TC97-040

C.O. / O.T.

TC97-040

DOCKET NO.

In the Matter of IN THE MATTER OF THE APPLICATION OF TEL-SAVE, INC. D/B/A THE PHONE COMPANY FOR AN AMENDED CERTIFICATE OF AUTHORITY TO PROVIDE LOCAL EXCHANGE SERVICE IN SOUTH DAKOTA

Public Utilities Commission of the State of South Dakota

DATE		MEMORANDA
4/15	97	Filed and Docketed;
4/17	97	TC Fax Filing;
6/10	97	Order Granting Amended Certificate of Authority;
6/10	97	Docket Closed

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APR 15 1997

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

Lance J.M. Steinhart
Attorney At Law
6455 East Johns Crossing
Suite 285
Duluth, Georgia 30155

Also Admitted in New York
and Maryland

Telephone: (770) 232-9200
Facsimile: (770) 232-9208

April 14, 1997

VIA FEDERAL EXPRESS

Mr. William Bullard
Executive Director
South Dakota Public Utilities Commission
500 East Capitol Avenue
Pierre, SD 57501-5070
(605) 773-3201

Re: Tel-Save, Inc. d/b/a The Phone Company

Dear Mr. Bullard:

Enclosed please find one original and ten (10) copies of Tel-Save, Inc. d/b/a The Phone Company's Amended Application for Registration of a Telecommunications Company to Provide Local Exchange Service.

In order to expedite the processing of this application, I would like to suggest that all requests for information by the analyst be made by either telephone or facsimile. I will make every effort to respond on the day of the request.

I have also enclosed a check in the amount of $250.00 payable to the "South Dakota Public Utilities Commission" for the filing fee, and an extra copy of this cover letter to be date stamped and returned to me in the enclosed self-addressed prepaid envelope.

If you have any questions or if I may provide you with any additional information, please do not hesitate to contact me.

Respectfully submitted,

Lance J.M. Steinhart

Attorney for Tel-Save, Inc.
d/b/a The Phone Company

Enclosures
cc: Mr. Dan Borislow
LJS/afs

TC97-040

**AMENDED APPLICATION FOR REGISTRATION
OF TELSAVE, INC. D/B/A THE PHONE COMPANY
FILED WITH THE
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION**

RECEIVED
APR 1 5 1997
SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION

IN THE MATTER OF THE)
AMENDED APPLICATION OF)
TELSAVE, INC.)
D/B/A THE PHONE COMPANY)
) Docket No.__________
FOR AN ORDER)
authorizing the registration)
of applicant as a)
telecommunications company)
to provide local exchange service)

APPLICATION

Application is hereby made to the South Dakota Public Utilities Commission for an Order authorizing Tel-Save, Inc. d/b/a The Phone Company ("Applicant") to register as a telecommunications company to provide local exchange service within the State of South Dakota. The following information is furnished in support thereof:

1. **Name, Address and Telephone Number of Applicant**

Tel-Save, Inc. d/b/a The Phone Company, Inc.
6805 Route 202
New Hope, PA 18938
(215) 862-1500
(800) 728-3288 (Customer Service)

All inquiries regarding complaints and regulatory matters should be addressed to:

Lance J.M. Steinhart, Esq.
6455 East Johns Crossing, Suite 285
Duluth, Georgia 30155
(770) 232-9200
(770) 232-9208 (Fax)

2. **Registered Agent**

The name and address of the Applicant's registered agent are:

CT Corporation System
319 South Coteau Street
Pierre, South Dakota 57501

3. **Description of the Applicant**

Applicant was incorporated in the State of Pennsylvania on May 17, 1989 with perpetual duration. Applicant is a wholly-owned subsidiary of Tel-Save Holdings, Inc., a Delaware corporation, which is publicly traded on the NASDAQ National Exchange. Applicant has been in the telecommunications industry since inception. Applicant has authority to transact business as a foreign corporation in the State of South Dakota and a copy of a Certificate of Good Standing issued by the Secretary of State dated March 20, 1997 is attached hereto as Exhibit A. A copy of the Applicant's Articles of Incorporation is attached hereto as Exhibit B. On June 19th, 1992, the Commission issued Order TC92-018 Granting Applicant's Registration and Approving its Tariff to provide interexchange telecommunications services in the State of South Dakota.

4. **Facilities**

Applicant does not own or maintain any transmission facilities or switching equipment in the State of South Dakota. The Applicant will provide services through certificated incumbent local exchange carriers ("LECs").

5. **Stockholders**

The names and address of the sole stockholder of Applicant are as follows:

Name and Address	Shares Owned	Percentage of all Shares Issued and Outstanding and Voting Control
Tel-Save Holdings, Inc. 6805 Route 202 New Hope, PA 18938	1,950	100%

6. **Officers and Directors**

The names and addresses of the officers and directors of Applicant are as follows:

Daniel Borislow, CEO & Chairman/Director

Gary McCulla
President/Director

Joe Schenk
Chief Financial Officer & Treasurer

Kevin Kelly
Controller

Emanuel DeMaio
Chief Operations Officer/Director

Aloysius Lawn
General Counsel & Secretary/Director

Edward Meyercord
Exec. VP, Mktg. & Corporate Development

Mary Kennon
Director of Customer Care & Human Resources

All of the above can be reached at Tel-Save Holdings, Inc., 6805 Route 202, New Hope, PA 18938.

7. **Corporate Ownership**

The name and address of any corporation, association or similar organization holding a five percent (5%) or greater ownership in the Applicant is as follows:

Tel-Save Holdings, Inc. (100%)

8. **Subsidiaries owned or controlled by Applicant**

None

9. **Description of Services**

Applicant is a reseller which intends to offer all local services provided by the incumbent LECs. As a switchless reseller, Applicant has no points of presence in the State of South Dakota, thus Applicant neither owns, leases, nor operates any switching, transmission, or other physical facilities in the State of South Dakota, and no such facilities will be used by Applicant in providing service in the State of South Dakota. Rather, Applicant will be engaged in reselling services provided by facilities-based LECs within the State of South Dakota. Upon receiving certification, Tel-Save intends to provide all forms of intrastate local exchange telecommunications services including: (1) Basic Residential Services (Local Exchange Flat Rate, Measured Rate Service, operator access, etc.); (2) Residential Custom Calling and Class Features (call waiting, caller ID, call forwarding, etc.); (3) Basic Business Exchange Services; (4) Business Custom Calling and Class Features; (5) Adjunct Provided Features (voice messaging, etc.); and (6) Business and Residentially Ancillary Services (911, directory listing, directory assistance, etc.). Tel-Save seeks authority to resell local exchange services throughout the State of South Dakota in the areas served by any LECs in South Dakota that are not eligible for a small or rural carrier exemption pursuant to Section 251(f)(1) of the Federal Act. Tel-Save does not seek to provide resold services to customer in those small or rural territories at this time. The Applicant is currently authorized to provide interexchange service in 48 states.

10. Financial Qualifications

Applicant is financially qualified to provide intrastate local exchange telecommunications services within South Dakota. In particular, Applicant has adequate access to the capital necessary to fulfill any obligations it may undertake with respect to the provision of intrastate local exchange telecommunications services in the State of South Dakota. See Exhibit C which is attached hereto, Applicant's parent company's Form 10K for the year ended December 31, 1995 and Form 10Q for the quarter ended September 30, 1996.

11. Tariff

Applicant will file a copy of its proposed tariff as Exhibit D upon completion of negotiations for interconnection.

WHEREFORE, the undersigned Applicant requests that the South Dakota Public Utilities Commission enter an order granting this amended application to its Certificate of Authority authorizing Applicant to provide resold local exchange services.

DATED this 15 day of April, 1997.

Tel-Save, Inc.
d/b/a The Phone Company

By: ______________________
Lance J.M. Steinhart
Its Attorney

STATE OF PENNSYLVANIA

COUNTY OF BUCKS

Daniel Borislow, being first duly sworn, deposes and says that he is the Chief Executive Officer of Tel-Save, Inc. d/b/a The Phone Company, the Applicant in the proceeding entitled above, that he has read the foregoing application and knows the contents thereof; that the same are true of his knowledge, except as to matters which are therein stated on information or belief, and to those matters he believes them to be true.

Daniel Borislow

Subscribed and sworn to before this 11th day of April, 1997.

Notary Public

My Commission expires: 5/10/99

NOTARIAL SEAL
KRISTINA M. SCHAEFER, Notary Public
New Hope Boro, Bucks County, PA
My Commission Expires May 10, 1999

LIST OF EXHIBITS

A - CERTIFICATE OF AUTHORITY

B - ARTICLES OF INCORPORATION

C - FINANCIAL STATEMENTS

D - PROPOSED TARIFF

EXHIBIT A - CERTIFICATE OF AUTHORITY

State of South Dakota

OFFICE OF THE SECRETARY OF STATE

CERTIFICATE OF GOOD STANDING

FOREIGN CORPORATION

I, Joyce Hazeltine, Secretary of State of the State of South Dakota, do hereby certify that TEL-SAVE, INC. (PA) was authorized to transact business in this state on April 6, 1992.

I, further certify that said corporation has complied with the South Dakota law governing foreign corporations transacting business in this state, and so far as the records of this office show, said corporation is in good standing in this State at the date hereof and duly authorized to transact business in the State of South Dakota. This certificate is not to be construed as an endorsement, recommendation or notice of approval of the corporation's financial condition or business activities and practices. Such information is not available from this office.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the Great Seal of the State of South Dakota, at Pierre, the Capital, this March 20, 1997.

JOYCE HAZELTINE
Secretary of State

EXHIBIT B - ARTICLES OF INCORPORATION

NEXT

DOCUMENT (S)

DISREGARD

BACKGROUND

8142 44 41 44

ARTICLES OF INCORPORATION

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF STATE – CORPORATION BUREAU
308 NORTH OFFICE BUILDING, HARRISBURG, PA 17120

PLEASE INDICATE (CHECK ONE) TYPE OF

- [ ] DOMESTIC BUSINESS CORPORATION
- [X] DOMESTIC BUSINESS CORPORATION A CLOSE CORPORATION – COMPLETE BACK
- [ ] DOMESTIC PROFESSIONAL CORPORATION ENTER BOARD LICENSE NO.

FEE $75.00

010 NAME OF CORPORATION (MUST CONTAIN A CORPORATE INDICATOR UNLESS EXEMPT UNDER 15 P.S. 2908 B)
TEL-SAVE, INC.

011 ADDRESS OF REGISTERED OFFICE IN PENNSYLVANIA (P.O. BOX NUMBER NOT ACCEPTABLE)
1017 North York Road - Unit I

013 CITY	023 COUNTY	013 STATE	084 ZIP CODE
Willow Grove	Montgomery	PA	19090

060 EXPLAIN THE PURPOSE OR PURPOSES OF THE CORPORATION

The purposes for which it was organized are: to engage in and do any lawful business for which corporations may be incorporated under the Pennsylvania Business Corporation Law.

(ATTACH 8½ x 11 SHEET IF NECESSARY)

The Aggregate Number of Shares, Classes of Shares and Par Value of Shares Which the Corporation shall have Authority to Issue:

040 Number and Class of Shares	041 Stated Par Value Per Share If Any	042 Total Authorized Capital	031 Term of Existence
5000 common	N/A	$10,000	perpetual

The Name and Address of Each Incorporator, and the Number and Class of Shares Subscribed to by each Incorporator

060 Name	061, 062 063, 064 Address (Street, City, State, Zip Code)	Number & Class of Shares
Daniel Borislow	1017 North York Road Unit I - Willow Grove PA 19090	1000 common

(ATTACH 8½ x 11 SHEET IF NECESSARY)

IN TESTIMONY WHEREOF, THE INCORPORATOR (S) HAS (HAVE) SIGNED AND SEALED THE ARTICLES OF INCORPORATION THIS First DAY OF May 19 89

x Daniel Borislow

– FOR OFFICE USE ONLY –

030 FILED	002 CODE	003 REV BOX	SEQUENTIAL NO.	100 MICROFILM NUMBER
MAY 11 1989	REVIEWED BY	004 SICC	AMOUNT $	8937 698
	DATE APPROVED			001 CORPORATION NUMBER 1507863
James J. Haggerty	DATE REJECTED	CERTIFY TO [ ] REV.	INPUT BY	LOG IN / LOG IN (REFILE)
Secretary of the Commonwealth Department of State Commonwealth of Pennsylvania	MAILED BY DATE	[ ] L & I [ ] OTHER	VERIFIED BY	LOG OUT / LOG OUT (REFILE)

8937 699

1. The following provisions shall regulate the status of the corporation as a close corporation:

(a) (Strike out(i) or (ii) below, whichever is not applicable.)

(i) All of the issued shares of the corporation of all classes, exclusive of treasury shares, shall be held of record by not more than 10 persons.
(NUMBER NOT TO EXCEED 30)

~~(ii) All of the issued shares of the corporation of all classes, exclusive of treasury shares, shall be held of record by not more than the smaller of twenty-five "shareholders" within the meaning of Subchapter S of the Internal Revenue Code of 1954, as amended, or 30 persons.~~

(b) All of the issued shares of all classes of the corporation shall be subject to one or more of the restrictions on transfer permitted by section 613.1 of the Business Corporation Law (15 P.S. § 1613.1).

(c) The corporation shall make no offering of any of its shares of any class which would constitute a "public offering" within the meaning of the Securities Act of 1933, as amended.

~~2. (Optional: BCL § 372B) A person (other than an estate) who is not an "individual" or who is a "non-resident alien," in either case within the meaning of the Internal Revenue Code of 1954, as amended ("Code"), shall not be entitled to be a holder of record of shares of the corporation. Only a person whose consent is currently in effect to the election of the corporation to be treated as an electing small business corporation under Subchapter S of the Code and a shareholder who has not affirmatively refused to consent to the election within sixty days after he acquires his stock, shall be entitled to be a holder of record of shares of the corporation.~~

3. (Optional: BCL § 382) The business and affairs of the corporation shall be managed by the shareholders of the corporation rather than by a board of directors.

4. (Optional: § 376B) The status of the corporation as a "close corporation" within the meaning of the Business Corporation Law shall not be terminated without the affirmative vote or written consent of (all holders of) (shareholders holding all of the) shares of all classes of the corporation.
(FRACTION AT LEAST TWO-THIRDS)

~~5. (Optional: BCL § 384B) (Any shareholder) (shareholders holding ______ of the shares) of the corporation may apply for the appointment of a provisional director of the corporation in the manner and upon the circumstances provided by statute.~~
(FRACTION)

6. (Optional: BCL § 386) (Any shareholder) (shareholders holding 100% of the shares) of the corporation shall have the right at will to cause the corporation to be dissolved by proceeding in the manner provided by statute.
(FRACTION)

EXHIBIT C - FINANCIAL STATEMENTS

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934 (Fee Required)
For the year ended December 31, 1995

Commission File No. 0 - 26728

TEL-SAVE HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**23-2827736**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

22 Village Square
New Hope, Pennsylvania 18938
(215) 862-1500

(Address, including zip code of principal
executive offices and registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
None	Not applicable

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

Common Stock, Par Value $.01 Per Share

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

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

The aggregate market value of voting stock held by non-affiliates of the Registrant as of March 21, 1996 was approximately $77,625,000 based on the average of the high and low prices of the Common Stock on March 21, 1996 of $15.00 per share as reported on the Nasdaq National Market.

As of March 21, 1996, the Registrant had outstanding 19,500,000 shares of its Common Stock, par value $.01 per share.

Documents Incorporated by Reference

Portions of the Tel-Save Holdings, Inc. definitive proxy statement for the 1996 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

TEL-SAVE HOLDINGS, INC.

INDEX TO FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 1995

PART I

ITEM 1. BUSINESS

For the definition of certain terms used in this Form 10-K, see "Glossary."

Overview

Tel-Save Holdings, Inc. ("Company") provides long distance services primarily to small and medium-sized businesses located throughout the United States. The Company's long distance service offerings include outbound service; inbound toll-free 800 service; and dedicated private line services for data. To date, the Company has operated as a switchless, nonfacilities-based reseller of AT&T long distance services. By purchasing large usage volumes from AT&T pursuant to contract tariffs, the Company has been able to procure substantial discounts and offer low cost, high quality long distance services to its customers at rates generally more favorable than those offered directly by AT&T. The Company generally provides its services through independent carriers and marketing companies known as "partitions," which allow the Company to minimize overhead expenses. The Company expands its business primarily by adding partitions and providing new and existing partitions with operational, financing, marketing and management support. The Company's services are marketed emphasizing the quality of the services provided using the AT&T network, the accuracy of AT&T billing and pricing advantages.

The Company has successfully established its position as a switchless reseller of AT&T long distance services as a result of its ability to negotiate with and obtain favorable contract tariffs from AT&T, to manage and distribute data, to bill accurately and to provide partition support. The Company's future strategy is to continue to support existing partitions, to attract additional partitions (including those now in the non-AT&T resale market) and to market services directly to end users. The Company intends to attract new partitions and support existing partitions by, among other things, increasing its current practice of offering advances to new partitions to enable such partitions to pay outstanding balances due to their existing long distance providers in order for such partitions to transfer their end users to the Company's service, and to existing partitions to support their marketing efforts.

To continue providing high quality telecommunication services at competitive rates and to position the Company for future growth, the Company is in the process of deploying its own nationwide long distance network, One Better Net ("OBN"). OBN features five, Company-owned, AT&T-manufactured 5ESS-2000 switches connected with AT&T digital transmission facilities. OBN's reduced cost structure will allow the Company to offer rates competitive with those of non-AT&T resellers while continuing to provide the quality of AT&T-manufactured switches and AT&T-provided transmission facilities and billing services. The non-AT&T based switchless resale market that OBN will allow the Company to pursue represents the majority of the switchless resale long distance market.

Tel-Save, Inc., the Company's predecessor ("Predecessor Corporation") and now its operating subsidiary, was incorporated in Pennsylvania in May 1989. The Company was incorporated in Delaware in June 1995. The address of the Company's principal executive offices is 22 Village Square, New Hope, Pennsylvania 18938, and its telephone number is (215) 862-1500. Unless the context otherwise requires, "Company" includes the Predecessor Corporation and the Company's other subsidiaries.

Industry Background

General

The $67.4 billion U.S. long distance industry is dominated by the nation's three largest long distance providers, AT&T, MCI and Sprint, which together generated approximately 82.7% of the aggregate revenues of all U.S. long distance interexchange carriers in 1994. Other long distance companies, some with national capabilities, accounted for the remainder of the market.

Based on published Federal Communications Commission ("FCC") estimates, toll service revenues of U.S. long distance interexchange carriers have grown from $38.8 billion in 1984 to $67.4 billion in 1994. While industry revenues have grown at a compound annual rate of 5.7% since 1984, the revenues of carriers other than AT&T, MCI and Sprint have grown at a compound annual rate of 27.8% during the same period. As a result, the aggregate market share of all interexchange carriers other than AT&T, MCI and Sprint has grown from 2.6% in 1984 to 17.3% in 1994. During the same period, the market share of AT&T declined from 90.1% to 55.2%.

Prior to The Telecommunications Act of 1996 ("Telecommunications Act"), the long distance telecommunications industry had been principally shaped by a court decree between AT&T and the United States Department of Justice, known as the Modification of Final Judgment (the "Consent Decree") that in 1984 required the divestiture by AT&T of its 22 Bell operating companies and divided the country into some 200 Local Access and Transport Areas or "LATAs." The 22 operating companies, which were combined into seven regional Bell operating companies ("RBOCs"), were given the right to provide local telephone service, local access service to long distance carriers and intraLATA toll service (service within LATAs), but were prohibited from providing interLATA service (service between LATAs). The right to provide interLATA service was maintained by AT&T and other carriers.

To encourage the development of competition in the long distance market, the Consent Decree and the FCC require most local exchange carriers ("LECs") to provide all carriers with access to local exchange services that is "equal in type, quality and price" to that provided to AT&T and with the opportunity to be selected by customers as their preferred long distance carrier. These so-called "equal access" and related provisions are intended to prevent preferential treatment of AT&T.

Regulatory, judicial and technological factors have helped to create the foundation for smaller companies to emerge as competitive alternatives to AT&T, MCI, and Sprint for long distance telecommunication services. The FCC requires that AT&T not restrict the resale of its services, and the Consent Decree and regulatory proceedings have ensured that access to LEC networks is, in most cases, available to all long distance carriers.

Long distance companies that have their own transmission facilities and switches, such as AT&T, are referred to as facilities-based carriers. Facilities-based carriers are switch-based carriers, meaning that they have at least one switch to direct their long distance traffic. Nonfacilities-based carriers either (i) depend upon facilities-based carriers for switching and transmission facilities ("switchless resellers") or (ii) install and operate their own switches but depend on facilities-based carriers for transmission facilities ("switch-based resellers").

The relationship between resellers and the major long distance carriers is predicated primarily upon the fact that the pricing strategies and cost structures of the major long distance carriers have resulted historically in their charging higher rates to the small to medium business customer. Small to medium business customers typically are not able to make the volume commitments necessary to negotiate reduced rates under individualized contracts. By committing to large volumes of traffic, the reseller is guaranteeing traffic to the major long distance carrier but the major long distance carrier is relieved of the administrative burden of qualifying and servicing large numbers of medium to small accounts. The successful reseller has lower overhead costs and is able to market efficiently the long distance product, process orders, verify credit and provide customer service to a large numbers of accounts.

With its own switches, the Company will be significantly less dependent on AT&T for switching services, although it will continue to be dependent on AT&T for transmission services. In recent years, national and regional network providers have substantially upgraded the quality and capacity of their domestic long distance networks, resulting in significant excess transmission capacity for voice and data communications. Due to anticipated advances in the technology involved in digital fiber optic transmission, excess capacity is expected to persist and may result in decreasing prices for use of transmission facilities. By deploying its own switches, the Company expects to be able to continue to provide long distance services using the quality of AT&T transmission facilities but at lower rates than it has historically charged, with the Company in control of establishing service or activating new end user accounts ("provisioning") and maintaining confidential end user lists.

Two recent regulatory developments may significantly alter the long distance business in the future. First, in October 1995, the FCC terminated AT&T's status as a "dominant" carrier for domestic services, which may make it more difficult for the Company to compete with AT&T for long distance subscribers. AT&T

is now no longer subject to price cap regulations that had previously governed its offerings to residences and small businesses, and is allowed to file, using streamlined procedures, tariffs that are presumed lawful and become effective on one day's notice, making it more difficult for the Company to protest such filings.

Second, on February 8, 1996, the President signed the Telecommunications Act, which is intended to introduce more competition into U.S. telecommunications markets. The legislation opens local services markets by requiring LECs to permit interconnection to their networks and by establishing, among other things, LEC obligations with respect to "unbundled" access, resale, number portability, dialing parity, access to rights-of-way and mutual compensation. The legislation also codifies the LECs' equal access and nondiscrimination obligations and preempts most state barriers to entry. Special provisions contained in the Telecommunications Act will, over time, allow RBOC provision of interLATA long distance services. RBOCs may immediately provide such services out-of-region (where they are not the LEC) and provide incidental interLATA services, including commercial mobile services. They will be allowed to provide such services in-region only with FCC approval after having met a competitive checklist. See "– Competition" and "– Regulation."

Development of the Company

The Company, originally incorporated in 1989 as Tel-Save, Inc., was formed to capitalize on the FCC mandate allowing the resale of AT&T services. The Company initially marketed AT&T's multi-location calling plan ("MLCP"), which provided incremental discounts earned by inclusion of the usage volume of diverse end user locations under a single service plan. The Company was successful in marketing MLCP, but realized that there were significant barriers to growth associated with the product, primarily the lack of reporting from AT&T, product inflexibility and the lack of control over end user accounts.

In late 1989, the Company successfully obtained an additional AT&T service plan developed by AT&T and marketed as Software Defined Network Service ("SDN"), an AT&T product designed for larger business customers. SDN provided the Company with higher margins, network controls, advanced features and the ability to rebill its end users through AT&T and AT&T's College and University Systems ("ACUS"), thus enabling the Company to have more control over the end user account. As a result of SDN, the Company began to offer services on a wholesale basis through partitions. The Company thereby outsourced its marketing and end user service expenses to partitions, allowing it to focus on managing the AT&T relationship and further developing its billing and information systems.

In December 1992, the Company obtained the first contract tariff created by AT&T specifically for the Company. The contract tariff provided the Company with significant additional price advantages at stabilized rates and the ability to absorb the traffic of competitors' plans into the contract tariff. The Company subsequently obtained other contract tariffs, which also provide AT&T inbound 800 services and AT&T private line services, in order to diversify its service offerings. This in turn has further enabled the Company to increase the number of its partitions and end users.

To date, the Company has primarily operated as a "switchless" and nonfacilities-based provider of long distance services by reselling AT&T services. The Company currently offers its partitions and end users nationwide access to AT&T long distance network services through contract tariffs, including outbound long distance, 800 service and private line service. Outbound long distance service accommodates voice, data and video transmissions. The Company's 800 service is currently provided by reselling AT&T's 800 Service (Readyline, Megacom 800, etc.), which is AT&T's inbound, toll-free (recipient of the call pays the charges) long distance service. The Company's private line service is currently provided by reselling AT&T Private Line Service, which includes dedicated transmission lines connecting pairs of sites.

One of the primary reasons that the Company has succeeded in the AT&T switchless reseller market has been its ability to negotiate with and obtain favorable contract tariffs from AT&T. Such contract tariff subscriptions do not impose restrictions on the rates the Company may charge its partitions and end users. By purchasing large usage volumes from AT&T pursuant to such contract tariffs, the Company is able to procure substantial volume discounts and offer long distance services to its partitions and end users at rates generally more favorable than those offered directly by AT&T. With its information systems, the Company is able to manage and distribute to partitions information such as data about end user usage and payment history.

Prior to 1995, substantially all of the Company's services consisted of reselling AT&T outbound or SDN long distance services. In 1994, the Company began to offer 800 services, which accounted for 30.9% of 1995 sales, and private line service, which accounted for 10.2% of 1995 sales.

Strategy

The Company's strategy for business growth is to continue to support existing partitions, to attract additional partitions, to market its services directly to end users and to introduce new services such as Competitive Telecommunications Provider ("CTP") services that will be possible with the deployment of OBN.

- *Provide Operational, Financing, Marketing and Management Support to Partitions.* The Company will continue to sell its services through partitions. To do so, the Company will continue to provide existing and new partitions with low rates and operational, marketing and management support. The operational, marketing and management support includes financing, training in customer service and use of the data base, collection services, lists of prospective end users and a business management system designed and developed by the Company exclusively for use by it and its partitions.
- *Increase End User Base Through Direct Marketing Efforts.* By marketing its services directly to end users, the Company expects to increase its profit margins by taking advantage of the difference between the reduced costs of offering services on OBN and the rates charged directly to end users.
- *Maintain Efficient, Low Cost Operations.* The Company attempts to control its administrative and marketing expenses through its extensive use of partitions. To the extent that the Company uses partitions to market long distance services and to provide service to end users, it reduces the investment that the Company must make in its own infrastructure because the Company does not have to provide these services directly and incur the associated costs. While the Company plans to begin conducting its own direct marketing to end users, it also intends to continue to aid partitions in the expansion of their marketing.
- *Provide Enhanced Information and Support Service.* The Company attempts to provide partitions and end users with complete information and support services. These services include the provisioning of the end user on the network by the Company, as discussed below. In addition, management systems are provided which (i) provide information tailored to the requirements of its partitions, (ii) provide accurate and timely copies of end user billings in a CD ROM format, (iii) allow the partitions to respond promptly to end user needs, (iv) integrate acquired end user bases, (v) facilitate end user retention by identifying end users who change their usage patterns and (vi) support operations and collection efforts.

The Company's basic strategy for business growth is based on the deployment of OBN. OBN is expected to lower the Company's costs, to maintain its access to AT&T services and equipment, to improve provisioning of new accounts, and to provide a network that can be expanded to add new products and services.

- *Provide Low Cost, High Quality Alternative to Other Carriers.* The Company's deployment of OBN will reduce its costs and allow it to offer pricing to its partitions and end users competitive with or below that typically offered by major long distance carriers and their resellers. The new cost structure is expected to allow the Company to expand its target market beyond the current AT&T resale market to include the balance of the switchless long distance market (i.e., the non-AT&T long distance resale market), which currently represents the majority of the long distance resale market. The Company also intends to market to AT&T's end users, as well as other end users including residential and larger commercial accounts. Historically, the discounts provided under the Company's tariffs have enabled the Company to offer prices to its partitions and end users that are generally below the prices marketed directly by AT&T to small and medium-sized businesses. As a result of the Telecommunications Act, RBOCs have become potential customers for the Company's long distance services, particularly because OBN will allow the Company to offer services based on the high quality AT&T telecommunications network at prices competitive with or below non-AT&T-based long distance providers.

- *Emphasize Quality and Functionality of AT&T-Manufactured Switches, and AT&T-Provided Transmission Facilities and Billing.* The Company will continue to offer products and services on OBN similar to those that it has offered as a switchless reseller of AT&T services. OBN is being built using AT&T-manufactured switches in conjunction with leased AT&T transmission facilities. The 5ESS-2000 switch is the most reliable switch in the telecommunications industry. In addition to offering services using AT&T as the underlying facilities-based carrier, the Company will continue to use the billing services of AT&T and ACUS.
- *Improve Provisioning of End User Accounts.* OBN will allow the Company to establish service directly for or activate end user accounts. The Company will provide new end user account data directly to the LEC, which will then change the end user account to the service provided by the Company or its partition. This is expected to increase the timeliness and the acceptance rate of the establishment of service, or provisioning, and will allow lists of end users to be maintained confidentially.
- *Expandable Network With Capability to Support New Products and Services.* The AT&T 5ESS-2000 switches can be expanded to increase capacity and can at the same time accommodate local, long distance, private line and wireless services. Thus, the Company's AT&T-manufactured switches and the implementation of OBN will enable the Company to provide new products and services beyond those currently possible as a switchless reseller. A key application of OBN will be the ability to provide telecommunications services to tenants of office and multi-family residential building complexes as a CTP. OBN will allow the Company to seek the right from a building owner, developer or mortgagor to provide a variety of telecommunications services to the tenants of a particular building or complex through the use of a remote switching module placed in the building, or in close proximity, which is connected to OBN. In effect, the building or building complex will have its own switch, controlled by the Company and connected to OBN, which will enable the Company to offer Centrex-type services (described below), as well as long distance services, and to bill end users for all services provided on a consolidated basis. OBN also will permit the Company to offer local telecommunications services, in addition to those provided under CTP arrangements, in markets in which the Company has a switch. See "– One Better Net."

The Company also intends to continue to explore strategic alliances with partitions and nonfacilities-based and other providers of long distance services.

Recent Developments

The Company has recently reached an agreement in principle with The Furst Group, Inc. ("The Furst Group"), a nationwide provider of long distance services, and on March 14, 1996 began providing services to The Furst Group through the Company's AT&T contract tariffs. The Furst Group's retail sales exceeded $100 million in 1995. The Company, through its AT&T contract tariffs, is fulfilling the majority of The Furst Group's present long distance requirements, which the Company estimates could result in additional sales to the Company ranging from $2 million to $4 million per month if these levels of traffic are maintained. Additionally, the Company recently commenced retail telemarketing efforts based in Clearwater, Florida. The Company has hired approximately 90 employees, 70 in direct sales and 20 in management and support, to offer the services of the Company, which will be targeted at small to medium-sized businesses.

Further, the Company has received from GMAC Commercial Mortgage ("GMAC") a letter of intent indicating GMAC's interest in building a strategic relationship with the Company. GMAC selected the Company based on its proposal to provide CTP services to tenants of certain multi-family residential buildings whose owners are GMAC mortgage customers. The Company and GMAC currently are negotiating the terms of a definitive agreement that contemplates the Company undertaking a test program, although there is no assurance as to when or if a definitive agreement will be reached.

Sales and Marketing

The Company primarily markets its services to small and medium-sized business end users (i.e., generally businesses with fewer than 200 employees) throughout the United States through partitions. Partitions sell and market the Company's products, allowing the Company to minimize its marketing and end user overhead. Partitions offer end users a variety of services and rates. As compensation for their services, partitions generally receive the difference between the amount received by the Company from end users and the amount charged by the Company to the partition for providing such services. The Company has contracted with approximately 65 such companies for such service.

A substantial number of the partitions have executed partition agreements with the Company pursuant to which the Company agrees to provide services utilizing the AT&T network service and end user billing services at agreed upon prices or discounts. The Company requires that the partitions adhere to certain Company established guidelines in marketing the Company's services and comply with federal and state regulations. These requirements include certain representations by each organization that it is acting as an independent contractor with regard to the sale of the Company's services, and not as a joint venture partner, agent or employee of the Company, along with provisions for the proper completion of forms and other sales procedures. In addition, most of the payments made by the end users are paid directly into a lock-box controlled by the Company. The Company's partition agreements typically run for three years or for the term of the applicable tariffs, whichever is less. The partitions generally make no minimum use or revenue commitments to the Company under these agreements.

As a result of deploying OBN, the Company will be required to reduce its emphasis on the use of the AT&T network in its marketing. The Company expects that certain of its current partitions and end users may cease or reduce purchasing services from the Company after it deploys OBN.

The Company is in the process of determining the changes that will need to be made to amend existing partition agreements in order to permit the Company to provide services using OBN. The Company believes that the discounts it will be able to offer partitions and end users using OBN, together with the functionality and quality of OBN operating in conjunction with AT&T-provided transmission facilities and the accuracy of billing services obtained from AT&T and ACUS, will enable it to attract current and future partitions to OBN. There can be no assurance that existing partitions will agree to amend their agreements with the Company. However, the Company will continue its policy of advancing funds to most partitions to support their marketing efforts. Historically, partitions of the Company have continued to do business under their partition agreements following changes in the Company's service offerings.

The Company intends to continue to promote increased marketing activities of certain of its partitions through advances collateralized by assets of such partitions. In return for providing such marketing advances, the Company seeks long-term arrangements with such partitions.

Although the Company will continue to use partitions to market services over OBN, the Company also plans to begin marketing its telecommunication services directly to end users. Through its direct marketing efforts, the Company expects to increase its profit margins by taking advantage of the difference between the reduced costs of providing services over OBN and the rates charged to end users. The Company is beginning its direct marketing with a telemarketing operation based in Clearwater, Florida. It has hired approximately 90 employees, 70 in direct sales and 20 in management and support. Direct marketing efforts will focus on inbound and outbound services to small and medium-sized businesses located in the states that will be served by the OBN switch in Jacksonville, Florida. The Jacksonville switch is expected to be the first OBN switch to come into service.

Services to Partitions

The Company offers operational, financing, marketing and management support to partitions, which provides the partitions with the ability to operate and manage their businesses and attract and maintain end users. Such support includes financial resources, low long distance rates, collection services, prospective customer lists and a management information system designed and developed by the Company exclusively for use by the Company and its partitions ("Business Management System" or "BMS"). The Company offers start-up financing as well as financing to its existing partitions and expects

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to increase such financing in the future. The Company's Business Management System provides a link between the Company's operations center and each partition, including information relating to billing, collection, provisioning, network usage and other end user information. The Company also compiles, evaluates and distributes prospective customer lists.

Service on a long distance network is activated by a process called provisioning. On a daily basis, through the Business Management System provided by the Company, the Company's partitions transmit required end user information to the Company. Orders for AT&T network services resold by the Company as a switchless reseller are formatted by the Company in the manner required by AT&T and transmitted to AT&T's information management system, where AT&T processes the information and sends status updates on orders to the Company which, in turn, reports such status to the partitions. Orders for OBN services will be processed and controlled by the Company. By controlling the provisioning process with OBN, the Company believes it will be able to increase acceptance rates of new end users and reduce the time required to initiate service provided through the Company.

The Company promotes increased marketing activities by certain of its partitions and attracts new partitions through advances and intends to increase the extent of its use of such advances. Such advances are made in installments subject to the success of marketing efforts by the applicable partition. As a condition to such advances, the Company generally requires a partition to agree to utilize the Company's Business Management System, to accept the Company's billing services and lock-box procedures pursuant to which sales generated by a partition are paid directly to the Company's lock-box account and to grant the Company a security interest in such sales. In return for providing such marketing advances, the Company seeks long-term arrangements with such partitions. The Company believes that such long-term arrangements benefit the Company and its partitions as such arrangements foster increases in the Company's end user base resulting in increases in minutes of traffic.

Information and Billing Services

The Company utilizes the billing services of AT&T and ACUS, a wholly owned strategic business unit of AT&T. As a result, the Company's end users have the ability to obtain the pattern of reliability and accuracy associated with AT&T billing. Detailed call information on the usage of each end user for the usage being billed is produced by AT&T in the case of switchless resale business and, for OBN business, will be produced by the Company from the OBN switches. In both cases, AT&T then processes the information and provides billing information to the Company. Historically, AT&T and ACUS have billed the end users pursuant to a custom billing format bearing the names of AT&T or AT&T Bill Manager Service and either the Company or the applicable partition in the bill heading. AT&T has announced its intention to remove the name of AT&T Bill Manager Service from the heading of the bills, although the text of the bills or bill inserts may still be able to refer to the fact that billing services are provided by an AT&T unit.

BMS is provided to each partition. BMS resides at the partitions' locations and communicates with the Network Management System ("NMS") located at the Company's headquarters. NMS allows direct interface with the LECs and the Company's network to perform functions historically handled by AT&T. These computerized management systems control order processing, accounts receivable, billing and status information in a streamlined fashion between the Company and its partitions. Furthermore, when applicable, the systems interface with the AT&T Provisioning System and ACUS for order processing and billing services, respectively. Enhancements and additional features are provided as needed. Electronic processing and feature activation are designed to maintain the Company's goal of minimizing overhead.

The Company is internally developing its own new information systems through the use of client/server technology. The Company has purchased symmetrical multi-processing ("SMP") hardware in conjunction with SQL Database software from Informix Corporation. When operational in late 1996, this system is expected to have the capacity to process the Company's current volume of information services and to exceed the Company's needs for the foreseeable future. The Company believes that its improved systems will be an asset to its business growth strategy because they will enhance the Company's ability to: (i) control and expedite the provisioning of end users, (ii) provide sophisticated information tailored to the requirements of its partitions, (iii) further increase the accuracy and speed of end user billing, (iv) allow the partitions to respond promptly to end user needs, (v) integrate acquired end user bases, (vi) facilitate end user retention by identifying end users who change their usage patterns and (vii) support operations and collection efforts.

The information functions of the system are designed to provide easy access to all information about an end user, including volume and patterns of use, which will help partitions identify value-added services that might be well suited for that end user. Such information is also expected to be used by the Company to identify emerging end user trends and respond with services to meet its end users' changing needs. It should also allow partitions to identify unusual or declining use by an individual end user, which frequently indicates that an end user is switching its service to a competitor.

One Better Net

In order to reduce its dependence on the AT&T contract tariffs and to increase its growth opportunities, the Company has invested in OBN, the Company's own network, which will utilize AT&T-manufactured switches owned by the Company in conjunction with AT&T-provided lines and digital cross-connect equipment (herein referred to as "transmission facilities") and AT&T-provided billing systems that the Company will use pursuant to agreements with AT&T and ACUS. The Company has purchased five AT&T 5ESS-2000 switches, the most reliable switches in the telecommunications industry. The Company will be one of the first installation sites for AT&T's 5ESS-2000 switching equipment utilizing the new Digital Networking Unit – SONET technology, a newly developed switching interface designed to increase the reliability of the 5ESS-2000 and to provide much greater capacity in a significantly smaller footprint. The switches also use new AT&T 5E10 software. While the 5ESS-2000 switches have operated successfully, the Digital Networking Unit-SONET and the 5E10 software offer new technologies that have not been used extensively, and there can be no assurance that the switches will provide long distance services within the scheduled time frame.

OBN, consisting of these five strategically deployed switches operating in conjunction with AT&T-provided transmission facilities, will allow the Company to offer long distance services directly to its end users and partitions throughout the continental United States at rates that will be competitive with or below those offered by the major long distance providers. OBN also will allow the Company to control provisioning of end user accounts. The Company expects the five switches — in Jacksonville, New York, Chicago, Dallas and San Francisco — to be operational in the third quarter of 1996.

The Company's current contract tariffs under which it resells AT&T services require the Company to pay one all-inclusive "bundled" charge to AT&T for the delivery of services, including switching and transmission services and the payment of LEC access fees. As a result of the deployment of OBN, the Company will pay "unbundled" charges consisting of charges paid directly to the LECs for access charges and, under AT&T contract tariffs, charges paid to AT&T for use of its network transmission facilities. The Company will pay AT&T "bundled" charges for use of its international facilities to handle the international portion of a call on OBN. The total cost per call to the Company for the LEC access fees, the charges for use of AT&T's transmission facilities and the overhead cost for calls using OBN is expected to be less than the "bundled" charge currently paid under AT&T contract tariffs. LEC access fees represent a substantial portion of the total cost of providing long distance services. As a result of the Telecommunications Act, it is generally expected that the entry over time of competitors into LEC markets will result in lowering of access fees, but there is no assurance that this will occur. To the extent it does occur, the Company, by using OBN, will receive the benefit of any future reduction in LEC access fees, which it would not automatically receive under contract tariffs.

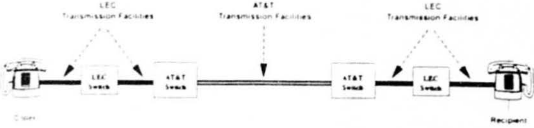
The Company intends to begin marketing outbound OBN services to new partitions and end users, by region, as each of the switches becomes operational during 1996. The Company then expects to transition existing outbound (SDN) service partitions and end users to OBN. Once OBN is fully operational, the Company plans to market OBN 800 services to new customers beginning in 1996 and to transition existing 800 service customers to OBN during the first half of 1997.

In 1996, the Company will continue to offer private line service through contract tariffs with AT&T. Although the Company will continue to provide such private line service through AT&T in 1997, the Company also will begin to offer private line service using OBN to new and existing customers.

Long Distance Calls Over OBN

A typical long distance telephone call generally consists of three segments — origination, long distance transmission and termination. A domestic interLATA call originates from an office or residence and is transported, by means of local transmission facilities and switching equipment of a LEC, to the network of a long distance carrier. The call then is carried to another LATA along the long distance network where the long distance carrier's switches route that call to the LEC over whose facilities the call is terminated. For each long distance call, both the originating LEC and the terminating LEC receive access fees from the facilities-based long distance carrier. The long distance provider builds these fees into its cost structure and bills and collects from the end user for the call. A long distance call over OBN will be handled as described above with an originating and terminating LEC, but OBN switches will route the call and, because the Company does not own transmission facilities, the call will be routed over AT&T transmission facilities.

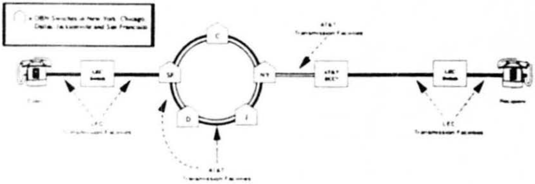
AT&T Domestic Long Distance Call
Company as a Switchless Reseller



Company pays "bundled" charge to AT&T, which includes LECs origination and termination access charges as well as a fee for use of AT&T switches and transmission facilities.

OBN Domestic Long Distance Call
Company as a Switch-Based Reseller

(Call originates in an area with an OBN switch and terminates in an area without an OBN switch)



Company pays "unbundled" charge directly to LECs for access and to AT&T for use of its transmission facilities.

***AT&T DCC is the AT&T Digital Cross Connect Switching Facility**

A typical international long distance call generally involves two long distance carriers: a carrier transporting the call from the country of origin and a carrier terminating the call in the country of termination. If the transporting carrier owns transmission facilities connecting the country of origin to the facilities of the country of termination, it can use those facilities to transport the call or use capacity leased from another carrier that has transmission facilities connecting the two countries. For international long distance switched service originating in the U.S., a customer compensates the U.S.-based carrier which then compensates the foreign carrier for terminating the call through a settlement process based on the destination and length of the call and call volume.

An international long distance call over OBN will involve OBN as well as two typical long distance carriers. The call will originate and be routed by an OBN switch or switches in the same manner as domestic long distance calls over OBN, except that the Company's switches will route the call to the appropriate AT&T international long distance facility. The international long distance call will then be handled on the AT&T network where it will be turned over to the foreign carrier terminating the call.

In order for the Company to provide service over OBN, the Company will install and operate, and be responsible for the maintenance of, its own switching equipment. The Company also is installing lines to connect its OBN switches to LEC switches and will be responsible for maintaining these lines. The Company entered into a contract with AT&T with respect to the monitoring, servicing and maintenance of the switching equipment purchased from AT&T. If the separation from AT&T discussed below occurs, this contract will be assumed by Lucent Technologies Inc., which would provide the service and maintenance of the AT&T-manufactured switches. There can be no assurance that the Company will be successful in operating as a switch-based carrier once it installs such equipment. Additional management personnel and information systems will be required to support OBN, the costs of which will increase the Company's overhead. Any delay or difficulties in hiring personnel or developing systems could adversely affect the implementation of OBN.

Moreover, operation as a switch-based provider subjects the Company to risk of significant interruption in the provision of services on OBN in the event of damage to the Company's facilities (switching equipment or connections to AT&T transmission facilities) such as could be caused by fire or natural disaster. Such interruption could have a material adverse impact on the Company's financial condition and results of operations.

Additional Services on OBN

The OBN switching system using AT&T-manufactured switches will allow the Company to benefit from, and offer a number of, additional or enhanced services including the following:

Signaling System 7 ("SS7"). SS7 provides the end user with the benefits of the fastest call setup time (time to connect the call after the number is dialed) available and would provide the Company with reduced costs realized from decreased call disconnect time (time to release circuits after callers hang up). Further savings may be realized by the look ahead routing feature of SS7. For example, the originating switch can communicate with the terminating switch and determine if the called number is busy before the network circuits are connected, thereby reducing the number of interoffice circuits required. To provide this service, the Company would contract with a provider of SS7.

Centrex. Centrex is a feature available on the 5ESS-2000 that offers many features such as call forwarding, call waiting, conference calling, distinctive ringing and least cost routing. These features traditionally were available only to end users with their own equipment or through purchase from the end users' LEC. The Company will offer these features as part of its CTP service, discussed below.

Advanced Intelligent Network ("AIN"). AIN provides an open network architecture allowing for interconnections of inexpensive peripheral equipment and databases. If the Company purchases the necessary computers and software, the Company and its partitions and end users will be able to deploy new products and services, such as calling cards, debit cards, voice recognition and caller identification, without involvement of the switch manufacturers.

Competitive Telecommunications Provider. The Company's AT&T-manufactured switches and the implementation of OBN will enable the Company to provide competitive telecommunications services to tenants of multi-tenant office and residential buildings and complexes ("CTP" services). OBN will allow the Company to seek the right from a building owner, developer or mortgagor to provide voice, data and video services, including local and long distance network service, to the tenants in a particular building or building complex through the use of a remote switching module placed in each building, or in a building in close proximity to the building housing the remote switching module, which is connected to OBN. The AT&T-manufactured switches allow the use of an on-site remote switching module, which is an extension of the 5ESS-2000 switch and has the same functions and features of main switches including reliability, and is less costly than purchasing and installing an independent on-site switch. In effect, the building or building complex will have its own switch, controlled by the Company and connected to OBN, which will enable the Company to offer features that Centrex incorporates, as well as long distance services, and to bill end users for all services provided on a consolidated basis. These services can be offered by direct lines to the end user as well as through wireless technologies. Depending on the circumstances, building tenants may have the option of declining to use the CTP services. In view of the Company's potential investment in remote switching modules and installation in the buildings for which it would offer CTP services, the Company plans to enter into long-term commitments with the building owners, developers or mortgagors.

Local Service. OBN will allow the Company to provide local service because the 5ESS-2000 switch has the capacity to direct both long distance and local service. The Company would need to purchase line side interfaces to its switches in order to provide local service.

Echo Cancellation. The Company has agreed to purchase voice enhancement software from Coherent Communications Systems Corp. ("Coherent") to suppress the echo that may develop on a long distance telephone call. Under its agreement with the Company, Coherent will develop a broadband echo canceller incorporating Coherent's voice enhancement software, known as "Sculptured Sound," which addresses the problem of varying signal levels across different networks that can adversely affect call quality. The echo cancellation equipment being purchased from Coherent and installed as part of OBN will enhance the quality of calls on the Company's new network.

AT&T Contract Tariffs

The Company historically has obtained services from AT&T through contract tariffs and has been able to obtain the services it seeks and to do so at increasingly favorable contract tariff rates. The deployment of OBN decreases the Company's dependence on AT&T contract tariffs. To the extent the Company will need future contract tariffs, there is no guarantee the Company will be able to obtain favorable contract tariffs, although it has been successful in the past in obtaining such contract tariffs.

The Company presently uses a contract tariff with AT&T for SDN, Readyline and MEGACOM 800 services that expires in 1997, and contract tariffs for private line services which expire in 1999. A new contract tariff that went into effect February 26, 1996 provides for SDN services, as well as MEGACOM and MEGACOM 800 services, used in the implementation of OBN. These contract tariffs, which are nonrenewable, set the terms and conditions of AT&T's services, including the pricing of services and minimum usage (volume and revenue) requirements. If minimum usage requirements are not met, the Company is obligated to pay shortfall fees to AT&T based on a percentage of the difference between the minimum requirement and the actual billed usage. In addition, if the contract tariffs with AT&T are terminated prior to the end of the contract tariff term, either by the Company or by AT&T for non-payment, the Company may be liable for "termination with liability" or "termination charge" and subject to material monetary penalties. The Company also could seek to terminate the existing contract tariffs without liability if future usage levels are insufficient, although there can be no assurance that it would be able to do so. The Company has a record of meeting its commitments to AT&T under contract tariffs. The Company, as compared to some of its switchless resale competitors, has had relatively modest commitments and favorable pricing under its AT&T contract tariffs. The Company had sales of $180.1 million in fiscal year 1995 and has total commitments of up to $17.3 million per year to AT&T over the next four years.

Competition

The long distance telecommunications industry is highly competitive and affected by the introduction of new services by, and the market activities of, major industry participants. Competition in the long distance business is based upon pricing, customer service, billing services and perceived quality. The Company competes against various national and regional long distance carriers composed of both facilities-based providers and switchless resellers offering essentially the same services as the Company. Several of the Company's competitors are substantially larger and have greater financial, technical and marketing resources. Although the Company believes it has the human and technical resources to pursue its strategy and compete effectively in this competitive environment, its success will depend upon its continued ability to provide profitably high quality, high value services at prices generally competitive with, or lower than, those charged by its competitors.

On September 20, 1995, AT&T announced that it would split itself into three separate and independently-owned and operated companies ("AT&T breakup"). One company would provide, among other services, long distance, wireless and other telecommunications services. Another will manufacture and sell communications equipment. A third would include AT&T's computer operations and will focus on the financial, retail and communications industries. AT&T has stated that the breakup will allow it to compete more effectively with providers of telecommunications services.

The Company will link its switching equipment with transmission facilities and services purchased or leased from AT&T and will continue to resell services obtained from AT&T, which will remain a competitor of the Company for the provision of telecommunications services. The Company also utilizes AT&T and ACUS to provide billing services. There can be no assurance that either AT&T or ACUS will continue to offer billing services to the Company at competitive rates or attractive terms.

On October 12, 1995, the FCC reclassified AT&T as a nondominant interexchange carrier. The FCC stated that AT&T would have greater incentives to cut its prices and offer innovative new services. Nondominant carriers are not subject to price cap regulation and can file tariffs (and tariff changes) under streamlined procedures that will be presumed lawful on one day's notice. See "- - Regulation." The Company would therefore no longer be able to file Petitions to Reject or to Suspend and Investigate AT&T tariff proposals with the FCC before those offerings take effect. The FCC's reclassification of AT&T as a nondominant carrier eliminates certain pricing restrictions and regulatory oversight and would allow AT&T to compete more aggressively with the Company.

As a nondominant carrier, AT&T will be subject to the same regulations as other long distance service providers. AT&T remains subject to Title II of the Communications Act (47 U.S.C. § 151, et seq.) and is required to offer service under rates, terms and conditions that are just, reasonable and not unreasonably discriminatory. AT&T is also subject to the FCC's complaint process and is required to file tariffs, though under streamlined procedures. In addition, AT&T is also required to give notice to the FCC and to affected customers prior to discontinuing, reducing, or impairing any services.

In seeking FCC approval of its motion, AT&T made a series of "voluntary commitments" to the FCC as a transitional mechanism to govern its conduct. With respect to business term plans and long-term contracts with customers, including resellers, AT&T agreed for a twelve-month period to provide advance notice to the customer of proposed changes that might affect a customer's reliance on its contract with AT&T and to file any such changes with advance notice and time for action by the FCC. AT&T also stated that it was willing to enter into mutually agreeable private party arbitration agreements with its reseller customers and is willing to develop a model agreement in negotiations with the Telecommunications Resellers Association Executive Board. The FCC accepted all of the "voluntary commitments" offered by AT&T and ordered AT&T's compliance with those commitments.

On February 8, 1996, the President signed the Telecommunications Act, which is intended to introduce more competition to U.S. telecommunications markets. The legislation opens the local services market by requiring LECs to permit interconnection to their networks and establishing, among other things, LEC obligations with respect to access, resale, number portability, dialing parity, access to rights-of-way, and mutual compensation. The legislation also codifies the LECs' equal access and nondiscrimination obligations and preempts most inconsistent state regulation. The legislation also contains special provisions that eliminate restrictions on the RBOCs providing long distance services, which means that the Company will face competition for providing long distance services from well-capitalized, well-known companies that prior to this time could not compete in long distance service.

The RBOCs have been prohibited from providing interLATA interexchange telecommunications services under the terms of the AT&T decree. The Telecommunications Act authorizes the RBOCs to provide certain interLATA interexchange telecommunications services immediately and others upon the satisfaction of certain conditions. Such legislation includes certain safeguards against anticompetitive conduct by the RBOCs in the provision of interLATA service. Anticompetitive conduct could result, among other things, from a RBOC's access to all subscribers on its existing network as well as its potentially lower costs related to the termination and origination of calls within its territory. It is impossible to predict whether such safeguards will be adequate to protect against anticompetitive conduct by the RBOCs and the impact that any anticompetitive conduct would have on the Company's business and prospects. Because of the name recognition that the RBOCs have in their existing markets and the established relationships that they have with their existing local service customers, and their ability to take advantage of those relationships, as well as the possibility of favorable interpretations of the Telecommunications Act by the RBOCs, it may be more difficult for other providers of long distance services, such as the Company, to compete to provide long distance services to RBOC customers. At the same time, as a result of the Telecommunications Act, RBOCs have become potential customers for the Company's long distance services.

Regulation

The Company's provision of communications services is subject to government regulation. Federal law regulates interstate and international telecommunications, while states have jurisdiction over telecommunications that originate and terminate within the same state.

As a nondominant, nonfacilities-based provider of long distance services, the Company has been subject to less restrictive regulation by the FCC and by various state public service and public utility commissions than AT&T and other facilities-based providers. The Company and its partitions are required to file tariffs for interstate and international service with the FCC. The Company's tariffs are in effect today. The Company and its partitions are also required to file tariffs or obtain approval for intrastate service provided in most of the states in which they market long distance telecommunications services. Changes in existing policies or regulations in any state or by the FCC could materially adversely affect the Company's financial condition or results of operations, particularly if those policies make it more difficult for the Company to obtain service from AT&T or other long distance companies at competitive rates, or otherwise increase the cost and regulatory burdens of marketing and providing service. There can be no assurance that the regulatory authorities in one or more states or the FCC will not take action having an adverse effect on the business or financial condition or results of operations of the Company. Regulatory action by the FCC or the states also could adversely affect the partitions, or otherwise increase the partitions' cost and regulatory burdens of marketing and providing long distance services.

Federal

The Company is classified by the FCC as a nondominant carrier. After the recent reclassification of AT&T as nondominant, only the LECs are classified as dominant carriers among domestic carriers. As a consequence, the FCC regulates many of the rates, charges, and services of the LECs to a greater degree than the Company's. Because AT&T is no longer classified as a dominant carrier, certain pricing restrictions that formerly applied to AT&T have been eliminated, which could make it easier for AT&T to compete with the Company for low volume long distance subscribers. The FCC generally does not exercise direct oversight over charges for service of nondominant carriers, although it has the statutory power to do so. Nondominant carriers are required by statute to offer interstate services under rates, terms, and conditions that are just, reasonable and not unreasonably discriminatory. The FCC has the jurisdiction to act upon complaints filed by third parties, or brought on the FCC's own motion, against any

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common carrier, including nondominant carriers, for failure to comply with its statutory obligations. Nondominant carriers are required to file tariffs listing the rates, terms and conditions of service, which are filed pursuant to streamlined tariffing procedures. The FCC also has the authority to impose more stringent regulatory requirements on the Company and change its regulatory classification from nondominant to dominant. In the current regulatory atmosphere, the Company believes, however, that the FCC is unlikely to do so.

The FCC imposes only minimal reporting requirements on nondominant resellers, although the Company is subject to certain reporting, accounting and record-keeping obligations. Both domestic and international nondominant carriers, including the Company, must maintain tariffs on file with the FCC. The Company currently has two tariffs on file with the FCC. Although the tariffs of nondominant carriers, and the rates and charges they specify, are subject to FCC review, they are presumed to be lawful and are seldom contested. As a domestic nondominant carrier, the Company is permitted to make tariff filings on a single day's notice and without cost support to justify specific rates. Resale carriers, like all other interstate carriers, are also subject to a variety of miscellaneous regulations that, for instance, govern the documentation and verifications necessary to change a subscriber's long distance carrier, limit the use of 800 numbers for pay-per-call services, require disclosure of certain information if operator assisted services are provided and govern interlocking directors and management. The Telecommunications Act grants explicit authority to the FCC to "forbear" from regulating any telecommunications services provider in response to a petition and if the agency determines that enforcement is unnecessary and the public interest will be served.

At present, the FCC exercises its regulatory authority to set rates primarily with respect to the rates of dominant carriers, and it has increasingly relaxed its control in this area. Even when AT&T was classified as a dominant carrier, the FCC most recently employed a "price cap" system, which essentially exempted most of AT&T's services, including virtually all of its commercial and 800 services, from traditional rate of return regulation because the FCC believes that these services were subject to adequate competition. Similarly, the FCC is in the process of changing the regulation and pricing of the local transport component of access charges (i.e., the fee for use of the LEC transmission facilities connecting the LEC's central offices and the IXC's access points). In addition, the LECs have been afforded a degree of pricing flexibility in setting interstate access charges where adequate competition exists. The impact of such repricing and pricing flexibility on IXCs, such as the Company, cannot be determined at this time.

On March 25, 1996, the FCC released a Notice of Proposed Rulemaking in which it proposed that nondominant IXCs should no longer file tariffs. The FCC also initiated a review of its regulation of interstate domestic interexchange telecommunications services to determine whether its policies and rules should be changed. The FCC asked for comment on the regulation of tariffs and other long-term service arrangements, including the application of the doctrine that requires that carriers file their rates as public tariffs and charge only the rates that appear in those publicly-filed tariffs, the "substantial cause" test for when a carrier can change the terms of a long-term commitment to a customer, and other issues relating to resellers.

State

The Company is subject to varying levels of regulation in the states in which it is currently authorized to provide intrastate telecommunications services. The vast majority of the states require the Company to apply for certification to provide intrastate telecommunications services, or at least to register or to be found exempt from regulation, before commencing intrastate service. The vast majority of states also require the Company to file and maintain detailed tariffs listing its rates for intrastate service. Many states also impose various reporting requirements and/or require prior approval for transfers of control of certified carriers, corporate reorganizations, acquisitions of telecommunications operations, assignments of carrier assets, including subscriber bases, carrier stock offerings and incurrence by carriers of significant debt obligations. Certificates of authority can generally be conditioned, modified, canceled, terminated or revoked by state regulatory authorities for failure to comply with state law and the rules, regulations and policies of the state regulatory authorities. Fines and other penalties, including the return of all monies received for intrastate traffic from residents of a state, may be imposed for such violations. In certain states, prior regulatory approval may be required for acquisitions of telecommunications operations.

As the Company expands its efforts to resell long distance services directly, the Company will have to remain attentive to relevant federal and state regulations. FCC rules prohibit switching a customer from one long distance carrier to another without the customer's consent and specify how that consent can be obtained. Most states have consumer protection laws that further define the framework within which the Company's marketing activities must be conducted. The Company intends to comply fully with all laws and regulations, and the constraints of federal and state restrictions could impact the success of direct marketing efforts.

Federal and state regulation affect the provision of CTP. FCC rules determine the interstate access charges that the Company will pay to link CTP customers to OBN through a local telephone network, and any changes in the FCC's rules could have a material adverse effect on the Company. In some states, the Company must obtain the approval of state regulators to offer CTP services, and obtaining such approval is not certain. Some states regulate rates and conditions of service. In addition, some states impose other rules, such as prohibiting flat rate local service, requiring use of measured local service, requiring use of a partitioned switch or PBX, banning service to multiple buildings from a single PBX, granting tenants the right to use the LEC, and banning the resale of local service at a profit. Such restrictions may affect where and how the Company offers CTP service.

Currently, the Company is certificated and tariffed to provide intrastate interLATA service in substantially all states where such authorization can be obtained. In connection with the implementation of OBN, modification or amendment of the Company's state certifications may be required and could delay implementation.

Employees

As of December 31, 1995, the Company employed 37 persons, of whom two were engaged in marketing and sales, 23 were engaged in partition and end user support, and 12 were engaged in systems development, finance, administration and management.

As of March 22, 1996, the Company employed 132 persons, of whom 73 were engaged in marketing and sales, 36 were engaged in partition and end user support, and 23 were engaged in systems development, finance, administration and management.

None of the Company's employees is covered by collective bargaining agreements. The Company considers relations with its employees to be good.

Glossary

ACUS: AT&T College and University Systems, a wholly owned strategic business unit of AT&T.

AIN: Advanced Intelligent Network.

AT&T: AT&T Corp.

BMS: The Company's database, which it provides to each of its partitions.

Consent Decree: A 1984 U.S. Department of Justice decree that, among other things, ordered AT&T to divest its wholly-owned local Bell operating subsidiaries.

End Users: Customers that utilize long distance telephone services.

Equal Access: Connection provided by a LEC permitting a customer to be automatically connected to the IXC of the customer's choice when the customer dials "1."

Facilities-based provider: Long distance service providers who own transmission facilities.

5ESS-2000: The switching equipment manufactured by AT&T, which the Company acquired from AT&T.

5E10 Software: AT&T software that enables switches to combine simultaneously wireline and wireless, local, long distance, voice, video and data services.

FCC: Federal Communications Commission.

Inbound "800" Service: A service that bills long distance telephone charges to the called party.

IXC: Interexchange carrier, a long distance carrier providing services between local exchanges.

LATA: Local Access and Transport Areas, the approximately 200 geographic areas defined pursuant to the AT&T Consent Decree between which the RBOCs are generally prohibited from providing long distance service.

CTP: Competitive Telecommunications Provider, sometimes referred to as Shared Tenant Services or STS, providing the full range of telecommunications services to tenants of office and multi-family residential buildings and complexes.

LEC: Local Exchange Carrier, a company providing local telephone services.

MEGACOM: An outbound long distance service offering by AT&T that requires dedicated access.

MEGACOM 800: An inbound 800 service offering provided by AT&T that requires dedicated access.

MCI: MCI Communications Corporation.

MLCP: AT&T's multi-location calling plan (a discounted long distance program).

Network: An integrated system composed of switching equipment and transmission facilities designed to provide for the direction, transport and recording of telecommunications traffic.

NMS: The Company's computerized internal management information system.

Nonfacilities-based provider: Long distance service providers that do not own transmission facilities.

OBN: One Better Net, the Company's nationwide long distance network.

Partition: An independent long distance and marketing company that contracts with the Company to purchase or otherwise provide to end users the long distance services provided by the Company.

Private Line: A full-time leased line directly connecting two points.

Provisioning: The process of initiating a carrier's service to an end user.

PUC: A state regulatory body empowered to establish and enforce rules and regulations governing public utility companies and others, such as the Company in many of its state jurisdictions.

RBOC: Regional Bell Operating Company — Any of seven regional Bell holding companies that the Consent Decree established to serve as parent companies for the Bell operating companies.

Readyline: An Inbound 800 service offering provided by AT&T.

SDN: The AT&T Software Defined Network.

Sprint: Sprint Corporation.

SS7: Signaling System 7.

Switching Equipment: A computer that directs telecommunication traffic in accordance with programmed instructions.

Tariff: The schedule of rates and regulations set by communications common carriers and filed with the appropriate Federal and state regulatory agencies; the published official list of charges, terms and conditions governing provision of a specific communication service or facility, which functions in lieu of a contract between the user and the supplier or carrier.

ITEM 2. PROPERTIES

The Company leases facilities for its corporate offices in New Hope, Pennsylvania and leases other properties in the cities in which OBN switches are being installed. The Company expects to enter into an agreement to purchase a 24,000 square foot facility in New Hope, Pennsylvania and currently plans to relocate its corporate offices in the second half of 1996.

ITEM 3. LEGAL PROCEEDINGS

The Company is a party to certain legal actions arising in the ordinary course of business. The Company believes that the ultimate outcome of these actions will not result in any liability that would have a material adverse effect on the Company's financial condition or results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 1995.

EXECUTIVE OFFICERS OF THE COMPANY

The executive officers of the Company are as follows:

Name	Age	Position
Daniel Borislow	34	Chairman of the Board, Chief Executive Officer and Director
Gary W. McCulla	36	President and Director of Sales and Marketing and Director
Emanuel J. DeMaio	37	Chief Operations Officer and Director
Joseph A. Schenk	37	Chief Financial Officer, Treasurer and Director of Investor Relations and Director
Aloysius T. Lawn, IV	37	General Counsel and Secretary
Kevin R. Kelly	31	Controller

Daniel Borislow. Mr. Borislow founded the Company and has served as a director and as Chief Executive Officer of the Company since its inception in 1989. Prior to founding the Company, Mr. Borislow formed and managed a cable construction company.

Gary W. McCulla. Mr. McCulla currently serves as President and Director of Sales and Marketing. In 1991, Mr. McCulla founded GNC and was its President. Until March 1994, GNC was a privately-held independent marketing company and one of the Company's partitions. At that time, the Company acquired certain assets of GNC. Prior to founding GNC, from 1988 through 1991, Mr. McCulla served as Vice President and Chief Financial Officer of the Harvard Group, a New York-based marketing services company.

Emanuel J. DeMaio. Mr. DeMaio joined the Company in February 1992 and currently serves as Chief Operations Officer. Prior to joining the Company, from 1981 through 1992, Mr. DeMaio held various technical and managerial positions with AT&T.

Joseph A. Schenk. Mr. Schenk joined the Company in January 1996 and currently serves as Chief Financial Officer and Treasurer. He is a certified public accountant. From September 1993 to January 1996, Mr. Schenk was Vice President, Capital Markets Group, with Jefferies & Co. Previously, Mr. Schenk was Vice President of Transcap Associates, a venture capital firm, and held various roles with Price Waterhouse and Deloitte & Touche.

Aloysius T. Lawn, IV. Mr. Lawn joined the Company in January 1996 and currently serves as General Counsel and Secretary of the Company. Prior to joining the Company, from 1985 through 1995, Mr. Lawn was an attorney at, and since 1992 a partner of, the law firm of Clark, Ladner, Fortenbaugh and Young, Philadelphia, Pennsylvania.

Kevin R. Kelly. Mr. Kelly joined the Company in April 1994 and currently serves as Controller. From 1987 to 1994, Mr. Kelly held various managerial positions with a major public accounting firm. Mr. Kelly is a certified public accountant.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock, $.01 par value per share ("Common Stock"), is traded on the Nasdaq National Market, and high and low quotations listed below are actual sales prices as quoted in the Nasdaq National Market under the symbol "TALK." All of the following quotations have been adjusted to reflect the three-for-two stock split of the Common Stock in the form of a 50% stock dividend that occurred on March 15, 1996.

	Price Range of Common Stock	
	High	Low
1995		
Fourth Quarter (from September 20, 1995).....	$11	$8
1996		
First Quarter (through March 21, 1996)........	15½	8

As of March 21, 1996, there were approximately 12 record holders of Common Stock.

The Company currently intends to retain all future earnings for use in the operation of its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future. The declaration and payment in the future of any cash dividends will be at the election of the Company's Board of Directors and will depend upon, among other things, the earnings, capital requirements and financial position of the Company, existing and/or future loan covenants and general economic conditions.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data should be read in conjunction with, and are qualified in their entirety by, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's Consolidated Financial Statements, related notes and other financial information included elsewhere in this Form 10-K.

	Year Ended December 31,				
	1991	1992	1993	1994	1995
	(In thousands, except per share amounts)				
Consolidated Statements of Income Data:					
Sales	$ 10,988	$ 17,668	$ 31,940	$ 82,835	$180,102
Cost of sales	9,429	14,803	26,715	70,104	156,121
Gross profit	1,559	2,865	5,225	12,731	23,981
Selling, general and administrative expenses	1,300	1,476	2,060	3,442	6,280
Operating income	259	1,389	3,165	9,289	17,701
Other income, net	18	32	108	66	331
Income before income taxes	277	1,421	3,273	9,355	18,032
Pro forma provision for income taxes(1)	111	568	1,309	3,742	7,213
Pro forma net income(1)	$ 166	$ 853	$ 1,964	$ 5,613	$ 10,819
Pro forma net income per share(1)(2)	$ 0.01	$ 0.06	$ 0.13	$ 0.37	$ 0.64
Weighted average common and common equivalent shares outstanding(2)	14,375	14,375	14,726	15,331	16,803

	At December 31,				
	1991	1992	1993	1994	1995
	(In thousands)				
Consolidated Balance Sheets Data:					
Working capital (deficit)	$ (64)	$ 1,312	$ 4,502	$ 12,265	$ 38,171
Total assets	1,968	2,178	6,694	21,435	71,388
Long-term debt	—	—	—	—	—
Total stockholders' equity (deficit)	(6)	1,414	4,687	14,042	41,314

(1) For the years and period ended December 31, 1991, 1992, 1993, 1994 and September 19, 1995, the Predecessor Corporation elected to report as an S corporation for federal and state income tax purposes. Accordingly, the Predecessor Corporation's stockholders included their respective shares of the Company's taxable income in their individual income tax returns. The pro forma income taxes reflect the taxes that would have been accrued if the Company had elected to report as a C corporation. See Note 7 to the Consolidated Financial Statements.

(2) Supplemental pro forma net income per share was $0.35 and $0.63 at December 31, 1994 and 1995, respectively. Supplemental pro forma net income per share is based on the weighted average number of shares of common stock and common stock equivalents used in the calculation of pro forma net income per share (15,331 and 16,803 shares at December 31, 1994 and 1995 respectively) plus the estimated number of shares that would need to be sold by the Company in order to fund the cash distribution of $4.5 million made in connection with the Company's reorganization paid out of the proceeds of the initial public offering on September 20, 1995.

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

The following discussion should be read in conjunction with the Consolidated Financial Statements (including the notes thereto) included elsewhere in this Form 10-K.

Introduction

The Company was founded in 1989 as a switchless reseller of AT&T long distance services to small and medium-sized businesses. In the third quarter of 1996, in connection with the deployment of OBN, the Company expects to complete the installation of its five AT&T-manufactured switches, forming a nationwide long distance network.

The Company's sales to date have been derived from the resale of long distance services. The Company's cost of sales consists principally of charges for bundled long distance services, as charged by AT&T, partition charges, net of usage and other discounts, which are based on the usage of partitions, and end user billing and support. The Company believes that, historically, the competitive terms of its tariffs with AT&T and its ability to manage and distribute data are the primary reasons for its sales increases. In 1992, the Company negotiated a contract tariff with AT&T, resulting in lower rates than its previous tariffs. In July 1994, the Company obtained two new tariffs with AT&T, resulting in further reduced rates for the AT&T-SDN service and competitive terms for AT&T 800 Service, which the Company then began to market actively.

While the Company has been successful in the past at negotiating with and obtaining new tariffs from AT&T at favorable rates, the Company intends to lessen its dependence on such AT&T tariffs by deploying OBN to reduce costs in the future. As a result of the deployment of OBN, the Company will pay "unbundled" charges, paying access charges directly to LECs and charges for use of the AT&T network transmission facilities directly to AT&T. The Company will avoid paying the all-inclusive "bundled" charge to AT&T under AT&T contract tariffs for switching and transmission services and payment of LEC access fees. The total cost per call to the Company for such "unbundled" charges and OBN's overhead is expected to be less than the "bundled" charge currently paid to AT&T.

Deployment of OBN is also expected to increase the Company's gross profit as a percentage of revenue ("gross margin"), which has declined over the past three years. Gross margin has decreased as a result of the Company's offering higher volume discounts to new and/or larger partitions. Such discounts reduce the amount charged by the Company to the partition. The Company expects to increase its gross margin as a result of the lower costs associated with providing services on OBN. However, operating income may not experience the same rate of growth because of increased expenses related not only to operating and maintaining OBN and converting existing end users to OBN, but also to the costs associated with the Company's expansion of its direct marketing efforts and delivery of CTP services.

The following table presents the Company's sales, operating income and pro forma net income by quarter since the first quarter of 1993.

Quarter Ended	Sales	Operating Income	Pro Forma Net Income
		(In thousands)	
1993:			
March 31	$ 5,250	$ 484	$ 295
June 30	6,493	701	423
September 30	9,024	945	570
December 31	11,173	1,035	676
Total	$ 31,940	$ 3,165	$ 1,964
1994:			
March 31	$ 14,413	$ 1,806	$ 1,092
June 30	14,705	1,846	1,102
September 30	22,521	2,608	1,573
December 31	31,196	3,029	1,846
Total	$ 82,835	$ 9,289	$ 5,613
1995:			
March 31	$ 36,617	$ 4,213	$ 2,555
June 30	44,728	4,855	2,897
September 30	48,366	4,008	2,519
December 31	50,391	4,625	2,848
Total	$180,102	$ 17,701	$ 10,819

Results of Operations

The following table sets forth for the periods indicated certain financial data as a percentage of sales:

	Percentage of Sales, Year Ended December 31,		
	1993	1994	1995
Sales	100.0%	100.0%	100.0%
Cost of sales	83.6	84.6	86.7
Gross profit	16.4	15.4	13.3
Selling, general and administrative expenses	6.4	4.2	3.5
Operating income	10.0	11.2	9.8
Other income, net	0.3	0.1	0.2
Income before income taxes	10.3	11.3	10.0
Pro forma provision for income taxes	4.1	4.5	4.0
Pro forma net income	6.2%	6.8%	6.0%

Year Ended December 31, 1994 Compared to Year Ended December 31, 1995

Sales. Sales increased by 117.4% from $82.8 million in 1994 to $180.1 million in 1995. The increase in sales related primarily to the continued expansion of the Company's distribution network of partitions, as well as increases in the number of end users obtained by the Company's existing partitions. As a result of the favorable contract tariffs obtained from AT&T, which took effect in July 1994, revenue from marketing inbound 800 service increased significantly in 1995, totaling $55.6 million for the year ended December 31, 1995 and accounting for approximately 30.9% of 1995 sales compared to $7.9 million, or 9.5% of sales, for the year ended December 31, 1994. The Company's revenues for private line services represented approximately 10.2% of 1995 sales compared to an insignificant amount from such services in 1994.

Although the Company expects sales to increase through the addition of new partitions, the growth of end user business through existing partitions, the Company's direct marketing efforts and possible future acquisitions, there can be no assurance that the Company will continue to increase sales on a quarter-to-quarter or year-to-year basis. In addition, during the transition period in which existing end users are transferred to OBN, the Company may experience increased end user attrition.

Cost of Sales. The Company's cost of sales increased by 122.7%, from $70.1 million in 1994 to $156.1 million in 1995, primarily as a result of the increase in sales by 117.4%. Cost of sales as a percentage of revenues increased at a higher rate than sales because the Company offered higher volume discounts to certain partitions.

Operation of its own switches and network will require the Company to incur systems and equipment maintenance, lease, and network personnel expenses significantly above the levels historically experienced by the Company as a switchless reseller of AT&T services. However, these per call costs, in combination with "unbundled" charges paid to LECs and AT&T, are expected to be less than the per call cost currently incurred by the Company as a switchless reseller paying "bundled" charges to AT&T.

Gross Profit. Gross profit decreased from 15.4% of sales for the year ended December 31, 1994 to 13.3% of sales for the year ended December 31, 1995. The decrease in gross margin was attributable primarily to the addition of new partitions who received higher volume discounts. Billing costs remained relatively constant as a percentage of sales during both of these periods.

To the extent that the Company offers service to new and larger partitions at greater volume discounts, gross margin may continue to decline in 1996. This further potential decline in gross margin may be offset by the lower anticipated costs of providing services on OBN. However, the Company's pricing to its end users may face competitive pressure, which may more than offset the expected gross margin increases.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by 82.5%, from $3.4 million in 1994 to $6.3 million in 1995, but decreased as a percentage of sales from 4.2% to 3.5%. Selling, general and administrative expenses decreased as a percentage of sales due to the Company's ability to spread its overhead expenses over a larger sales base. The increase in selling, general and administrative expenses was due primarily to the increase in personnel from 27 to 37 employees, resulting from the increased administrative and management demands on the Company as it has grown, and an increase in fees for professional services.

The Company expects selling, general and administrative expenses to increase as it implements, operates and maintains OBN. In addition, it is expected that selling, general and administrative expenses will increase as a percentage of sales as the Company expands its direct marketing efforts. These efforts will require additional personnel, equipment and support. The additional selling, general and administrative expenses may be offset by the increased sales and profit gained as a result of the implementation of the components of the Company's strategic plan, but increased costs may have an adverse impact on results of operations until OBN is fully implemented and existing end users have been transitioned to OBN.

Pro Forma Income Taxes. On June 1, 1991, the Company, with the consent of its stockholders, elected to be taxed as an S Corporation. As a result of the election, all earnings of the Predecessor Corporation were taxed directly to the stockholders. Accordingly, the statements of income, prior to the termination of the S Corporation status on September 19, 1995, did not include provisions for income taxes. Pro forma income tax provisions have been calculated as if the Company's results of operations were taxable as a C Corporation under the Internal Revenue Code for all periods presented. See Note 7 to Consolidated Financial Statements.

Year Ended December 31, 1993 Compared to Year Ended December 31, 1994

Sales. Sales increased by 159.3%, from $31.9 million in 1993 to $82.8 million in 1994. The increase in sales related primarily to the continued expansion of the Company's distribution network of partitions as well as increases in the number of orders submitted by the Company's existing partitions. Sales from marketing inbound 800 service began in July 1994 and totaled $7.9 million for the six-month period ended December 31, 1994.

Cost of Sales. The Company's cost of sales increased by 162.4%, from $26.7 million in 1993 to $70.1 million in 1994. The increase in cost of sales resulted primarily from the increase in sales of AT&T-SDN and inbound 800 services. Cost of sales as a percentage of revenues increased at a higher rate than sales because the Company offered higher volume discounts to certain partitions.

Gross Profit. Gross profit decreased from 16.4% of sales for the year ended December 31, 1993 to 15.4% of sales for the year ended December 31, 1994. The decrease in gross margin was attributable primarily to the addition of new partitions during the third and fourth quarters of fiscal 1994 that received increased volume discounts. Billing costs remained relatively constant as a percentage of sales during both of these periods.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by 67.1%, from $2.1 million in 1993 to $3.4 million in 1994, but decreased as a percentage of sales from 6.4% to 4.2%. Selling, general and administrative expenses decreased as a percentage of sales as the Company spread its overhead costs over a larger sales base. The increase in selling, general and administrative expenses was primarily due to the increase of personnel to strengthen the Company's marketing, partition and end user support efforts during 1994.

Liquidity and Capital Resources

The Company consummated its initial public offering of 3,450,000 shares of Common Stock in September 1995. The Company received net proceeds from such offering of approximately $42.8 million, of which $4.5 million was used to pay the minority stockholder of the Predecessor Corporation in connection with the reorganization of such Predecessor Corporation to form the Company ("Reorganization"). See Notes 1(b) and 6(a) to the Consolidated Financial Statements. As of December 31, 1995, the Company had cash and cash equivalents of approximately $41.2 million.

In connection with the Reorganization, the Company made distributions to its two founding stockholders, Mr. Daniel Borislow and Mr. Paul Rosenberg. Messrs. Borislow and Rosenberg received distributions consisting of the Predecessor Corporation's 1995 taxable income through September 19, 1995 less approximately $13.2 million in previous advances to such stockholders, which advances were deemed repaid by setting off such distributions against the advances. The Company's 1995 taxable income through September 19, 1995 was approximately $13.2 million. As a result of the Reorganization and the change of tax status of the Predecessor Corporation from an S corporation to a C corporation, the Company recognized income for federal and state tax purposes in the amount of approximately $15.0 million, the tax on which was approximately $6.4 million. The income will be recognized, and the tax will be required to be paid, over four years. Pursuant to the Plan, the Company has guaranteed the obligations of the Predecessor Corporation to indemnify Messrs. Borislow and Rosenberg from any additional taxes, interest or penalties resulting from (i) the operations of the Predecessor Corporation during the period it was an S corporation ("S Period") and (ii) tax returns, schedules and reports prepared or filed by the Predecessor Corporation and utilized in preparing the personal tax returns of

Messrs. Borislow and Rosenberg which include any portion of the S Period. Also as part of the Reorganization, Mr. Rosenberg exchanged all of his shares of the Predecessor Corporation for 3,795,000 shares of Common Stock of the Company, $4.5 million in cash plus a note in the original principal amount of $6.9 million, bearing interest at the rate of 10.0% per annum. During the quarter ended December 31, 1995, the Company paid the first installment of $979,000 due under the terms of the note. In January 1996, the Company paid the remaining balance of $5,921,000 (a $10,000 discount from the interest due on the original note) from operating cash flow subsequent to the initial public offering.

Since its inception, the Company has funded its operations primarily from cash generated by operations and, to a lesser extent, advances from stockholders and bank borrowings. The Company's cash flow provided by (used in) operations was $24.5 million, $1.6 million and ($585,000) for the years ended December 31, 1995, 1994 and 1993, respectively. Accounts receivable and partition payable increases are primarily due to growth over the prior year. Increase in income taxes payable is primarily due to the Predecessor Corporation's termination of its S Corporation election. See Note 7 to the Consolidated Financial Statements.

The Company's working capital was $38.2 million and $12.3 million at December 31, 1995 and 1994, respectively. The significant increase in working capital is primarily a result of the completion of the Company's initial public offering.

On March 25, 1996, the Company filed a registration statement with the Securities and Exchange Commission for the offering of 9,000,000 shares of Common Stock ("Offering"). Of the 9,000,000 shares being offered, 8,250,000 are being offered by the Company and 750,000 shares are being offered by Mr. Borislow. The Company also has granted to the underwriters an overallotment option covering an additional 1,350,000 shares of Common Stock. The Company expects the Offering to be completed before the end of the second quarter of 1996.

The Company intends to use the proceeds from the Offering to fund the following: (i) advances to new partitions to enable such partitions to pay outstanding balances due to their existing long distance providers in order for such new partitions to move their end users to the Company's service and in continued advances to existing partitions to support their marketing efforts; (ii) procurement of additional hardware and software to enhance OBN and additional costs of conversion to OBN; (iii) equipment necessary for the initial development and implementation of the Company's CTP services; (iv) expenses of initiating and providing direct marketing activities; and (v) general corporate purposes and possible future acquisitions. Mr. Borislow will use a portion of the proceeds of the sale of his shares of Common Stock to repay his current outstanding indebtedness to the Company in the principal amount of $5.0 million.

The Company invested net cash of $2.3 million in capital equipment during the year ended December 31, 1995, of which $2.0 million was used primarily for deposits on the AT&T-manufactured switches for OBN. Since that time, the Company has invested approximately $8.0 million for capital equipment and installation costs relating to the deployment of OBN, and estimates that it will incur additional costs of up to approximately $7.0 million in connection with the acquisition of additional capital equipment and installation costs relating to the deployment of OBN. These expenditures, totalling approximately $17.0 million, are being funded by the proceeds of the Company's initial public offering. It is anticipated that up to $30.0 million of the proceeds of the Offering will be used to pay for, deploy and install expansions of capacity and voice enhancements of the switching equipment for use in connection with OBN. Such purchases will satisfy approximately $7.8 million of the Company's obligation to purchase an additional $10.0 million of switching equipment from AT&T over a five-year period beginning in August 1995. In addition, the Company may incur capital expenditures of up to $25.0 million in connection with the acquisition of remote switching and other equipment for the implementation of CTP services, including approximately $2.0 million necessary for initial testing.

The Company intends to continue to promote increased marketing activities by certain of its partitions and to attract new partitions through advances or loans. The total extent of these advances and loans could be up to $80.0 million; such amount would be funded using the proceeds of the Offering.

The Company has begun to fund its own business and residential retail marketing efforts. Using its expertise and the experience gained from supporting its existing partitions, the Company is developing its own marketing facility. The Company employs telemarketing personnel, implements the requisite management systems and offers services under its own brand. Additionally, the Company is planning to execute a direct response marketing program. The costs and expenses of these programs are expected to approximate up to $20.0 million over the next 12 to 18 months; such amount would be funded using the proceeds of the Offering.

In the event that the Offering is not consummated, the Company expects to fund enhancements to OBN, advances to partitions, and residential and retail marketing efforts through a combination of cash on hand, cash generated from operations and bank borrowings under the committed line of credit described below. Depending upon the availability of such sources of funds, expenditures for advances to partitions and residential and retail marketing efforts may be reduced.

In March 1996, the Company negotiated an unsecured, committed line of credit with PNC Bank, N.A. ("Credit Facility") under which borrowings of up to $50.0 million are available. The Company is required to pay an availability fee of $62,500 per annum, or 0.125% of the total available borrowings. Interest on borrowings is payable monthly at PNC Bank's prime rate less 0.5% or LIBOR plus 0.875%, at the Company's option. Principal is payable upon demand by PNC Bank. Under the terms of the Credit Facility, the Company must maintain certain financial covenants and adhere to certain restrictions. At March 25, 1996, the Company had no borrowings outstanding under the Credit Facility. Under the Company's prior credit facility with Midlantic Bank, N.A. ("Prior Credit Facility"), the Company could borrow up to $5.0 million. During the year ended December 31, 1995, the Company briefly borrowed (under a temporary increase in the Prior Credit Facility) and repaid $6.3 million. The borrowings were used to finance the payments of certain liabilities in connection with the termination of the S Corporation election. During the year ended December 31, 1994, the greatest amount the Company borrowed under the Prior Credit Facility was $4.7 million, which was primarily used to make advances to partitions to finance their marketing activities. At December 31, 1995 and 1994, the Company had no borrowings under the Prior Credit Facility.

The Company expects to enter into an agreement to purchase a new headquarters building in New Hope, Pennsylvania for approximately $1.5 million.

In 1994, the Company incurred approximately $2.0 million in asset acquisition expense related to the acquisition of long distance service contract pricing plans and customer lists, including the acquisition of certain assets of Global Network Communications, Inc. ("GNC") in March 1994 for an aggregate purchase price of $750,000, together with the agreement of Gary W. McCulla, the owner of GNC, to become an employee of the Company. GNC was a privately-held independent marketing company that was one of the Company's partition customers.

The Company does not have a significant concentration of credit risk with respect to accounts receivable due to the large number of partitions and end users comprising the Company's customer base and their dispersion across different geographic regions. The Company maintains reserves for potential credit losses and, to date, such losses have been within the Company's expectations.

Recent Accounting Pronouncements

In March 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." The Company will adopt SFAS No. 121 as of January 1, 1996 and its implementation is not expected to have a material effect on the Consolidated Financial Statements.

In October 1995, FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 establishes a fair value method for accounting for stock-based compensation plans either through recognition or disclosure. The Company intends to adopt the employee stock-based compensation provisions of SFAS No. 123 by disclosing the pro forma net income and pro forma net income per share amounts, assuming the fair value method was adopted January 1, 1995. The adoption of this standard will not impact the Company's consolidated results of operations, financial position or cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors
and Stockholders of Tel-Save Holdings, Inc.

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

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

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

BDO Seidman, LLP

New York, New York
February 7, 1996, except for Notes 4, 6(c)
and 10 which are dated March 25, 1996

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except for share data)

	December 31, 1994	December 31, 1995
Assets		
Current:		
Cash and cash equivalents	$ 11	$41,211
Accounts receivable, trade, net of allowance for uncollectible accounts of $987 and $804, respectively	15,910	19,088
Advances to partitions and notes receivable	1,863	3,563
Due from broker	—	1,100
Prepaid expenses	1,594	194
Total current assets	19,378	65,156
Property and equipment, net	466	2,667
Intangibles, net of accumulated amortization of $417 and $1,574, respectively	1,591	1,490
Note receivable from stockholder	—	2,075
Total assets	$21,435	$71,388
Liabilities and Stockholders' Equity		
Current:		
Accounts payable and accrued expenses:		
Trade	$ 670	$12,622
Partitions	3,070	3,047
Sales and excise taxes payable	1,560	1,406
Other	88	514
Due to related parties	1,725	—
Securities sold short, at cost to purchase	—	1,100
Income taxes payable	—	2,375
Note payable to stockholder	—	5,921
Total current liabilities	7,113	26,985
Deferred credits	280	280
Deferred income taxes payable	—	2,809
Total liabilities	7,393	30,074
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value, 5,000,000 shares authorized; no shares outstanding	—	—
Common stock, $.01 par value, 30,000,000 shares authorized, 9,550,000 and 19,500,000 issued and outstanding, respectively	95	195
Additional paid-in capital	—	37,245
Retained earnings	13,947	3,874
Total stockholders' equity	14,042	41,314
Total liabilities and stockholders' equity	$21,435	$71,388

See accompanying notes to consolidated financial statements.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except for per share data)

	Year ended December 31,		
	1993	1994	1995
Sales	$ 31,940	$ 82,835	$180,102
Cost of sales	26,715	70,104	156,121
Gross profit	5,225	12,731	23,981
Selling, general and administrative expenses	2,060	3,442	6,280
Operating income	3,165	9,289	17,701
Other income, net	108	66	331
Income before provision for income taxes	3,273	9,355	18,032
Provision for income taxes	—	—	8,997
Net income	$ 3,273	$ 9,355	$ 9,035
Pro forma:			
Income before provision for income taxes	$ 3,273	$ 9,355	$ 18,032
Pro forma provision for income taxes	1,309	3,742	7,213
Pro forma net income	$ 1,964	$ 5,613	$ 10,819
Pro forma net income per share	$ 0.13	$ 0.37	$ 0.64
Weighted average common and common equivalent shares outstanding	14,726	15,331	16,803

See accompanying notes to consolidated financial statements.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

	Common stock		Additional paid-in capital	Retained earnings	Total stockholders' equity
	Shares	Amount			
Balance, January 1, 1993	9,550	$ 95	$ —	$ 1,319	$ 1,414
Net income	—	—	—	3,273	3,273
Balance, December 31, 1993	9,550	95	—	4,592	4,687
Net income	—	—	—	9,355	9,355
Balance, December 31, 1994	9,550	95	—	13,947	14,042
Net income	—	—	—	9,035	9,035
Cash distributions	—	—	—	(13,200)	(13,200)
Stock redemption	—	—	—	(11,400)	(11,400)
Reclassification of S Corporation deficit	—	—	(5,492)	5,492	—
Sale of common stock	3,450	35	42,802	—	42,837
Three-for-two stock split	6,500	65	(65)	—	—
Balance, December 31, 1995	19,500	$ 195	$37,245	$ 3,874	$ 41,314

See accompanying notes to consolidated financial statements.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year ended December 31,		
	1993	1994	1995
Cash flows from operating activities:			
Net income	$3,273	$ 9,355	$ 9,035
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Unrealized loss on marketable securities	—	—	234
Provision for bad debts	(195)	52	(28)
Depreciation and amortization	31	477	1,287
Deferred credits	—	280	—
(Increase) decrease in:			
Accounts receivable, trade	(3,407)	(10,899)	(2,996)
Advances to partitions and notes receivable	—	(1,862)	(1,700)
Prepaid expenses and other current assets	(786)	(804)	1,400
Increase (decrease) in:			
Accounts and partitions payable and accrued expenses	499	5,023	12,047
Income taxes and deferred income taxes payable	—	—	5,184
Net cash provided by (used in) operating activities	(585)	1,622	24,463
Cash flows from investing activities:			
Acquisition of intangibles	—	(2,007)	(1,057)
Capital expenditures, net	(77)	(343)	(2,330)
Securities sold short not yet purchased	—	—	866
Liability to purchase securities sold short	—	—	(1,100)
Loans to stockholder	—	—	(2,075)
Net cash used in investing activities	(77)	(2,350)	(5,696)
Cash flows from financing activities:			
Proceeds from loan transactions	—	4,700	6,300
Payments of loan transactions	(44)	(4,700)	(6,300)
Payment of note payable to stockholder	—	—	(979)
Proceeds from related party transactions	2,977	7,767	—
Payments to related parties	(2,263)	(7,038)	(1,725)
Proceeds from sale of common stock	—	—	42,837
Distributions to stockholders	—	—	(13,200)
Stock redemption	—	—	(4,500)
Net cash provided by financing activities	670	729	22,433
Net increase in cash and cash equivalents	8	1	41,200
Cash and cash equivalents, at beginning of period	2	10	11
Cash and cash equivalents, at end of period	$ 10	$ 11	$ 41,211

See accompanying notes to consolidated financial statements.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — SUMMARY OF ACCOUNTING POLICIES

(a) Business

Tel-Save Holdings, Inc. (the "Company"), which is incorporated in Delaware, is a provider of long distance telecommunications services to small and medium-sized businesses located throughout the United States. The Company provides these services primarily through contract tariffs with AT&T Corp. ("AT&T") and markets these services nationally primarily through an established distribution network of independent long distance and marketing companies known as "partitions".

(b) Reorganization

On September 21, 1995, the Company consummated its initial public offering ("IPO") (Note 6(a)). The shares of Tel-Save, Inc., a Pennsylvania corporation (the "Predecessor Corporation"), owned by the two founding stockholders were contributed to the Company as of the date of the IPO. The majority stockholder exchanged all of his shares of the Predecessor Corporation for 10,530,000 shares of the common stock of the Company plus loans of up to $5,000,000. The loans may be made at any time prior to the third anniversary of the closing of the IPO, bear interest at 8.75%, will be due upon the earlier of the third anniversary of the closing of the IPO or on the closing date of the secondary offering of the majority stockholder's shares of common stock and is secured by 1,250,000 shares of common stock held by the Company. At December 31, 1995, loans of $2,075,000 were outstanding.

The minority stockholder exchanged all his shares of the Predecessor Corporation for 3,795,000 shares of the common stock of the Company, $4,500,000 in cash plus a note (the "Cash Flow Note") in the original principal amount of $6,900,000 bearing interest at 10% per annum which is guaranteed by the majority stockholder. The payment and the issuance of the Cash Flow Note to the minority stockholder are accounted for as a distribution of capital. In January 1996, the Company paid the remaining balance of $5,921,000 due under the Cash Flow Note. The transactions described above are collectively referred to as the "Reorganization."

(c) Basis of financial statements presentation

The consolidated financial statements include the accounts of Tel-Save Holdings, Inc. and its two wholly-owned subsidiaries, Tel-Save, Inc. and TS Investment Corporation, and have been prepared as if the entities had operated as a single consolidated group since their respective dates of incorporation. All intercompany balances and transactions have been eliminated.

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

(d) Recognition of revenue

The Company recognizes revenue upon completion of telephone calls by end users. Allowances are provided for estimated uncollectible usage.

(e) Cash and cash equivalents

The Company considers all temporary cash investments purchased with a maturity of three months or less to be cash equivalents.

(f) Property and equipment and depreciation

Property and equipment are recorded at cost. Depreciation and amortization is calculated using the straight-line method over the estimated useful lives of the assets or, for leaseholds, over the lease terms, which range from three to seven years.

(g) Intangibles and amortization

Intangibles include the costs to acquire billing bases of customer accounts, long-distance service contract pricing plans and a sign-on bonus (Note 5).

Amortization is computed on a straight-line basis over the estimated useful lives of the intangibles which range from 1 to 4 years and amounted to $417,000 and $1,157,000 for the years ended December 31, 1994 and 1995, respectively.

(h) Income taxes

Deferred tax assets and liabilities are recorded for the estimated future tax effects attributable to temporary differences between the basis of assets and liabilities recorded for financial and tax reporting purposes (Note 7).

(i) Pro forma net income per share

Pro forma net income per share is based on the weighted average number of shares of common stock equivalents outstanding during each period, as adjusted for the effects of the application of Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 83 (78,150 shares in all years). Pursuant to SAB No. 83, options granted within one year of the IPO which have an exercise price less than the IPO price are treated as outstanding for all periods presented. Pro forma earnings per share is computed using the treasury stock method, under which the number of shares outstanding reflects an assumed use of the proceeds from the assumed exercise of such options to repurchase shares of the Company's common stock at the average market value during the period.

Supplemental pro forma net income per share was $0.35 and $0.63 at December 31, 1994 and 1995, respectively. Supplemental pro forma net income per share is based on the weighted average number of shares of common stock and common stock equivalents used in the calculation of pro forma net income per share (15,331,377 and 16,802,727) at December 31, 1994 and 1995, respectively) plus the estimated number of shares that would need to be sold by the Company in order to fund the cash distribution of $4,500,000 made in connection with the Reorganization paid out of the proceeds of the IPO (Note 1(b)). All references in the financial statements with regard to average number of shares of common stock and related per share amounts have been calculated giving retroactive effect to the exchange of shares in the Reorganization and the stock split discussed in Note 6(c).

(j) Financial instruments and risk concentration

Financial instruments which potentially subject the Company to concentrations of credit risk are cash investments. The Company currently invests most of its cash investments in money market funds and overnight repurchase agreements. The carrying amount of these cash investments approximates the fair value due to their short maturity. The Company believes no significant concentration of credit risk exists with respect to these cash investments.

(k) Securities sold short/financial investments with off-balance sheet risk

At December 31, 1995, securities sold short by the Company, which consist of equity securities valued at market, resulted in an obligation to purchase such securities at a future date. The short position was closed in January 1996, and the Company recorded a gain of $152,000.

(l) Recent accounting pronouncements

In March 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 121, "Accounting For the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." The Company will adopt SFAS No. 121 as of January 1, 1996 and its implementation is not expected to have a material effect on the consolidated financial statements.

In October 1995, FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 establishes a fair value method for accounting for stock-based compensation plans either through recognition or disclosure. The Company intends to adopt the employee stock-based compensation provisions of SFAS No. 123 by disclosing the pro forma net income and pro forma net income per share amounts assuming the fair value method was adopted January 1, 1995. The adoption of this standard will not impact the Company's consolidated results of operations, financial position or cash flows.

NOTE 2 — MAJOR PARTITIONS

Partitions who provided end user accounts, which in the aggregate account for more than 10% of sales, are as follows:

	Number of Partitions	Total Percentage of Sales
Year ended December 31, 1993	1	15%
Year ended December 31, 1994	1	13%
Year ended December 31, 1995	—	—

NOTE 3 — PROPERTY AND EQUIPMENT

	Year Ended December 31, 1994	Year Ended December 31, 1995
	(In thousands)	
Furniture and equipment	$ 416	$ 604
Vehicles	192	185
Leasehold improvements	2	2
Switching equipment under construction	—	2,126
	610	2,917
Less: Accumulated depreciation and amortization	(144)	(250)
	$ 466	$2,667

Switching equipment under construction represents the costs associated with the purchase of AT&T switching equipment and the related installation costs incurred through December 31, 1995 for the deployment of the Company's long distance network — One Better Net ("OBN"). The Company anticipates that the total cost to deploy OBN will be up to $47,000,000.

NOTE 4 — REVOLVING LOAN AGREEMENT

In August 1994, the Company entered into a revolving loan agreement with a bank pursuant to which it may borrow up to $5,000,000. During September 1995, the bank provided a temporary increase in the amount available under the agreement to $6.3 million.

In March 1996, the Company replaced its revolving loan agreement with an unsecured, committed line of credit with a bank under which borrowings of $50,000,000 are available through March 18, 1997. The Company is required to pay an availability fee per annum of 0.125% of the total available borrowings. Principal is payable upon demand by the bank. Interest is payable monthly at the bank's prime rate less 0.5% or LIBOR plus 0.875%, at the Company's option. Under the terms of the agreement, the Company must maintain certain financial covenants and adhere to certain restrictions.

NOTE 5 — RELATED PARTY TRANSACTIONS

In March 1994, the Company paid an aggregate of $750,000, $300,000 for the acquisition of the customer list of a partition owned by an officer of the Company and a sign-on bonus of $450,000 as part of his employment agreement (Note1(g)).

At December 31, 1994, the Company borrowed from the stockholders non-interest bearing loans totaling approximately $1,725,000. In connection with these loans, the two stockholders had personal loans outstanding from a bank which were guaranteed by the Company. The loans to the Company were paid to the stockholders in January 1995, who in turn paid the personal loans outstanding.

In connection with the Reorganization (Note 1(b)), the Company made distributions of the Company's 1995 taxable income through September 19, 1995 of approximately $13,200,000 in 1995 to its two founding stockholders.

NOTE 6 — STOCKHOLDERS' EQUITY

(a) Initial Public Offering

In September and October, 1995, the Company consummated its IPO of 5,175,000 shares of common stock (adjusted to reflect the stock split, see Note 6(c)), including the underwriter's overallotment option, at a price of $9.17 per share. Proceeds of the offering less underwriting discounts of approximately $3,151,000 were $44,287,000. Expenses for the IPO totaled approximately $1,450,000, resulting in net proceeds to the Company of approximately $42,837,000.

In connection with the IPO, the Company issued warrants to purchase 450,000 shares of common stock to the underwriter. The exercise price of the warrants is $11.46 per share of common stock and such warrants expire on September 21, 2000.

(b) Stock Option Agreements and Stock Option Plan

The Company has granted to seven individuals options to purchase shares of the Company's common stock. The options, which were valued based on the fair market value of the Company at the date of grant, vest 22 months from the date of issuance and expire five years from the date of grant. The options granted in 1993 were vested at December 31, 1995.

In September 1995, the Company granted options to purchase 15,000 shares of common stock at the IPO price to each of the two nonemployee directors of the Company.

In September 1995, the Company's Board of Directors and stockholders adopted the Company's 1995 Employee Stock Option Plan (the "Option Plan"). The Option Plan provides for the granting, at the discretion of the Board of Directors, of: (i) options that are intended to qualify as incentive stock options, within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, to employees and (ii) options not intended to so qualify to employees, officers and directors. The total number of shares of common stock for which options may be granted under the Option Plan is 975,000 shares (Note 10).

The exercise price of all stock options granted under the Option Plan must be at least equal to the fair market value of such shares on the date of the grant. The maximum term of each option granted under the Option Plan is five years from the date of grant. Options shall become exercisable at such times and in such installments as the Board of Directors shall provide in the terms of each individual option provided; however, no option in part or in whole will be exercisable before one year from the date of grant.

As of December 31, 1995, 945,000 options (Notes 6(c) and 10) have been granted at the IPO price per share under the Option Plan. No options issued under the Option Plan were exercisable at December 31, 1995. A total of 30,000 shares remains available for future grants under the Option Plan.

Options outstanding under the option agreements and the Option Plan are as follows:

	Options	
	Shares	Option Price Per Share
Balance, January 1, 1993	—	$ —
Options granted	757,800	$ .63
Balance, December 31, 1993	757,800	$ .63
Options granted	470,100	$1.18—$3.12
Balance, December 31, 1994	1,227,900	$ .63—$3.12
Options granted	975,000	$ 9.17
Balance, December 31, 1995	2,202,900	$ .63—$9.17

(c) Stock Split

On February 16, 1996, the Company's Board of Directors approved a three-for-two split of the common stock in the form of a 50% stock dividend. The additional shares resulting from the stock split were distributed on March 15, 1996, to all stockholders of record at the close of business on February 29, 1996. The consolidated balance sheet as of December 31, 1995 and the consolidated statement of stockholders' equity for the year ended December 31, 1995 reflect the recording of the stock split as if it had occurred on December 31, 1995. Further, all references in the consolidated financial statements to average number of shares outstanding and related prices, per share amounts, warrant and stock option data have been restated for all periods to reflect the stock split.

NOTE 7 — INCOME TAXES

On June 1, 1991, the Company, with the consent of its stockholders, elected to be taxed as an S Corporation. As a result of the election, all earnings of the Predecessor Corporation were taxed directly to the stockholders. Accordingly, the statements of income prior to September 20, 1995 did not include provisions for income taxes. In connection with the Company's IPO, as described in Note 6(a), on September 19, 1995, the Company terminated its S Corporation status. Pro forma tax provisions have been calculated as if the Company's results of operations were taxable as a C Corporation under the Internal Revenue Code for all periods presented.

The following summarizes the provision for pro forma income taxes:

	Year ended December 31,		
	1993	1994	1995
		(In thousands)	
Current:			
Federal	$1,012	$2,892	$5,574
State and local	297	850	1,639
Pro forma provision for income taxes	$1,309	$3,742	$7,213

The provision for pro forma income taxes on adjusted historical income for the three years in the period December 31, 1995 differs from the amounts computed by applying the applicable Federal statutory rates due to the following:

	Year ended December 31,		
	1993	1994	1995
		(In thousands)	
Provision for Federal income taxes at the statutory rate.	$1,113	$3,274	$6,311
State and local income taxes, net of Federal benefit....	196	561	1,082
Other	—	(93)	(180)
Pro forma provision for income taxes	$1,309	$3,742	$7,213

As a result of the termination, the Company was required to provide for taxes on income for the period subsequent to September 19, 1995 and for the previously earned and untaxed S Corporation income which has been deferred primarily as a result of reporting on a cash basis. The provision for income taxes for the period from September 20, 1995 through December 31, 1995 consisted of the following:

	(In thousands)
Current:	
Federal..	$4,379
State and local	1,809
Total current	6,188
Deferred:	
Federal..	2,201
State and local	608
Total deferred..	2,809
	$8,997

A reconciliation of the Federal statutory rate to the provision for income taxes for the year ended December 31, 1995 is as follows:

	(In thousands)	
Federal income taxes computed at the statutory rate	$ 6,311	35.0%
Increase (decrease):		
Federal income taxes at the statutory rate from January 1, 1995 to September 19, 1995................................	(4,086)	(22.7)
Federal and state taxes resulting from cash to accrual basis for tax reporting	6,399	35.5
State income taxes less Federal benefit for the period September 20, 1995 to December 31, 1995	373	2.1
Total provision for income taxes..........................	$ 8,997	49.9%

Deferred tax (assets) liabilities at December 31, 1995 are comprised of the following elements:

	(In thousands)
Federal and state taxes resulting from cash to accrual basis for tax reporting	$6,399
Amortization of certain intangibles	(227)
Unrealized loss on marketable securities	(94)
Total tax liabilities	6,078
Less: current portion (included in income taxes payable)	3,269
Deferred tax liabilities	$2,809

NOTE 8 — STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	1993	1994	1995
		(In thousands)	
Supplemental disclosure of cash flow information:			
Cash paid for:			
Interest	$ 2	$55	$ 24
Income taxes	$—	$—	$3,813

During 1995, the Company issued the Cash Flow Note in the amount of $6,900,000 to the minority stockholder of the Predecessor Corporation in connection with the IPO and Reorganization (Note 1(b)).

NOTE 9 — QUARTERLY FINANCIAL DATA (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except for share data)			
1995				
Sales	$36,617	$44,728	$48,366	$50,391
Gross profit	5,374	6,113	5,670	6,824
Operating income	4,213	4,855	4,008	4,625
Pro forma net income	2,555	2,897	2,519	2,848
Pro forma net income per share	0.17	0.19	0.16	0.14
1994				
Sales	$14,413	$14,705	$22,521	$31,196
Gross profit	2,357	2,778	3,423	4,173
Operating income	1,806	1,846	2,608	3,029
Pro forma net income	1,092	1,102	1,573	1,846
Pro forma net income per share	0.07	0.07	0.10	0.12

NOTE 10 — SUBSEQUENT EVENTS

(a) Warrant Agreements

The Company granted, at or above market value, warrants to purchase up to 4,306,000 shares of the Company's common stock to certain partitions in January 1996 and March 1996 in order to encourge long term relationships with such partitions. The exercise price of the warrants ranges from $8.17 to $11.44 and the warrants are exercisable, depending on the relevant agreement, from May 1996 to September 1998. The majority of such warrant agreements require the partitions to meet certain performance criteria.

(b) Authorized Shares and Option Plan Amendments

On March 16, 1996, the Board of Directors, subject to stockholder approval, adopted the following amendments:

(1) to increase the authorized shares of the Company's $0.01 par value common stock to 100,000,000 shares.

(2) to increase the number of shares that can be issued under the Company's 1995 Employee Stock Option Plan to 2,500,000 shares.

(c) 1996 Option Grants

From January 1, 1996 through March 25, 1996, the Company granted options to employees and non-employee directors at or above fair market value to purchase 1,587,500 shares of common stock. The exercise prices of such options range from $8.17 to $11.83 and, depending on the option agreement, vest from one to three years.

(d) Stock Offering

On March 25, 1996, the Company filed a registration statement with respect to a public offering of 8,250,000 shares of previously unissued common stock.

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

None

PART III

ITEMS 10 THROUGH 13.

Information required by Part III (Items 10 through 13) of this Form 10-K is incorporated by reference to the Company's definitive proxy statement for the Annual Meeting of Stockholders to be held on April 15, 1996, which will be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year to which this Form 10-K relates.

PART IV

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

(a) The following documents are filed as part of this annual Report on Form 10-K.

1. Consolidated Financial Statements:

The Consolidated Financial Statements filed as part of this Form 10-K are listed in the "Index to Consolidated Financial Statements" in Item 8.

2. Consolidated Financial Statement Schedule:

The Consolidated Financial Statement Schedule filed as part of this report is listed in the "Index to S-X Schedule."

Schedules other than those listed in the accompanying Index to S-X Schedule are omitted for the reason that they are either not required, not applicable, or the required information is included in the Consolidated Financial Statements or notes thereto.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

INDEX TO S-X SCHEDULE

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors
and Stockholders of Tel-Save Holdings, Inc.

The audits referred to in our report dated February 7, 1996, except with respect to Notes 4, 6(c) and 10, as to which the date is March 25, 1996, relating to the consolidated financial statements of Tel-Save Holdings, Inc. and subsidiaries which is contained in Item 8 of this Form 10-K, included the audits of the financial statement schedule listed in the accompanying index for each of the three years in the period ended December 31, 1995. The financial statement schedule is the responsibility of management. Our responsibility is to express an opinion on this schedule based on our audits.

In our opinion, the financial statement Schedule II — Valuation and Qualifying Accounts, presents fairly, in all material respects, the information set forth therein.

BDO Seidman, LLP

New York, New York
February 7, 1996

NEXT

DOCUMENT (S)

DISREGARD

BACKGROUND

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

(In thousands)

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Other Changes	Deductions	Balance at End of Period
Year ended December 31, 1993:					
Reserves and allowances deducted from asset accounts:					
Allowance for uncollectible accounts	$555	$(195)	$ (73)(a)	$—	$287
Year ended December 31, 1994:					
Reserves and allowances deducted from asset accounts:					
Allowance for uncollectible accounts	$287	$ 53	$ 647(a)	$—	$987
Year ended December 31, 1995:					
Reserves and allowances deducted from asset accounts:					
Allowance for uncollectible accounts	$987	$ (13)	$(170)(a)	$—	$804

(a) Amount represents portion of change in allowance for uncollectible accounts applied against Accounts Payable - Partitions.

(3) Exhibits:

Exhibit No.	Description
2.1	Plan of Reorganization between and among Tel-Save Holdings, Inc., a Delaware corporation, Tel-Save, Inc., a Pennsylvania corporation, Daniel Borislow and Paul Rosenberg, and exhibits thereto (incorporated by reference to Exhibit 2.1 to the Company's registration statement on Form S-1 (File No. 33-94940)).
3.1	Amended and Restated Certificate of Incorporation of the Company, as amended (incorporated by reference to Exhibit 3.1 to the Company's registration statement on Form S-1 (File No. 33-94940)).
3.2	Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company's registration statement on Form S-1 (File No. 33-94940)).
9.1	Voting Trust Agreement between Daniel Borislow and Paul Rosenberg (included as part of Exhibit 2.1).
10.1*	Employment Agreement between the Company and Daniel Borislow and related Agreement (incorporated by reference to Exhibit 10.1 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.2*	Employment Agreement between the Company and Emanuel J. DeMaio (incorporated by reference to Exhibit 10.2 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.3*	Employment Agreement between the Company and Gary W. McCulla (incorporated by reference to Exhibit 10.3 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.4*	Employment Agreement between the Company and Joseph A. Schenk (incorporated by reference to Exhibit 10.4 to the Company's registration statement on Form S-1 (File No. 333-2738)).
10.5*	Employment Agreement between the Company and Aloysius T. Lawn, IV(incorporated by reference to Exhibit 10.5 to the Company's registration statement on Form S-1 (File No. 333-2738)).
10.6	Indemnification Agreement between the Company and Daniel Borislow (incorporated by reference to Exhibit 10.4 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.7	Indemnification Agreement between the Company and Emanuel J. DeMaio (incorporated by reference to Exhibit 10.5 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.8	Indemnification Agreement between the Company and Gary W. McCulla (incorporated by reference to Exhibit 10.6 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.9	Indemnification Agreement between the Company and Joseph M. Morena (incorporated by reference to Exhibit 10.7 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.10	Indemnification Agreement between the Company and Peter K. Morrison (incorporated by reference to Exhibit 10.8 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.11	Indemnification Agreement between the Company and Kevin R. Kelly (incorporated by reference to Exhibit 10.9 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.12	Indemnification Agreement between the Company and Aloysius T. Lawn, IV.
10.13	Agreement dated as of March 15, 1994 between the Company and Global Network Communications (incorporated by reference to Exhibit 10.10 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.14	AT&T Contract Tariff No. 516 (incorporated by reference to Exhibit 10.11 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.15	AT&T Contract Tariff No. 1715 (incorporated by reference to Exhibit 10.15 to the Company's registration statement on Form S-1 (File No. 333-2738)).
10.16	AT&T Contract Tariff No. 2039 (incorporated by reference to Exhibit 10.16 to the Company's registration statement on Form S-1 (File No. 333-2738)).
10.17	AT&T Contract Tariff No. 2432 (incorporated by reference to Exhibit 10.17 to the Company's registration statement on Form S-1 (File No. 333-2738)).
10.18	AT&T Contract Tariff No. 3628 (incorporated by reference to Exhibit 10.18 to the Company's registration statement on Form S-1 (File No. 333-2738)).
10.19	$50,000,000 line of credit from PNC Bank, N.A., dated March 22, 1996 (incorporated by reference to Exhibit 10.19 to the Company's registration statement on Form S-1 (File No. 333-2738)).
10.20†	General Agreement between Tel-Save, Inc. and AT&T Corp. dated June 26, 1995 (incorporated by reference to Exhibit 10.14 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.21*	Tel-Save Holdings, Inc. 1995 Employee Stock Option Plan (incorporated by reference to Exhibit 10.15 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.22*	Tel-Save Holdings, Inc. Employee Bonus Plan (incorporated by reference to Exhibit 10.16 to the Company's registration statement on Form S-1 (File No. 33-94940)).

Exhibit No.	Description
10.23*	Non-Qualified Stock Option Agreement between the Company and Daniel Borislow (incorporated by reference to Exhibit 10.17 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.24*	Non-Qualified Stock Option Agreement between the Company and Emanuel J. DeMaio (incorporated by reference to Exhibit 10.18 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.25*	Non-Qualified Stock Option Agreement between the Company and Mary Kennon (incorporated by reference to Exhibit 10.19 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.26*	Non-Qualified Stock Option Agreement between the Company and Gary W. McCulla (incorporated by reference to Exhibit 10.20 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.27*	Non-Qualified Stock Option Agreement between the Company and Joseph M. Morena (incorporated by reference to Exhibit 10.21 to the Company's registration statement on Form S-1 (File No. 33-94940)).
10.28*	Non-Qualified Stock Option Agreement between the Company and Peter K. Morrison (incorporated by reference to Exhibit 10.22 to the Company's registration statement on Form S-1 (File No. 33-94940)).
11.1	Net Income Per Share Calculation (incorporated by reference to Exhibit 11.1 to the Company's registration statement on Form S-1 (File No. 333-2738)).
21.1	Subsidiaries of the Company (incorporated by reference to Exhibit 21.1 to the Company's registration statement on Form S-1 (File No. 333-2738)).

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* Management contract or compensatory plan or arrangement.

† Confidential treatment previously has been granted for a portion of this exhibit.

(b) Reports on Form 8-K.

There were no Current Reports on Form 8-K filed by the Company during the three months ended December 31, 1995.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated:	**TEL-SAVE HOLDINGS, INC.**
March 29, 1996	By: /s/ Daniel Borislow Daniel Borislow Chairman of the Board, Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

March 29, 1996	By: /s/ Daniel Borislow Daniel Borislow Chairman of the Board, Chief Executive Officer and Director
March 29, 1996	By: /s/ Gary W. McCulla Gary W. McCulla President, Director of Sales and Marketing and Director
March 29, 1996	By: /s/ Emanuel J. DeMaio Emanuel J. DeMaio Chief Operations Officer and Director
March 29, 1996	By: /s/ Joseph A. Schenk Joseph A. Schenk Chief Financial Officer, Treasurer and Director
March 29, 1996	By: /s/ Kevin R. Kelly Kevin R. Kelly Controller
March 29, 1996	By: /s/ Harold First Harold First Director
March 29, 1996	By: /s/ Ronald R. Thoma Ronald R. Thoma Director

Tel-Save Holdings, Inc. and Subsidiaries
Balance Sheet
December 31, 1996

ASSETS	12/31/96	12/31/95
Current assets		
Cash and cash equivalents	8,022,568	41,210,946
Marketable securities	149,237,625	0
Accounts receivable, trade	19,970,892	19,088,503
Partition advances and note receivables	13,410,448	3,562,652
Note receivable from stockholder-current	0	0
Prepaid income taxes	3,464,688	0
Due from related entity	0	0
Due from broker	866,700	1,100,000
Prepaid expenses and other current assets	3,549,902	193,541
Total current assets	198,522,822	65,155,642
Furniture and equipment, net	30,097,414	2,667,682
Intangibles	24,463,853	1,489,811
Note receivable from stockholder	0	2,074,888
Other Assets	3,923,942	0
Total assets	257,008,031	71,388,022

Tel-Save Holdings, Inc. and Subsidiaries
Balance Sheet
December 31, 1996

LIABILITIES AND STOCKHOLDERS' EQUITY	12/31/96	12/31/95
Current liabilities		
Note payable, bank	0	0
Accounts payable and accrued expenses:		
Trade	17,812,313	12,622,459
Partitions	4,397,696	3,047,156
Sales, use and excise taxes	1,592,562	1,405,676
Other	1,619,184	513,645
Due to related parties	0	0
Due to related entity	0	0
Securities sold but not yet purchased, at market	866,700	1,100,000
Income taxes payable	0	2,375,210
Note payable to stockholder - current	0	5,920,439
Total current liabilities	26,288,455	26,984,585
Deferred credits	0	280,000
Deferred income taxes payable	0	2,809,000
Total liabilities	26,288,455	30,073,585
Commitments and contingent liabilities		
Stockholders' equity		
Preferred stock	0	0
Common stock	311,190	195,000
Additional paid-in capital	210,926,106	37,245,434
Treasury stock	(4,560,000)	0
Retained earnings	24,042,279	3,874,003
Total stockholders' equity	230,719,575	41,314,437
Total liabilities and stockholders' equity	257,008,031	71,388,022

Tel-Save Holdings, Inc. and Subsidiaries
Statements of Operations
Year Ended December 31, 1996 and 1995

	Year Ended 12/31/96	Year Ended 12/31/95
Sales	$232,424,223	$180,101,585
Cost of sales	200,597,548	156,121,250
Gross profit	31,826,675	23,980,335
Gross profit margin	13.7%	13.3%
Total SG&A	10,038,355	6,279,769
Operating income	21,788,320	17,700,566
Operating margin	9.4%	9.8%
Other:		
Interest income	7,190,111	888,348
Interest expense	(137,808)	(179,193)
Other, net	3,532,211	(377,777)
Total other	10,584,513	331,378
Income before taxes	32,372,833	18,031,944
Pre-tax margin	13.9%	10.0%
Provision for income taxes	12,204,558	7,212,778
Net income	$20,168,275	$10,819,166

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 1996.

[ ] TRANSACTION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the transition period from ______ to ___________

Commission file number 0 - 26728

Tel-Save Holdings, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

23-2827736
(I.R.S. Employer Identification No.)

6805 Route 202, New Hope, Pa. 18938
(Address of principal executive offices - Zip code)

Registrant's telephone number, including area code: 215 - 862 - 1500

Former name, former address and former fiscal year, if changes since last report.

Indicate by check 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 (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12,13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court

Yes ____ No ____

APPLICABLE ONLY TO CORPORATE ISSUERS: Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, $.01 par value, 29,917,446 shares outstanding as of November 7, 1996.

TEL-SAVE HOLDINGS, INC.
FORM 10-Q
September 30, 1996

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except for share data)

	September 30, 1996 (Unaudited)	December 31, 1995
Assets:		
Current:		
Cash and cash equivalents	**$160,226**	$41,211
Marketable securities	**12,737**	-
Accounts receivable, trade net of allowance for uncollectible accounts of $931 and $804, respectively	**21,952**	19,088
Advances to partitions and note receivables	**14,833**	3,563
Due from broker	-	1,100
Prepaid expenses and other current assets	**2,389**	194
Total current assets	**212,137**	65,156
Property and equipment, net of accumulated depreciation of $398 and $250, respectively	**22,527**	2,667
Intangibles, net of accumulated amortization of $3,159 and $1,574, respectively	**2,793**	1,490
Note receivable from stockholder	-	2,075
Other assets	**1,921**	-
Total assets	**$239,378**	$71,388
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses:		
Trade and other	**$ 19,296**	$12,622
Partitions	**4,740**	3,047
Sales and excise taxes payable	**1,211**	1,406
Other	**996**	514
Securities sold short, at cost to purchase	-	1,100
Income taxes payable	**2,340**	2,375
Note payable to stockholder - current	-	5,921
Total current liabilities	**28,583**	26,985
Deferred credits	**400**	280
Deferred income taxes payable	**2,599**	2,809
Total liabilities	**31,582**	30,074
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $.01 par value, 5,000,000 shares authorized; no shares outstanding	-	-
Common stock - $.01 stated value, 100,000,000 authorized; 29,049,000 and 19,500,000 issued and outstanding, respectively	**290**	195
Additional paid-in capital	**187,710**	37,245
Retained earnings	**18,341**	3,874
Unrealized gain on marketable securities	**1,455**	-
Total stockholders' equity	**207,796**	41,314
Total liabilities and stockholders' equity	**$239,378**	$71,388

See accompanying notes to consolidated financial statements.

B142.44.80

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands, except for per share data)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	1996	1995	**1996**	1995
Sales	**$60,079**	$48,366	**$168,159**	$129,711
Cost of sales	**51,756**	42,696	**145,617**	112,555
Gross profit	**8,323**	5,670	**22,542**	17,156
Selling, general and administrative	**2,452**	1,662	**7,244**	4,080
Operating income	**5,871**	4,008	**15,298**	13,076
Other income, net	**5,416**	191	**7,923**	210
Income before provision for income taxes	**11,287**	4,199	**23,221**	13,286
Provision for income taxes	**4,255**	7,145	**8,754**	7,145
Net income (loss)	**$ 7,032**	$ (2,946)	**$ 14,467**	$ 6,141
Pro forma:				
Income before provision for income taxes		$ 4,199		$ 13,286
Pro forma provision for income taxes		1,680		5,314
Pro forma net income		$ 2,519		$ 7,972
Net income per share - Primary	**$ .22**	$ .16	**$ .53**	$ .51
Weighted average common and common equivalent shares outstanding - Primary	**31,699**	15,928	**27,269**	15,567
Net income per share - Fully Diluted	**$ .22**	$ .16	**$ .52**	$ .51
Weighted average common and common equivalent shares outstanding - Fully Diluted	**32,370**	15,937	**28,089**	15,581

See accompanying notes to consolidated financial statements.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1996
(Unaudited)
(In thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Unrealized Gain on Marketable Securities	Total
	Shares	Amount				
Balance, January 1, 1996	19,500	$195	$ 37,245	$ 3,874	$ -	$ 41,314
Net income	-	-	-	14,467	-	14,467
Issuance of warrants to partitions	-	-	1,077	-	-	1,077
Sale of common stock	8,534	85	138,984	-	-	139,069
Exercise of common stock options	1,015	10	4,461	-	-	4,471
Income tax benefit related to exercise of common stock options	-	-	5,943	-	-	5,943
Unrealized gain on marketable securities	-	-	-	-	1,455	1,455
Balance, September 30, 1996	29,049	$290	$187,710	$18,341	$1,455	$207,796

See accompanying notes to consolidated financial statements.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	For the Nine Months Ended September 30,	
	1996	1995
Cash flows from operating activities:		
Net income	$14,467	$6,141
Adjustment to reconcile net income to net cash provided by (used in) operating activities:		
Unrealized loss (gain) on securities sold short and marketable securities	2	(149)
Provision for bad debts	23	(18)
Depreciation and amortization	1,733	769
Deferred credits	120	120
(Increase) decrease in:		
Accounts receivable - trade	(2,991)	(5,804)
Advances to partitions and note receivables	(11,270)	(996)
Prepaid expenses and other current assets	(2,195)	1,432
Other assets	(1,921)	-
Increase (decrease) in:		
Accounts and partition payables and accrued expenses	8,757	6,605
Income taxes payable	4,914	7,146
Net cash provided by operating activities	11,639	15,246
Cash flows from investing activities:		
Acquisition of intangibles	(1,811)	(457)
Capital expenditures	(20,006)	(939)
Securities sold short	(1,100)	749
Due from broker	1,100	(600)
Loans to stockholder	(3,034)	-
Repayments of stockholder loans	5,109	-
Purchase of marketable securities	(10,501)	-
Net cash used in investing activities	(30,243)	(1,247)
Cash flows from financing activities:		
Payments to related parties	-	(1,725)
Loans to stockholder	(5,921)	(1,042)
Proceeds from sale of common stock	139,069	37,061
Proceeds from exercise of common stock options	4,471	-
Distribution to stockholders	-	(13,200)
Stock redemption	-	(4,500)
Net cash provided by financing activities	137,619	16,594
Net increase in cash and cash equivalents	119,015	30,593
Cash and cash equivalents, at beginning of period	41,211	11
Cash and cash equivalents, at end of period	$160,226	$30,604

See accompanying notes to consolidated financial statements.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The consolidated financial statements include the accounts of Tel-Save Holdings, Inc. and its two wholly-owned subsidiaries, Tel-Save, Inc. and TS Investment Corporation, and have been prepared as if the entities had operated as a single consolidated group since their respective dates of incorporation. All intercompany balances and transactions have been eliminated.

The consolidated financial statements and related notes thereto as of September 30, 1996 and for the three and nine months ended September 30, 1996 and 1995 are presented as unaudited but in the opinion of management include all adjustments necessary to present fairly the information set forth therein. These adjustments consist solely of normal recurring accruals. The consolidated balance sheet information for December 31, 1995 was derived from the audited financial statements included in the Company's Form 10-K. These interim financial statements should be read in conjunction with that report. The interim results are not necessarily indicative of the results for any future periods.

2. Stock Split

On February 16, 1996, the Company's Board of Directors approved a three-for-two split of the common stock in the form of a 50% stock dividend. The additional shares resulting from the stock split were distributed on March 15, 1996, to all stockholders of record at the close of business on February 29, 1996. The consolidated balance sheet as of December 31, 1995 reflects the recording of the stock split as if it had occurred on December 31, 1995. Further, all references in the consolidated financial statements to average number of shares outstanding and related prices, per share amounts, warrant and stock option data have been restated for all periods to reflect the stock split.

3. Income Taxes

On June 1, 1991, the Company, with the consent of its stockholders, elected to be taxed as an S Corporation. As a result of the election, all earnings of the Company were taxed directly to the stockholders. On September 19, 1995, the Company terminated its S Corporation status. Pro forma tax provisions have been calculated as if the Company's results of operations were taxable as a C Corporation under the Internal Revenue Code for the three and nine months ended September 30, 1995.

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

4. Marketable Securities

Marketable securities as of September 30, 1996 consist primarily of equity securities classified as available-for-sale. Available-for-sale securities are stated at fair value, and unrealized holding gains and losses, net of the related deferred tax effect, are reported as a component of stockholders' equity. Realized gains and losses are determined on the basis of the specific securities sold.

5. Other Income

Other income was $5.4 million in the third quarter of 1996 versus $191,000 for the third quarter of 1995. Other income for the quarter includes two nonrecurring gains: a $1.4 million gain on the sale of securities of another long distance company and a $1.5 million gain on the sale of short term U.S. Treasury securities. The remainder of other income consists primarily of interest income earned on the Company's cash balances resulting primarily from the unapplied proceeds of the Company's public offering in April 1996 and excess cash from operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

The Company was founded in 1989 as a switchless reseller of AT&T long distance services to small and medium-sized businesses. The Company is in the process of completing the deployment of its own nationwide long distance network, One Better Net ("OBN").

The Company's sales to date have been derived from the resale of long distance services. The Company's cost of sales consists principally of charges for bundled long distance services, as charged by AT&T, partition charges, net of usage and other discounts, which are based on the usage of partitions, and end user billing and support. The Company believes that, historically, the competitive terms of its contract tariffs with AT&T and its ability to manage and distribute data are the primary reasons for its sales increases. In 1992, the Company negotiated a contract tariff with AT&T, resulting in lower rates than its previous contract tariffs. In July 1994, the Company obtained two new contract tariffs with AT&T, resulting in further reduced rates for the AT&T-SDN service and competitive terms for AT&T 800 Service, which the Company then began to market actively.

In October 1996, the Company subscribed to a new AT&T contract tariff, which permits the Company to continue to resell AT&T long distance services, including AT&T-SDN service, through mid-1998. The new AT&T contract tariff also includes other AT&T services (such as international long distance, inbound and outbound services) that will be used in the Company's new nationwide long distance network, OBN. The rates that the Company will pay under the new AT&T contract tariff are more favorable to the Company than under previous tariffs. During its term, the new AT&T contract tariff will enable the Company to minimize possible attrition that might result from moving existing end users from the AT&T network to OBN. The new AT&T contact tariff also permits a more gradual introduction of OBN, which should reduce the expense of providing the capacity required in a more rapid phase-in of OBN and lessen the impact of any technical difficulties during the phase-in of OBN. The more gradual introduction of OBN, however, will postpone the Company's realization of the anticipated benefit of the more favorable margins for OBN service, and the new AT&T contract tariff requires the Company to commit to purchase $240 million of service from A&T over the next 4 years. This commitment is larger than any previous commitment that the Company has made, but the Company believes that it can be met based on its current purchases of long distance service from AT&T of approximately $10 million per month. Further, the Company can terminate the new contract tariff without liability to AT&T at the end of the first 18 months if the Company has purchased $90 million in services from AT&T under the new contract tariff. The Company can also terminate the new contract tariff without liability to AT&T in the first 18 months if the Company and AT&T enter into a new contract tariff or another contract with a revenue commitment of at least $5 million per month and a term of at least the difference between 18 months and the number of months that the Company subscribed to the contract tariff, provided that the Company must purchase or pay for AT&T services under the contract tariff of at least $5 million per month for the months prior to such termination.

The Company is continuing the deployment of OBN, which features five Company-owned, AT&T (now Lucent Technologies, Inc., hereinafter "Lucent") manufactured 5ESS-2000 switches connected by AT&T digital transmission facilities. Installation of the transmission facilities and the five switches -- in Jacksonville, New York City, Chicago, Dallas and San Francisco -- is substantially complete, and testing of the network is being performed by the Company and the local exchange carriers ("LECs") whose local networks interconnect with the Company's long distance network. The Company is now in the process of activating access to the local areas that will be served by each switch, and has begun placing end users on OBN through the Jacksonville switch. OBN includes echo cancellation equipment purchased from Lucent. The Company expects OBN to become functional over the next three months.

The Company believes that gross margins for OBN long distance service will be higher than for AT&T long distance service. AT&T long distance service is "bundled," which means that the Company pays a single, all-inclusive price to AT&T for switching, transmission, and LEC access. OBN long distance service is "unbundled," which means that the Company provides its own switching, pays AT&T for transmission, and pays access fees directly to LECs. The "unbundled" charges per call on OBN are expected to be less than the "bundled" charge paid to AT&T. In addition, OBN should result in a faster and more reliable "provisioning" process, in which end users who have requested the Company's services actually begin to receive those services.

OBN is the focus of the Company's current direct marketing efforts to end users. The Company is also encouraging OBN sales through its partitions that purchase the Company's services for resale to end users. The Company expects that by the end of the fourth quarter of 1996 a significant portion of its new end users will be provisioned to OBN.

OBN also will provide the local service capabilities needed to support the Company's planned provision of Competitive Telecommunications Provider or "CTP" services. The Company intends to begin activities in planning and marketing CTP services, and purchasing, installing and testing the switching modules necessary to provide such services, after OBN becomes fully functional.

In October 1995, FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 establishes a valuation method for accounting for stock-based compensation plans either through recognition or disclosure. The Company intends to adopt the employee stock-based compensation provisions of SFAS No. 123 by disclosing the pro forma net income and pro forma net income per share amounts assuming the fair value method was adopted January 1, 1995. While the adoption of this standard will not impact the Company's consolidated results of operations, financial position or cash flows, the implementation of this disclosure requirement could have an impact on the stock valuations of public companies with options or warrants.

Results of Operations

The following tables sets forth for the periods indicated certain financial data as a percentage of sales:

	Percentage of Sales			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	1996	1995(A)	1996	1995(A)
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	86.1	88.3	86.6	86.8
Gross profit	13.9	11.7	13.4	13.2
Selling, general and administrative	4.1	3.4	4.3	3.1
Operating income	9.8	8.3	9.1	10.1
Other income, net	9.0	0.4	4.7	0.1
Income before provision for income taxes	18.8	8.7	13.8	10.2
Provision for income taxes	7.1	3.5	5.2	4.0
Net income	11.7%	5.2%	8.6%	6.2%

(A) Pro forma tax provisions have been calculated as if the Company's results of operations were taxable as a C corporation (the Company's current tax status) for the three and nine months ended September 30, 1995. Prior to September 20, 1995, the Company was an S corporation with all earnings taxed directly to its shareholders.

Three Months Ended September 30, 1996 to the Three Months Ended September 30, 1995

Sales. Sales increased by 24.2% to $60.1 million in the third quarter of 1996 from $48.4 million in the third quarter of 1995. The increase in sales related primarily to the continued expansion of the Company's distribution network of partitions, as well as increases in the number of orders submitted by the Company's existing partitions. One partition, The Furst Group, Inc. accounted for approximately 13% of the Company's sales for the third quarter of 1996 versus zero in the third quarter of 1995. In addition, significant partition marketing efforts focused on inbound 800 service resulted in sales of $22.6 million for the three month period ended September 30, 1996 versus $14.0 million for the three month period ended September 30, 1995.

Cost of Sales. The Company's costs of sales increased by 21.1% to $51.8 million in the third quarter of 1996 from $42.7 million in the third quarter of 1995. The increase in cost of sales resulted primarily from the increase in sales of AT&T-SDN and inbound 800 services and the initiation of direct marketing activities in 1996.

Gross Margin. Gross margin increased to 13.9% in the third quarter of 1996 from 11.7% during the third quarter of 1995. The increase in gross margin was due to lower network costs offset by direct marketing expenses and higher volume discounts to certain partitions.

Although, the basic rates of the three largest long distance carriers AT&T, MCI and Sprint have consistently increased over the past three years, AT&T and other carriers have announced new price plans aimed at residential customers with significantly simplified rate structures, which may have the impact of lowering overall long distance prices. There can be no assurance that AT&T or other carriers will not make similar offerings available to the small to medium sized businesses that the Company serves. Although OBN is expected to make the Company more price competitive, a reduction in long distance prices still may have a material adverse impact on the Company's gross margin in future periods.

Selling, general and administrative expenses. Selling, general and administrative expenses increased by 47.5% to $2.5 million in the third quarter of 1996 from $1.7 million in the third quarter of 1995. The increase in selling, general and administrative expenses was due primarily to the costs associated with hiring additional management personnel to support the Company's continuing growth, and increased fees for professional services.

Other Income. Other income was $5.4 million in the third quarter of 1996 versus $191,000 for the third quarter of 1995. Other income for the quarter includes two nonrecurring gains : a $1.4 million gain on the sale of securities of another long distance company and a $1.5 million gain on the sale of short term U.S. Treasury securities. The remainder of other income consists primarily of interest income earned on the Company's cash balances resulting primarily from the unapplied proceeds of the Company's public offering in April 1996 and excess cash from operations.

Provision for income taxes. The Company's effective tax rate declined to 37.7% for the three months ended September 30, 1996 from the pro forma effective tax rate of 40.0% for the three months ended September 30, 1995 due to an anticipated lower effective state tax rate in 1996.

Nine Months Ended September 30, 1996 to the Nine Months Ended September 30, 1995

Sales. Sales increased by 29.6% to $168.2 million in the first nine months of 1996 from $129.7 million in the first nine months of 1995. The increase in sales related primarily to the continued expansion of the Company's distribution network of partitions, as well as increases in the number of orders submitted by the Company's existing partitions. In addition, significant partition marketing efforts focused on inbound 800 service resulted in sales of $58.8 million for the nine month period ended September 30, 1996 versus $35.1 million for the nine month period ended September 30, 1995.

Cost of Sales. The Company's costs of sales increased by 29.4% to $145.6 million in the first nine months of 1996 from $112.6 million in the first nine months of 1995. The increase in cost of sales resulted primarily from the increase in sales of AT&T-SDN and inbound 800 services and the initiation of direct marketing activities in 1996.

Gross Margin. Gross margin increased to 13.4% in the first nine months of 1996 from 13.2% during the first nine months of 1995. The increase in gross margin was due to lower network costs offset by direct marketing expenses and higher volume discounts to certain partitions.

Selling, general and administrative expenses. Selling, general and administrative expenses increased by 77.5% to $7.2 million in the first nine months of 1996 from $4.1 million in the first nine months of 1995. The increase in selling, general and administrative expenses was due primarily to the costs (including bonus plan accruals) associated with hiring additional management personnel to support the Company's continuing growth, and increased fees for professional services.

Other Income. Other income for the first nine months of 1996 was $7.9 million versus $210,000 for the first nine months a year ago. Other income for the quarter includes two nonrecurring gains : a $1.4 million gain on the sale of securities of another long distance company and a $1.5 million gain on the sale of short term U.S. Treasury securities. The remainder of other income consists primarily of interest income earned on the Company's cash balances resulting primarily from the unapplied proceeds of the Company's public offering in April 1996 and excess cash from operations.

Provision for income taxes. The Company's effective tax rate declined to 37.7% for the nine months ended September 30, 1996 from the pro forma effective tax rate of 40.0% for the nine months ended September 30, 1995 due to an anticipated lower effective state tax rate in 1996.

Liquidity and Capital Resources

The Company consummated its initial public offering of 5,175,000 shares of Common Stock in September and October of 1995. The Company received net proceeds from such offering of $42.8 million, of which $4.5 million was used to pay the minority stockholder. The Company consummated a public offering of 8,534,000 shares of Common Stock in April and May, 1996. The Company received net proceeds from such offering of approximately $139.1 million. In addition, in June 1996, certain options to purchase shares of the Company's Common Stock were exercised and the Company received net proceeds of approximately $4.5 million. The tax benefit realized from the exercise of stock options was approximately $5.9 million and is reflected as an adjustment to additional paid-in capital and taxes payable. As of September 30, 1996, the Company had cash, cash equivalents and marketable securities of approximately $173.0 million.

Since its inception, the Company has funded its operations primarily from cash generated by operations and, to a lesser extent, advances from stockholders and bank borrowings. The Company's cash flow provided by operations was $11.6 million and $15.2 million for the nine months ended September 30, 1996 and 1995, respectively.

The Company's working capital was $183.6 million and $35.7 million at September 30, 1996 and 1995, respectively. The significant increase in working capital is primarily a result of the completion of the Company's public offering in April and May, 1996.

The Company invested $20.0 million in capital equipment during the nine months ended September 30, 1996, of which $16.5 million was used for the acquisition of capital equipment and installation costs relating to the deployment of OBN. In June 1996, the Company purchased a new headquarters building in New Hope, Pennsylvania for approximately $1.5 million. In July 1996, the Company also purchased a building in Clearwater, Florida which will be used for direct marketing for approximately $900,000.

In March 1996, the Company negotiated an unsecured, committed line of credit with PNC Bank, N.A. ("Credit Facility") under which borrowings of up to $50.0 million are available. The Company is required to pay an availability fee of $62,500 per annum, or 0.125% of the total available borrowings. Interest on borrowings is payable monthly at PNC Bank's prime rate less 0.5% or LIBOR plus 0.875%, at the Company's option. Principal is payable upon demand by PNC Bank. Under the terms of the Credit Facility, the Company must maintain certain financial covenants and adhere to certain restrictions. At September 30, 1996, the Company had no borrowings outstanding under the Credit Facility.

The Company has used a portion of the proceeds from its 1996 stock offering for: (i) advances to new and existing partitions to support their marketing efforts, (ii) procurement of additional hardware and software for OBN, (iii) direct marketing efforts, including the purchase of a direct marketing center in Clearwater, Florida, and (iv) the purchase of a new headquarters building in New Hope, Pennsylvania. The Company intends to use the remaining proceeds: (i) to further fund new and existing partitions, (ii) to expand direct marketing efforts, including the build out of the direct marketing center, and (iii) to take advantage of growth opportunities, including but not limited to, possible acquisitions and development of CTP Services. Excess cash is invested primarily in short term government securities and cash equivalents consisting of money market accounts with major international brokerage firms. The Company expects to spend less of the proceeds of the 1996 stock offering to start up OBN than originally planned because of the new AT&T contract tariff, which will allow the Company to avoid some of the costs associated with moving existing end users to OBN and permit the Company to phase in OBN more cost effectively by not leasing transmission facilities before traffic levels are sufficient to fill them. There can be no assurance that the Company's financial performance will meet analyst expectations in the future.

The Company does not have a significant concentration of credit risk with respect to accounts receivable due to the large number of end users comprising the Company's customer base and their dispersion across different geographic regions. The Company maintains reserves for potential credit losses and, to date, such losses have been within the Company's expectations.

The Company believes that its current cash position, marketable securities, the Credit Facility and the cash flow expected to be generated from operations, will be sufficient to fund its capital expenditures, working capital and other cash requirements for at least the next twelve months.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Securities

None

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

(a) Not applicable;

(b) Not applicable;

(c) Not applicable.

Item 5. Other Information

As discussed above in Part I, Item 2, the Company has subscribed to a new contract tariff with AT&T a copy of which is filed herewith on Exhibit 10.29 and incorporated herein by reference.

Item 6 Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 10.29 AT&T Contract Tariff No. 5776
Exhibit 11 Computation of Net Income Per Share

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended September 30, 1996.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 7, 1996

TEL-SAVE HOLDINGS, INC. AND SUBSIDIARIES

By: \s\ Daniel Borislow
Daniel Borislow
Chairman of the Board,
Chief Executive Officer and Director

By: \s\ Joseph A. Schenk
Joseph A. Schenk
Chief Financial Officer, Treasurer and Director

By: \s\ Kevin R. Kelly
Kevin R. Kelly
Controller

EXHIBIT D - PROPOSED TARIFF

8142.44.35

TEL-SAVE, INC.
6805 ROUTE 202
NEW HOPE, PA 18938
PH (215) 862-1500

EXPLANATION	AMOUNT

2563

3-5 310

PAY AMOUNT OF: two hundred fifty ——— xx/100 DOLLARS

CHECK AMOUNT

DATE	TO THE ORDER OF	DESCRIPTION	CHECK NUMBER	
4/9/97	South Dakota PUC	Filing Fee	2563	$ 250.–

PNC BANK
PNC BANK, N.A.
PHILADELPHIA, PA 020

⑈002563⑈ ⑆031000053⑆ 8611719706⑈

TC97-041	Application by One Step Billing, Inc. for a Certificate of Authority to operate as a telecommunications company within the state of South Dakota. (Staff: TS/KC) "Applicant seeks authority to offer a full range of 1+ interexchange telecommunications services on a resale basis. Specifically, Applicant seeks authority to provide MTS, out-WATS, in-WATS, and calling card services. Applicant does not intend to provide operator services, 900 or 700 services."	04/15/97	05/02/97
TC97-043	Application by Association Administrators, Inc. for a Certificate of Authority to operate as a telecommunications company within the state of South Dakota. (Staff: TS/KC) "Applicant is a switchless reseller which intends to offer 1+ direct dialing, 800 toll free, and travel card (no prepaid calling cards) service through resale of telephone services provided by facilities based interexchange carriers."	04/17/97	05/02/97
LOCAL EXCHANGE COMPANY COMPLIANCE WITH FCC PAYPHONE ORDERS			
TC97-039	Petition of MCI and AT&T to Certify all LECs as to Compliance With FCC Payphone Orders. MCI and AT&T hereby file this petition to investigate compliance of all certificated local exchange companies (LECs) with the Federal Communications Commission (FCC) orders on payphone reclassification. Specifically, MCI and AT&T request that the Commission determine and certify whether all certificated LECs have met all state-specific requirements identified in the FCC's orders.	04/14/97	05/02/97
WAIVER OF SWITCHED ACCESS RULES			
TC97-042	Petition of the independent telephone companies that have purchased U S WEST exchange areas for an extension of the waiver of the switched access rules which the Commission granted as part of its final Order approving the sale of U S WEST exchanges. The Commission approved a composite switched access rate of 7 cents per minute of use. "The rate, which was stipulated to within the purchase agreements between U S WEST and [the purchasing] companies, was accepted by the Commission and approved as a reasonable interim rate in recognition of the fact that no rate could be established pursuant to the Commission's switched access rules (ARSD Chapters 20:10:27 to 20:10:29) until each of the purchasing companies had operated the transferred exchange areas for at least a one-year time period. Because [the purchasing] companies have not yet operated the acquired exchanges for one year, it is necessary to request from the Commission an extension of the waiver previously granted in the exchange sale dockets. Based on the following, the [purchasing] companies request an extension of the waiver until such time that cost studies based on 1997 calendar year operations can be provided."	04/15/97	05/02/97

Important Notice: The Commission is compiling a list of internet addresses. If you have an internet address please notify the Commission by E-mailing ... at ...@puc.state.sd.us ... at (605) 773-3809

South Dakota
Public Utilities Commission
State Capitol 500 E. Capitol
Pierre, SD 57501-5070
Phone: (800) 332-1782
Fax: (605) 773-3809

TELECOMMUNICATIONS SERVICE FILINGS

These are the telecommunications service filings that the Commission has received for the period of:

04/11/97 through 04/17/97

If you need a complete copy of a filing faxed, overnight expressed, or mailed to you, please contact Delaine Kolbo within five days of this filing.

DOCKET NUMBER	TITLE/STAFF/SYNOPSIS	DATE FILED	INTERVENTION DEADLINE
REQUEST FOR CERTIFICATE OF AUTHORITY			
TC97-036	Application by IDT Corporation for a Certificate of Authority to operate as a telecommunications company within the state of South Dakota. (Staff: TS/CH) "Applicant is a switchless reseller which intends to offer 1+ direct dialing, 800 toll free, travel card, and prepaid calling card service through the resale of telephone services provided by facilities-based interexchange carriers."	04/11/97	05/02/97
TC97-037	Application by America's Tele-Network Corp. for a Certificate of Authority to operate as a telecommunications company within the state of South Dakota. (Staff: TS/KC) "Intrastate interLATA and, where permitted, intraLATA telecommunication services will be offered to the public on a resale basis. The Company provides service to commercial enterprises and residential customers. This application does not seek authority at this time to provide any form of operator services nor any service to pay phones."	04/11/97	05/02/97
TC97-038	Application by LDM Systems Inc. for a Certificate of Authority to operate as a telecommunications company within the state of South Dakota. (Staff: DJ/CH) "Applicant respectfully seeks to amend its Certificate of [Authority] to permit it to provide resold local exchange services in the state of South Dakota. The specific manner in which Applicant will provide local exchange service depends upon the result of negotiations with the incumbent local exchange carriers currently operating within the State. Applicant seeks authority to resell local exchange service in the existing service areas of U S WEST and any other relevant carriers. Applicant is unable to file a proposed tariff. As soon as such rates are available, and prior to the commencement of service, Applicant shall file a proposed tariff (containing its rates, terms and conditions of service) with the Commission for its review."	04/14/97	05/02/97
TC97-040	Application by Tel-Save, Inc. d/b/a The Phone Company for a Certificate of Authority to operate as a telecommunications company within the state of South Dakota. (Staff: DJ/CH) "Applicant is a reseller which intends to offer all local services provided by the incumbent LECs. Tel-Save seeks authority to resell local exchange services throughout the state of South Dakota in the areas served by any LECs in South Dakota that are not eligible for a small or rural carrier exemption pursuant to Section 251(f)(1) of the Federal Act. Tel-Save does not seek to provide resold services to customers in those small or rural territories at this time. Applicant will file a copy of its proposed tariff upon completion of negotiations for interconnection."	04/15/97	05/02/97

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF TEL-SAVE, INC. D/B/A THE PHONE COMPANY, INC. FOR AN AMENDED CERTIFICATE OF AUTHORITY TO PROVIDE LOCAL EXCHANGE SERVICE IN SOUTH DAKOTA	))))))	**ORDER GRANTING AMENDED CERTIFICATE OF AUTHORITY** **TC97-040**

On April 15, 1997, the Public Utilities Commission (Commission), in accordance with SDCL 49-31-3 and ARSD 20:10:24:02, received an application for an amended certificate of authority from Tel-Save, Inc. d/b/a The Phone Company, Inc. (Tel-Save).

Tel-Save, currently a South Dakota certified interexchange provider, seeks authority to resell local exchange services throughout the state of South Dakota, in areas served by local exchange carriers which are not eligible for a small or rural carrier exemption pursuant to 47 U.S.C. § 251(f)(1).

On April 17, 1997, the Commission electronically transmitted notice of the filing and the intervention deadline of May 2, 1997, to interested individuals and entities. No petitions to intervene or comments were filed and at its regularly scheduled June 3, 1997, meeting, the Commission considered Tel-Save's request for an amended certificate of authority. Commission Staff recommended granting an amended certificate of authority.

The Commission finds that it has jurisdiction over this matter pursuant to Chapter 49-31, specifically 49-31-3 and ARSD 20:10:24:02 and 20:10:24:03. The Commission finds that Tel-Save has met the legal requirements established for the granting of an amended certificate of authority. Tel-Save has, in accordance with SDCL 49-31-3, demonstrated sufficient technical, financial and managerial capabilities to offer telecommunications services in South Dakota. The Commission approves Tel-Save's application for an amended certificate of authority. Further, the Commission waives the provisions of ARSD 20:10:24:02 (8) and (12). As the Commission's final decision in this matter, it is therefore

ORDERED, that Tel-Save's application for an amended certificate of authority is hereby granted, effective June 15, 1997. It is

FURTHER ORDERED, that Tel-Save shall file informational copies of tariff changes with the Commission as the changes occur.

Dated at Pierre, South Dakota, this 10th day of June, 1997.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that this document has been served today upon all parties of record in this docket, as listed on the docket service list, by first class mail, in properly addressed envelopes, with charges prepaid thereon.

By Delaine Kolbo

Date 6/12/97

(OFFICIAL SEAL)

BY ORDER OF THE COMMISSION

James A. Burg

JAMES A. BURG, Chairman

Pam Nelson

PAM NELSON, Commissioner

Laska Schoenfelder

LASKA SCHOENFELDER, Commissioner

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

AMENDED CERTIFICATE OF AUTHORITY

To Conduct Business As A Telecommunications Company
Within The State Of South Dakota

Authority was Granted June 3, 1997, effective June 15, 1997
Docket No. TC97-040

This is to certify that

TEL-SAVE, INC. D/B/A THE PHONE COMPANY, INC.

is authorized to provide telecommunications services in South Dakota.

This certificate is issued in accordance with SDCL 49-31-3 and ARSD 20:10:24:02, and is subject to all of the conditions and limitations contained in the rules and statutes governing its conduct of offering telecommunications services.

Dated at Pierre, South Dakota, this 10th day of June, 1997

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION:

James A. Burg

JAMES A. BURG, Chairman

Pam Nelson

PAM NELSON, Commissioner

Laska Schoenfelder

LASKA SCHOENFELDER, Commissioner