
<b>Balance Sheet Data</b>					
Total Assets	\$ 469,682	\$ 359,788	\$ 323,583	\$ 357,588	\$ 367,144
Long-Term Debt and Capital Lease Obligations	143,752	84,337	255,880	245,445	255,292
Redeemable Preferred Stock	—	—	4,118	63,406	58,416
Shareowners' Equity (Deficit)	\$ 201,735	\$ 195,259	\$ (38,005)	\$ (58,284)	\$ (25,952)
<b>Earnings per Common Share<sup>(C)</sup></b>					
Income (Loss) Per Share Before					
Extraordinary Items	\$ 0.03	\$ (0.20)	\$ (2.66)	\$ (1.74)	\$ (0.28)
Extraordinary Loss Per Share	—	(0.35)	—	—	—
<b>Income (Loss) Per Share</b>	<b>\$ 0.03</b>	<b>\$ (0.55)</b>	<b>\$ (2.66)</b>	<b>\$ (1.74)</b>	<b>\$ (0.28)</b>
Weighted Average Number of Common Shares	33,328	23,586	15,710	15,736	15,588

(A) Includes loss contingency expenses, restructuring charges, and loss on disposal and write-off of assets of \$13,754 in 1993, \$24,400 in 1992 and \$6,350 in 1991.

(B) Earnings before Interest, Income Taxes, Depreciation and Amortization (EBITDA), excludes nonrecurring charges discussed in note (A) above.

(C) All share and earnings per share amounts have been restated to reflect the 2 for 1 stock dividend effective in July 1994.

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Introduction**

LCI International, Inc. and subsidiaries (LCI or the Company) is a facilities-based long distance telecommunications carrier that provides a broad array of domestic and international voice and data services to commercial and residential customers. The Company provides service to its customers through digital fiber optic facilities which are both leased and owned. Collectively, these facilities constitute the Company's network (the Network).

The Company operates in the approximately \$70 billion long distance telecommunications industry. The industry is highly competitive and dominated by the three largest interexchange carriers: AT&T Corp. (AT&T), MCI Communications Corporation (MCI) and Sprint Corporation (Sprint). Fewer than ten other interexchange carriers, including the Company, have annual revenues exceeding \$200 million. The balance of the industry is comprised of several hundred smaller interexchange carriers.

The current industry environment subjects the Company to varying degrees of regulatory and legislative oversight on both the national and state levels. Changes in the regulatory and/or legislative environment can impact the nature and degree of the Company's competition, including the ability of local exchange carriers to compete in the long distance telecommunications industry. Although there are several pending proposals, the Company is unable to predict whether any significant regulatory or legislative changes will be implemented in 1995 that would fundamentally alter the current competitive structure of the long distance telecommunications industry.

The Company has developed a marketing strategy that focuses on differentiating LCI through simple, fair and inexpensive telecommunications services. This strategic direction is supported by growth through expansion in sales offices and network operating facilities, service offerings to each market segment and selective acquisitions. This

approach is dependent on maintaining efficient, low cost operations in order to preserve pricing flexibility and operating margins.

The Company's ability to implement its strategy was dependent on the restructuring and recapitalization activities undertaken in 1992 and 1993. Although these activities resulted in significant one-time charges in 1992 and 1993, the financial and operating structure that was established enabled the Company to achieve its 1994 performance.

While the long distance telecommunications industry revenue has grown between 7% and 9% annually in recent years, the Company has experienced 36% and 51% growth in revenues and 45% and 35% growth in the volume of switched minutes of use (MOU) in 1994 and 1993, respectively. This growth has been driven by growth in all service areas of the Company's business, with significant growth in the commercial, wholesale, residential and international segments. The Company's residential revenue grew at 119% and 116% in 1994 and 1993, respectively, and represented approximately 16% of the Company's revenues by the end of 1994. This compares to approximately 5% of the Company's revenues at the end of 1992. The Company intends to continue to expand its sales, marketing and promotional efforts in the residential market. Revenue from business international services, which represents approximately 5% of total revenues, grew by 49% and 63% in 1994 and 1993, respectively, as a result of the Company's efforts to take full advantage of opportunities in the global telecommunications market. The Company expects continued growth in international service revenue as a result of the continued marketing and sales focus on international service offerings. Revenues from business domestic services exhibited overall growth rates of 28% and 26% in 1994 and 1993, respectively.

In 1994, the Company recorded a nonrecurring charge of \$62.5 million for the probable loss of its investments

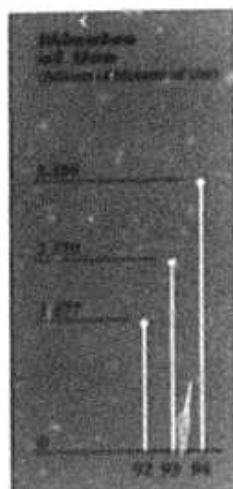


in STN Incorporated (STN) and for accrued loss contingencies related to the STN investments (See Note 4 to the Consolidated Financial Statements).

## Review of Operations

### Revenues

Total revenues reached \$463.9 million in 1994, an increase of 36% from \$341.2 million in 1993. Total revenues in 1993 exceeded 1992 revenues of \$260.5 million by 31%. The following table provides further information regarding the Company's revenues.



In Thousands, Except Revenue Per MOU	1994	1993	1992
Revenues — Switched	\$403,113	\$298,957	\$211,825
Revenues — Private Line and Other	60,828	52,265	48,669
<b>Total Revenues</b>	<b>\$463,941</b>	<b>\$341,220</b>	<b>\$260,494</b>
MOUs	2,288,500	2,270,554	1,677,189
Revenue Per MOU	\$ 0.1220	\$ 0.1275	\$ 0.1265

The 39.5% increase in 1994 switched revenues over 1993, and 36.4% increase in 1993 switched revenues over 1992 were primarily due to increases in volumes (as measured in MOUs) across all service types. The Company's growth in volumes has resulted from geographic expansion through new sales offices and third party sales agents in areas not previously served by the Company. The increase in volumes accounted for approximately \$151.4 million and \$78.4 million of the increases in revenues for 1994 and 1993, respectively. The Company's overall revenue growth rate was driven by growth rates of 119% and 116% in residential services and 49% and 63% in business international

services for 1994 and 1993, respectively, reflecting the Company's strategy to participate in all market segments.

The 3.7% decrease in revenue per MOU in 1994 reflects competitive market pressures and LCI's commitment to grow in all market segments, including wholesale and national account services which have lower revenue per MOU than other market segments. The overall impact of the rate and mix changes was to reduce 1994 revenue by approximately \$8.7 million. The slight increase in revenue per MOU in 1993 reflects increased revenues from residential and international services, which offset rate reductions in other services, and accounted for \$2.3 million of the increase in revenues over 1992.

### Gross Margin

The Company's gross margin increased to \$189.7 million in 1994 from \$145.9 million in 1993 and \$109.0 million in 1992. The following table provides information regarding gross margin.

In Thousands	1994	1993	1992
Revenues	\$463,941	\$341,220	\$260,494
Cost of Services	274,270	197,315	151,508
<b>Gross Margin</b>	<b>\$189,671</b>	<b>\$143,907</b>	<b>\$108,986</b>
Gross Margin %	40.9%	42.2%	41.8%

The gross margin as a percentage of revenues decreased to 40.9% in 1994 from 42.2% in 1993 due to growth in traffic originating and terminating off the Company's Network which increased the cost of services, and due to the decrease in the average revenue per MOU discussed above. Gross margin as a percentage of revenues increased slightly in 1993 from 1992 primarily due to the increase in the revenue per MOU.

The Company executed several strategies to manage and reduce its cost of services. During September and October 1994, the Company completed installation of three new switching centers. These switching centers,

which extended the Company's Network, are intended to assist in the management of volume growth and reduce off-network costs. Also in the fourth quarter of 1994, the Company completed negotiations with an interexchange carrier to consolidate a substantial amount of its leased line and interexchange services for a fixed contract period in return for reduced service costs, increased service availability and access to new technologies. The Company expects to realize the benefits from the operation of the new switching centers and lower interexchange costs beginning in 1995.

#### Operating Expenses and Operating Income

The following table provides information regarding operating expenses and operating income:

<i>In Thousands</i>	1994	1993	1992
<b>Gross Margin</b>	\$189,671	\$143,907	\$108,986
Selling, General and Administrative Expenses	(62,670)	76,284	58,654
<b>Earnings Before Interest, Income Taxes, Depreciation and Amortization (EBITDA)</b>	86,975	67,623	50,332
Depreciation and Amortization	(5,113)	(2,696)	(2,471)
<b>Recurring Operating Income</b>	50,262	34,927	17,861
Loss Contingencies, Restructuring and Other Charges		13,754	24,400
<b>Operating Income (Loss)</b>	\$ 50,262	\$ 21,173	\$ (6,539)

#### As a Percent of Revenue:

<b>Gross Margin</b>	40.9%	42.2%	41.8%
Selling, General and Administrative Expenses	27.4%	22.4%	22.5%
<b>EBITDA</b>	18.8%	19.8%	19.5%
Depreciation and Amortization	7.8%	9.6%	12.4%
<b>Recurring Operating Income</b>	11.0%	10.2%	6.9%
Loss Contingencies, Restructuring and Other Charges		4.0%	9.4%
<b>Operating Income (Loss)</b>	11.0%	6.2%	(2.5)%

*Selling, General and Administrative Expenses:* Selling, general and administrative expenses increased 34.6% to \$102.7 million in 1994 and increased 30.1% to \$76.3 million in 1993. However, as a percentage of revenues, selling, general and administrative expenses have declined from 1992 to 1994 as a result of management's efforts to control these expenses in a period of rapid revenue growth. The dollar increase in selling, general and administrative expenses reflects, in part, increased payroll and commission expenses of approximately \$19.1 million and \$11.1 million in 1994 and 1993, respectively, due to an increase in the number of personnel and successful sales activity. The remaining increase in selling, general and administrative expenses was primarily due to higher outside billing service expenses in 1994 and 1993 that resulted from the increase in residential service call volume and higher marketing and promotional expenses associated with the Company's growth and service line expansion.

*Depreciation and Amortization Expense:* Depreciation and amortization expense for 1994 increased 10.5% over 1993, primarily due to the Company's increased capital expenditures to support its growth. However, depreciation and amortization expense as a percentage of revenues continued to decline reflecting increased utilization of the Company's owned network through increased volumes.

#### *Loss Contingencies, Restructuring, and Other Charges*

In 1993, the Company decided that marketing support for certain service lines would be discontinued and that certain equipment and software was no longer needed. A non-recurring charge of \$2.2 million in 1993 for loss on disposal and write-off of assets was recorded to reflect these decisions. Also in 1993, the Company recorded \$11.5 million to provide accrued loss contingencies for various pending and threatened litigation matters, including an age discrimination case.

In 1992, the Company recorded a \$15.7 million restructuring charge and \$8.7 million loss on disposal and write-off of assets. Of the restructuring charge, \$12.4 million consisted of the write-off of various assets, and \$3.3 million consisted of accrued loss contingencies associated with litigation, elimination of redundant facilities and certain other costs.

*Operating Income:* Recurring operating income increased \$15.9 million or 45.6% in 1994 and \$17.1 million or 95.5% in 1993. Operating income before nonrecurring charges as a percentage of revenues increased to 11.0% and 10.2% in 1994 and 1993, respectively. After the nonrecurring charges, operating income increased \$29.7 million in 1994 and \$27.7 million in 1993 and was 11.0% and 6.2%, respectively, as a percentage of revenues.

#### Interest Expense, Net

Interest expense, net of capitalized interest decreased to \$8.8 million in 1994 from \$23.3 million in 1993 which reflects the Company's recapitalization completed during 1993 and 1994, as discussed in Liquidity and Capital Resources below. Interest expense declined \$9.4 million in 1993 from \$32.7 million in 1992, which was also directly attributable to the recapitalization completed in 1993. The effective weighted average interest rate on indebtedness outstanding was 7.35% in 1994 as compared to 11.3% in 1993 and 11.9% in 1992.

#### Other Expense, Net

Other expense, net increased from less than \$0.1 million of expense in 1993 to \$59.8 million of expense in 1994. This variance is primarily a result of the nonrecurring charge of \$62.5 million relating to the probable loss on STN investments and accrued loss contingencies related to future STN obligations. (See Note 4 to the Consolidated Financial Statements.)

#### Income Taxes

Income taxes changed from an expense of \$0.4 million in 1993 and \$0.2 million in 1992, to a benefit of \$24.5 million in 1994. The income tax benefit in 1994 primarily arises from the Company's expectation that a portion of the available net operating losses (NOLs) will be realized in future years as permitted by Statement of Financial Accounting Standards No. 109. (See Note 9 to the Consolidated Financial Statements.)

#### Income (Loss)

The Company generated income on common shares of \$1.1 million in 1994, versus a loss on common before extraordinary items (and after preferred dividends accrued) of \$4.7 million in 1993. After extraordinary items and preferred dividends, the Company reflected a loss on common of \$13.0 million in 1993. The following table exhibits the improvement in earnings per share.

#### Earnings per Common Share

	1994	1993	1992
Income (Loss) Per Share Before:			
Extraordinary Items	\$0.03	\$(0.20)	\$(2.06)
Extraordinary Loss Per Share		(0.35)	—
Income (Loss) Per Share	\$0.03	\$(0.55)	\$(2.06)
Weighted Average Number			
of Common Shares	37,325	23,586	15,710

For the years ended December 31, 1994 and 1993, the income (loss) per share is calculated as the income (loss) on common stock divided by the weighted average number of common shares outstanding. The weighted average shares outstanding for 1994 include common stock and common stock equivalents using the treasury stock method. Common stock equivalents were anti-dilutive in 1993, and as such, were not included in the weighted average number of shares of common stock outstanding. (See Note 2 to the Consolidated Financial Statements.)

For the year ended December 31, 1992, the income (loss) per share is calculated as the net income (loss) divided by the weighted average number of common shares outstanding.

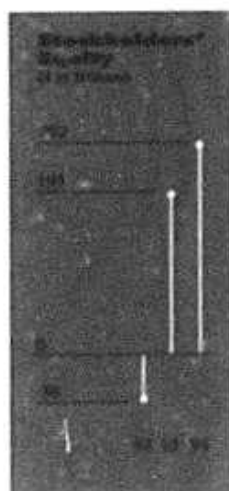
All share and per share amounts have been restated to reflect the 2-for-1 stock dividend which was effective in July 1994.

### Liquidity and Capital Resources

During 1995 and January 1994, the Company completed changes to its capital structure that significantly improved

its financial position. Net proceeds of \$215.5 million were raised in an initial public offering and preferred stock offering completed in May and August 1995, respectively. During January 1994, the Company completed the negotiations for its Revolving Credit Facility (Credit Facility) of \$200 million with a syndicate of banks. Proceeds from the stock offerings and Credit

Facility were used to early retire or refinance over \$255 million of debt and capital lease obligations that existed as of December 31, 1992. The capital changes, together with the successful growth in operations, have significantly improved operating cash flows since 1992 as measured by EBITDA. The Company uses EBITDA as a measure of its liquidity and ability to finance capital expenditures, interest and preferred dividends.



The following table provides a summary of EBITDA, cash interest and preferred dividends, coverage ratio and capital spending for the last three years.

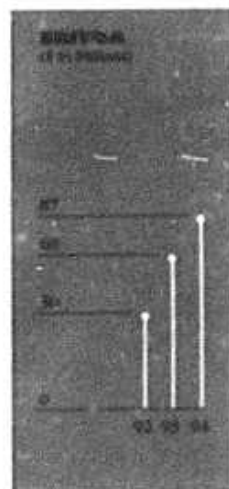
	1994	1995	1992
EBITDA	\$86.07x	\$67.629 <sup>(A)</sup>	\$50.832 <sup>(B)</sup>
Cash Interest and Preferred Dividends	\$13.17x	\$21.290	\$28.800
Coverage Ratio <sup>(C)</sup>	6.47x	3.17x	1.74x
Capital Expenditures and Acquisitions	\$7.013	\$55.961	\$15.411

(A) Excludes the 1993 nonrecurring charges of \$13.754

(B) Excludes the 1992 nonrecurring charges of \$24.400

(C) EBITDA divided by cash interest and preferred dividends

The Company uses its Credit Facility to supplement its ability to fund its activities. The Credit Facility provides the capability of borrowing up to \$200.0 million for use in connection with acquisitions, capital spending and investment purposes and for any working capital requirements. The banks' commitment to lend is subject to reduction starting on March 31, 1996 and ending on December 31, 1998, when all then-outstanding amounts are to be redeemed. As of December 31, 1994, the



company had borrowed \$151 million at a weighted average interest rate of 7.2% under its Credit Facility.

The Credit Facility bears interest at a rate consisting of two components. The base rate component is dependent upon a market indicator. The second component varies from 0.75% to 1.5% depending on the Company's leverage ratio. To minimize exposure to interest rate fluctuations, in February 1994, the Company purchased

an interest rate cap from a commercial bank that limits the Company's base interest rate to 5.5% on a notional principal balance of \$41 million for a two-year period ending February 1996. In the event of nonperformance by the commercial bank, the Company would have exposure to the extent of any increase in the interest rate above 5.5% and the remaining unamortized balance of the interest rate cap. The Company believes an event of nonperformance by the bank would be remote.

The Credit Facility contains certain balance sheet, operating cash flow, capital expenditure and negative covenant requirements. The Company is not permitted to pay cash dividends on its common stock or acquire shares of its common stock except that dividends payable in common stock are permitted. As of December 31, 1994, the Company was in compliance with all covenants.

The Company had available \$46.1 million under its Credit Facility as of December 31, 1994. This available borrowing capacity is net of letters of credit provided for various business purposes including support for STN (see Note 4 to the Consolidated Financial Statements). The Company believes that its existing operating cash flow as measured by EBITDA and available borrowing capacity are sufficient to fund its operations and anticipated capital and investment requirements through 1995.

The Company is investigating the possible exchange of its Preferred Stock for Convertible Subordinated Debentures (Convertible Debentures) after August 31, 1995. The Convertible Debentures would have an interest rate equal to the Preferred Stock dividend rate of 5%. If exchanged, this transaction would increase long-term debt and decrease shareholders' equity by \$115.0 million. The annual accrued preferred dividend requirement of \$5.8 million would be replaced by a corresponding charge to interest expense.

However, this interest expense would be deductible for income tax purposes. The Company is unable to predict when or if it will exchange the Preferred Stock for Convertible Debentures.

#### **Capital and Investment Requirements**

The Company's capital expenditures for the year ended December 31, 1994 were \$66 million. These expenditures have primarily been used to acquire switching, transmission and other network facilities arising from the Company's strategic expansion plans and to develop information systems to support the Company's expansion. In 1994, the Company also acquired the assets of Teledial America of North Carolina, Inc. (TANC) for approximately \$5.5 million and T.M. Sepulveda, Inc. and Premium Access, Inc. (collectively TMS) for approximately \$4.0 million. The Company financed these acquisitions and capital spending to date with available cash flow and borrowings under its Credit Facility.

The Company has relied upon strategic acquisitions as a means of expanding its Network, customer base and revenues. The Company evaluates each potential acquisition to determine its strategic fit with the Company's growth objectives. In addition, each acquisition candidate should profitably contribute to the Company's operating margins and income. The Company expects to actively explore potential acquisitions and may enter into discussions from time to time with potential acquisition candidates, but there can be no assurance that the Company will be able to enter into agreements with respect to, or consummate, acquisitions on acceptable terms.

During 1995, the Company expects that its nonbinding commitment for capital expenditures (excluding acquisitions) will approximate the levels expended in 1994 and

are dependent on the Company's geographic and revenue growth. These capital expenditures include switching, transmission and distribution facilities to support the Company's growth as well as expenditures for infrastructure support consisting of information systems hardware and software.

#### **Investment in STN Incorporated**

At the end of 1993 and throughout 1994, the Company invested in STN, a Canadian reseller of long distance telecommunications services, as part of its effort to create a strategic business alliance with STN and augment LCI's international operations by obtaining access to the Canadian telecommunications market. STN common stock and debentures were purchased and a series of interim loans were provided for total cash outlays of \$31.5 million in 1994 and \$8.9 million in 1993. The Company also exchanged 79,438 shares of LCI common stock valued at \$2.9 million for 749,500 common shares of STN. In addition to its investment, LCI agreed to provide STN network management, information and billing services. As a result of an unfavorable Canadian telecommunications regulatory environment and unfavorable financing alternatives for STN, the Company recorded a nonrecurring charge of \$62.5 million in Other Expense, Net, which included \$47.6 million for the probable loss of its STN investments and \$14.9 million for accrued loss contingencies related to future STN obligations (see Note 4 to the Consolidated Financial Statements).

#### **Federal Income Taxes**

The Company has generated significant net operating losses (NOLs) in prior years that are available to reduce current cash requirements for income taxes. See Note 9

of the Consolidated Financial Statements for a discussion of the availability and timing of the utilization of the existing NOLs.

#### **Impact of Inflation and Seasonality**

The Company does not believe that the relatively moderate levels of inflation that have been experienced in the United States in recent years have had a significant effect on its revenues or earnings.

The Company's long distance revenue is subject to seasonal variations, primarily because most of the Company's revenue is generated by commercial customers. Use of long distance services by commercial customers is typically lower on weekends throughout the year, and in the fourth quarter due to holidays. As residential revenue increases as a proportion of the Company's total revenues, the seasonal impact due to changes in commercial calling patterns will be reduced. The Company is unable to predict the seasonal impact of a shift to a larger residential customer base.

#### *Other Matters*

#### **Accounting Pronouncement Not Yet Effective**

A new accounting pronouncement on advertising has been issued but is effective for fiscal years beginning after June 15, 1994 (see Note 2 to the Consolidated Financial Statements for a discussion of the potential impact of this pronouncement).

## Report of Management

The management of LCI International, Inc. is responsible for the preparation of all information, including the financial statements and related notes, included in this Annual Report. The financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances, and include amounts based on the best judgment of management. Financial information included elsewhere in this Annual Report is consistent with these financial statements.

In recognition of its responsibility for the integrity and objectivity of data in the financial statements, management maintains a system of internal accounting controls. This system has been established to ensure within reasonable limits, that assets are safeguarded, that transactions are properly recorded and executed in accordance with management's authorization and that accounting records provide a solid foundation from which to prepare the financial statements. The system is supported by an internal auditing function which assesses the effectiveness of internal controls and reports its findings to management throughout the year. It is recognized that no system of internal controls can detect and prevent all errors and irregularities. Management believes that the established system provides an acceptable balance between benefits to be gained and their related costs.

The Company's independent public accountants are engaged to express an opinion on the year-end financial statements. As part of their audit of the Company's 1994 financial statements, they considered the Company's system of internal control to the extent they deemed necessary to determine the nature, timing and extent of their audit tests.

The Audit Committee of the Board of Directors meets regularly with the independent public accountants, management and internal auditors to review the work performed and to ensure that each is properly discharging its responsibilities. The independent public accountants independently have full and free access to the Committee, without the presence of management, to discuss the results of their examinations, internal accounting controls and financial reporting.



Joseph A. Lawrence  
Senior Vice President Finance and  
Development and Chief Financial Officer

## Report of Independent Public Accountants

To the Board of Directors and Shareowners of  
LCI International, Inc.:

We have audited the accompanying consolidated balance sheets of LCI International, Inc. (a Delaware corporation) and subsidiaries as of December 31, 1994 and 1993, and the related consolidated statements of operations, shareowners equity and cash flows for each of the three years in the period ended December 31, 1994. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LCI International, Inc. and subsidiaries, as of December 31, 1994 and 1993, and the results of their operations and cash flows for each of the three years in the period ended December 31, 1994, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Arthur Andersen LLP  
Columbus, Ohio,  
February 14, 1995

**Consolidated Statements of Operations**

<i>In Thousands, Except Earnings Per Common Share</i>	For the Year Ended December 31,		
	1994	1993	1992
<b>Revenues</b>	\$ 163,941	\$ 541,220	\$ 260,494
Cost of Services	274,270	197,313	151,508
<b>Gross Margin</b>	189,671	143,907	108,986
Selling, General and Administrative Expenses	102,696	76,284	58,654
Depreciation and Amortization	30,113	32,696	32,471
Loss Contingencies, Restructuring and Other Charges		13,754	24,400
<b>Operating Income (Loss)</b>	50,862	21,173	(6,539)
Other Expense, Net	59,751	18	2,237
Interest Expense, Net	8,838	23,329	32,705
<b>Loss Before Income Taxes</b>	(17,727)	(2,174)	(41,481)
Income Tax Expense (Benefit)	(24,530)	396	240
<b>Net Income (Loss) Before Extraordinary Items</b>	6,803	(2,570)	(41,721)
Extraordinary Loss — Debt Retirement		8,345	—
<b>Net Income (Loss)</b>	6,803	(10,915)	(41,721)
Preferred Dividends	5,750	2,124	5,227
<b>Income (Loss) on Common Stock</b>	\$ 1,053	\$ (13,039)	\$ (46,948)
<b>Earnings Per Common Share</b>			
Income (Loss) Per Share Before Extraordinary Items	\$ 0.03	\$ (0.20)	\$ (2.66)
Extraordinary Loss Per Share	—	(0.55)	—
<b>Income (Loss) Per Share</b>	\$ 0.03	\$ (0.55)	\$ (2.66)
Weighted Average Number of Common Shares	33,328	23,586	15,710

*The accompanying notes are an integral part of these statements.*



**Consolidated Balance Sheets**

<i>In Thousands</i>	December 31,	
	1994	1993
<b>Assets</b>		
<b>Current Assets</b>		
Trade Accounts Receivable, Less Allowance for Doubtful Accounts of \$6,455 and \$6,020	\$ 82,701	\$ 47,744
Current Deferred Taxes Assets, Net	23,409	—
Prepays and Other	9,644	2,903
Other Accounts and Notes Receivable, Net	2,883	3,522
<b>Total Current Assets</b>	<b>118,637</b>	<b>54,169</b>
<b>Property, Plant and Equipment</b>		
Fiber Optic Network	302,914	248,854
General Office Equipment and Building Lease	70,643	50,478
Less — Accumulated Depreciation and Amortization	(114,005)	(112,880)
	228,952	186,452
Plant Under Construction	28,452	15,907
<b>Total Property, Plant and Equipment, Net</b>	<b>257,404</b>	<b>202,339</b>
		8,931
<b>Investment in STN Incorporated</b>		
<b>Other Assets</b>		
Excess of Cost Over Net Assets Acquired, Net of Accumulated Amortization of \$12,776 and \$10,690	89,437	89,466
Other, Net	14,367	4,883
<b>Total Other Assets</b>	<b>103,804</b>	<b>94,349</b>
<b>Total Assets</b>	<b>\$ 479,845</b>	<b>\$ 359,788</b>

<i>In Thousands</i>	December 31,	
	1994	1993
<b>Liabilities and Shareowners' Equity</b>		
<b>Current Liabilities</b>		
Accounts Payable	\$ 29,545	\$ 16,481
Facility Costs Accrued and Payable	47,215	28,905
Accrued Expenses and Other	31,110	13,590
Accrued Taxes	7,631	1,288
Total Current Liabilities	105,501	60,264
<b>Long-Term Debt</b>	131,000	70,264
<b>Capital Lease Obligations</b>	13,752	14,073
<b>Other Liabilities and Deferred Credits</b>	17,688	19,928
<b>Commitments and Contingencies</b>		
<b>Shareowners' Equity</b>		
Preferred Stock — Authorized 15,000 Shares, Issued and Outstanding 4,599.8 and 4,600 Shares in 1994 and 1993, respectively	114,995	115,000
Common Stock — Authorized 100,000 Shares, Issued and Outstanding 29,643 and 29,260 Shares in 1994 and 1993, respectively	290	146
Paid-in Capital	200,741	195,463
Retained Deficit	(114,297)	(115,350)
Total Shareowners' Equity	201,739	195,259
Total Liabilities and Shareowners' Equity	\$ 409,682	\$ 359,788

*The accompanying notes are an integral part of these statements*

**Consolidated Statements of Shareowners' Equity**

<i>In Thousands</i>	Preferred Stock	Common Stock	Paid in Capital	Retained Deficit	Total Shareowners' Equity
	\$ 01 Par Value	\$ 01 Par Value			
<b>Balance at December 31, 1991</b>	\$ —	\$ 6	\$ (2,927)	\$ (55,363)	\$ (58,284)
Repurchase of Stock	—	—	(30)	—	(30)
Redeemable Preferred Stock Conversion	—	38	64,477	—	64,515
Issuance of 1992 Stock Options	—	—	2,887	—	2,887
Deferred Compensation Stock Options	—	—	(145)	—	(145)
Net Loss	—	—	—	(41,721)	(41,721)
Preferred Dividends Accrued	—	—	—	(5,227)	(5,227)
<b>Balance at December 31, 1992</b>	—	44	64,262	(102,311)	(58,005)
Initial Public Offering	—	61	103,919	—	103,980
Conversion of Convertible Notes	—	15	26,117	—	26,132
Redeemable Preferred Stock Conversion	—	4	4,114	—	4,118
Preferred Stock Offering	115,000	—	(5,462)	—	111,538
Stock Offering Costs	—	—	(2,762)	—	(2,762)
Employee Stock Purchases	—	—	706	—	706
Deferred Compensation and Other	—	22	252	—	274
Issuance of Warrants	—	—	2,317	—	2,317
Net Loss	—	—	—	(10,915)	(10,915)
Preferred Dividends Accrued	—	—	—	(2,124)	(2,124)
<b>Balance at December 31, 1993</b>	115,000	146	195,463	(115,350)	195,259
Employee Stock Purchases	—	1	1,614	—	1,615
STN Incorporated Stock Exchange	—	1	2,879	—	2,880
Exercise of Options/Warrants and Related Tax Benefits	—	—	(67)	—	(67)
Other	(5)	148	118	—	261
Net Income	—	—	—	6,803	6,803
Preferred Dividends Accrued	—	—	—	(5,750)	(5,750)
<b>Balance at December 31, 1994</b>	\$114,995	\$ 296	\$200,741	\$ (114,297)	\$ 201,735

*The accompanying notes are an integral part of these statements.*

**Consolidated Statements of Cash Flows**

<i>In Thousands</i>	For the Year Ended December 31,		
	1994	1993	1992
<b>Operating Activities</b>			
Cash Received from Customers	\$ 435,454	\$ 330,717	\$ 252,763
Cash Paid to Suppliers and Employees	(375,867)	(271,456)	(223,941)
Interest Paid	(8,827)	(19,645)	(27,414)
Income Taxes Paid	(1,194)	(270)	(108)
Net Cash Provided by Operating Activities	89,566	59,346	1,300
<b>Investing Activities</b>			
Capital Expenditures — Property, Plant and Equipment	(65,589)	(24,092)	(13,411)
Payment for Acquisitions	(7,924)	(11,869)	—
Investment in STN Incorporated	(31,454)	(8,951)	—
Net Cash Used in Investing Activities	(104,967)	(44,892)	(13,411)
<b>Financing Activities</b>			
Financing Fee Payments	(803)	(3,118)	(1,523)
Proceeds from Debt Issuance	133,500	22,694	59,827
Debt and Capital Lease Payments	(73,386)	(226,543)	(26,393)
Equity Proceeds — Common and Preferred Stock Offerings, net of Related Costs	—	213,222	—
Preferred Dividend Payments	(5,750)	(1,645)	—
Sale of Common Stock	2,140	936	—
Net Cash Provided by Financing Activities	55,701	5,546	12,111
Net Increase (Decrease) in Cash and Cash Equivalents	40,300	19,999	1,999
Cash and Cash Equivalents at the Beginning of the Year	—	—	—
Cash and Cash Equivalents at the End of the Year	\$ 40,300	\$ 19,999	\$ 1,999

The accompanying notes are an integral part of these statements.

## Notes to Consolidated Financial Statements

### 1. Business Organization and Purpose

The financial statements presented herein include consolidated balance sheets of LCI International, Inc., a Delaware corporation, and its subsidiaries (LCI or the Company) as of December 31, 1994 and 1995, and the related consolidated statements of operations, shareholders' equity and cash flows for the three years ended December 31, 1994.

LCI is a facilities-based long distance telecommunications carrier that provides a broad range of domestic and international voice and data services to commercial and residential customers. The Company serves its customers through digital fiber optic facilities which are both leased and owned.

### 2. Accounting Policies

#### Estimates

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

#### Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany transactions and balances have been eliminated.

#### Trade Accounts Receivable

Trade accounts receivable represent amounts due from customers for telecommunications services. These amounts include revenues recognized but not yet billed for switched

services. Trade accounts receivable are shown net of the related allowance for doubtful accounts.

#### Prepays and Other

Prepays and other include deferred customer promotion costs that are amortized over the life of the related contract.

#### Property, Plant and Equipment

These assets are stated at cost or at fair market value if obtained as part of an acquisition. Construction costs include material, labor, interest and overheads for certain general and payroll related costs. Property, plant and equipment includes a \$15.8 million capitalized building lease for the Company's operational headquarters. Routine repairs and maintenance of property and replacements of minor items are charged to expense as incurred. Depreciation of buildings and equipment is provided on a straight line basis over the estimated useful lives of these assets. The building lease is amortized on a straight line basis over the term of the lease.

The applicable depreciation and amortization periods by asset type is as follows:

Asset Category	Years
Fiber Optic Network	
Outside Plant and Buildings	50
Transmission, Distribution and Switching Installations	10
General Office Equipment	2 to 5
Capitalized Building Lease	5 to 10
	15

#### Excess of Cost Over Net Assets Acquired

Excess of cost over net assets acquired (goodwill) consists of the excess of the cost to acquire an entity over the estimated fair market value of the net assets acquired. These amounts are amortized on a straight line basis over 10 years. Subsequent to an acquisition, the Company continually

The weighted average number of common shares used to calculate earnings per share include common stock and

#### Earnings per Common Share

#### Weighted Average Shares of Common Stock and

since January 1, 1992 (see Note 9)

The Company has followed Statement of Financial Accounting Standards (SFAS) No. 109 "Accounting for Income Taxes"

#### Income Taxes

views are provided

Telecommunications revenues are recognized when ser-

#### Revenue Recognition

the respective customer life or non-competitive agreement card as part of purchase accounting and amortized over the customer list and non-competitive agreements are also the life of the respective agreements. The original cost of debt agreements. Rights of way costs are amortized over issuance costs are amortized over the life of the applicable competitive agreements and other deferred costs. Debt-

debt issuance costs, rights of way, customer lists, non-

#### Other Assets

Other assets consist of net long-term deferred tax assets, good will is recoverable. Amortization of goodwill was \$2.8 million, \$2.3 million, and \$2.0 million for the years ended December 31, 1994, 1993, and 1992, respectively. In evaluating the remaining life of the goodwill in measuring whether impairment, the Company would estimate cash flow over balance of goodwill may not be recoverable. In evaluating of goodwill may warrant revision or that the remaining occurred that indicate the remaining estimated useful life evaluates whether later events and circumstances have

calculations yield the same result primary and fully diluted earnings per share, as the two above. All earnings per share amounts represent both weighted average number of common shares, as defined as the net loss before preferred dividends divided by the above. The 1992 earnings per common share is calculated the weighted average number of common shares, as defined related as the income (loss) on common stock divided by

For 1991 and 1993, earnings per common share is cal-

July 1991 for shares of common stock

stock dividend approved by the Board of Directors in have been adjusted to reflect a 2-for-1 split effected as a warrants granted in March 1993. The shares outstanding December 1992 and common stock issuable pursuant to options issued under the 1992 Stock Option Plan in and March 1993, common stock issuable pursuant to stock red stock exchanged for common stock in December 1992 common stock equivalents include LT's Redeemable Preferred average number of common shares outstanding. The 1992 were anti-dilutive and therefore not included in the weighted shares outstanding. In 1993, all common stock equivalents not included in the weighted average number of common to the earnings per share calculation in 1994 and were

upon conversion of the Preferred stock were anti-dilutive. However, the 6,052,000 shares of common stock issuable Preferred Stock (Preferred Stock) issued in August of 1993 conversion of the 5% Cumulative Convertible Exchangeable nearly 6,052,000 shares of common stock from the assumed and warrants using the treasury stock method, and approx- include common stock issuable pursuant to stock options common stock equivalents. Common stock equivalents

### Reclassifications

Certain reclassifications have been made to the consolidated financial statements to conform with the 1994 presentation.

### Accounting Pronouncement Not Yet Effective

In December 1993, the Accounting Standard-Executive Committee issued Statement of Position 93-7, "Reporting on Advertising Costs" (SOP). The SOP is effective for financial statements beginning after June 15, 1994, and does not apply to financial statements of interim periods. Generally, the SOP requires reporting the costs of all advertising as expenses in the periods in which these costs are incurred or the first time the advertising takes place, except for certain defined direct response advertising. The SOP requires that costs incurred before the initial application of the SOP should not be adjusted to the amounts that would have been reported as assets had the SOP been in effect when those costs were incurred. The Company has adopted the SOP effective January 1, 1995. The Company historically has expensed advertising costs over a period not to exceed one year and, therefore, does not expect the adoption of the SOP to have a material impact on the results of operations.

### 3. Acquisitions

Effective July 1, 1994, the Company purchased certain assets of T.M. Sepulveda, Inc. and Premium Access, Inc., (collectively TMS) two closely held and affiliated resellers of long distance telecommunications services, which are based in California. The combined cash price paid and to be paid by the Company for the assets and certain consulting services and covenants by the owner of the selling companies was \$4 million.

On February 4, 1994, the Company acquired certain assets of Teledial America of North Carolina, Inc. (TANC), a

reseller of long distance services, primarily in the southeastern United States. The Company acquired substantially all of TANC's assets and assumed substantially all of TANC's liabilities for a cash purchase price of approximately \$5.5 million.

On April 29, 1993, the Company purchased the assets and assumed certain liabilities of Long Distance Service of Washington, Inc. (LDSW) for a cash purchase price of approximately \$12.5 million. LDSW provided long distance telecommunications services to customers in the District of Columbia, Pennsylvania, Virginia, Delaware, Maryland, New Jersey, New York and West Virginia.

The TMS, TANC, and LDSW acquisitions have been accounted for as purchases, and accordingly, the cost of the acquisitions were allocated to net assets based upon their estimated fair value and consolidated as of the respective acquisition dates. Results of operations for these acquisitions have been included in the Company's consolidated financial statements from the date of their respective acquisition dates. The TMS, TANC, and LDSW acquisitions were not considered significant for financial reporting purposes.

### 4. Investment in STN Incorporated

The Company entered into investment, financing and service arrangements with STN Incorporated (STN), a Canadian reseller of long distance telecommunications services, as part of an effort to create a strategic business alliance with STN and augment LCI's international operations by obtaining access to the Canadian telecommunications market. The Company's investment, financing and service arrangements are detailed below.

### Debenture Purchase

In December 1993, the Company purchased a convertible secured debenture from STN for \$8.4 million. The Company

increased its investment with the purchase of a second convertible debenture for \$8.5 million in January 1994. A total of \$1.2 million in accumulated interest was recorded in 1994 relating to these debentures.

#### **Share Purchase**

In January 1994, the Company purchased 2,409,004 shares of STN common stock for \$9.2 million and exchanged 79,438 shares of LCI common stock (valued at \$2.9 million) for 749,500 additional shares of STN common stock.

#### **Interim Financing**

Throughout 1994, LCI provided STN with interim financing totaling \$15.1 million. A total of \$0.5 million in accumulated interest was recorded in 1994 relating to this interim financing.

#### **Letter of Credit**

In August 1994, LCI provided an irrevocable letter of credit to a Canadian bank to secure an increased credit facility from the bank for STN. As of December 31, 1994, the letter of credit amount was \$12 million with an expiration date of March 15, 1995. This letter of credit reduces the amount available under the Company's Revolving Credit Facility (see Note 5).

#### **Other STN Receivables and Payables**

In addition to its investments, LCI agreed to provide STN network management, information and billing services and granted to STN a non-exclusive license to use its software in Canada for providing these services. A total of \$1.7 million in information and billing services fees and \$1.8 million in license and technical fees were recorded in 1994.

LCI and STN also agreed to exchange certain trans-border traffic. As a result, LCI recorded receivables from

STN of \$2.1 million and payables to STN of \$1.2 million throughout 1994.

#### **Investment Loss and Accrued Loss Contingencies**

In February 1995, the Company determined that it was probable that a loss had been incurred on its investments in STN and that certain additional loss contingencies had been incurred as a result of that loss. The Company based this determination on two factors. First, contrary to public policy pronouncements, regulatory action in Canada has not supported true competition. This regulatory climate has allowed the dominant long distance and local exchange carrier to abuse its monopoly position and impair the emergence of effective competition. Second, during the fourth quarter, in support of STN's objectives, the Company assisted STN in exploring several financing alternatives. Based on an analysis of both of these factors, the Company determined that it was probable a loss of \$62.5 million had been incurred on its investments in STN. This loss, recorded in Other Expense, Net, included \$47.6 million for the full impairment of the STN investments and \$14.9 million for accrued loss contingencies related to future STN obligations.

#### **5. Debt**

##### **Debt Retirement**

During January 1994, LCI refinanced the remaining \$70.3 million of its \$140 million Senior Secured Notes with proceeds from a five-year \$200 million Revolving Credit Facility (Credit Facility). During 1995, the Company early retired \$169.7 million of other long term debt and converted \$26.1 million of certain shareowner notes into common stock. As a result of the early retirement of debt and the early redemption of capital lease obligations, the



STN of \$2.1 million and payables to STN of \$1.2 million

throughout 1994.

#### Investment Loss and Accrued Loss Contingencies

In February 1995, the Company determined that it was probable that a loss had been incurred on its investments in STN and that certain additional loss contingencies had been incurred as a result of that loss. The Company based this determination on two factors. First, contrary to public policy pronouncements, regulatory action in Canada has not supported true competition. This regulatory climate has allowed the dominant long distance and local exchange carrier to abuse its monopoly position and impair the emergence of effective competition. Second, during the fourth quarter, in support of STN's objectives, the Company assisted STN in exploring several financing alternatives based on an analysis of both of these factors.

The Company determined that it was probable a loss of \$62.5 million had been incurred on its investments in

STN. This loss, recorded in Other Expense, Net, included \$17.6 million for the full impairment of the STN investments and \$14.9 million for accrued loss contingencies related to future STN obligations.

#### 5. Debt

##### Debt Retirement

During January 1994, LCI refinanced the remaining \$70.5 million of its \$140 million Senior Secured Notes with proceeds from a five-year \$200 million Revolving Credit Facility (Credit Facility). During 1993, the Company early retired \$169.7 million of other long-term debt and converted \$26.1 million of certain shareholder notes into common stock. As a result of the early retirement of debt and the early redemption of capital lease obligations, the

increased its investment with the purchase of a second

convertible debenture for \$8.5 million in January 1994. A total of \$1.2 million in accumulated interest was recorded in 1994 relating to these debentures.

##### Share Purchase

In January 1994, the Company purchased 2,409,004 shares of STN common stock for \$9.2 million and exchanged 79,158 shares of LCI common stock (valued at \$2.9 million) for 49,500 additional shares of STN common stock.

##### Interim Financing

Throughout 1994, LCI provided STN with interim financing totaling \$15.1 million. A total of \$0.5 million in accumulated interest was recorded in 1994 relating to this interim financing.

##### Letter of Credit

In August 1994, LCI provided an irrevocable letter of credit to a Canadian bank to secure an increased credit facility from the bank for STN. As of December 31, 1994, the letter of credit amount was \$1.2 million with an expiration date of March 15, 1995. This letter of credit reduces the amount available under the Company's Revolving Credit Facility (see Note 5).

##### Other STN Receivables and Payables

In addition to its investments, LCI agreed to provide STN network management, information and billing services and granted to STN a non-exclusive license to use its software in Canada for providing these services. A total of \$1.7 million in information and billing services fees and \$1.8 million in license and technical fees were recorded in 1994. LCI and STN also agreed to exchange certain trans-border traffic. As a result, LCI recorded receivables from

company recorded \$8.5 million in extraordinary charges in 1995. The extraordinary charges included the write-off of unamortized deferred financing fees, redemption premiums and prepayment penalties.

**Credit Facility**

The Credit Facility with a syndicate of banks is subject to principal reductions of a maximum of \$12.5 million per quarter depending on the outstanding balance, beginning on March 31, 1990, and ending on December 31, 1998. When all outstanding amounts are due, the interest rate on the debt outstanding is variable based on several indices. The weighted average interest rate on the outstanding borrowings under the Credit Facility at December 31, 1994 was approximately 7.2%.

The Credit Facility contains certain balance sheet, operating cash flow, capital expenditure and negative covenants. The Company is not permitted to pay cash dividends on its common stock or acquire shares of its common stock except that dividends payable in common stock are permitted. The Company is also limited to an aggregate total investment in STN of \$505.0 million without the consent of the banks. As of December 31, 1994, the Company was in compliance with all Credit Facility covenants.

The Company purchased an interest rate cap from a commercial bank in February, 1994 that limits the Company's base interest rate exposure on its Credit Facility to 5.5% on a notional principal balance of \$11 million for a two-year period ending February, 1996. In the event of non-performance by the commercial bank, the Company would have exposure to the extent of any increase in the base interest rate above 5.5%. The Company believes an event of non-performance by the bank would be remote.

The Company's capital leases primarily include its subsidiaries' headquarters building. The Company has operating leases for office space, and equipment with lease terms from three to ten years with options for renewals. The Company has entered into several rights-of-way (ROW) lease agreements that allowed for installation of its fiber

○ Leases

and term notes payable was \$1.4 million in 1995 and \$1.8 million in 1992.

Interest expense relating to shareholder demand

*(1) The senior secured notes matured in 1994 that were classified as long term, as such debt was refinanced in January, 1994 with long-term borrowings from the credit facility.*

Debt		Interest Rate		Due 1994 1995	
Revolving Credit Facility		7.20% 1996-1998		\$ 51,000 \$ —	
Senior Secured Floating Rate Notes		6.15%		1994 — 46,014	
Senior Secured Fixed Rate Notes		11.50%		1994 — 24,250	
Notes to Teletron		11.80%		1994 — 182	
Total Debt		141,000		70,446	
Less — Amounts Due Within One Year		—		(182)	
Noncurrent Portion of Debt		51,000		570,264	

as follows:

1994 and 1995, with the prevailing interest rate, are obligations under debt outstanding as of December 31, 1994, as a result of letters of credit issued for various business matters including support of STN. An additional \$151 million under the Credit Facility. An additional \$22.4 million of the Credit Facility is reserved at

optic network facilities. The terms of these agreements range from 1 to 30 years, and most contain options to renew. These agreements also provide for rental payments to be made for use of other land and buildings occupied in connection with the ROW agreements, maintenance and repairs.

Total expenses for operating leases for the years ended December 31, 1994, 1993 and 1992, were \$7.5 million, \$6.4 million and \$6.0 million, respectively. The Company is required, at a minimum, to make the following payments on capital and operating leases:

<i>In Thousands</i>	Capital	Operating
1995	\$ 2,493	\$ 9,170
1996	2,774	6,760
1997	2,756	6,063
1998	2,685	5,397
1999	2,550	4,627
Thereafter	17,095	19,418
Total Minimum Lease Payments	\$30,352	\$51,435
Less — Amounts		
Representing Interest	16,264	
Capital Lease Obligations	14,088	
Less — Amounts Due		
Within One Year	339	
Noncurrent Portion of		
Capital Lease Obligations	\$13,752	

## 7. Commitments and Contingencies

### Capital Expenditures

During 1995, the Company expects that its nonbinding commitment for capital expenditures (excluding acquisitions) will approximate the levels expended in 1994 and are dependent on the Company's geographic and revenue growth. The Company's capital requirements are primarily for switching and transmission facilities and information systems arising from the Company's strategic expansion plans

### Vendor Agreements

In the fourth quarter of 1994, the Company completed negotiations with an interexchange carrier to consolidate a substantial amount of its leased line and interexchange services for a fixed contract period in return for reduced service costs and increased service availability. The Company's minimum annual billing commitment under this contract is approximately \$48 million beginning in August of 1995 with increasing annual minimums until July 2000. The cumulative annual commitments under this contract are subject to an underutilization charge of 25% of the shortfall calculated under the contract provisions. The Company also has agreements with certain other telecommunications companies and third party vendors that provide that the Company maintain minimum monthly billings based on usage. The Company's minimum monthly billing commitments under these other vendor agreements are approximately \$1.9 million through the end of 1995. The Company has historically met all minimum billing and believes that the minimum usage commitments will be met.

### Legal Matters

Two former employees of the Company's management filed suit against the Company in 1991, alleging age discrimination, among other things, and seeking \$42.8 million in compensatory and punitive damages. During 1993 a jury returned a verdict in favor of the former employees and the Court awarded approximately \$8.1 million in damages and attorney's fees.

Both the Plaintiffs and the Company have appealed this matter. Plaintiffs appealed the trial court's decisions which rejected Plaintiffs' claim of approximately \$5 million in connection with certain unvested stock rights denied.

a requested award of approximately \$1 million for pre-judgment interest; and denied Plaintiffs' request for approximately \$2 million in additional attorney's fees.

In its appeal, LCI has argued that certain evidence was wrongfully admitted; the evidence was legally insufficient to support the jury's finding; the trial court erred in awarding additional damages for Plaintiffs' unvested stock; the award of certain damages was legally invalid and punitive damages were improperly awarded.

No decision has been rendered on the appeals.

The Company has also been named as a defendant in various other litigation matters. Management intends to vigorously defend these outstanding claims. The Company believes it has adequate accrued loss contingencies and that current pending or threatened litigation matters will not have a material adverse impact on the Company's results of operations or financial condition.

## **B. Shareowners' Equity**

### **Preferred Stock**

On August 18, 1993, the Company issued 4,600,000 shares of 5% Cumulative Convertible Exchangeable Preferred Stock (Preferred Stock). Proceeds from the offering net of underwriters' discount were \$111.5 million and were used to early retire long-term debt and capital leases. In May 1994, the shareowners approved an increase in the number of authorized shares to 15,000,000. The Preferred Stock has a liquidation preference of \$25.00 per share plus accrued and unpaid dividends. Dividends on the Preferred Stock are cumulative from the date of issuance and payable at an annual rate of \$1.25 per share and are payable

quarterly commencing on November 30, 1993. The Preferred Stock is convertible into shares of common stock (\$0.01 par value) of the Company at a conversion price of \$19.00 per share subject to adjustment under certain conditions. The conversion is at the option of the holder, at any time, unless previously redeemed. The Preferred Stock is exchangeable, in whole but not in part, at the option of the Company on any quarterly dividend payment date on or after August 31, 1995 into LCI's 5% Convertible Subordinated Debentures (Convertible Debentures) due 2003 at a rate of \$25.00 principal amount of Convertible Debentures for each share of Preferred Stock. If exchanged, the Debentures would also be convertible into shares of common stock (\$0.01 par value) of the Company at a conversion price of \$19.00 per share subject to adjustment under certain conditions.

### **Common Stock**

In May 1993, the Company issued 10,600,000 shares of common stock (post split basis) in an initial public offering and an additional 1,590,000 shares of Common Stock were issued May 19, 1993, when the underwriters' over-allotment option was exercised. Proceeds from the offering net of underwriters' discount were \$104.0 million and were used to redeem outstanding debt obligations.

In May 1993, shareowner notes of \$26.1 million were converted to 3,063,584 shares of common stock based upon the initial public offering price per share net of underwriters' discount.

Effective July 1994, a 2 for 1 split effected in the form of stock dividends for common stock was approved by

the Board of Directors and a transfer of paid-in capital was made in the respective years to restore par value.

#### Common Stock Warrants

On March 31, 1993, in connection with the Company's recapitalization, certain shareowners received warrants exercisable for 2,704,450 shares of common stock at \$5.67 per share that expire ten years from the date of issue. The estimated value of the warrants at the time of issuance of \$2.3 million was credited to paid-in capital. As of December 31, 1994, there were 2,683,842 unexercised common stock warrants.

#### Stock Options

The Company has stock option plans under which options to purchase shares of common stock may be granted to directors and key employees. Under the plans, the Company may grant incentive stock options (ISOs) as defined by the Internal Revenue Code or non-qualified options (NQOs). Stock options generally have a five-year vesting period. Twenty percent of each option granted generally becomes exercisable on the first anniversary of the grant and 1.66% each month thereafter for 48 months. Under the plans, options expire up to ten years after the date of the grant. Except in the case of ISOs, the option price may be less than the fair market value of the common stock as of the date of grant. The option price under all plans shall be fixed by an administrative committee of the Board of Directors, in its discretion, at the time of grant. During 1994 and 1993, the option price for all options granted was the fair market value of the shares on the date of grant. As of December 31, 1994, there were 4,218,716 options authorized under the Company's stock option plans.

In 1992, the Company recorded compensation expense for vested options at the difference between the exercise price and \$5.67 per share, which was deemed to be fair market value on the date of grant. Compensation expense of \$2.7 million was recorded in connection with the options granted in 1992.

Information regarding these stock option plans is as follows:

	Number of Shares	Exercise Price
Outstanding as of December 31, 1991 <sup>(A)</sup>	—	—
Options granted	1,102,182	\$ 0.33 - 5.67
Options exercised	—	—
Options surrendered	—	—
Outstanding as of December 31, 1992	1,102,182	\$ 0.33 - 5.67
Options granted	1,017,176	\$ 9.13 - 19.50
Options exercised	(450)	\$ 0.33 - 5.67
Options surrendered	(35,250)	\$ 9.13
Outstanding as of December 31, 1993	2,083,658	\$ 0.33 - 19.50
Options granted	906,800	\$ 14.25 - 24.88
Options exercised	(76,260)	\$ 0.33 - 9.13
Options surrendered	(1,228,260)	\$ 2.83 - 19.88
Outstanding as of December 31, 1994	2,683,938	\$ 0.33 - 24.88
Exercisable Options as of December 31, 1994	1,002,508	
Options Available for Grant as of December 31, 1994	4,532,776	

(A) Amounts have been restated to reflect the 2-for-1 stock split which occurred in July 1991.

#### Employee Benefit Plans

During 1993, the Company established an Employee Stock Purchase Plan (ESPP), which enables substantially all employees to subscribe to shares of common stock on monthly offering dates at a purchase price of 85% of

the fair market value of the shares as established at intervals from time to time. A maximum of 600,000 shares are authorized for subscription over a 27-month period. During 1994 and 1993, 109,517 and 88,072 shares were issued under the ESPP at an average price of \$11.75 and \$7.98, respectively.

The Company also maintains a defined contribution plan for its employees. Under this plan, eligible employees may contribute a percentage of their base salary, subject to certain limitations. Beginning in 1994, the Company elected to match a portion of the employees' contributions. The expense of the Company's matching contribution was \$3 million in 1994. Under this plan, employees may purchase shares of LCI's common stock at the market price. During 1994, 17,664 shares were issued under this plan at an average price of \$18.64.

#### 9. Income Taxes

The Company has followed the provisions of SFAS No. 109 for income taxes since January 1, 1992. The provision

(benefit) for income taxes for the years ended December 31, 1994, 1993 and 1992, consisted of

	1994	1993	1992
<b>Current Tax Expense</b>			
Federal	\$ 500	\$ 140	\$ —
State	650	396	240
<b>Deferred Tax Expense (Benefit)</b>			
Increase in Deferred Tax Liability	15,002	2,221	1,949
(Increase) in Deferred Tax Asset	(22,943)	(9,592)	(14,345)
Increase (Decrease) in Valuation Allowance	(17,719)	7,231	12,404
<b>Income Tax Expense (Benefit)</b>	<b>\$ (2,550)</b>	<b>\$ 396</b>	<b>\$ 240</b>

As of December 31, 1994 and 1993, the Company paid an alternative minimum tax (AMT) of \$0.6 million and \$0.1 million, respectively. The AMT payment is a deferred tax credit carryforward with no expiration date. The decrease in the valuation allowance in 1994 resulted from the Company's expectation to realize a portion of its net operating loss (NOLs) carryforwards in future years based on the Company's growth in recurring operating income in 1994.

The effective income tax rate varies from the Federal statutory rate for the years ended December 31, 1994, 1993 and 1992, as follows:

In Thousands	1994		1993		1992	
	\$	%	\$	%	\$	%
Expected Tax Expense (Benefit) at Federal Statutory Income Tax Rate	\$ (10,200)	(35.0)	\$ (5,681)	(35.0)	\$ (14,104)	(34.0)
Effect of:						
State Income Tax Expense	650	2.5	396	3.8	240	0.6
Non-Deductible Expenses	647	5.0	832	7.9	1,619	3.9
Change in Valuation Allowance	(17,719)	(69.9)	7,231	68.6	12,404	29.9
Other, Net	(1,703)	(1.6)	(4,382)	(41.5)	81	0.2
<b>Income Tax Expense (Benefit)</b>	<b>\$ (21,530)</b>	<b>(43.8)</b>	<b>\$ 396</b>	<b>3.8</b>	<b>\$ 240</b>	<b>0.6</b>

The Company pays state income taxes on the greater of a net worth basis or on an income basis in a majority of the states in which it operates. The Company records state deferred tax assets and liabilities at an average blended rate of 6%.

The significant items giving rise to the deferred tax (assets) and liabilities as of December 31, 1994 and 1993 were:

<i>In Thousands</i>	1994	1993
<b>Deferred Tax Liabilities</b>		
Property, Plant and Equipment	\$ 31,057	\$ 27,499
Acquisition Related	13,542	11,480
Deferred Expenses	4,772	25
Total Deferred Tax Liabilities	49,371	39,004
<b>Deferred Tax (Assets)</b>		
STN Impairment	125,625	—
Other Loss Contingencies	111,200	(11,483)
Property and Other Taxes	34,280	(5,404)
Accrued Expenses	(1,280)	(1,585)
NOLs and Tax Credit Carryforwards	157,430	(60,483)
Total Deferred Tax (Assets)	139,800	(76,955)
Valuation Allowance	20,092	37,811
Net Deferred Tax (Assets)	119,708	(39,144)
Net Deferred Tax (Assets) and Liabilities	\$ 30,735	\$ (140)

The Company's 1994 deferred income tax balances are included in current deferred tax assets, net (\$25.4 million) and in other assets (\$7.5 million).

The Company has generated significant NOLs that may be used to offset future taxable income. Each year's NOL has a maximum 15-year carryforward period. The Company's ability to fully use its NOL carryforwards is dependent upon future taxable income. As of December 31, 1994, the Company has NOL carryforwards of \$140.1 million subject to various expiration dates beginning in 1998 and ending in 2008. The potential tax benefit of these NOL carryforwards of \$57.4 million in 1994 using a 41% effective tax rate, represent a deferred tax asset. A portion of the \$57.4 million NOL tax benefit has been recognized for book purposes, to the extent of net deferred tax liabilities and expected future realization of those NOLs.

The Company has provided a valuation allowance of \$20.1 million in 1994 and \$37.8 million in 1993. Due to the uncertainty of future taxable income and the Company's past history of financial reporting and income tax reporting losses, management believes the future use of its remaining available NOL carryforwards may be limited; however, the Company will continue to evaluate the valuation allowance requirements in light of future results of operations and expected taxable income.

#### 10. Cash Flow Information

The reconciliations of net income in the Statements of Operations to net cash provided by operating activities in the Statements of Cash Flows are as follows:

<i>In Thousands</i>	1994	1993	1992
<b>Net Income (Loss)</b>	\$ 1,803	\$ (10,915)	\$ (1,721)
<b>Adjustments to Net Income:</b>			
Depreciation and Amortization	36,111	32,696	32,471
Allowance for Bad Debt	5,771	5,914	5,175
Change in Deferred Taxes	(30,735)	—	—
Stock Option Compensation	—	41	2,298
Loss Contingencies, Restructuring and Other Charges	2,236	13,764	20,550
Noncash Extraordinary Items	—	5,552	—
Trade Accounts Receivable	(55,413)	(10,501)	(9,815)
Prepays and Other	(6,553)	(1,778)	(1,189)
Accounts Payable and Facility Costs Accrued and Payable	11,650	9,499	(10,229)
Noncash Interest	—	5,673	5,291
Other	(1,118)	(605)	552
Net Cash Provided by Operating Activities	\$ 1,300	\$ 32,546	\$ 1,500

During January 1994 the Company exchanged 79,438 shares of its common stock (valued at \$2.9 million) for 749,500 shares of STN common stock. Noncash capital leases were \$7.5 million in 1993 and \$6.7 million in 1992.

### 11. Financial Instruments

#### Fair Values

The carrying amounts of current assets and liabilities approximate their fair value because of the immediate or short-term maturity of these financial instruments. The carrying amount of the Credit Facility of \$131 million as of December 31, 1994, approximates its fair value as the underlying instruments are variable rate notes that reprice frequently. The carrying value of the long-term debt outstanding as of December 31, 1993, approximated its fair value based on borrowing rates available at that time on loans with similar terms.

#### Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of trade accounts receivable. The risk is limited due to the large number of entities comprising the Company's customer base and their dispersion across many different industries and several different geographic regions. At December 31, 1994, the Company had no significant concentrations of credit risk.

### 12. Loss Contingencies, Restructuring and Other Charges

#### 1993

During the fourth quarter, the Company recorded a loss on disposal and write-off of assets of \$2.2 million primarily consisting of a customer list that had no continuing value. In addition, the Company recorded \$11.5 million in loss contingency expenses primarily to provide accrued loss contingencies for various pending and threatened litigation matters (see Note 7).

#### 1992

During the fourth quarter, the Company recorded a restructuring charge of \$15.7 million and an \$8.7 million charge related to the loss on disposal and write-off of assets. The restructuring charge included the write-off of certain non-core assets that contained \$0.9 million for personal communication network assets, \$9.9 million for software in service or under development that did not meet the Company's service standards, and \$1.6 million for other assets that were no longer required to implement the Company's operating and strategic plans. Restructuring charges also included \$3.3 million to recognize accrued loss contingencies primarily associated with litigation, elimination of redundant facilities and other costs. The loss on disposal and write-off of assets included \$6.8 million for the disposal of videoconferencing equipment development assets and \$1.9 million related to the write-off of customer lists.



### 13. Quarterly Results of Operations (Unaudited)

The following is a tabulation of the unaudited quarterly results of operations for the two years ended December 31:

In Thousands, Except Earnings Per Common Share

	1994			
	First	Second	Third	Fourth
Revenues	\$105,178	\$108,824	\$119,079	\$130,860
Cost of Services	62,033	64,601	70,332	77,304
Gross Margin	43,145	44,223	48,747	53,556
Selling, General and Administrative Expenses	23,118	23,414	26,097	30,067
Depreciation and Amortization	8,852	8,878	9,121	9,262
Operating Income	11,175	11,931	13,529	14,227
Other Expense (Income)	159	(617)	(1,004)	(1,233)
Interest Expense, net	1,701	1,891	2,379	2,867
Income (Loss) Before Income Taxes	9,335	10,657	12,154	(9,873)
Income Tax Expense (Benefit)	1,294	1,477	1,685	(28,086)
Net Income (Loss)	8,041	9,180	10,469	(20,887)
Income (Loss) on Common Stock	\$ 6,604	\$ 7,743	\$ 9,031	\$ (22,325)
<b>Earnings Per Common Share <sup>(B)</sup></b>				
Income (Loss) Per Share	\$0.20	\$0.24	\$0.27	\$ (0.75)
Weighted Average Shares	32,560	32,714	38,822 <sup>(A)</sup>	29,628 <sup>(C)</sup>
	1993			
	First	Second	Third	Fourth
Revenues	\$74,696	\$82,853	\$90,417	\$ 93,254
Cost of Services	43,350	47,922	52,108	53,933
Gross Margin	31,346	34,931	38,309	39,321
Selling, General and Administrative Expenses	15,762	18,476	20,407	21,639
Depreciation and Amortization	7,739	8,103	8,524	8,330
Loss Contingencies, Restructuring and Other Charges	—	—	—	13,754
Operating Income (Loss)	7,845	8,552	9,378	(4,402)
Other Expense (Income)	208	83	185	(458)
Interest Expense, net	8,401	7,477	4,182	3,269
Income (Loss) before Income Taxes	(764)	792	5,011	(7,213)
Income Tax Expense	99	99	99	99
Income (Loss) before Extraordinary Item	(863)	693	4,912	(7,312)
Extraordinary Loss — Debt Retirement	—	4,897	207	3,241
Net Income (Loss)	(863)	(4,204)	4,705	(10,553)
Income (Loss) on Common Stock	\$ (863)	\$ (4,204)	\$ 4,034	\$ (12,006)
<b>Earnings Per Common Share <sup>(B)</sup></b>				
Income (Loss) Per Share Before Extraordinary Items	\$(0.05)	\$ 0.03	\$ 0.13	\$(0.30)
Extraordinary Loss Per Share	—	(0.20)	(0.01)	(0.11)
Income (Loss) Per Share	\$(0.05)	\$(0.17)	\$ 0.12	\$(0.41)
Weighted Average Shares <sup>(C)</sup>	15,676	24,003	32,043	29,234

(A) The weighted average shares include the assumed conversion of preferred stock. Income per share is calculated as net income divided by weighted average shares outstanding. The assumed conversion was antidilutive in the first, second and fourth quarters of 1994. Therefore, income per share is calculated as income on common stock divided by weighted average shares outstanding.

(B) The quarterly per share amounts represent both primary and fully diluted as both calculations yield the same result.

(C) The weighted average shares exclude common stock equivalents that were antidilutive.

## Corporate Information

### Annual Shareowners' Meeting

Date: May 16, 1995  
Time: 10:30 am  
Location: Hyatt Regency  
1800 Presidents Street  
Reston, Virginia 22090

### Corporate Headquarters

8180 Greensboro Drive  
McLean, VA 22102

### Subsidiaries Headquarters

4650 Lakehurst Court  
Dublin, OH 43017

### Form 10-K

A copy of LCI International, Inc.'s annual report to the Securities and Exchange Commission on Form 10-K may be obtained by writing to the Secretary of the Company, 4650 Lakehurst Court, Dublin, Ohio 43017, or by calling LCI Investor Relations at 1-800-555-2124.

### Transfer Agents

Fifth Third Bank  
Corporate Trust Operations  
38 Fountain Square  
Cincinnati, OH 45263

### Independent Public Accountants

Arthur Andersen LLP  
41 South High Street  
Huntington Center  
Suite 2000  
Columbus, OH 43215

### Stock Information

LCI International, Inc.'s common and preferred stock trades on the New York Stock Exchange under the symbols LCI and LCIPR, respectively.

### Stock Performance

(Adjusted for July 1994 two-for-one stock split. Based on closing prices.)

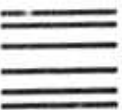
	1994		1993	
	High	Low	High	Low
1st Quarter	21	17	—	—
2nd Quarter	22	15	12 1/2	10
3rd Quarter	21 1/2	13	18 1/2	11 1/2
4th Quarter	26	18	21 1/2	15

The Company's stock began trading in May 1993.

### Sales and Operations Locations

Akron, OH	Indianapolis, IN
Asheville, NC	Jersey City, NJ
Atlanta, GA	Knoxville, TN
Baltimore, MD	Lima, OH
Cedar Rapids, IA	Los Angeles, CA
Charlotte, NC	Louisville, KY
Chicago, IL	Mansfield, OH
Cincinnati, OH	McLean, VA
Cleveland, OH	New York, NY
Columbus, OH	Peoria, IL
Davenport, IA	Philadelphia, PA
Dayton, OH	Pittsburgh, PA
Decatur, IL	Richmond, VA
Delta, OH	Roanoke, VA
Des Moines, IA	Rockford, IL
Detroit, MI	Rosemont, IL
Dublin, OH	St. Louis, MO
Frankfort, KY	South Bend, IN
Fort Wayne, IN	Toledo, OH
Grand Rapids, MI	Virginia Beach, VA
Greensboro, NC	Washington, DC
Hickory, NC	Youngstown, OH

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Worldwide Telecommunications



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 **Business Voice and Data Services**  
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Address: \_\_\_\_\_

City/State/ZIP: \_\_\_\_\_

Home Phone: (     ) \_\_\_\_\_

Business Phone: (     ) \_\_\_\_\_

Best Time to Call: \_\_\_\_\_

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Worldwide Telecommunications.



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residential and business  
services call:

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**LCI International**

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**Worldwide Telecommunications**

**8180 Greensboro Drive · Suite 800 · McLean, VA · 22102**

**LOCAL SERVICE APPLICATION**

**EXHIBIT B**

# ARTHUR ANDERSEN LLP

## Report of Independent Public Accountants

To the Stockholder  
of LCI International Telecom Corp.:

We have audited the accompanying balance sheets of LCI INTERNATIONAL TELECOM CORP. (a Delaware corporation and wholly-owned subsidiary of LCI International Management Services, Inc.) as of December 31, 1994 and 1993, and the related statements of operations, stockholder's equity and cash flows for the years then ended. 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 LCI International Telecom Corp., as of December 31, 1994 and 1993 and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

As discussed in Note 2, Afford-A-Call Corp. and LDS Telecommunications Corp. were merged with LCI International Telecom Corp. during 1993. The financial statements presented have been restated to include the financial data of Afford-A-Call Corp. for all periods presented, and the financial data of LDS Telecommunications Corp. since the date of its acquisition, April 23, 1993.

*Arthur Andersen LLP*

Columbus, Ohio,  
February 14, 1995.

LCI INTERNATIONAL TELECOM CORP.

BALANCE SHEETS  
AS OF DECEMBER 31,  
(in 000s)

<u>ASSETS</u>	<u>1994</u>	<u>1993</u>
<b>CURRENT ASSETS:</b>		
Trade accounts receivable, less allowance for doubtful accounts of \$6,141 and \$6,020, respectively	\$ 80,194	\$ 47,744
Other accounts and notes receivable, net	2,749	1,997
Current deferred tax assets, net	8,226	-
Prepays and other	7,496	1,072
Total current assets	<u>98,665</u>	<u>50,813</u>
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Fiber optic network	59,104	49,603
General office equipment	18,280	101
Less- Accumulated depreciation and amortization	<u>(41,843 )</u>	<u>(33,114 )</u>
	35,541	16,590
Plant under construction	<u>91</u>	<u>1,381</u>
Total property, plant and equipment, net	<u>35,632</u>	<u>17,971</u>
<b>OTHER ASSETS:</b>		
Excess of cost over net assets acquired, net of accumulated amortization of \$9,184 and \$7,155	73,461	71,134
Other, net	<u>10,654</u>	<u>775</u>
Total other assets	<u>84,115</u>	<u>71,909</u>
Total assets	<u>\$ 218,412</u>	<u>\$ 140,693</u>

(Continued on next page)

BALANCE SHEETS  
AS OF DECEMBER 31,  
(Continued)

<u>LIABILITIES AND STOCKHOLDER'S EQUITY</u>	<u>1994</u>	<u>1993</u>
CURRENT LIABILITIES:		
Advance from Parent	\$ 119,028	\$ 73,982
Accrued facility costs	18,538	8,142
Accrued expenses and other	12,910	8,544
Total current liabilities	<u>150,476</u>	<u>90,668</u>
LONG-TERM DEBT - Due to Parent	<u>35,308</u>	<u>35,308</u>
CAPITAL LEASE OBLIGATIONS	<u>608</u>	<u>804</u>
OTHER LIABILITIES AND DEFERRED CREDITS	<u>4,248</u>	<u>3,535</u>
COMMITMENTS AND CONTINGENT LIABILITIES	<u>          </u>	<u>          </u>
STOCKHOLDER'S EQUITY:		
Common stock, no par value, authorized 1,000 shares; 117.54 issued and outstanding	2,507	2,507
Paid-in capital	46,440	46,440
Retained deficit	<u>(21,175 )</u>	<u>(38,569 )</u>
Total stockholder's equity	<u>27,772</u>	<u>10,378</u>
Total liabilities and stockholder's equity	<u>\$ 218,412</u>	<u>\$ 140,693</u>

The accompanying notes are an integral part of these statements.



LCI INTERNATIONAL TELECOM CORP.

STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED DECEMBER 31,  
(in 000's)

	<u>1994</u>	<u>1993</u>
REVENUES:		
Non-affiliates	\$451,380	\$ 341,220
Affiliates	<u>1,804</u>	<u>967</u>
Total revenues	453,184	342,187
Cost of services	<u>267,245</u>	<u>198,066</u>
GROSS MARGIN	185,939	144,121
Selling, general and administrative expenses	76,268	55,517
Depreciation and amortization	11,240	11,101
Loss on disposal and write-off of assets	<u>-</u>	<u>1,766</u>
INCOME BEFORE OTHER EXPENSES	98,431	75,737
OTHER EXPENSES:		
Intercompany charges	98,040	74,605
Interest expense, net	7	635
Other, net	<u>298</u>	<u>461</u>
INCOME BEFORE INCOME TAXES	86	36
Income Tax Expense (Benefit)	<u>(17,308)</u>	<u>-</u>
NET INCOME	<u>\$ 17,394</u>	<u>\$ 36</u>

The accompanying notes are an integral part of these statements.

LCI INTERNATIONAL TELECOM CORP.

STATEMENTS OF STOCKHOLDER'S EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 1994 AND 1993

(in 000's)

	<u>Common Stock</u>	<u>Paid-in Capital</u>	<u>Retained Deficit</u>	<u>Total</u>
Balance at December 31, 1992	\$ 2,507	\$ 43,233	\$ (38,605)	\$ 7,135
LDS Telecommunications Corp. merger	-	3,207	-	3,207
Net income	<u>-</u>	<u>-</u>	<u>36</u>	<u>36</u>
Balance at December 31, 1993	2,507	46,440	(38,569)	10,378
Net income	<u>-</u>	<u>-</u>	<u>17,394</u>	<u>17,394</u>
Balance at December 31, 1994	<u>\$ 2,507</u>	<u>\$ 46,440</u>	<u>\$ (21,175)</u>	<u>\$ 27,772</u>

The accompanying notes are an integral part of these statements.

LCI INTERNATIONAL TELECOM CORP.

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31,  
(in 000's)

	<u>1994</u>	<u>1993</u>
OPERATING ACTIVITIES:		
Cash received from customers	\$ 424,327	\$ 330,717
Cash paid to Parent and suppliers	<u>(395,451 )</u>	<u>(310,740 )</u>
Net cash provided by operating activities	<u>28,876</u>	<u>19,977</u>
INVESTING ACTIVITIES:		
Capital expenditures -- property, plant and equipment	(26,340 )	(8,422 )
Payment for acquisition	<u>(2,340 )</u>	<u>-</u>
Net cash used in investing activities	<u>(28,680 )</u>	<u>(8,422 )</u>
FINANCING ACTIVITIES:		
Debt payments	-	(30,375 )
Proceeds from debt	-	20,780
Payments of capital lease obligations	<u>(196 )</u>	<u>(1,960 )</u>
Net cash used in financing activities	<u>(196 )</u>	<u>(11,555 )</u>
Net (decrease) increase in cash	<u>-</u>	<u>-</u>
Cash at the beginning of the year	<u>-</u>	<u>-</u>
Cash at the end of the year	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of these statements.

LCI INTERNATIONAL TELECOM CORP.

NOTES TO FINANCIAL STATEMENTS  
(Dollar amounts in thousands)

(1) BUSINESS ORGANIZATION AND PURPOSE

LCI International Telecom Corp. (LCIT) is a Delaware corporation which was formed in December 1983, to function as an operating subsidiary of LCI International Management Services, Inc. (LCIM). All of the issued and outstanding capital stock of LCIT is owned by LCIM. On November 15, 1988, LCIM was acquired in a leveraged buyout (LBO) by LCI International, Inc. (LCI) (collectively the Companies). There was no change in ownership of LCIT as LCIM continued to own 100% of the outstanding capital stock.

LCIT operates LCIM's fiber optic telecommunications network (the Network) pursuant to an agreement which grants LCIT access to and use of the Network in exchange for payment to LCIM of a management service fee and network rental fee (see Note 5). LCIT provides worldwide telecommunications service via high quality voice and data transmission facilities.

(2) MERGER

During 1993, Afford-A-Call Corp. (AAC) and LDS Telecommunications Corp. (LDS), both wholly-owned subsidiaries of LCIM, were merged with LCIT. The merger involved no consideration and the surviving corporation, LCIT, remained a wholly-owned subsidiary of LCIM. All of the issued and outstanding common stock of AAC and LDS were canceled. The merger was consummated to eliminate redundant operations and expenses and to simplify marketing activities.

The merger has been accounted for at historical cost in a manner similar to that in pooling-of-interest accounting pursuant to Interpretation No. 39 to Accounting Principles Board Opinion No. 16 "Business Combinations." Consistent with pooling-of-interests accounting, the 1993 financial statements of LCIT have been restated for all periods during which AAC and LDS were subsidiaries of LCIM. All significant intercompany transactions have been eliminated. No changes in accounting policies were required as a result of the merger.

(3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Estimates.**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and

liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

**Revenue Recognition.**

Telecommunications revenues are recognized when the services are provided. Revenues for services provided to LCIM were \$1,804 and \$967 for the years ended December 31, 1994 and 1993, respectively.

**Trade Accounts Receivable.**

Trade accounts receivable represent amounts due from customers for telecommunications services. These amounts include revenues recognized but not yet billed for switched services. Trade accounts receivable are shown net of the related allowance for doubtful accounts.

**Prepays and Other.**

Prepays and other include deferred customer promotion costs that are amortized over the life of the related contract.

**Property, Plant and Equipment.**

These assets are stated at cost or at the fair market value if obtained as part of an acquisition. Construction costs include material, labor, interest and overheads for certain general and payroll related costs. Routine repairs and maintenance of property and replacements of minor items are charged to expense as incurred. Depreciation and amortization is recorded using the straight-line method based on the estimated useful lives of the assets as follows:

<u>Asset Category</u>	<u>Useful Life</u> (years)
Circuit installations	3 to 7
Telecommunications equipment	2 to 10
General Office Equipment	3 to 10

**Excess of Cost Over Net Assets Acquired.**

Excess of cost over net assets acquired (goodwill) consists of the excess of the cost to acquire an entity over the estimated fair market value of the net assets acquired. These amounts are amortized on a straight-line basis over 40 years. Subsequent to an acquisition, LCIT continually evaluates whether later events and circumstances have occurred that indicate the remaining estimated useful life of goodwill may warrant revision or that the remaining balance of goodwill may not be recoverable. In evaluating impairment, LCIT would estimate cash flow over the remaining life of the goodwill in measuring whether goodwill is recoverable. Amortization of goodwill was \$2,004 and \$1,724 for the years ended December 31, 1994 and 1993, respectively.

**Other Assets.**

Costs associated with preliminary engineering work, feasibility studies, licenses, easements, etc., are initially deferred. Once a specific project is approved, costs associated with the project are capitalized as part of the cost of the asset. Canceled project costs are expensed.

The costs associated with customer base acquisitions are deferred and amortized over a five to seven year period.

**Income Taxes.**

LCIT has followed Statement of Financial Accounting Standards (SFAS) No. 109 "Accounting for Income Taxes" since January 1, 1992 (see Note 4).

**Reclassifications.**

Certain reclassifications have been made to the 1993 financial statements to conform with the 1994 presentation.

**Accounting Pronouncement Not Yet Effective.**

In December 1993, the Accounting Standards Executive Committee issued Statement of Position 93-7, "Reporting on Advertising Costs" (SOP). The SOP is effective for financial statements beginning after June 15, 1994 and does not apply to financial statements of interim periods. Generally, the SOP requires reporting the costs of all advertising as expenses in the periods in which these costs are incurred or the first time the advertising takes place, except for certain defined direct response advertising. The SOP requires that costs incurred before the initial application of the SOP should not be adjusted to the amounts that would have been reported as assets had the SOP been in effect when those costs were incurred. LCIT has adopted the SOP effective January 1, 1995. LCIT historically has expensed advertising costs over a period not to exceed one year and therefore, does not expect the adoption of the SOP to have a material impact on the results of operations.

(4) INCOME TAXES

LCIT is part of LCI's consolidated group that files a consolidated Federal income tax return. LCI allocates the consolidated tax provision to its subsidiaries based upon their respective contribution to the consolidated taxable income.

The Company has followed the provisions of SFAS No. 109 for income taxes since January 1, 1992. The provision (benefit) for income taxes for the years ended December 31, 1994 and 1993 consisted of:

	<u>1994</u>
<b>Current Tax Expense</b>	
State	\$ 75
<b>Deferred Tax Expense (Benefit)</b>	
Increase in Deferred Tax Liability	6,562
Increase in Deferred Tax Asset	(7,766)
(Decrease) in Valuation Allowance	<u>(16,179)</u>
Income Tax (Benefit)	<u>\$ (17,308)</u>

No tax provision was recorded for the year ended December 31, 1993 as LCIT had used its available net operating losses (NOLs) to reduce its effective tax rate to zero.

The decrease in the valuation allowance in 1994 resulted from LCIT's expectation to realize a portion of its net operating loss (NOLs) carryforwards in future years based on LCIT's growth in recurring operating income in 1994. The effective tax rate for 1994 reflects this valuation allowance decrease.

The significant items giving rise to deferred tax (assets) and liabilities as of December 31, 1994 and 1993 were:

	<u>1994</u>	<u>1993</u>
<b>Deferred Tax Liabilities</b>		
Acquisition Related	\$ 11,737	\$ 9,621
Deferred Expenses	<u>4,472</u>	<u>25</u>
Total Deferred Tax Liabilities	<u>16,209</u>	<u>9,646</u>
<b>Deferred Tax (Assets)</b>		
Property, Plant and Equipment	(4,779)	(5,520)
Other Loss Contingencies	(3,407)	(2,392)
Property and Other Taxes	(2,500)	(1,155)
Accrued Expenses	(828)	(795)
NOLs and Tax Credit Carryforwards	<u>(42,169)</u>	<u>(36,055)</u>
Deferred Tax (Assets)	(53,683)	(45,917)
Valuation Allowance	20,092	36,271
Net Deferred Tax (Assets)	<u>(33,591)</u>	<u>(9,646)</u>
Net Deferred Tax (Assets) and Liabilities	<u>\$ (17,382)</u>	<u>\$ -</u>

LCIT's 1994 deferred income tax balances are included in current deferred tax assets, net (\$8,226) and in other assets (\$9,156).

LCIT has generated significant NOLs that may be used to offset future taxable income by LCI's consolidated group. Each year's NOL has a maximum 15-year carryforward period. LCIT's ability to fully use its NOL carryforwards is dependent upon future taxable income by LCI's consolidated group. As of December 31, 1994, LCIT has NOL carryforwards of \$102,850 subject to various expiration dates beginning in 1998 and ending in 2008. The potential tax benefit of these NOL carryforwards of \$42,169 in 1994, using a 41% effective tax rate, represent a deferred tax asset. A portion of the \$42,169 NOL tax benefit has been recognized for book purposes, to the extent of net deferred tax liabilities and expected future realization of those NOLs by LCI's consolidated group.

LCIT has provided a valuation allowance of \$20,092 in 1994 and \$36,271 in 1993. Due to the uncertainty of future taxable income by LCI's consolidated group and LCIT's past history of financial reporting and income tax reporting losses, management believes the future use of its remaining available NOL carryforwards may be limited; however, LCIT will continue to evaluate the valuation allowance requirements in light of future results of operations and expected taxable income.



(5) INTERCOMPANY TRANSACTIONS

**Management Service and Network Rental Fees.**

LCIT is charged a network rental fee and management service fee by LCIM for use of and access to the Network and other management services pursuant to a Master License and Services Agreement. LCIM bills LCIT for approximately 100% of LCIM's operating expense (including interest) plus a reasonable profit thereon.

This arrangement also allows for a deferral of the billings to prevent a default under any agreement to which LCIT or LCIM is a party. Deferred billings may be reinvoiced to LCIT in the future to the extent no default will occur. Deferred billings as of December 31, 1993 were \$47,117 and were entirely reinvoiced during 1994. The intercompany charges to LCIT from LCIM for network rental, management service fees and interest on the note payable to Parent (see Note 8) for 1994 and 1993 are as follows:

	<u>1994</u>	<u>1993</u>
Network rental fee	\$ 21,825	\$ 16,896
Management service fees	25,199	51,697
Interest	3,899	3,546
Billings reinvoiced	<u>47,117</u>	<u>2,466</u>
	<u>\$ 98,040</u>	<u>\$ 74,605</u>

The advance from Parent account is used to reflect the intercompany liability for network rental and management service charges, payments made by LCIT on behalf of LCIM and vice versa and the transfer to LCIM of cash received by LCIT from accounts receivable.

(6) STOCKHOLDER'S EQUITY

All of LCIT's outstanding shares of common stock are owned by LCIM. LCIM has pledged all the shares as collateral for LCI's Revolving Credit Facility dated December 30, 1993.

(7) ACQUISITION

Effective July 1, 1994, LCIT purchased certain assets of T.M. Sepulveda, Inc. and Premium Access, Inc., (collectively TMS) two closely-held and affiliated resellers of long distance telecommunications services, which are based in California. The combined cash price paid and to be paid by the LCIT for the assets and certain consulting services and covenants by the owner of the selling companies was \$4 million.

On April 29, 1993, LCIM purchased the assets and assumed certain liabilities of Long Distance Service of Washington, Inc. (LDSW) through LDS Telecommunications Corp. (LDS) for a cash purchase price of approximately \$12.5 million. LDSW provided long distance telecommunications services to customers in the District of Columbia, Pennsylvania, Virginia, Delaware, Maryland, New Jersey, New York and West Virginia. As discussed in Note 2, LDS was merged into LCIT during 1993. The results of operations have been included in LCIT's financial statements beginning April 29, 1993.

The TMS and LDSW acquisitions have been accounted for as purchases, and accordingly, the cost of the acquisitions were allocated to net assets based upon their estimated fair value and consolidated as of the respective acquisition dates. Results of operations for these acquisitions have been included in LCIT's financial statements from the date of their respective acquisition dates. The TMS and LDSW acquisitions were not considered significant for financial reporting purposes.

(8) LONG-TERM DEBT

Obligations under long-term debt outstanding for LCIT as of December 31, 1994 and 1993 are as follows:

	<u>1994</u>	<u>1993</u>
Note payable to Parent due November 2, 1999, 11%	\$ 7,149	\$ 7,149
Note payable to Parent due January 5, 2000, 11%	18,530	18,530
Note payable to Parent due April 28, 2003, 11%	<u>9,629</u>	<u>9,629</u>
Long-Term debt	<u>\$ 35,308</u>	<u>\$ 35,308</u>

Total third party interest expense including interest on capital lease obligations and long-term debt was \$7 and \$635 for the years ended December 31, 1994 and 1993, respectively.

**Notes Payable to Parent.**

The notes payable to Parent are unsecured and each bear interest at the rate of 11% which is payable monthly. The notes mature and are due in full on their respective due dates.

(9) LEASES

LCIT leases telecommunications equipment for use in their operations. These leases have been capitalized using interest rates ranging from 8.0% to 15.8%. Obligations under capital and operating leases as of December 31, 1994 are as follows:

	<u>Capital</u>	<u>Operating</u>
1995	\$ 271	\$ 1,857
1996	254	1,340
1997	237	1,183
1998	166	1,149
1999	-	810
Thereafter	-	<u>1,927</u>
Total minimum lease payments	928	<u>\$ 8,266</u>
Less: Amounts representing interest	<u>(105)</u>	
Capital lease obligations	823	
Less: Amounts due within one year	<u>(215)</u>	
Noncurrent portion of capital lease obligations	<u>\$ 608</u>	

LCIM maintains certain equipment rental agreements and allocates a portion of the lease cost to LCIT.

Total expense for operating leases was \$2,316 and \$2,336 for the years ended December 31, 1994 and 1993, respectively.

(10) COMMITMENTS AND CONTINGENCIES

**Capital Expenditures.**

During 1995, LCIT expects that its nonbinding commitment for capital expenditures (excluding acquisitions) will approximate the levels expended in 1994 and are dependent on geographic and revenue growth. LCIT's capital requirements are primarily for customer related equipment and information systems arising from strategic expansion plans.

**Vendor Agreements.**

In the fourth quarter of 1994, LCIT completed negotiations with an interexchange carrier to consolidate a substantial amount of its leased line and interexchange services for a fixed contract period in return for reduced service costs and increased service availability.

LCIT's minimum annual billing commitment under this contract is approximately \$48 million beginning in August of 1995 with increasing annual minimums until July 2000. The cumulative annual commitments under this contract are subject to an underutilization charge of 25% of the shortfall calculated under the contract provisions. LCIT also has agreements with certain other telecommunications companies and third party vendors that provide that LCIT maintain minimum monthly billings based on usage. LCIT's minimum monthly billing commitments under these other vendor agreements are approximately \$1.9 million through the end of 1995. LCIT has historically met all minimum billing commitments and believes that the minimum usage commitments will be met.

**Legal Matters.**

Two former management employees filed suit against the Companies in 1991, alleging age discrimination, among other things, and seeking \$42.8 million in compensatory and punitive damages. During 1993, a jury returned a verdict in favor of the former employees and the Court awarded approximately \$8.1 million in damages and attorney's fees. The necessary expense has been recorded in intercompany charges in 1993.

Both the Plaintiffs and the Companies have appealed this matter. Plaintiffs appealed the trial court's decisions which rejected Plaintiffs' claim of approximately \$5 million in connection with certain unvested stock rights; denied a requested award of approximately \$0.1 million for pre-judgment interest; and denied Plaintiffs' request for approximately \$2 million in additional attorney's fees.

In its appeal, the Companies argued that certain evidence was wrongfully admitted; the evidence was legally insufficient to support the jury's finding; the trial court erred in awarding additional damages for Plaintiffs' unvested stock; the award of certain damages was legally invalid and punitive damages were improperly awarded.

No decision has been rendered on the appeals.

LCIT has also been named as a defendant in various other litigation matters. Management intends to vigorously defend these outstanding claims. LCIT believes it has adequate accrued loss contingencies and that current pending or threatened litigation matters will not have a material adverse impact on LCIT's results of operations or financial condition.

(11) CASH FLOW INFORMATION

The reconciliation of net income in the Statements of Operations to net cash provided by operating activities in the Statement of Cash Flows are as follows:

	Year Ended December 31,	
	1994	1993
Net income	\$ 17,394	\$ 36
Adjustments to net income -		
Depreciation and amortization	11,239	11,101
Allowance for bad debt	5,639	3,914
Noncash loss on disposal and write-off of assets	-	1,766
Change in deferred taxes	(17,382)	-
Trade accounts receivable	(38,589)	(16,059)
Advance from Parent	45,046	22,078
Accrued facility costs	10,396	(3,572)
Other	(4,867)	713
Net cash provided by operating activities	<u>\$ 28,876</u>	<u>\$ 19,977</u>

(12) RESTRUCTURING CHARGES, LOSS ON DISPOSAL AND WRITE-OFF OF ASSETS AND OTHER LOSS CONTINGENCIES

During the fourth quarter of 1993, LCIT recorded a loss on disposal and write-off of assets of \$1,766 primarily consisting of a customer list asset, which had no continuing value.

(13) FINANCIAL INSTRUMENTS

**Fair Values.**

The carrying amounts of current assets and liabilities approximate their fair value because of the immediate or short-term maturity of these financial instruments. Management believes the carrying amount of the Long-Term Debt due to Parent of \$35,308 as of December 31, 1994 and 1993 approximates its fair value as the interest rates and terms of the borrowings are commensurate with terms available on similar unsecured borrowings.

**Concentration of Credit Risk.**

Financial instruments that potentially subject LCIT to concentrations of credit risk consist principally of trade accounts receivable. The risk is limited due to the large number of entities comprising LCIT's customer base and their dispersion across many different

industries and several different geographic regions. At December 31, 1994, LCIT had no significant concentrations of credit risk.