



# **TECHNICAL DOCUMENTATION**

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## **REPORT ON DECLINE IN CLEC MARKET CAPITALIZATION**

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## ATTACHMENTS

**Attachment 1:**                      *Comparison of Market Capitalization*

## **EXECUTIVE SUMMARY**

The relative financial strength of the key companies in the telecommunications industry has changed dramatically over the last 37 months, from December 31, 1999 to January 17, 2003. Once high-flying new entrants are either bankrupt or a mere shell of their operations during the high growth period of the competitive local exchange segment of the telecommunications industry. Competitive local exchange carriers (“CLECs”) once accounted for over 55% of the total competitive local exchange industry market capitalization as investors bet that new entrants would take a significant portion of the regional bell operating companies’ (“RBOCs”) business away. The CLEC share of market capitalization is now only 20% as investors have realized that building a sustainable alternative to the major incumbent carriers is a long-term endeavor laced with high risk and operating losses.

For the CLECs to survive during this period of stock market decline, federal and state regulators must ensure that competitors have unfettered access to the critical network elements required to provide local exchange service at just and reasonable cost-based prices.

## INTRODUCTION

This Technical Document is provided by QSI Consulting (“QSI”) to highlight the tremendous decline in the market value of the competitive telecommunications industry since the end of 1999. This market capitalization analysis calculates the dramatic change in market value of the CLEC industry over the period of December 31, 1999 through January 17, 2003, based on the value of the common shares held by investors. For the IXC, CLEC and carrier’s carrier segments, the total decline in market capitalization over this period is a staggering *\$570 billion, or 90%*.<sup>1</sup> The decline for just CLECs, excluding IXCs and carrier’s carriers, is *\$150 billion, or 86%*. By contrast, the RBOCs experienced declines in market capitalization over the same period of *only 49%* compared to a decline in the S&P 500 Index of approximately 39% over the time period of this analysis.<sup>2</sup>

### I. DESCRIPTION OF ANALYSIS

QSI created an analysis of 45 companies which comprise the vast majority of publicly traded CLECs and the four RBOCs to demonstrate the disparate financial strength of new entrants versus incumbent carriers. Market capitalization as of December 31, 1999 was used as the baseline value in this analysis for two primary reasons: (1) this point in time was still within the bull market period before the first significant market correction took place in the first quarter of 2000; and (2) the components necessary to calculate market capitalization, common shares outstanding and market price, were both readily available from publicly available sources such as websites that provide current and historical price quotes and Securities Exchange Commission (“SEC”) filings.

The companies included in the analysis were classified into three categories:

#### (1) *CLECs & Wholesale Suppliers*

This category includes CLECs and wholesale suppliers. Not included are the CLEC divisions of the major IXCs – they are included in the third category described below. (The companies included in this category are identified in Attachment 1.)

#### (2) *RBOCs*

This category includes the four RBOCs: Qwest, SBC, BellSouth, and Verizon.

#### (3) *Major IXCs – CLECs and Carrier’s Carriers*

This category includes the major IXCs: Williams Communications, Level 3 Communications, Global Crossing, Sprint, WorldCom, and AT&T.

These categories mirror the groups of companies that are compared and contrasted within the Kellogg-Huber Report of April 5, 2001, *Competition for Special Access Service, High*

<sup>1</sup> Table 1 summarizes the change in market capitalization for CLECs, RBOCs and IXCs. Attachment 1 provides a detailed calculation for each company included in the analysis.

<sup>2</sup> The S&P 500 Index was 1,469 on December 31, 1999 and 902 on January 17, 2003. Index amounts obtained from BigCharts.com.

*Capacity Loops, and Interoffice Transport*, attached to the petition filed by Verizon, SBC and BellSouth before the FCC to be relieved of their obligations to provide unbundled access to high-capacity facilities.<sup>3</sup> Major IXCs such as AT&T, WorldCom, Sprint, Level 3, Williams and Global Crossing that also operate as CLECs and carrier’s carriers were separated from the CLECs & Wholesale Suppliers category because the nature and scope of their operations are quite different from the other CLECs.

The Debt to Equity ratio was also determined for each company over the same time period to measure changes in relative financial strength based on the amount of long-term debt used to fund operations versus stockholder’s equity. Large ratios or ratios that increase over time indicate declining financial strength as debt becomes a larger component of the firm’s capital structure. This can be attributed to a greater use of debt as equity markets dry up, declining stockholder’s equity as a result of accumulated operating deficits, or a combination of both.

**II. DISCUSSION OF ANALYSIS**

The analysis demonstrates that the competitive carriers have suffered serious financial setbacks over the last three years. The decline in market capitalization for the three categories, CLECs & Wholesale providers, RBOCs and Major IXCs, is summarized as follows:

**TABLE 1**

<b>CATEGORY</b>	<b>DECLINE IN MARKET CAPITALIZATION</b>	<b>% DECLINE IN MARKET CAPITALIZATION</b>
<b>Category 1: CLECs &amp; Wholesale Providers</b>	\$ (149.9) Billion	- 86%
<b>Category 2: RBOCs</b>	\$ (239.3) Billion	- 49%
<b>Category 3: Major IXC - CLEC / Carrier’s Carrier</b>	\$ (419.8) Billion	- 92%

A more detailed breakdown of the decline in market capitalization for these three categories of carriers is found in Attachment 1. The summary results are illustrated in Charts 1 – 4 below. Charts 1 and 2 compare the decline in market capitalization among the three company categories on both a dollar and percentage basis. Charts 3 and 4 depict the increasing dominance of the RBOCs as their market capitalization accounts for a greater share of the overall competitive telecommunications industry market capitalization.

<sup>3</sup> See *Joint Petition of BellSouth, SBC, and Verizon for Elimination of Mandatory Unbundling of High-Capacity Loops and Dedicated Transport*, CC Docket No. 96- 98, DA 01-911, April 2001.

CHART 1

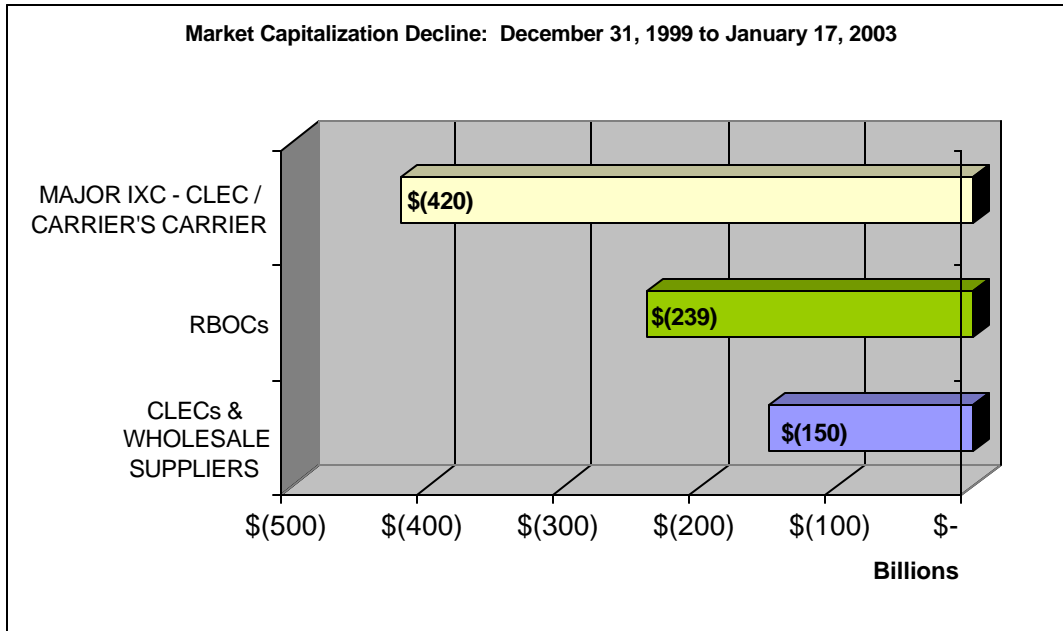
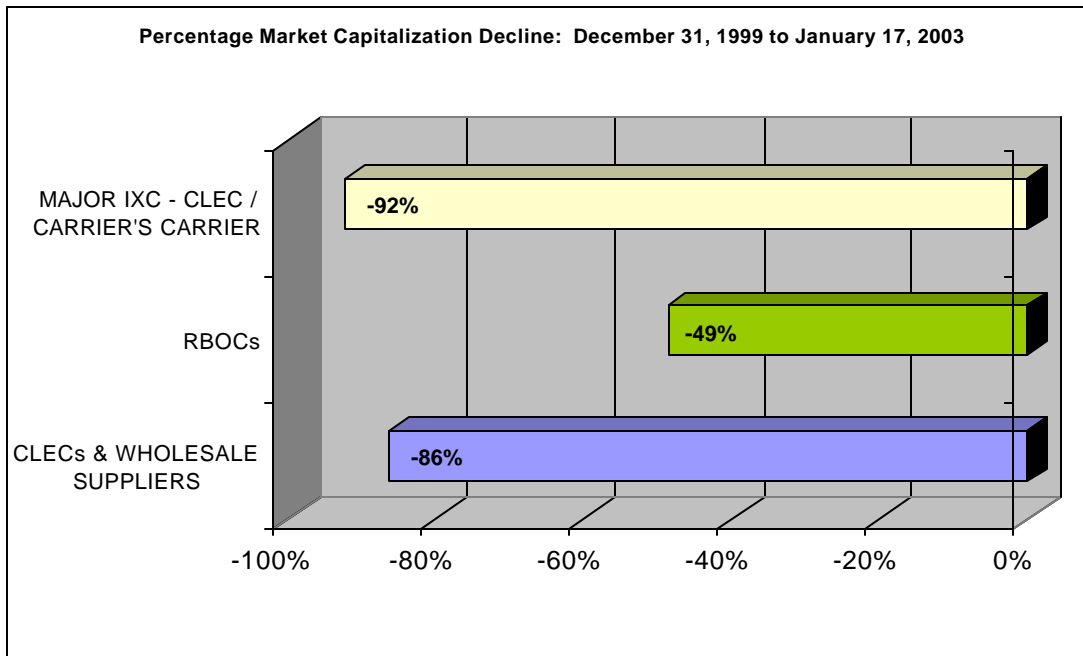
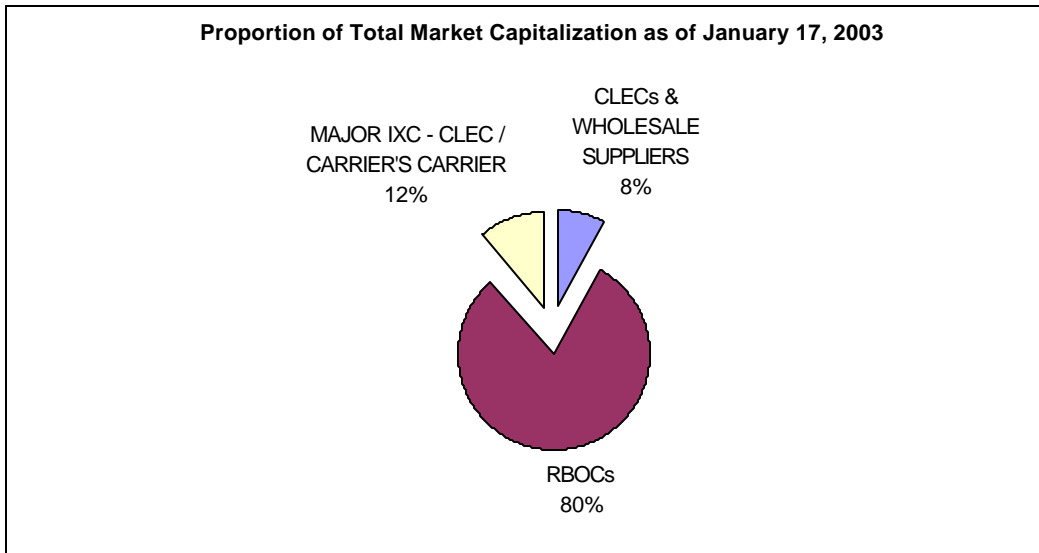


CHART 2

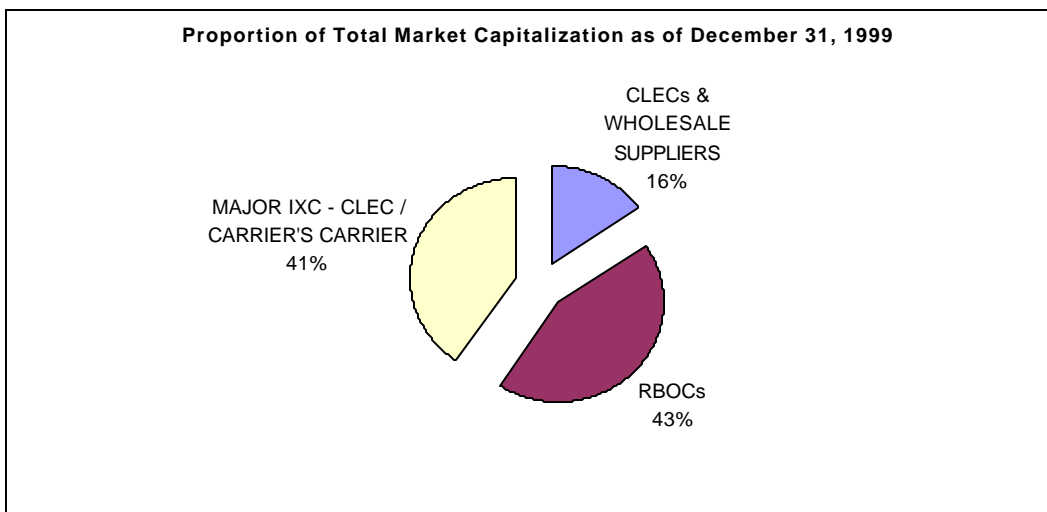


Since the market capitalization decline of the CLECs and IXC's is significantly greater than for the RBOCs, the relative value of each group to the total of the three groups combined has also changed dramatically. The following pie charts illustrate the increasing relative financial strength of the RBOCs over the last 32 months:

**CHART 3**



**CHART 4**



It is clear from Charts 3 and 4 that the financial strength of the remaining four RBOCs is increasingly dominating the telecommunications industry as their share of total market capitalization has essentially doubled.

### III. IMPACT OF BANKRUPTCY FILINGS

Of the 41 companies comprising the CLEC and IXC categories (Categories 1 and 3), 21 have filed for bankruptcy protection since December 31, 1999 with 10 of these filings occurring in the last 12 months.<sup>4</sup> A few of the carriers that initially filed for protection have since closed down their operations and sold off their assets to competitors. Conversely, four of the 21, Covad, McLeod USA, Mpower and ICG Communications, actually emerged from bankruptcy in the last year after undergoing significant restructuring to the detriment of their shareholders. The number of CLECs and IXCs that have reported negative stockholders' equity due to accumulated operating deficits increased to 28 as of January 17, 2003 compared to eight as of December 31, 1999.<sup>5</sup>

Some of the reasons for the numerous bankruptcy filings include decline in demand, over-investment, large debt burdens, aggressive business expansion, and questionable accounting practices. However, one cannot overlook the impact that RBOC anti-competitive behavior has had on CLEC cash flow and profitability. CLECs have (1) spent a tremendous amount of time and money on litigating provisions of the Telecommunications Act of 1996 and subsequent FCC orders, (2) faced excessive prices for the critical network elements and central office space required to provide local exchange service, and (3) experienced significant delays in achieving the critical mass necessary to pay for the investment required to operate a telecommunications network due to inadequate RBOC operational support systems and RBOC claims of facility exhaust.

While it is conceivable that a company filing for protection under Chapter 11 of the bankruptcy code will improve its balance sheet after shedding debt and restructuring its operations, the equity investment community may no longer support this company after losing their previous investment in the bankruptcy filing. The four CLECs that have emerged from bankruptcy protection have yet to see any significant rebound in their stock price.<sup>6</sup>

### IV. VIEWS OF THE FINANCIAL MEDIA

The collapse in market value of the competitive telecommunications industry, including long distance, which is apparent from the financial data, has been duly noted by the financial

<sup>4</sup> See detailed listing of bankruptcy filing dates on Attachment 1.

<sup>5</sup> The 28 carriers with Stockholder's Deficits as of January 17, 2003 include carriers that have filed for bankruptcy since December 31, 1999.

<sup>6</sup> See Attachment 1 to this Technical Document.

Company	As of 1/17/03		As of 12/31/99		% Increase (Decrease)	
	Stock Price	Market Cap	Stock Price	Market Cap	Stock Price	Market Cap
Covad	\$1.240	\$276,520,000	\$55.938	\$5,291,687,500	(97.78%)	(94.77%)
McLeod USA	\$0.850	\$138,125,000	\$58.875	\$27,833,803,875	(98.56%)	(99.50%)
Mpower	\$0.240	N/A	\$50.750	\$1,769,474,469	(99.53%)	N/A
ICG	\$4.000	\$220,980,000	\$18.750	\$895,518,750	(78.67%)	(75.32%)



community and the press. Not a day goes by without some pundit or another commenting on the dismal state of telecommunications competition. As one analyst concludes:

In telecommunications, we are rolling back the competitive progress made over the last ten years – disabling the enabling industry of economic growth when we need it most.<sup>7</sup>

Other articles go so far as to declare the entire competitive effort to be a failure and note that the RBOCs have slowly but steadily out-maneuvered their would be competitors. A 2001 article in *The New York Times* declared that the battle is over:

Of the Baby Bell local phone carriers, once seven in number, three [sic] remain — Qwest Communications, SBC Communications and Verizon Communications — and they are by far the most powerful and important communications companies in the nation. The corporations once known as long-distance carriers, like AT&T, are shells of their former selves. ... The Bells — the race's tortoises — have won.<sup>8</sup>

The potential danger to the nation's economy cannot be overstated. As is well recognized, the telecommunications industry is a critical component in the “high-tech engine” that has propelled our economy forward over a period longer than any other in modern times. That “engine” is now at risk of being usurped -- as a natural result of the corporate quest for profit maximization -- by a small group of very powerful companies: the RBOCs. As *Wired* magazine notes in yet another article on the demise of the competitive telecommunications industry:

The Bells own 88 percent of the local lines in the US and upgrade on their own terms – conveniently, after most of their competitors have died off.<sup>9</sup>

## V. NEED FOR REGULATORY OVERSIGHT

Whatever may be the merit of these somber prognoses, the fact remains that the competitive telecommunications industry is struggling to survive. In the war of attrition waged by the RBOCs against their competitors in the market place, in the U.S. Congress, the courts, and before regulators, it has not gone well for the CLEC industry and the financial community knows it. Regulatory policies are a critical component of the overall landscape, and it is most important that regulators stand firm -- now more than ever -- against all attempts on the part of the ILECs to raise barriers to entry any further. Unfettered access to the critical network elements required to provision competitive local exchange service is required at just and reasonable cost-based rates if the CLEC industry is to survive and present consumers with a sustainable alternative to the incumbent LEC.

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<sup>7</sup> Brian Adamik, Yankee Group, *The Death of Competitive Telecom?* CBS MarketWatch, May 3, 2001.

<sup>8</sup> Seth Schiesel, *Sitting Pretty: How Baby Bells May Conquer Their World*. *The New York Times*, Money&Business, Section 3, page 1. Sunday, April 22, 2001.

<sup>9</sup> Frank Rose, *Telechasm: Can we get to the future from here? First we have to get telecom out of the Stone Age*. *Wired*, May 2001, page 131.

# **ATTACHMENT 1**

## ***COMPARISON OF MARKET CAPITALIZATION***

COMPARISON OF MARKET CAPITALIZATION SORTED IN DESCENDING ORDER OF VALUATION DECLINE

		AS OF 01/17/2003				AS OF 12/31/1999						
Ticker	Company	CLOSING PRICE *	SHARES OUTSTANDING *	MARKET CAPITALIZATION (price X shares)	DEBT / EQUITY RATIO **	CLOSING PRICE ***	SHARES OUTSTANDING **	MARKET CAPITALIZATION (price X shares)	DEBT / EQUITY RATIO **	CHANGE IN MARKET CAP	% CHANGE	
1	MCLD	\$ 0.850	162,500,000	\$ 138,125,000	116.7%	\$ 58.875	472,761,000	\$ 27,833,803,875	159.1%	\$ (27,695,678,875)	-100%	
2	MFNXA	Bankruptcy (5/20/02)	671,572,000	N/A	Stockholders' Deficit	\$ 47.938	478,655,000	\$ 22,945,524,063	102.2%	\$ (22,945,524,063)	-100%	
3	XOXO	Bankruptcy (6/17/02)	337,792,000	N/A	Stockholders' Deficit	\$ 83.063	267,940,000	\$ 22,255,766,250	Stockholders' Deficit	\$ (22,255,766,250)	-100%	
4	COX	\$ 31.310	592,527,000	\$ 18,552,020,370	84.6%	\$ 51.500	603,767,000	\$ 31,094,000,500	55.3%	\$ (12,541,980,130)	-40%	
5	ALGX	\$ 0.590	125,129,000	\$ 73,826,110	745.4%	\$ 92.250	97,384,000	\$ 8,983,674,000	122.0%	\$ (8,909,847,890)	-99%	
6	CVC	\$ 19.360	233,013,000	\$ 4,511,131,680	Stockholders' Deficit	\$ 75.500	173,211,000	\$ 13,077,430,500	Stockholders' Deficit	\$ (8,566,298,820)	-66%	
7	WCIEQ	Bankruptcy (4/18/01)	N/A	N/A	Stockholders' Deficit	\$ 75.250	83,640,000	\$ 6,293,910,000	Stockholders' Deficit	\$ (6,293,910,000)	-100%	
8	TWTC	\$ 2.581	48,891,000	\$ 126,187,671	127.8%	\$ 49.938	104,760,000	\$ 5,231,452,500	95.4%	\$ (5,105,264,829)	-98%	
9	COVD	\$ 1.240	223,000,000	\$ 276,520,000	41.7%	\$ 55.938	94,600,000	\$ 5,291,687,500	54.3%	\$ (5,015,167,500)	-95%	
10	RCNC	\$ 0.710	110,496,000	\$ 78,452,160	Stockholders' Deficit	\$ 48.500	77,160,000	\$ 3,742,260,000	545.9%	\$ (3,663,807,840)	-98%	
11	ABIZQ	\$ 0.026	47,767,000	\$ 1,241,942	Stockholders' Deficit	\$ 48.000	69,438,000	\$ 3,333,024,000	301.9%	\$ (3,331,782,058)	-100%	
12	TGNTQ	Bankruptcy (5/21/01)	42,583,000	N/A	Stockholders' Deficit	\$ 61.750	52,633,000	\$ 3,250,087,750	Stockholders' Deficit	\$ (3,250,087,750)	-100%	
13	RTHM	Bankruptcy (8/1/01)	77,769,000	N/A	Stockholders' Deficit	\$ 31.000	77,270,000	\$ 2,395,370,000	435.1%	\$ (2,395,370,000)	-100%	
14	COMM	\$ 0.370	30,000,000	\$ 11,100,000	Stockholders' Deficit	\$ 59.375	38,556,000	\$ 2,289,262,500	141.3%	\$ (2,278,162,500)	-100%	
15	MPOW	\$ 0.240	N/A	N/A	Stockholders' Deficit	\$ 50.750	34,866,492	\$ 1,769,474,469	155.4%	\$ (1,769,474,469)	-100%	
16	ITCDQ	Bankruptcy (6/25/02)	62,365,000	N/A	Stockholders' Deficit	\$ 27.625	59,557,000	\$ 1,645,262,125	270.2%	\$ (1,645,262,125)	-100%	
17	NASC	Bankruptcy (6/4/02)	53,637,000	N/A	Stockholders' Deficit	\$ 33.000	45,280,000	\$ 1,494,240,000	26.0%	\$ (1,494,240,000)	-100%	
18	ZTEL	\$ 0.800	35,192,000	\$ 28,153,600	Stockholders' Deficit	\$ 40.375	31,600,000	\$ 1,275,850,000	9.1%	\$ (1,247,696,400)	-98%	
19	NPLS	Bankruptcy (2/7/02)	67,140,000	N/A	Stockholders' Deficit	\$ 21.000	54,795,000	\$ 1,150,695,000	33.7%	\$ (1,150,695,000)	-100%	
20	CPTLQ	Bankruptcy (10/3/02)	27,368,000	N/A	Stockholders' Deficit	\$ 44.000	25,774,000	\$ 1,134,056,000	Stockholders' Deficit	\$ (1,134,056,000)	-100%	
21	PACW	\$ 0.640	36,399,000	\$ 23,295,360	240.5%	\$ 26.500	35,393,000	\$ 937,914,500	141.2%	\$ (914,619,140)	-98%	
22	NTKQ	Bankruptcy (11/16/01)	40,336,000	N/A	Stockholders' Deficit	\$ 23.750	37,681,000	\$ 894,923,750	26.8%	\$ (894,923,750)	-100%	
23	CLEC	\$ 2.010	26,698,000	\$ 53,662,980	Stockholders' Deficit	\$ 32.250	27,501,000	\$ 886,907,250	51.8%	\$ (833,244,270)	-94%	
24	DSLN	\$ 0.670	64,930,000	\$ 43,503,100	48.5%	\$ 14.438	58,382,200	\$ 842,893,013	16.8%	\$ (799,389,913)	-95%	
25	CWON	\$ 0.240	42,343,000	\$ 10,162,320	Stockholders' Deficit	\$ 35.500	22,022,000	\$ 781,781,000	196.0%	\$ (771,618,680)	-99%	
26	ICGCV	\$ 4.000	55,245,000	\$ 220,980,000	Stockholders' Deficit	\$ 18.750	47,761,000	\$ 895,518,750	Stockholders' Deficit	\$ (674,538,750)	-75%	
27	ARTT	Bankruptcy (4/2/01)	29,249,000	N/A	Stockholders' Deficit	\$ 24.000	27,968,000	\$ 671,232,000	Stockholders' Deficit	\$ (671,232,000)	-100%	
28	NPNTQ	Bankruptcy (1/16/01)	N/A	N/A	Stockholders' Deficit	\$ 24.000	24,593,000	\$ 590,232,000	27.6%	\$ (590,232,000)	-100%	
29	CONV	Bankruptcy (4/19/01)	29,910,000	N/A	Stockholders' Deficit	\$ 15.875	28,642,000	\$ 454,691,750	530.2%	\$ (454,691,750)	-100%	
30	FTGQ	\$ 0.110	792,164,000	\$ 86,979,607	779.9%	\$ 15.125	25,933,000	\$ 392,236,625	1.4%	\$ (305,257,018)	-78%	
31	ESPI	Bankruptcy (3/22/01)	54,929,000	N/A	Stockholders' Deficit	\$ 5.813	51,149,800	\$ 297,308,213	Stockholders' Deficit	\$ (297,308,213)	-100%	
32	FCOMQ	Bankruptcy (12/19/02)	4,936,000	N/A	Stockholders' Deficit	\$ 24.125	1,735,685	\$ 41,873,401	171.6%	\$ (41,873,401)	-100%	
	Acquired by Citizens Communications (6/18/02)		N/A	N/A	Stockholders' Deficit	N/A	N/A	0	N/A	\$ -	0%	
33	ELIX	\$ 4.650	2,877,000	\$ 13,378,050	0.0%	\$ 4.125	1,994,000	\$ 8,225,250	51.7%	\$ 5,152,800	63%	
34	OPTC	\$ 26.940	1,355,072,000	\$ 36,505,639,680	71.2%	\$ 47.875	742,435,862	\$ 35,544,116,893	84.2%	\$ 961,522,787	3%	
35	CMCSA											
	<b>CLECs &amp; WHOLESALE SUPPLIERS</b>			<b>\$ 24,235,341,900</b>				<b>\$ 174,132,469,882</b>		<b>\$ (149,897,127,981)</b>	<b>-86%</b>	
36	SBC	\$ 27.280	3,320,203,000	\$ 90,575,137,840	58.5%	\$ 48.750	3,433,125,000	\$ 167,364,843,750	65.4%	\$ (76,789,705,910)	-46%	
37	Q	\$ 5.470	1,695,357,000	\$ 9,273,602,790	59.6%	\$ 51.750	1,655,000,000	\$ 85,646,250,000	32.4%	\$ (76,372,647,210)	-89%	
38	VZ	\$ 38.500	2,751,650,000	\$ 105,938,525,000	144.5%	\$ 55.125	2,751,816,000	\$ 151,693,857,000	97.4%	\$ (45,755,332,000)	-30%	
39	BLS	\$ 25.420	1,858,564,000	\$ 47,244,696,880	70.5%	\$ 46.813	1,872,000,000	\$ 87,633,000,000	61.5%	\$ (40,388,303,120)	-46%	
	<b>RBOCs</b>			<b>\$ 253,031,962,510</b>				<b>\$ 492,337,950,750</b>		<b>\$ (239,305,988,240)</b>	<b>-49%</b>	
40	WCOEQ	WorldCom (Bankruptcy - 7/21/02)	\$ 0.182	2,962,645,000	\$ 539,201,390	Stockholders' Deficit	\$ 53.063	2,842,980,000	\$ 150,855,626,250	37.5%	\$ (150,316,424,860)	-100%
41	T	\$ 26.000	770,385,000	\$ 20,030,010,000	84.9%	\$ 50.813	3,196,437,000	\$ 162,418,955,063	29.4%	\$ (142,388,945,063)	-88%	
42	FON	\$ 14.900	894,558,000	\$ 13,328,914,200	148.9%	\$ 67.313	874,200,000	\$ 58,844,587,500	115.7%	\$ (45,515,673,300)	-77%	
43	GBLXQ	Bankruptcy (1/28/02)	887,106,000	N/A	Stockholders' Deficit	\$ 50.000	799,137,000	\$ 39,956,850,000	54.4%	\$ (39,956,850,000)	-100%	
44	LVLQ	\$ 5.200	422,689,000	\$ 2,197,982,800	Stockholders' Deficit	\$ 81.750	371,397,000	\$ 30,361,704,750	117.2%	\$ (28,163,721,950)	-93%	
45	WCCR	Bankruptcy (4/22/02)	491,979,000	N/A	Stockholders' Deficit	\$ 28.938	463,600,000	\$ 13,415,425,000	140.6%	\$ (13,415,425,000)	-100%	
	<b>MAJOR IXC - CLEC / CARRIER'S CARRIER</b>			<b>\$ 36,096,108,390</b>				<b>\$ 455,853,148,563</b>		<b>\$ (419,757,040,173)</b>	<b>-92%</b>	

\* Nasdaq Info Quotes, Fundamentals (<http://www.nasdaq.com>)

\*\* Debt and stockholder's equity per the individual company's most recent 10Q report for 2002 and 10K report for 1999. Debt to Equity ratio is result of dividing Long-term Debt by Stockholder's Equity. 12/31/1999 Common shares outstanding per 10K report.

\*\*\* Per BigCharts.com, Historical Quotes (<http://www.bigcharts.com/historical>)

A Effective 7/1/02, CoreComm Limited completed its recapitalization; all shares are now owned by CoreComm Holdco, Inc. Business will be renamed ATX Communications.

B Price, shares and financial information as of 3/31/00 because the company went public on 3/10/00.

C Price, shares and financial information as of 3/31/00 because it was the company's year-end at that time.

D Price, shares and financial information as of 3/31/00 because company went public on 2/16/00.

E Price as of 7/3/00 since it is the first trading day after merging with U S WEST. Shares and financial information as of 6/30/00 from 2nd Quarter 10Q.

F Price as of 7/3/00 since it is the first trading day after Bell Atlantic merged with GTE. Shares and financial information as of 6/30/00 per 2nd Quarter 10Q.

G Adelphia Business Solutions has been in bankruptcy since 3/27/02.