PROSPECTUS

7,250,000 Shares

The Emerging Markets Telecommunications Fund, Inc.

Common Stock

The Emerging Markets Telecommunications Fund, Inc. (the "Fund") is a newly organized, non-diversified, closed-end management investment company. The Fund's investment objective is long-term capital appreciation. The Fund seeks to achieve its objective by investing primarily in equity securities of telecommunications companies in emerging countries, as defined below under "Investment Objective and Policies." It is the policy of the Fund, under normal market conditions, to invest not less than 65% of its total assets in equity securities of telecommunications companies in emerging countries. The Fund's remaining assets, under normal circumstances, will be invested in equity securities of companies that provide other essential services in the development of an emerging country's infrastructure (up to 25% of the Fund's total assets) and in equity securities of telecommunications companies in developed countries when these securities, in the opinion of the Fund's investment adviser, have investment characteristics similar to emerging country telecommunications companies. To the extent not invested as described above, the remainder of the Fund's assets may be invested in equity or debt securities of emerging country corporate or governmental issuers, the equity or debt securities of corporate or governmental issuers in developed countries, and in certain short-term and medium-term debt instruments. Although the Fund will seek to invest primarily in public companies, up to 25% of its total assets may be invested in equity securities of closely-held companies or private placements of public companies in cases where the Fund's investment adviser anticipates that a liquid market for these securities will develop within a period of two to five years from the date such securities are acquired by the Fund. There can be no assurance that the Fund's investment objective will be achieved.

An investment in the Fund involves certain special considerations, particularly in relation to the Fund's investing in emerging countries, such as restrictions on foreign investment and repatriation of capital, price volatility, limited liquidity and small market capitalization of the securities markets, currency devaluations and fluctuations in currency exchange rates, high inflation, government regulation, government involvement in the economy and political uncertainty, which are not typically associated with investments in the United States. See "Investment Objective and Policies" and "Special Considerations and Risk Factors."

The Fund is hereby offering an aggregate of 7,250,000 shares of its Common Stock in concurrent offerings in the United States (the "U.S. Offering") and outside the United States (the "International Offering"). Except for Individual Retirement Accounts and other retirement plans, the minimum purchase in the offering made hereby is 100 shares ($1,500) of Common Stock. 3,625,000 U.S. Shares are initially being offered hereby for sale in the United States by the U.S. Underwriters and 3,625,000 International Shares are initially being offered for sale outside the United States by the International Managers. See "Underwriting."

BEA Associates will serve as investment adviser to the Fund.

Prior to this offering, there has been no public market for the Fund's Common Stock. The Common Stock has been approved, subject to notice of issuance, for listing on the New York Stock Exchange under the symbol "ETF."

The address of the Fund is One Citicorp Center, 58th Floor, 153 East 53rd Street, New York, New York 10022, and the Fund's telephone number is (212) 832-2626. Investors are advised to read this Prospectus and to retain it for future reference.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	Underwriting Discount(1)	Proceeds to the Fund(2)
Per Share	$15.00	$1.05	$13.95
Total(3)	$108,750,000	$7,612,500	$101,137,500

(1) The Fund and BEA Associates have agreed to indemnify the U.S. Underwriters and the International Managers against certain liabilities, including liabilities under the Securities Act of 1933, as amended. See "Underwriting."

(2) Before deducting offering expenses payable by the Fund, estimated at $865,000, including up to $250,000 payable to the U.S. Underwriters and the International Managers in partial reimbursement of their expenses.

(3) The Fund has granted the U.S. Underwriters and the International Managers 30-day options to purchase up to an aggregate of 1,087,500 additional shares of Common Stock on the same terms and conditions as set forth above, solely to cover over-allotments, if any. If all such shares are purchased, the total Price to Public, Underwriting Discount and Proceeds to the Fund will be $125,062,500, $8,754,375, and $116,308,125, respectively. See "Underwriting."

The U.S. Shares are offered when, as and if delivered to and accepted by the U.S. Underwriters and subject to certain conditions. It is expected that delivery of the U.S. Shares will be made on or about June 24, 1992 at the offices of Bear, Stearns & Co. Inc., New York, New York 10167.

Bear, Stearns & Co. Inc.

A.G. Edwards & Sons, Inc.

Nomura Securities International, Inc.

PaineWebber Incorporated

June 17, 1992

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE FUND'S COMMON STOCK AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH TRANSACTIONS MAY BE EFFECTED ON THE NEW YORK STOCK EXCHANGE, IN THE OVER-THE-COUNTER MARKET OR OTHERWISE. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Unless otherwise specified, all references in this Prospectus to "U.S. dollars," "dollars," "US$" or "$" are to United States dollars.

PROSPECTUS SUMMARY

The following summary is qualified in its entirety by the more detailed information included elsewhere in this Prospectus.

The Fund	The Emerging Markets Telecommunications Fund, Inc. (the "Fund") is a newly organized, non-diversified, closed-end management investment company. The Fund seeks to achieve its objective by investing primarily in equity securities of telecommunications companies in emerging countries. As used in this Prospectus, an "emerging country" is any country that is generally considered to be an emerging or developing country by the World Bank, the International Finance Corporation, the United Nations or its authorities. See "The Fund."
Investment Objective and Policies......	The Fund's investment objective is long-term capital appreciation. The Fund seeks to achieve its objective by investing primarily in equity securities of telecommunications companies in emerging countries. It is the policy of the Fund, under normal market conditions, to invest not less than 65% of its total assets in equity securities of telecommunications companies in emerging countries. Telecommunications companies engage in such activities as the operation, development, financing or manufacture and sale of equipment relating to telephone, cellular and radio common carrier communication services, and the production, financing and operation of telegraph, satellite, microwave and private communications networks, electronic mail and other emerging telecommunications technologies. The Fund's remaining assets, under normal circumstances, will be invested in equity securities of companies that provide other essential services in the development of an emerging country's infrastructure (up to 25% of the Fund's total assets) and in equity securities of telecommunications companies in developed countries when these securities, in the opinion of the Fund's investment adviser, have investment characteristics similar to emerging country telecommunications companies. To the extent not invested as described above, the remainder of the Fund's assets may be invested in equity or debt securities of emerging country corporate or governmental issuers, the equity or debt securities of corporate or governmental issuers in developed countries, and in certain short-term and medium-term debt instruments. The equity securities in which the Fund will invest will include common stock, preferred stock (including convertible preferred stock), warrants and convertible debt securities. No assurance can be given that the Fund's investment objective will be realized. See "Investment Objective and Policies."
	The Fund will invest in equity securities (including American, Global and other types of Depositary Receipts) of telecommunications companies, as well as companies that provide other essential services in the development of an emerging country's infrastructure, (i) the principal securities trading market for which is in an emerging country, (ii) whose principal trading market is in any country, provided that, alone or on a consolidated basis, they derive 50% or more of their annual revenue from either goods produced, sales made or services performed in emerging countries, or (iii) that are organized under the laws of, and with a principal office in, an emerging country.

Although the Fund will seek to invest primarily in public companies, up to 25% of its total assets may be invested in equity securities of closely-held companies or private placements of public companies in cases where the Fund's investment adviser anticipates that a liquid market for these securities will develop within a period of two to five years from the date such securities are acquired by the Fund. The Fund will treat investments in such securities as illiquid for purposes of any applicable limitations under the Investment Company Act of 1940, as amended, until a liquid market for these securities develops. As a closed-end fund, the Fund is not currently limited under that Act in the amount of illiquid securities it may acquire.

Investment Rationale .... BEA Associates, the Fund's investment adviser, believes that telecommunications companies in emerging countries present attractive opportunities for long-term capital appreciation due to a variety of factors, including: the shift to market-driven economics, which requires a technologically sophisticated telecommunications network; the privatization of government-owned operators of telecommunications services; a favorable regulatory climate to facilitate the financing of necessary capital expenditures; and the acquisition of equity interests in the telecommunications industries of emerging countries by network operators from developed countries.

The Offerings .... The Fund is offering 7,250,000 shares of Common Stock ($.001 par value) (the "Shares") to investors in two concurrent offerings, as follows: 3,625,000 shares (the "U.S. Shares") in the United States (the "U.S. Offering") through a group of U.S. underwriters represented by Bear, Stearns & Co. Inc., A.G. Edwards & Sons, Inc., Nomura Securities International, Inc. and PaineWebber Incorporated (the "U.S. Underwriters") and 3,625,000 shares (the "International Shares") outside the United States (the "International Offering"; together with the U.S. Offering, the "Offerings") through a group of international managers represented by Bear, Stearns International Limited, Merrill Lynch International Limited, Nomura International plc, PaineWebber International (U.K.) Ltd. and S.G. Warburg Securities (the "International Managers"; together with the U.S. Underwriters, the "Underwriters"). The Underwriters have been granted options to purchase up to an aggregate of 1,087,500 additional shares of the Fund's Common Stock to cover over-allotments. The minimum purchase is 100 shares (US$1,500), except that there is no minimum investment for purchase by Individual Retirement Accounts and other retirement plans. See "Underwriting."

Listing .... The Common Stock has been approved, subject to notice of issuance, for listing on the New York Stock Exchange.

Stock Symbol .... ETF

Investment Adviser .... BEA Associates, a U.S. investment advisory firm, will act as the Fund's investment adviser. BEA Associates emphasizes a global investment strategy and, as of April 30, 1992, acted as adviser for approximately $15.7 billion of assets, including approximately $1.3 billion of assets invested in emerging country markets. See "Management of the Fund."

Special Considerations and Risk Factors .... The Fund will concentrate its investments in the telecommunications industry and may invest a significant portion of its assets—not to exceed 25% of its total assets—in companies that provide other essential services in the development of an emerging country's infrastructure. As a result, the Fund's investments may be subject to greater risk and market fluctuation than a fund that has in its portfolio securities representing a broader range of investment alternatives. The telecommunications industry and the industries which are comprised of companies that provide such other essential services are subject to competitive pressures, technological change, extensive governmental regulation and other factors which could adversely affect the Fund's performance. See "Investment Objective and Policies—Concentration" and "Special Considerations and Risk Factors—Telecommunications Industry."

The Fund is classified as a "non-diversified" investment company under the Investment Company Act of 1940, as amended, which means that the Fund is not limited by that Act in the proportion of its assets that may be invested in the securities of a single issuer. The Fund, however, intends to comply with the diversification requirements imposed by the U.S. Internal Revenue Code of 1986, as amended, for qualification as a regulated investment company. As a non-diversified investment company, the Fund may invest a greater proportion of its assets in the securities of a smaller number of issuers and, as a result, may be subject to greater risk with respect to portfolio securities. The Fund may also invest in passive foreign investment companies. See "Investment Restrictions" and "Taxation—United States Federal Income Taxes."

While the Fund expects to invest primarily in publicly traded equity securities, it may, subject to local investment restrictions, invest up to 25% of its total assets in non-publicly traded equity securities where BEA Associates anticipates that a liquid market for these securities will develop within a period of two to five years from the date such securities are acquired by the Fund. Such investment may involve a high degree of business and financial risk. Because of the absence of any current liquid trading market for these investments, the Fund may take longer to liquidate these positions than is the case for publicly traded companies. In addition to the financial and business risks, companies that are not publicly traded may not be subject to the same disclosure requirements applicable to companies whose securities are publicly traded. See "Special Considerations and Risk Factors—Investments in Non-Publicly Traded Securities."

Investing in emerging country securities involves certain considerations not typically associated with investing in securities of U.S. companies, including (a) controls on foreign investment and limitations on repatriation of invested capital and on the Fund's ability to exchange local currencies for U.S. dollars, (b) greater price volatility, substantially less liquidity and significantly smaller market capitalization of securities markets, (c) currency devaluations and other currency exchange rate fluctuations, (d) more substantial government involvement in the economy, (e) higher rates of inflation, (f) less government supervision and regulation of the securities markets and participants in those markets and (g) political uncertainty and other considerations. The Fund will treat investments in countries with repatriation restrictions as illiquid for purposes of any applicable limitations under the Investment Company Act of 1940, as amended. As a closed-end fund, the Fund is not currently limited under that Act in the amount of illiquid securities it may acquire. Because of the limited forward market for the purchase of U.S. dollars in most, if not all, emerging countries and the limited circumstances in which the Fund expects to hedge against declines in the value of emerging country currencies generally, the Fund will be adversely affected by devaluations of emerging country currencies against the U.S. dollar to the extent the Fund is invested in securities denominated in currencies experiencing a devaluation. In addition, accounting, auditing and financial reporting standards in emerging countries are different from U.S. standards. As a result, certain material disclosures may not be made and less information may be available to the Fund and other investors than would be the case if the Fund's investments were restricted to securities of U.S. issuers. Moreover, it may be more difficult to obtain a judgment in a court outside the United States. Interest and dividends paid on securities held by the Fund and gains from the disposition of such securities may be subject to withholding taxes imposed by emerging countries. See "Special Considerations and Risk Factors."

The Fund may invest in loans, assignments of loans and participations in loans. Such investments are subject to special risks, including the lack of a liquid secondary market for such securities and, in the case of loan participations, assumption of the credit risk of both the underlying borrower and the selling lender of the participation. See "Special Considerations and Risk Factors—Loan Participations." The Fund may also invest in debt instruments of governments of emerging countries, which are subject to special risks, including default on payment of principal and interest, requests to reschedule debt and requests to extend further loans. See "Special Considerations and Risk Factors—Sovereign Debt." The Fund also may invest in debt instruments of corporate issuers which may have speculative characteristics, involve great risk and may not be paying interest or may be in payment default. See "Special Considerations and Risk Factors—Debt Securities."

Certain provisions of the Fund's Articles of Incorporation may have the effect of inhibiting the Fund's possible conversion to open-end status and limiting the ability of other persons to acquire control of the Fund's Board of Directors. In certain circumstances, these provisions might also inhibit the ability of shareholders to sell their shares at a premium over prevailing market prices. See "Common Stock."

Discount to Net Asset Value .... Shares of closed-end investment companies frequently trade at a discount from net asset value. This characteristic of shares of a closed-end fund is a risk separate and distinct from the risk that the Fund's net asset value may decrease. The Fund cannot predict whether its shares will trade at, below or above net asset value. The risk of purchasing shares of closed-end funds that might trade at a discount to net asset value is more pronounced for investors who wish to sell their shares in a relatively short period of time after completion of the Fund's initial public offering. For those investors, realization of a gain or loss on their investment is likely to be more dependent upon the existence of a premium or discount than upon portfolio performance. The net asset value per share immediately following the completion of the Offerings will be $13.95, less the per share offering expenses of the Offerings. If, at any time after the second anniversary of the Offerings, shares of the Fund's Common Stock trade publicly for a substantial period of time at a substantial discount from the Fund's then current net asset value per share, the Board of Directors of the Fund will consider, at its next regularly scheduled meeting, taking various actions designed to reduce or eliminate the discount. See "Net Asset Value" and "Common Stock."

Advisory Fees; Estimated Expenses.... The fee payable by the Fund to BEA Associates for investment advice will be payable quarterly at an annual rate equal to 1.25% of the first $100 million of the Fund's average weekly net assets, 1.125% of the next $100 million and 1.00% of net assets above $200 million. This fee is higher than that paid by most other U.S. investment companies investing exclusively in the securities of U.S. issuers, primarily because of the additional time and expense required of BEA Associates when investing in emerging country equity securities. Such investments entail additional time and expense because available public information concerning emerging country equity securities is limited in comparison to that available for U.S. companies and accounting standards are more flexible. In addition, available research concerning emerging country companies is not comparable to available research concerning U.S. companies. See "Management of the Fund."

The Fund will be responsible for all of its operating expenses. Assuming no exercise of the Underwriters' over-allotment options, the Fund's annual operating expenses, including advisory, administration and custodial fees, are estimated to be $2,158,450. Costs incurred by the Fund in connection with its organization are estimated to be $40,000, which will be amortized over a period of 60 months, starting at the commencement of the Fund's operations. The expenses of the Offerings, estimated to be $865,000, will be charged to capital. See "Management of the Fund—Estimated Expenses."

Administration.......................... Bear Stearns Funds Management Inc.(the "Administrator") provides administrative services to the Fund pursuant to an Administration Agreement (the "Administration Agreement") with the Fund. The Fund will pay to the Administrator an annual administration fee of 0.10% of the average weekly net assets of the Fund. BEA Associates will provide certain administrative and shareholder services to the Fund that are not provided by the Administrator, for which BEA Associates will be reimbursed by the Fund for costs incurred on behalf of the Fund (up to $20,000 per annum) and out-of-pocket expenses. See "Management of the Fund—Administration."

Dividends and Distributions............ The Fund intends to distribute annually to its shareholders substantially all of its net investment income and net realized short-term capital gains. The Fund will determine annually whether to distribute any net realized long-term capital gains in excess of net realized short-term capital losses; however, it currently expects to distribute any excess annually to its shareholders. See "Taxation—United States Federal Income Taxes." Under the Fund's Dividend Reinvestment and Cash Purchase Plan, each shareholder will be deemed to have elected, unless contrary written instructions are received, to have all distributions from the Fund automatically reinvested in additional shares of the Fund. See "Dividends and Distributions; Dividend Reinvestment and Cash Purchase Plan."

Custodian .... Brown Brothers Harriman & Co. will act as the custodian of the Fund's assets and may employ sub-custodians outside the United States approved by the Directors of the Fund in accordance with regulations of the Securities and Exchange Commission. Provident National Bank will act as the Fund's transfer agent and dividend-paying agent and registrar. See "Custodian, Transfer and Dividend-Paying Agent and Registrar."

THE FUND

The Emerging Markets Telecommunications Fund, Inc. (the "Fund"), incorporated in Maryland on February 11, 1992, is a newly organized, non-diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act").

The Fund's investment objective is long-term capital appreciation. The Fund seeks to achieve its objective by investing primarily in equity securities of telecommunications companies in emerging countries, as defined below under "Investment Objective and Policies." It is the policy of the Fund, under normal market conditions, to invest not less than 65% of its total assets in equity securities of telecommunications companies in emerging countries. The Fund's remaining assets under normal circumstances will be invested in equity securities of companies that provide other essential services in the development of an emerging country's infrastructure and will benefit from macroeconomic growth in an emerging country, but whose growth is not directly linked to favorable changes in commodity prices (up to 25% of the Fund's total assets) (examples of such infrastructure companies in which the Fund may invest include electric and gas utilities, oil and gas distribution companies and companies that have toll-road concessions) and equity securities of telecommunications companies in developed countries when these securities, in the opinion of the Fund's investment adviser, have investment characteristics similar to emerging country telecommunications companies. To the extent not invested as described above, the remainder of the Fund's assets may be invested in equity or debt securities of emerging country corporate or governmental issuers, the equity or debt securities of corporate or governmental issuers in developed countries, and in the short-term and medium-term debt instruments described below under "Investment Objective and Policies—Temporary Investments."

Although the Fund will seek to invest primarily in publicly traded equity securities, it may, subject to local investment limitations, invest up to 25% of its total assets in non-publicly traded equity securities in cases where the Fund's investment adviser anticipates that a liquid market for these securities will develop within a period of two to five years from the date such securities are acquired by the Fund.

Investment Rationale

BEA Associates believes that telecommunications companies in emerging countries present attractive opportunities for long-term capital appreciation due to:

- *political changes* in governments in Latin America and elsewhere favoring a shift from socialism/populism and government involvement in the private sector to a market-driven economy, which requires a technologically sophisticated telecommunications network, which often leads to—
- *privatizations* of government-owned operators of telecommunications services in these countries, which in turn promotes—
- *a favorable regulatory climate* to facilitate the financing of necessary capital expenditures, thereby encouraging—
- *globalization,* whereby network operators in highly regulated markets or markets in which competition is growing through deregulation acquire equity interests in other network operators or specific sectors of the telecommunications industry with higher anticipated rates of return and introduce operating efficiencies and technological innovations.

As a result of these developments, BEA Associates believes that substantial opportunities for long-term capital appreciation will be presented both by telecommunications companies currently in existence that have attractive growth characteristics and by new companies that may emerge in the future to provide basic and ancillary telecommunications services.

Political Changes. Emerging countries in Latin America, the Far East and Eastern Europe are in the process of implementing broad market reforms to revitalize their economies. BEA Associates expects that over time these reforms should lead to significantly increased economic activity, and that telecommunications companies will benefit as a consequence of the increasing demand for modern, efficient telecommunications systems. BEA Associates believes that the potential for sustained earnings growth is enhanced in a number of these countries by a significant backlog in demand for telecommunications services and by the considerable scope for efficiency improvement through privatizations.

Privatizations. Privatizations of telecommunications companies in emerging countries provide a source of capital and afford a means of improving the efficiency of services. Since 1980, the pace of privatizations has accelerated considerably. During the period 1980-1989 the telephone companies of five countries were privatized—Chile, Hong Kong, Japan, Spain and Great Britain—and since 1989 the telephone companies of an additional five countries have been privatized —Argentina, Malaysia, Mexico, New Zealand and Venezuela. As other emerging countries privatize their telephone companies, BEA Associates believes that many of these companies may provide significant growth potential in servicing the demand for enhanced telecommunications capacity created by increasing economic activity.

Favorable Regulatory Climate. Given the essential role provided by telecommunications companies in establishing the infrastructure necessary to support economic growth, BEA Associates anticipates that emerging country governments will be favorably disposed to provide the requisite support to enable these companies to finance the considerable capital expenditures needed to meet existing and anticipated demand for telephone lines and related services. This support can take a variety of forms, including tax concessions, the provision of more favorable rate or tariff structures or a limited monopoly on services, which in turn may enhance the market value of these companies.

Globalization. The number of acquisitions of equity positions in network operators by telecommunications companies from other countries has increased significantly in the recent past. The involvement of foreign network operators in emerging countries is expected to provide expertise in updating outmoded networks as well as indirectly providing funds for capital expenditures.

BEA Associates also believes that many of the factors which may enhance the value of telecommunications investments in emerging countries, such as the favorable regulatory climate and the shift to a market-oriented economy, may also have the effect that companies that provide other essential services in these countries may offer similar growth opportunities.

Of course, there can be no assurance that the favorable developments described above will occur as anticipated, or at all, or that the equity securities acquired by the Fund will provide long-term capital appreciation.

USE OF PROCEEDS

The net proceeds of the Offerings, after the underwriting discounts and organizational and offering expenses payable by the Fund, estimated to be $100,232,500 (assuming no exercise of the over-allotment options by the Underwriters) will be invested in accordance with the policies set forth under "Investment Objective and Policies." Pending such investment, the proceeds will be invested in certain short-term and medium-term debt instruments, as described under "Investment Objective and Policies—Temporary Investments." The Fund intends to invest promptly in equity securities of telecommunications companies and companies that provide other essential services in emerging countries as investment opportunities are identified, but over a period of time in order to minimize local market impact. The Fund expects that, subject to market conditions, not less than 65% of the Fund's total assets will be invested in equity securities of telecommunications companies in emerging countries within six months from the date of this Prospectus.

SPECIAL CONSIDERATIONS AND RISK FACTORS

Investors should consider the following special considerations associated with an investment in the Fund.

Concentration; Non-Diversified Status

The Fund will concentrate its investments in the telecommunications industry and may invest a significant portion of its assets — not to exceed 25% of its total assets — in companies that provide other essential services in the development of a country's infrastructure. As a result, the Fund's investments may be subject to greater risk and market fluctuation than a fund that has securities representing a broader range of investment alternatives. The telecommunications industry and the industries that are comprised of companies that provide such other essential services are subject to extensive governmental regulation, which could adversely affect the Fund's performance. The Fund is classified as a non-diversified investment company under the 1940 Act, which means that the Fund is not limited by that Act in the proportion of its assets that may be invested in the securities of a single issuer. However, the Fund intends to comply with the diversification requirements imposed by the U.S. Internal Revenue Code of 1986, as amended (the "Code"), for qualification as a regulated investment company. As a non-diversified investment company, the Fund may invest a greater proportion of its assets in the obligations of a smaller number of issuers and, as a result, may be subject to greater risk with respect to its portfolio securities.

Telecommunications Industry

Investing in telecommunications companies involves certain special considerations. Telecommunications companies in both developed and emerging countries are undergoing significant change due to varying and evolving levels of governmental regulation or deregulation and other factors. As a result, competitive pressures are intense and the securities of such companies may be subject to rapid price volatility. In addition, companies offering telephone services are experiencing increasing competition from cellular telephones, and the cellular telephone industry, because it has a limited operating history, faces uncertainty concerning the future of the industry and demand for cellular telephones. All telecommunications companies in both developed and emerging countries are subject to the additional risk that technological innovations will make their products and services obsolete. While telephone companies in developed countries and certain emerging countries may pay an above average dividend, the Fund's investment decisions are based upon capital appreciation potential rather than income considerations.

In virtually every country, certain aspects of the telecommunications industry are subject to some government regulation. The nature and scope of such regulation generally is subject to political forces and market considerations, the effect of which cannot be predicted. Such regulation can have significant effects upon the operations of a telecommunications venture. It is difficult to predict the directions, types or effects of future telecommunications-related regulation.

Telecommunications regulation typically limits rates charged, returns earned, providers of services, types of services, ownership, areas served and terms for dealing with competitors and customers. Telecommunications regulation generally has tended to be less stringent for newer services than for traditional telephone service, although there can be no assurances that such newer services will not be heavily regulated in the future. Regulation may also limit the use of new technologies and hamper efficient depreciation of existing assets. If regulation limits the use of new technologies by established carriers or forces cross-subsidies, large private networks may emerge. Service providers may also be subject to regulations regarding ownership and control, providers of services, subscription rates and technical standards.

Privatizations

The Fund anticipates investment in telecommunications companies that have been or will be transferred from government to private ownership. Many of these telecommunications companies have underdeveloped or obsolete technologies and equipment. It is impossible to predict whether any further privatizations will take place or what the terms or effects of such privatizations may be. There can be no assurance that any privatizations will be undertaken or, if undertaken, that such plans will be successfully completed or even completed at all. There also can be no assurance that, if a privatization is undertaken on a private placement basis, the Fund will have the opportunity to participate in the investing consortium. Investors should also be aware that changes in governments or economic factors could result in a change in an emerging country's policies on privatization.

Investments in Non-Publicly Traded Securities

Although the Fund expects to invest primarily in publicly traded equity securities, it may, subject to local investment limitations, invest up to 25% of its assets in non-publicly traded equity securities which may involve a high degree of business and financial risk and may result in substantial losses. Because of the absence of any liquid trading market currently for these investments, the Fund may take longer to liquidate these positions than would be the case for publicly traded securities. Although these securities may be resold in privately negotiated transactions, the prices realized on such sales could be less than those originally paid by the Fund. Further, companies whose securities are not publicly traded may not be subject to the disclosure and other investor protection requirements applicable to companies whose securities are publicly traded.

Market Value and Net Asset Value

The Fund is a newly organized, non-diversified, closed-end management investment company with no previous operating history. Shares of closed-end investment companies frequently trade at a discount from net asset value. This characteristic of shares of a closed-end fund is a risk separate and distinct from the risk that the Fund's net asset value will decrease. The Fund cannot predict whether its shares will trade at, below or above net asset value. The risk of purchasing shares of a closed-end fund that might trade at a discount is more pronounced for investors who wish to sell their shares in a relatively short period of time after completion of the Fund's initial public offering because, for those investors, realization of a gain or loss on their investments is likely to be more dependent upon the existence of a premium or discount than upon portfolio performance. The net asset value per share immediately following the completion of the Offerings will be $13.95, less the per share offering expenses of the Offerings. The Fund's shares are not subject to redemption. Investors desiring liquidity may, subject to applicable securities laws, trade their shares in the Fund on any exchange where such shares are then listed at the then current market value, which may differ from the then current net asset value.

Currency Hedging

BEA Associates will not seek to hedge against a decline in the value of the Fund's non-dollar-denominated portfolio securities resulting from currency devaluations or fluctuations unless suitable hedging instruments are available on a timely basis and on acceptable terms. Unless the Fund engages in currency hedging transactions, it will be subject to the risk of changes in relation to the U.S. dollar of the value of the emerging country currencies in which its assets are denominated. The Fund may from time to time seek to protect, during the period prior to the remittance, the value of the amount of interest, dividends and net realized capital gains received or to be received in a local currency that it intends to remit out of an emerging country by investing in high-quality short-term U.S. dollar-denominated debt securities of such country and/or participating in the forward currency market for the purchase of U.S. dollars in the country. There can be no guarantee that suitable U.S. dollar-denominated investments will be available at the time BEA Associates wishes to use them to hedge amounts to be remitted. Moreover, investors should be aware that dollar-denominated securities may not be available in some or all emerging countries, that the forward currency market for the purchase of U.S. dollars in many emerging countries is not highly developed and that in certain emerging countries no forward market for foreign currencies currently exists or that such market may be closed to investment by the Fund.

Investing in equity securities of companies in emerging countries involves certain considerations not typically associated with investing in the securities of U.S. companies, including those discussed below.

Investment Controls

Foreign investment in the securities of issuers in emerging countries is restricted or controlled to varying degrees. These restrictions or controls may at times limit or preclude foreign investment in certain issuers and increase the costs and expenses of the Fund. Certain countries require governmental approval prior to investments by foreign persons, or limit the amount of investment by foreign persons in a particular company, or limit investment by foreign persons to only a specific class of securities of a company that may have less advantageous terms than the classes available for purchase by nationals. Certain countries may restrict investment opportunities in issuers or industries deemed important to national interests. Some countries require governmental approval for the repatriation of investment income, capital or the proceeds of sales of securities by foreign investors. In addition, if there is a deterioration in a country's balance of payments or for a number of other reasons, a country may impose temporary restrictions on foreign capital remittances abroad. The Fund could be adversely affected by delays in, or a refusal to grant, any required governmental approval for repatriation of capital, as well as by the application to the Fund of any restrictions on investments. If for any reason the Fund was unable to distribute substantially all of its investment company taxable income (as defined for U.S. tax purposes) within applicable time periods, the Fund would cease to qualify for the favorable tax treatment afforded to regulated investment companies under the Code. See "Taxation."

In certain emerging countries that currently preclude direct foreign investment in the securities of their companies, indirect foreign investment in the securities of companies listed and traded on the stock exchanges in these countries is permitted through investment funds which have been specifically authorized. The Fund may invest in these investment funds subject to the provisions of the 1940 Act as discussed below under "Investment Restrictions." If the Fund invests in such investment funds, the Fund's shareholders will bear not only their proportionate share of the expenses of the Fund (including operating expenses and the fees of BEA Associates), but also indirectly will bear similar expenses of the underlying investment funds. See also "Taxation—United States Federal Income Taxes—Passive Foreign Investment Companies."

Market Illiquidity

The securities markets of emerging countries are substantially smaller, less liquid and more volatile than the major securities markets in the United States. A high proportion of the securities of many companies in emerging countries may be held by a limited number of persons, which may limit the number of securities available for investment by the Fund. A limited number of issuers in many emerging country securities markets may represent a disproportionately large percentage of market capitalization and trading value. The limited liquidity of emerging country securities markets may also affect the Fund's ability to acquire or dispose of securities at the price and time it wishes to do so. These characteristics may be magnified in relation to the Fund in light of its policy of concentrating in the telecommunications industry and its ability to invest a substantial portion of its remaining assets in companies that provide other essential services in the development of an emerging country's infrastructure.

In addition to their smaller size, lesser liquidity and greater volatility, emerging country securities markets are less developed than U.S. securities markets. Disclosure and regulatory standards are in many respects less stringent than U.S. standards. Furthermore, there may be a low level of monitoring and regulation of the markets and the activities of investors in such markets and the enforcement of existing regulations may be extremely limited. Consequently, the prices at which the Fund may acquire investments may be affected by other market participants' anticipation of the Fund's investing, by trading by persons with material non-public information and by securities transactions by brokers in anticipation of transactions by the Fund in particular securities. Commissions and other transaction costs associated with emerging country securities exchanges are generally higher than in the United States.

Currency Devaluations and Fluctuations

The Fund normally will invest principally in securities denominated in currencies of emerging countries. Accordingly, a change in the value of these currencies against the U.S. dollar will result in a corresponding change in the U.S. dollar value of the Fund's assets denominated in those currencies. Such changes will also affect the Fund's income. The Fund will compute its income on the date of its receipt by the Fund at the exchange rate in effect with respect to the relevant currency on that date. If the value of such currency declines relative to the U.S. dollar between the date income is received and the date the Fund makes distributions, the Fund may need to liquidate portfolio securities to make distributions to shareholders. There can be no assurance that the Fund will be able to liquidate securities in order to meet such distribution requirements. The Fund is permitted to borrow money to make distributions required to maintain its status as a regulated investment company for U.S. tax purposes. If the exchange rate against the U.S. dollar of a currency in which a portfolio security is denominated declines between the time the Fund incurs expenses in U.S. dollars and the time cash expenses are paid, the amount of such currency required to be converted into U.S. dollars in order to pay expenses in U.S. dollars will be greater than the equivalent amount in such currency of such expenses at the time they are incurred. Many of the currencies of emerging countries have experienced steady devaluations relative to the U.S. dollar, and major adjustments have been made in certain of them at times.

Inflation

Many emerging countries have experienced substantial, and in some periods extremely high, rates of inflation for many years. Inflation and rapid fluctuations in inflation rates have had and may continue to have negative effects on the economies and securities markets of certain emerging countries. In an attempt to control inflation, wage and price controls have been imposed at times in certain countries.

Political and Economic Factors

The economies of individual emerging countries may differ favorably or unfavorably from the U.S. economy in such respects as the rate of growth of gross domestic product, the rate of inflation, capital reinvestment, resource self-sufficiency and balance of payments position. Governments of many emerging countries have exercised and continue to exercise substantial influence over many aspects of the private sector. In some cases, the government owns or controls many companies, including some of the largest in the country. Accordingly, government actions in the future could have a significant effect on economic conditions in an emerging country, which could affect private sector companies and the Fund, and on market conditions, prices and yields of securities in the Fund's portfolio. Expropriation, confiscatory taxation, nationalization, political, economic or social instability or other developments could adversely affect the assets of the Fund held in particular emerging countries. Moreover, it may be more difficult to obtain a judgment in a court outside the United States. Interest and dividends paid on securities held by the Fund and gains from the disposition of such securities may be subject to withholding taxes imposed by emerging countries.

Loan Participations

The debt securities held by the Fund may include Loans and Assignments of and Participations in Loans, as defined below. Loans are fixed and floating rate debt obligations arranged through private negotiations between a borrower and one or more financial institutions ("Lenders") represented in each case by one or more Lenders acting as agent ("Agent") of the several Lenders. The Agent is frequently the commercial bank that originated the Loan on behalf of the several Lenders and was primarily responsible for negotiating the loan agreement or agreements ("Loan Agreement") relating to the Loan. In larger transactions it is common to have several Agents, although only one Agent typically has primary responsibility for documentation and administration of the Loan.

The Fund will invest in participations ("Participations") in Loans and will purchase assignments ("Assignments") of portions of Loans from third parties. The majority of the Fund's investments in Loans will be in Assignments and Participations of new Loans.

Loan Agreements may include various restrictive covenants designed to limit the activities of the borrower in an effort to protect the right of the Lenders to receive timely payments of interest on and repayment of principal of the Loans. Restrictive covenants in Loan Agreements may include mandatory prepayment provisions arising from excess cash flow and typically include restrictions on dividend payments, specific mandatory minimum financial ratios, limits on total debt and other financial tests. Breach of the covenants, if not waived by the Lenders, is generally an event of default under the applicable Loan Agreement and may give the Lenders the right to accelerate principal and interest payments. BEA Associates will consider the terms of any restrictive covenants, as well as the performance history of the Loans, in deciding whether to invest in Loans for the Fund's portfolio.

The Fund's investment in Participations in a Lender's portion of a Loan typically will result in the Fund having a contractual relationship only with the Lender, not with the borrower. The Fund will have the right to receive payments of principal, interest and any fees to which it is entitled only from the Lender selling the Participation and only upon receipt by the Lender of the payments from the borrower. In connection with purchasing Participations, the Fund generally will have no right to enforce compliance by the borrower with the terms of the Loan Agreement, nor any rights of set-off against the borrower, and the Fund may not directly benefit from any collateral supporting the Loan in which it has purchased the Participation. As a result, the Fund will assume the credit risk of both the borrower and the Lender selling the Participation. In the event of the insolvency of the Lender selling a Participation, the Fund may be treated as a general creditor of the Lender, and may not benefit from any set-off between the Lender and the borrower. The Fund will acquire Participations only if the Lender interpositioned between the Fund and the borrower is deemed by BEA Associates to be creditworthy.

The Fund also may purchase Assignments from Lenders under which it will succeed to all the rights and obligations under the Loan Agreement of the assigning Lender and become a Lender under the Loan Agreement with the same rights and obligations as the assigning Lender. Assignments are, however, arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an Assignment may differ from, and be more limited than, those held by the assigning Lender. The Fund may have difficulty disposing of Assignments and Participations because to do so it will have to assign such securities to a third party. Because there is no liquid market for such securities, the Fund anticipates that such securities could be sold only to a limited number of institutional investors. The lack of a liquid secondary market may have an adverse impact on the value of such securities and the Fund's ability to dispose of particular Assignments or Participations when necessary to meet the Fund's liquidity needs or in response to a specific economic event such as a deterioration in the creditworthiness of the borrower. The lack of a liquid secondary market for Assignments and Participations also may make it more difficult for the Fund to assign a value to these securities for purposes of valuing the Fund's portfolio and calculating its net asset value.

Sovereign Debt

Investments in debt securities issued by governments of emerging countries involve special risks. The issuer or governmental authority that controls the repayment of such sovereign debt may not be able or willing to repay the principal and/or interest when due in accordance with the terms of such debt. A debtor's willingness or ability to repay principal and interest due in a timely manner may be affected by, among other factors, its cash flow situation, and, in the case of a sovereign debtor, the extent of its foreign reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the sovereign debtor's policy towards the International Monetary Fund and the political constraints to which a sovereign debtor may be subject. Sovereign debtors may default on their debt and may also be dependent on expected disbursements from foreign governments, multilateral agencies and others abroad to reduce principal and interest arrearages on their debt. The commitment on the part of these governments, agencies and others to make such disbursements may be conditioned on a sovereign debtor's implementation of economic reforms and/or economic performance and the timely service of such debtor's obligations. Failure to implement such reforms, achieve such levels of economic performance or repay principal or interest when due may result in the cancellation of such third parties' commitments to lend funds to the sovereign debtor, which may further impair such debtor's ability or willingness to timely service its debts.

Holders of sovereign debt, including the Fund, may be requested to participate in the rescheduling of such debt and to extend further loans to sovereign debtors. There is no bankruptcy proceeding by which sovereign debt on which a sovereign entity has defaulted may be collected in whole or in part. See "Investment Objective and Policies—General."

Debt Securities

It is likely that many of the debt securities in which the Fund will invest will be unrated, and whether or not rated, such securities may have speculative characteristics. Such debt securities involve great risk and are deemed to be the equivalent in terms of quality to securities rated below investment grade by Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Corporation ("S&P"). Such securities are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal in accordance with the terms of the obligations and involve major risk when the issuer faces adverse financial conditions. Some of such debt securities, which may not be paying interest currently or may be in payment default, may be comparable to securities rated D by S&P or C by Moody's. The Fund may have difficulty disposing of certain such obligations because there may be a thin trading market for such securities, which may have an adverse impact on the market price of such securities, the Fund's ability to dispose of such obligations and the Fund's obtaining accurate market quotations for purposes of valuing its portfolio and calculating net asset value.

Reporting Standards

Companies in emerging countries are subject to accounting, auditing and financial standards and requirements that differ, in some cases significantly, from those applicable to U.S. companies. The assets and profits appearing on the financial statements of a company in an emerging country may not reflect its financial position or results of operations in the way they would be reflected had such financial statements been prepared in accordance with U.S. generally accepted accounting principles. In addition, for companies that keep accounting records in local currency, inflation accounting rules in some emerging countries require, for both tax and accounting purposes, that certain assets and liabilities be restated on the company's balance sheet in order to express items in terms of currency of constant purchasing power. Inflation accounting may indirectly generate losses or profits. Consequently, financial data may be materially affected by restatements for inflation and may not accurately reflect the real condition of companies and securities markets. There may be substantially less publicly available information about companies in an emerging country than there is about U.S. companies.

Operating Expenses

The Fund's estimated annual operating expenses, which are higher than those of many other investment companies of comparable size, are believed by the Fund's management to be comparable to expenses of other closed-end management investment companies that invest primarily in the securities of emerging countries.

INVESTMENT OBJECTIVE AND POLICIES

General

The Fund's investment objective is long-term capital appreciation. The Fund seeks to achieve this objective by investing in equity securities of telecommunications companies and companies that provide other essential services in the development of an emerging country's infrastructure. The Fund's investment objective is a fundamental policy and cannot be changed without the approval of the holders of a majority of the Fund's outstanding voting securities. As used herein, a "majority of the Fund's outstanding voting securities" means the lesser of (i) 67% of the shares of the Fund's common stock, \$.001 par value per share (the "Common Stock"), represented at a meeting at which more than 50% of the outstanding shares of the Fund's Common Stock are represented, or (ii) more than 50% of the outstanding shares of the Fund's Common Stock. No assurance can be given that the Fund's investment objective will be achieved.

It is the policy of the Fund, under normal market conditions, to invest not less than 65% of the Fund's total assets in equity securities of telecommunications companies in emerging countries. As used in this Prospectus, an emerging country is any country which is generally considered to be an emerging or developing country by the International Bank for Reconstruction and Development (more commonly referred to as the World Bank) and the International Finance Corporation, as well as countries that are classified by the United Nations or otherwise regarded by its authorities as emerging or developing, at the time of the Fund's investment. The countries that will not be considered emerging countries include: Australia; Austria; Belgium; Canada; Denmark; Finland; France; Germany; Ireland; Italy; Japan; Luxembourg; Netherlands; New Zealand; Norway; Spain; Sweden; Switzerland; United Kingdom; and United States. A substantial portion of the Fund's remaining assets under normal circumstances (up to 25% of the Fund's total assets) will be invested in equity securities of companies that provide other essential services in the development of an emerging country's infrastructure and will benefit from macroeconomic growth in an emerging country, but whose growth is not directly linked to favorable changes in commodity prices. Examples of such infrastructure companies in which the Fund may invest include electric and gas utilities, oil and gas distribution companies and companies that have toll-road concessions. The Fund may also seek to invest in equity securities of telecommunications companies in developed countries when these securities, in the opinion of the Fund's investment adviser, have investment characteristics similar to emerging country telecommunications companies. In determining if the securities of a telecommunications company in a developed country has investment characteristics similar to those of emerging country telecommunications companies, the Fund's investment adviser will consider whether the potential for growth in such company is similar to that of telecommunications companies in emerging countries, based on analysis and comparison of such factors as earnings potential, ratio of revenue per employee and revenue per telephone line, the density of telephone lines per household, management performance and other pertinent measurements.

Many of the companies in which the Fund invests may be in the early stages of their growth cycle and/or may have only recently been privatized; accordingly, the Fund anticipates that certain investments (up to 25% of the Fund's total assets at the time of purchase) will be in equity securities of closely-held companies or private placements of public companies, where BEA Associates anticipates that a liquid market will develop for these securities within a period of two to five years from the date such securities are acquired by the Fund. Securities that are not publicly traded in the United States but that can be sold to "qualified institutional buyers" pursuant to Rule 144A under the Securities Act of 1933, as amended, will not be subject to the 25% limitation if the Fund's Board of Directors determines on an ongoing basis that an adequate trading market exists for these securities. The Board of Directors may adopt guidelines and delegate to BEA Associates the function of determining and monitoring the liquidity of Rule 144A securities, although the Board of Directors will retain ultimate responsibility for any determination regarding an adequate market for Rule 144A securities.

The Fund does not intend to invest in any security in a country where the currency is not freely convertible to U.S. dollars, unless the Fund has obtained the necessary governmental licensing to convert such currency or other appropriately licensed or sanctioned contractual guarantee to protect such investment against loss of that currency's external value, or the Fund has a reasonable expectation at the time the investment is made that such governmental licensing or other appropriately licensed or sanctioned guarantee would be obtained or that the currency in which the security is quoted would be freely convertible at the time of any proposed sale of the security by the Fund.

An emerging country equity security is defined as common stock and preferred stock (including convertible preferred stock); bonds, notes and debentures convertible into common or preferred stock; stock purchase warrants and rights; equity interests in trusts and partnerships; and American, Global or other types of Depositary Receipts of companies: (i) the principal securities trading market for which is in an emerging country; (ii) whose principal trading market is in any country, provided that, alone or on a consolidated basis, they derive 50% or more of their annual revenue from either goods produced, sales made or services performed in emerging countries; or (iii) that are organized under the laws of, and with a principal office in, an emerging country. Determinations as to eligibility will be made by the Fund based on publicly available information and inquiries made to the companies. (See "Special Considerations and Risk Factors" for a discussion of the nature of information publicly available for non-U.S. companies.)

The Fund's definition of emerging country equity securities includes securities of companies that may have characteristics and business relationships common to companies in a country or countries other than an emerging country. As a result, the value of the securities of such companies may reflect economic and market forces applicable to other countries, as well as to an emerging country. BEA Associates believes, however, that investment in such companies will be appropriate because the Fund will invest only in those companies which, in its view, have sufficiently strong exposure to economic and market forces in an emerging country such that their value will tend to reflect developments in such emerging country to a greater extent than developments in another country or countries. For example, the Fund may invest in companies organized and located in countries other than an emerging country, including companies having their entire production facilities outside of an emerging country, when securities of such companies meet one or more of the three elements of the Fund's definition of emerging country equity securities set forth above and so long as BEA Associates believes at the time of investment that the value of the company's securities principally will reflect conditions in such emerging country.

To the extent that the Fund's assets are not invested as described above, the remainder of the assets may be invested in (i) debt securities denominated in the currency of an emerging country or issued or guaranteed by an emerging country company or the government of an emerging country, (ii) equity or debt securities of corporate or governmental issuers located in developed countries, and (iii) short-term and medium-term debt securities of the type described below under "Temporary Investments." The Fund's assets may be invested in debt securities when BEA Associates believes that, based upon factors such as relative interest rate levels and foreign exchange rates, such debt securities offer opportunities for long-term capital appreciation. The debt securities in which the Fund may invest include bonds, notes, bank deposits and bank obligations (including certificates of deposit, time deposits and bankers' acceptances), commercial paper, repurchase agreements, assignments of loans and loan participations. See "Special Considerations and Risk Factors—Debt Securities." In addition, for temporary defensive purposes, the Fund may invest less than 65% of its total assets in equity securities of telecommunications companies in emerging countries, in which case the Fund may invest in debt securities of the kind described under "Temporary Investments" below.

The Fund may invest indirectly in securities of emerging country issuers through sponsored or unsponsored American Depositary Receipts ("ADRs"), Global Depositary Receipts ("GDRs") and other types of Depositary Receipts (which, together with ADRs and GDRs, are hereinafter referred to as "Depositary Receipts"). Depositary Receipts may not necessarily be denominated in the same currency as the underlying securities into which they may be converted. In addition, the issuers of the stock of unsponsored Depositary Receipts are not obligated to disclose material information in the United States and, therefore, there may not be a correlation between such information and the market value of the Depositary Receipts. ADRs are Depositary Receipts typically issued by a United States bank or trust company which evidence ownership of underlying securities issued by a foreign corporation. GDRs and other types of Depositary Receipts are typically issued by foreign banks or trust companies, although they also may be issued by United States banks or trust companies, and evidence ownership of underlying securities issued by either a foreign or a United States corporation. Generally, Depositary Receipts in registered form are designed for use in the United States securities markets and Depositary Receipts in bearer form are designed for use in securities markets outside the United States. For purposes of the Fund's investment policies, the Fund's investments in ADRs, GDRs and other types of Depositary Receipts will be deemed to be investments in the underlying securities.

In selecting companies for investment, BEA Associates generally will consider such factors as overall growth prospects, competitive position, leadership in technology, quality of management, financial strength, price/earnings ratios, research and development, productivity, production costs, profit margin, return on investment, capital resources, government regulation, price of securities and other factors.

Concentration

The Fund intends to concentrate its investments in telecommunications companies so that, under normal market conditions, not less than 65% of the Fund's total assets will be invested in equity securities issued by telecommunications companies in emerging countries. If adverse economic conditions prevail in the telecommunications industry at some future date, the Fund, for defensive purposes, temporarily may invest less than 65% of its total assets in the telecommunications industry. The Fund's concentration policy with respect to investing in securities issued by telecommunications companies in emerging countries is a fundamental policy of the Fund and cannot be changed without approval by the vote of a majority of the Fund's outstanding voting securities. A substantial portion of the Fund's remaining assets under normal circumstances (up to 25% of the Fund's total assets) will be invested in equity securities of companies that provide other essential services in the development of an emerging country's infrastructure and will benefit from macroeconomic growth in an emerging country, but whose growth is not directly linked to favorable changes in commodity prices. The Fund may also seek to invest in equity securities of telecommunications companies in developed countries when such securities, in the opinion of BEA Associates, have investment characteristics similar to emerging country telecommunications companies.

Consistent with the limitations set forth in the preceding paragraph, the portion of the Fund's assets invested in the telecommunications and other industries will vary from time to time. The concentration of the Fund's assets in the telecommunications industry and significant investment of the Fund's assets in the industries comprised of infrastructure companies are each a source of potential risk, although the Fund intends to diversify its investments among issuers in order to reduce risk.

Telecommunications Stocks. Telecommunications companies may engage in any of the following activities: (a) operation of, development, financing or manufacture and sale of equipment relating to long distance and local telephone services, cellular radio telephone services and other radio common carrier communications services, including paging and specialized mobile radio systems; and (b) production, financing and operation of telegraph, satellite, microwave and private communications networks, electronic mail and other emerging telecommunications technologies.

Many of the telecommunications companies in emerging countries in which the Fund will invest face great demand for basic telecommunications services incorporating equipment and technology which already exist, but which are limited due to lack of national infrastructure and other reasons. In addition, the telecommunications companies of all nations, including emerging countries, are and will be faced with rapidly developing new technologies and equipment and expanding demand for new services. Telecommunications companies will have to react to new innovations which will increase the efficiency of existing modes of communication and to newly created innovative modes of communication which may supplement or replace existing telecommunications systems.

Portfolio Turnover

The Fund does not expect to trade in securities for short-term gain. It is anticipated that the Fund's annual portfolio turnover rate will not exceed 75%. This rate is calculated by dividing the lesser of sales or purchases of portfolio securities for any given year by the average monthly value of the Fund's portfolio securities for such year. For purposes of this calculation, portfolio securities exclude purchases and sales of debt securities having a maturity at the date of purchase of one year or less. Portfolio turnover directly affects the amount of transaction costs that will be borne by the Fund. The rate of portfolio turnover will not be a limiting factor when BEA Associates deems it appropriate to purchase or sell securities for the Fund. However, the Code requirement that the Fund derive less than 30% of its gross income from the sale or other disposition of stock or securities held less than three months in order to qualify for regulated investment company status may limit the Fund's ability to dispose of its securities. See "Taxation—United States Federal Income Taxes."

Temporary Investments

During periods in which BEA Associates believes changes in economic, financial or political conditions make it advisable, the Fund may for temporary defensive purposes reduce its holdings in equity and other securities and invest in certain short-term (less than twelve months to maturity) and medium-term (not greater than five years to maturity) debt securities or hold cash. The short-term and medium-term debt securities in which the Fund may invest consist of: (a) obligations of the United States or emerging country governments, their respective agencies or instrumentalities; (b) bank deposits and bank obligations (including certificates of deposit, time deposits and bankers' acceptances) of U.S. or emerging country banks denominated in any currency; (c) floating rate securities and other instruments denominated in any currency issued by international development agencies; (d) finance company and corporate commercial paper and other short-term corporate debt obligations of U.S. and emerging country corporations meeting the Fund's credit quality standards; and (e) repurchase agreements with banks and broker-dealers with respect to such securities. The Fund intends to invest only in short-term and medium-term debt securities that BEA Associates believes to be of high quality, i.e., rated in one of the two highest rating categories by Moody's or S&P or, if unrated, determined to be equivalent in credit quality by BEA Associates. The Fund will also invest in the instruments described above pending investment of the net proceeds of the Offerings.

Repurchase agreements with respect to the securities described in the preceding paragraph are contracts under which a buyer of a security simultaneously commits to resell the security to the seller at an agreed-upon price and date. Under a repurchase agreement, the seller is required to maintain the value of the securities subject to the repurchase agreement at not less than their repurchase price. BEA Associates will monitor the value of such securities daily to determine that the value equals or exceeds the repurchase price. Repurchase agreements may involve risks in the event of default or insolvency of the seller, including possible delays or restrictions upon the Fund's ability to dispose of the underlying securities.

Lending of Portfolio Securities

Consistent with applicable regulatory requirements, the Fund may lend its portfolio securities to securities broker-dealers or financial institutions, provided that the loans are callable at any time by the Fund (subject to the notice provisions described below) and are at all times secured by cash or cash equivalents which are maintained in a segregated account pursuant to applicable regulations and that are equal to at least the market value, determined daily, of the loaned securities. The advantage of making such loans is that the Fund continues to receive the income on the loaned securities while at the same time earning interest on the cash amounts deposited as collateral, which will be invested in short-term obligations. The Fund will not lend more than 33% of the value of its total assets.

A loan may generally be terminated by the borrower on one business day's notice or by the Fund on five business days' notice. If the borrower fails to deliver the loaned securities within five days after receipt of notice, the Fund could use the collateral to replace the securities while holding the borrower liable for any excess of replacement cost over collateral. As with any extensions of credit, there are risks of delay in recovery and in some cases even loss of rights in the collateral should the borrower of the securities fail financially. However, loans of portfolio securities will only be made to firms deemed by the Fund's management to be creditworthy and when the income that can be earned from the loans justifies the attendant risks. The Board of Directors of the Fund will oversee the creditworthiness of the contracting parties on an ongoing basis. Upon termination of the loan, the borrower is required to return the securities to the Fund. Any gain or loss in the market price during the loan period would inure to the Fund. The risks associated with loans of portfolio securities are substantially similar to those associated with repurchase agreements.

When voting or consent rights that accompany loaned securities pass to the borrower, the Fund will follow the policy of calling the loaned securities, to be delivered within one day after notice, to permit the exercise of such rights if the matters involved would have a material effect on the Fund's investment in such loaned securities. The Fund may pay reasonable finder's, administrative and custodial fees in connection with a loan of its securities.

Currency Transactions

BEA Associates generally will not seek to hedge against a decline in the value of the Fund's non-dollar-denominated portfolio securities resulting from a currency devaluation or fluctuation unless suitable hedging instruments are available on a timely basis and on acceptable terms. Under these circumstances, BEA Associates may, in its discretion, hedge all or part of the value of the Fund's non-dollar-denominated portfolio securities, although it is not obligated to do so. Unless the Fund engages in hedging transactions, it will be subject to the risk of changes in value of the emerging country currencies in which its assets are denominated. In addition to hedging against a decline in the value of its portfolio assets, the Fund may from time to time seek to protect, during the time prior to the remittance, the value of the amounts of interest, dividends and net realized capital gains received or to be received in a local currency that it intends to remit out of a particular emerging country by investing such amounts in U.S. dollar-denominated debt securities and engaging in the forward currency market for the purchase of U.S. dollars in the subject country. There can be no guarantee that suitable U.S. dollar-denominated investments will be available at the time BEA Associates wishes to use them to hedge amounts to be remitted. Moreover, investors should be aware that the forward currency market for the purchase of U.S. dollars in many emerging countries is not highly developed. In certain countries no forward market for foreign currencies currently exists and in other countries such markets may be closed to investment by the Fund. Consequently, the risk of currency devaluations and fluctuations should be carefully considered by investors in determining whether to purchase shares of the Fund.

The Fund will conduct any currency exchange transactions either on a spot, i.e., cash, basis at the rate prevailing in the currency exchange market, or through entering into forward contracts to purchase or sell currency. A forward currency contract typically involves an obligation to purchase or sell a specific currency at a future date, which may be any fixed number of days from the date of the contract agreed upon by the parties, at a price set at the time of the contract. If the Fund enters into a forward contract, the Fund's U.S. or non-U.S. custodian will place cash or readily marketable securities in a segregated account of the Fund in an amount equal to the value of the Fund's total assets committed to the consummation of the forward contract. If the value of the securities placed in the segregated account declines, additional cash or securities will be placed in the account so that the value of the account will equal the amount of the Fund's commitment with respect to the contract.

At or before the maturity of a forward contract, the Fund may either sell a portfolio security and make delivery of the currency or retain the security and offset its contractual obligation to deliver the currency by purchasing a second contract pursuant to which the Fund will obtain, on the same maturity date, the same amount of the currency which it is obligated to deliver. If the Fund retains the portfolio security and engages in an offsetting transaction, the Fund, at the time of execution of the offsetting transaction, will incur a gain or a loss to the extent that movement has occurred in forward contract prices. Should forward prices decline during the period between the Fund's entering into a forward contract for the sale of a currency and the date it enters into an offsetting contract for the purchase of the currency, the Fund will realize a gain to the extent the price of the currency it has agreed to sell exceeds the price of the currency it has agreed to purchase. Should forward prices increase, the Fund will suffer a loss to the extent the price of the currency it has agreed to purchase exceeds the price of the currency it has agreed to sell.

The cost to the Fund of engaging in currency transactions will vary with respect to factors such as the length of the contract period and the market conditions then prevailing. Because forward currency exchange transactions are usually conducted on a principal basis, no fees or commissions are involved, although the price charged in the transaction includes a dealer's markup. The use of forward currency contracts does not eliminate fluctuations in the underlying prices of the securities, but it does establish a rate of exchange that can be achieved in the future. In addition, although forward currency contracts limit the risk of loss due to a decline in the value of the hedged currency, at the same time they limit any potential gain that might result should the value of the currency increase.

If a devaluation is generally anticipated, the Fund may not be able to contract to sell the currency at a price above the devaluation level it anticipates.

There is a risk that the U.S. dollar value of the Fund's dividends, interest and net realized capital gains in local currency will decline, to the extent of any devaluation of the currency, during the interval between the time the Fund becomes entitled to receive or receives dividends and interest and realizes gains and the time such amounts are converted into U.S. dollars for remittance.

INVESTMENT RESTRICTIONS

The Fund has adopted certain fundamental investment restrictions that may not be changed without the prior approval of the holders of a majority of the Fund's outstanding voting securities. For purposes of the restrictions listed below, all percentage limitations apply immediately after a purchase or initial investment, and any subsequent change in any applicable percentage resulting from market fluctuations does not require elimination of any security from the Fund's portfolio. Fund policies that are not fundamental may be modified by the Board of Directors if, in the reasonable exercise of the Board's business judgment, modification is determined to be necessary or appropriate to carry out the Fund's investment objective. Under its fundamental investment restrictions, the Fund may not:

1. Issue senior securities, borrow money or pledge its assets, except that the Fund may borrow from a lender (i) for temporary or emergency purposes, (ii) for such short-term credits as may be necessary for the clearance or settlement of the transactions, (iii) to finance repurchases of its shares (see "Common Stock"), in amounts not exceeding 10% (taken at the lower of cost or current value) of its total assets (not including the amount borrowed), or (iv) to pay any dividends required to be distributed in order for the Fund to maintain its qualification as a regulated investment company under the Code or otherwise to avoid taxation under the Code. Additional investments will not be made when borrowings exceed 5% of the Fund's total assets. The Fund may pledge its assets to secure such borrowings. For the purpose of this investment restriction, collateral arrangements with respect to the writing of options or the purchase or sale of future contracts or related options or forward currency contracts are not deemed a pledge of assets or the issuance of a senior security.

2. Lend money to other persons except through (i) the purchase of debt obligations, loans or participation interests in loans, (ii) the entering into of repurchase agreements and (iii) lending its portfolio securities consistent with applicable regulatory requirements, in each case consistent with the Fund's investment objective and policies.

3. Make short sales of securities or maintain a short position in any security.

4. Purchase securities on margin, except such short-term credits as may be necessary or routine for the clearance or settlement of transactions and the maintenance of margin with respect to forward contracts or other hedging securities.

5. Underwrite securities of other issuers, except insofar as the Fund may be deemed an underwriter under applicable securities laws in selling portfolio securities.

6. Purchase or sell commodities or real estate, except that the Fund may invest in securities secured by real estate or interests in real estate or in securities issued by companies, including real estate investment trusts, that invest in real estate or interests in real estate, and may purchase and sell forward contracts on foreign currencies to the extent permitted under applicable law.

7. Make investments for the purpose of exercising control over, or management of, the issuers of any securities.

8. Invest more than 25% of its total assets in the securities of issuers in any single industry other than the telecommunications industry, except that this limitation will not be applicable to the

purchase of obligations issued or guaranteed by the U.S. Government or its agencies or instrumentalities.

Except for the Fund's investment objective, the Fund's policy of investing at least 65% of its total assets in equity securities of telecommunications companies in emerging countries and the investment restrictions listed above, the other policies and percentage limitations set forth in this Prospectus are not fundamental policies or investment restrictions of the Fund and can be changed by the Board of Directors.

In addition to the restrictions described above, some emerging countries limit, or prohibit, all direct foreign investment in the securities of their companies. See "Special Considerations and Risk Factors—Investment Controls." However, the governments of some emerging countries have authorized the organization of investment funds to permit indirect foreign investment in such securities. Under the 1940 Act, the Fund may neither invest more than 5% of its total assets in the securities of any one investment fund nor acquire more than 3% of the outstanding voting securities of any such fund. In addition, the Fund may not invest more than 10% of its total assets in securities issued by all investment funds. These provisions may limit the ability of the Fund to invest in some of the special emerging country investment funds. To the extent that this restriction limits the Fund's investments in emerging countries, and subject to the approval of the Securities and Exchange Commission (as to which no assurance can be given), the Fund may create its own investment fund or may exceed these limits.

MANAGEMENT OF THE FUND

Directors and Officers

The names of the directors and principal officers of the Fund are set forth below, together with their positions and their principal occupations during the past five years.

Name and Address	Position with the Fund
Emilio Bassini* One Citicorp Center 58th Floor 153 East 53rd Street New York, New York 10022	Director, Chairman of the Board, President and Chief Investment Officer
Piers Playfair* One Citicorp Center 58th Floor 153 East 53rd Street New York, New York 10022	Director, Executive Vice President and Investment Officer
Peter A. Gordon 28 East 63rd Street New York, New York 10021	Director
George W. Landau 680 Park Avenue New York, New York 10021	Director
Martin M. Torino Reconquista 575 Buenos Aires, Argentina	Director
Michael A. Pignataro One Citicorp Center 58th Floor 153 East 53rd Street New York, New York 10022	Chief Financial Officer, Chief Accounting Officer, Treasurer and Secretary

* Messrs. Bassini and Playfair are "interested persons" of the Fund within the meaning of the 1940 Act by virtue of their positions as directors and/or officers of BEA Associates.

Emilio Bassini is a member of the Executive Committee, Chief Financial Officer and Managing Director of BEA Associates (since 1985). Mr. Bassini is also a director, Chairman of the Board, President and Chief Investment Officer of The Latin America Investment Fund, Inc. and The Latin America Equity Fund, Inc., a director, President and Chief Investment Officer of The Chile Fund, Inc. and The Portugal Fund, Inc., a director, Chairman of the Board, President and Chief Executive Officer of The Brazilian Equity Fund, Inc. and President and Secretary of The Indonesia Fund, Inc.

Piers Playfair is a Senior Vice President of BEA Associates (since January 1992) and has been with BEA Associates since August 1990. Mr. Playfair is a director, Executive Vice President and Investment Officer of The Latin America Equity Fund, Inc. and a director, Executive Vice President and Chief Investment Officer of The Brazilian Equity Fund, Inc. From 1985 until 1990, Mr. Playfair was a director of the Equity Capital Markets Group of Salomon Brothers Inc.

Peter A. Gordon is a financial consultant. From 1981 to February 1992, Mr. Gordon was a managing director of international corporate finance activities at Salomon Brothers Inc. Mr. Gordon is also a director of TCS Fund Inc., a trustee of the Contemporary Art Institute of New York and a director of the American Friends of Canada.

George W. Landau is President of the Americas Society and Council of the Americas (since July 1985) and is also a director of The Latin America Investment Fund, Inc., The Latin America Equity Fund, Inc., The Chile Fund, Inc. and The Brazilian Equity Fund, Inc. Ambassador Landau served as

United States Ambassador to Venezuela from 1982 to 1985, United States Ambassador to Chile from 1977 to 1982 and United States Ambassador to Paraguay from 1972 to 1977. He is a Member of the Council on Foreign Relations and a director of the Emigrant Savings Bank as well as the Chairman of the Latin American Advisory Board of the Coca-Cola Corporation.

Martin M. Torino has been the Executive Director of TAU S.A., a commodities trading firm, since November 1990. Mr. Torino is also a director of Greenwich Investments (Buenos Aires), an investment bank, since January 1991; President of San Lucas S.A., an agribusiness, since October 1990; and President of Dipoler S.A., a grain processing company, since October 1989. Mr. Torino has also been a member of the Coffee, Sugar & Cocoa Exchange, Inc. since 1985. Mr. Torino, from 1984 until 1990, was Vice President of Louis Dreyfus Sugar Company, Inc., a commodities trading firm. Mr. Torino is also a director of The Latin America Investment Fund, Inc., The Latin America Equity Fund, Inc., The Portugal Fund, Inc. and The Brazilian Equity Fund, Inc.

Michael A. Pignataro is an Assistant Vice President and the Chief Administrative Officer for Investment Companies of BEA Associates (since August 1984). Mr. Pignataro is also the Chief Financial Officer, Chief Accounting Officer, Treasurer and Secretary of The Latin America Equity Fund, Inc., The Latin America Investment Fund, Inc., The Portugal Fund, Inc., The Chile Fund, Inc. and The Brazilian Equity Fund, Inc. and Chief Financial Officer, Treasurer and Assistant Secretary of The Indonesia Fund, Inc.

The Fund intends to pay each of its directors who is not a director, officer or employee of BEA Associates or any affiliate thereof an annual fee of $5,000 plus $500 for each Board of Directors meeting attended. In addition, the Fund will reimburse those directors for travel and out-of-pocket expenses incurred in connection with Board of Directors meetings.

The Articles of Incorporation and Bylaws of the Fund provide that the Fund will indemnify directors and officers and may indemnify employees or agents of the Fund against liabilities and expenses incurred in connection with litigation in which they may be involved because of their positions with the Fund to the fullest extent permitted by law. In addition, the Fund's Articles of Incorporation provide that the Fund's directors and officers will not be liable to shareholders for money damages, except in limited instances. However, nothing in the Articles of Incorporation or the Bylaws of the Fund protects or indemnifies a director, officer, employee or agent against any liability to which such person would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office. No insurance obtained by the Fund shall protect or purport to protect officers or directors, the investment adviser or any principal underwriter of the Fund against any liability to the Fund or its shareholders to which they would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of their obligations and duties.

Commencing with the first annual meeting of shareholders, the Board of Directors will be divided into three classes, having terms of one, two and three years, respectively. At the annual meeting of shareholders in each year thereafter, the term of one class will expire and directors will be elected to serve in that class for terms of three years. See "Common Stock—Special Voting Provisions."

BEA Associates

BEA Associates serves as the Fund's investment adviser pursuant to an Advisory Agreement with the Fund (the "Advisory Agreement"). BEA Associates is a general partnership organized under the laws of the State of New York and, together with its predecessor firms, has been engaged in the investment advisory business for over 50 years. Credit Suisse Capital Corporation ("CS Capital") is an 80% partner and Basic Appraisals, Inc. is a 20% partner in BEA Associates. CS Capital is a wholly-owned subsidiary of Credit Suisse Investment Corporation, which is a wholly-owned subsidiary of Credit Suisse, the third largest Swiss bank, which in turn is a subsidiary of CS Holding, a Swiss corporation. No one person or entity possesses a controlling interest in Basic Appraisals, Inc. BEA Associates is registered as an investment adviser under the Investment Advisers Act of 1940, as amended.

BEA Associates is a diversified asset manager, handling global equity, balanced, fixed income and derivative securities accounts for private individuals, as well as corporate pension and profit-sharing plans, state pension funds, union funds, endowments and other charitable institutions. As of April 30, 1992, BEA Associates managed approximately $15.7 billion in assets.

As an investment adviser, BEA Associates emphasizes a global investment strategy. BEA Associates currently acts as investment adviser for eleven investment funds that invest primarily in equity securities with total assets at April 30, 1992 exceeding $1.0 billion, including six funds registered under the 1940 Act—The Chile Fund, Inc., The Portugal Fund, Inc., The Latin America Investment Fund, Inc., The Indonesia Fund, Inc., The Latin America Equity Fund, Inc. and The Brazilian Equity Fund, Inc.—and five offshore funds—The South America Fund N.V., the Mexican Investment Company, The Brazilian Equity Investments Partnership, Universal Global Fund and Universal Emerging Markets Fund. BEA Associates also acts as Latin American debt adviser for Strategic Global Income Fund, Inc., which is also registered under the 1940 Act, and to three offshore funds focusing on investments in debt securities—the BEA/VestcorP Latin American Debt Fund Ltd., The Argentina Debt Fund N.V. and The Mexican Liquid Assets Fund N.V. At April 30, 1992, BEA Associates acted as investment adviser for approximately $1.3 billion of assets invested in emerging countries.

BEA Associates has sole investment discretion for the Fund and will make all decisions affecting assets in the Fund's portfolio under the supervision of the Fund's Board of Directors and in accordance with the Fund's stated policies. BEA Associates will select investments for the Fund and will place purchase and sale orders on behalf of the Fund. For its services, BEA Associates will be paid a quarterly fee computed at an annual rate of 1.25% of the first $100 million of the Fund's average weekly net assets, 1.125% of the next $100 million and 1.00% of amounts above $200 million.

The Advisory Agreement provides that BEA Associates shall not be liable, and shall be indemnified, for any error of judgment or mistake of law or for any loss suffered by the Fund in connection with the matters to which the Advisory Agreement relates, except liability resulting from willful misfeasance, bad faith or gross negligence on BEA Associates' part in the performance of its duties or from reckless disregard of its obligations and duties under the Advisory Agreement.

BEA Associates has retained PaineWebber Incorporated to provide certain research, statistical and other support services to BEA Associates. BEA Associates will pay PaineWebber Incorporated a fee for the provision of such services. The Fund is not a party to these arrangements and will not compensate PaineWebber Incorporated for the provision of such services to BEA Associates. PaineWebber Incorporated is an Underwriter of the Fund's offering of its Common Stock.

Administrator

Bear Stearns Funds Management Inc. (the "Administrator") serves as the Fund's administrator pursuant to an agreement with the Fund (the "Administration Agreement"). The Administrator is located at 245 Park Avenue, Tenth Floor, New York, New York 10167. Under the Administration Agreement, the Fund pays the Administrator a fee that is computed monthly and paid quarterly at an annual rate of 0.10% of the value of the Fund's average weekly net assets.

The Administrator will provide office facilities and personnel adequate to perform the following services for the Fund: oversight of the determination and publication of the Fund's net asset value in accordance with the Fund's policy as adopted from time to time by the Board of Directors; maintenance, and oversight of the maintenance, of the books and records of the Fund as required under the 1940 Act; assistance in the preparation and filing of the Fund's U.S. federal, state and local income tax returns; review of and arrangement for payment of the Fund's expenses; preparation of financial information for the Fund's proxy statements and semiannual and annual reports to the shareholders; preparation of certain of the Fund's reports to the Securities and Exchange Commission; preparation of various reports relating to the business and affairs of the Fund, including the performance of the Fund's service providers; consultation with the Fund's officers, accountants, legal counsel and others; responding to or referring shareholder inquiries; and assistance with such other services as generally may be required to properly carry on the business and operations of the Fund.

The Administrator offers administrative services to open- and closed-end investment funds and other managed pooled investment vehicles generally with assets of at least $50 million each. The

Administrator is an affiliate of Bear, Stearns & Co. Inc. and Bear, Stearns International Limited, who are Underwriters of the Fund's offering of its Common Stock.

The Fund has retained BEA Associates to provide certain administrative and shareholder services to the Fund that are not provided by the Administrator, subject to the supervision and direction of the Board of Directors of the Fund pursuant to an Administrative Services Agreement with BEA Associates (the "Administrative Services Agreement"). These services include furnishing certain internal executive and administrative services, responding to shareholder inquiries, acting as liaison between the Fund and the Fund's various service providers, furnishing corporate secretarial services, which include assisting in the preparation of materials for meetings of the Board of Directors, coordinating the preparation of proxy statements, annual, semi-annual and quarterly reports and filings with state blue sky authorities, assisting in the preparation of tax returns and generally assisting in monitoring and developing compliance procedures for the Fund. BEA Associates will be reimbursed by the Fund for costs incurred on behalf of the Fund (up to $20,000 per annum). Costs incurred on behalf of two or more funds for which BEA Associates provides administrative and shareholder services will be apportioned among such funds according to their respective net asset values. The Fund will also reimburse BEA Associates for any out-of-pocket expenses in providing these services to the Fund, including postage, telephone and other telecommunications charges and duplicating costs.

Duration and Termination; Non-Exclusive Services

Unless earlier terminated as described below, the Advisory Agreement is effective on the date the Fund's registration statement is declared effective by the Securities and Exchange Commission and will remain in effect initially for two years and will remain in effect from year to year thereafter if approved annually (1) by the Board of Directors of the Fund or by the holders of a majority of the Fund's outstanding voting securities and (2) by a majority of the directors who are not parties to the Advisory Agreement or "interested persons" (as defined in the 1940 Act) of any such party. The Advisory Agreement terminates on its assignment by any party and may be terminated without penalty on 60 days' written notice at the option of any party or by vote of the shareholders of the Fund.

Each of the Administration Agreement and the Administrative Services Agreement is terminable upon 60 days' notice by either party.

The services of BEA Associates and the Administrator are not deemed to be exclusive, and nothing in the relevant service agreements will prevent any of them or their affiliates from providing similar services to other investment companies and other clients (whether or not such clients' investment objectives and policies are similar to those of the Fund) or from engaging in other activities.

Estimated Expenses

Except as otherwise provided in the Administrative Services Agreement, BEA Associates and the Administrator are each obligated to pay expenses associated with providing the services contemplated by the agreements to which they are parties. The Fund pays all other expenses incurred in the operation of the Fund including, among other things, expenses for legal and independent accountants' services, costs of printing proxies, stock certificates and shareholder reports, charges of the custodians, any sub-custodians and the transfer and dividend-paying agent, expenses in connection with the Fund's Dividend Reinvestment and Cash Purchase Plan, Securities and Exchange Commission fees and fees of emerging country regulatory bodies, fees and expenses of unaffiliated directors, accounting and pricing costs, membership fees in trade associations, fidelity bond coverage for the Fund's officers and employees, directors' and officers' errors and omissions insurance coverage, interest, brokerage costs and stock exchange fees, taxes, stock exchange listing fees and expenses, expenses of qualifying the Fund's shares for sale in various states and foreign jurisdictions, litigation and other extraordinary or non-recurring expenses and other expenses properly payable by the Fund.

On the basis of the anticipated size of the Fund immediately following this offering, assuming no exercise of the over-allotment option, BEA Associates estimates that the Fund's annual operating expenses, including advisory, administrative and custody fees, exclusive of amortization of organization expenses, will be approximately $2,158,450. No assurance can be given, in light of the Fund's investment objective and policies, however, that actual annual operating expenses will not be substantially more or less than this estimate. The Fund's estimated annual operating expenses will be higher than the normal annual operating expenses of most other investment companies of comparable size investing in the United States and reflect the specialized nature of the Fund, the extent of the advisory effort involved and the costs of communication and other costs associated with investing in emerging countries rather than in the United States.

Costs incurred by the Fund in connection with its organization, estimated at $40,000, will be amortized on a straight-line basis over 60 months starting at the commencement of the Fund's operations. Offering expenses, estimated at $865,000, will be payable upon completion of the Offerings and will be charged to capital upon the commencement of investment operations of the Fund.

PORTFOLIO TRANSACTIONS

Decisions to buy and sell securities for the Fund will be made by BEA Associates, subject to the overall review of the Fund's Board of Directors. Portfolio securities transactions for the Fund will be placed on behalf of the Fund by persons authorized by BEA Associates. BEA Associates manages other investment companies and accounts (the "BEA Accounts") that invest in emerging country securities. Although investment decisions for the Fund are made independently from those of the BEA Accounts, investments of the type the Fund may make may also be made on behalf of the BEA Accounts. When the Fund and one or more of the BEA Accounts is prepared to invest in, or desires to dispose of, the same security, available investments or opportunities for each will be allocated in a manner believed by BEA Associates to be equitable to each. In some cases, this procedure may adversely affect the price paid or received by the Fund or the size of the position obtained or disposed of by the Fund. BEA Associates will report to the Board of Directors of the Fund on a quarterly basis whenever the Fund and a BEA Account are allocated portions of the same investment opportunities and will review with the Board the basis for each allocation. The Fund may utilize affiliates of Credit Suisse in connection with the purchase or sale of securities in accordance with rules or exemptive orders adopted by the Securities and Exchange Commission when BEA Associates believes that the charge for the transaction does not exceed usual and customary levels.

Transactions on U.S. and some foreign stock exchanges involve the payment of negotiated brokerage commissions, which may vary among different brokers. The cost of securities purchased from underwriters includes an underwriter's commission or concession, and the prices at which securities are purchased from and sold to dealers in the over-the-counter markets include an undisclosed dealer's mark-up or mark-down.

In selecting brokers or dealers to execute portfolio transactions on behalf of the Fund, BEA Associates will seek the best overall terms available. The Advisory Agreement provides that, in assessing the best overall terms available for any transaction, BEA Associates will consider the factors it deems relevant, including the breadth of the market in the security, the price of the security, the financial condition and execution capability of the broker or dealer, and the reasonableness of the commission, if any, for the specific transaction and on a continuing basis. In addition, the Advisory Agreement authorizes BEA Associates, in selecting brokers or dealers to execute a particular transaction and in evaluating the best overall terms available, to consider the brokerage and research services (as those terms are defined in Section 28(e) of the Securities Exchange Act of 1934) provided to the Fund and/or other accounts over which BEA Associates exercises investment discretion. The fees payable under the Advisory Agreement are not reduced as a result of BEA Associates' receiving such brokerage and research services.

The Fund's Board of Directors will review periodically the commissions paid by the Fund to determine if the commissions paid over representative periods of time were reasonable in relation to the benefits inuring to the Fund.

DIVIDENDS AND DISTRIBUTIONS; DIVIDEND REINVESTMENT AND CASH PURCHASE PLAN

The Fund intends to distribute annually to shareholders substantially all of its net investment income (i.e., its income other than its net realized long- and short-term capital gains) and net realized short-term capital gains. The Fund will determine annually whether to distribute any net realized long-term capital gains in excess of net realized short-term capital losses (including any capital loss carryovers), although it currently expects to distribute any such gains.

Pursuant to the Fund's Dividend Reinvestment and Cash Purchase Plan (the "Plan"), each shareholder will be deemed to have elected, unless Provident National Bank, the Fund's transfer agent, as the Plan Agent (the "Plan Agent"), is otherwise instructed by the shareholder in writing, to have all distributions, net of any applicable U.S. withholding tax, automatically reinvested in additional shares of the Fund. Shareholders who do not participate in the Plan will receive all dividends and distributions in cash, net of any applicable U.S. withholding tax, paid in dollars by check mailed directly to the shareholder by Provident National Bank, as dividend-paying agent. Shareholders who do not wish to have dividends and distributions automatically reinvested should notify Provident National Bank, as the Plan Agent for The Emerging Markets Telecommunications Fund, Inc., c/o Provident Financial Processing Corporation, 103 Bellevue Parkway, Wilmington, Delaware 19809. Dividends and distributions with respect to shares registered in the name of a broker-dealer or other nominee (i.e., in "street name") will be reinvested under the Plan unless such service is not provided by the broker or nominee or the shareholder elects to receive dividends and distributions in cash. A shareholder whose shares are held by a broker or nominee that does not provide a dividend reinvestment program may be required to have his shares registered in his own name to participate in the Plan. Investors who own shares of the Fund's Common Stock registered in street name should contact the broker or nominee for details concerning participation in the Plan.

Certain distributions of cash attributable to (a) some of the dividends and interest amounts paid to the Fund and (b) certain capital gains earned by the Fund that are derived from securities of certain emerging country issuers are subject to taxes payable by the Fund at the time amounts are remitted. Such taxes will be borne by the Fund and allocated to all shareholders in proportion to their interests in the Fund.

The Plan Agent serves as agent for the shareholders in administering the Plan. If the Board of Directors of the Fund declares an income dividend or a capital gains distribution payable either in the Fund's Common Stock or in cash, as shareholders may have elected, nonparticipants in the Plan will receive cash and participants in the Plan will receive Common Stock to be issued by the Fund. If the market price per share on the valuation date equals or exceeds net asset value per share on that date, the Fund will issue new shares to participants valued at net asset value or, if the net asset value is less than 95% of the market price on the valuation date, then valued at 95% of the market price. If net asset value per share on the valuation date exceeds the market price per share on that date, the Plan Agent, as agent for the participants, will purchase shares of Common Stock on the open market, on the New York Stock Exchange or elsewhere, for the participants' accounts. If, before the Plan Agent has completed its purchases, the market price exceeds the net asset value per share, the average per share purchase price paid by the Plan Agent may exceed the net asset value per share, resulting in the acquisition of fewer shares than if the dividend or distribution had been paid in shares issued by the Fund at net asset value. If the market price exceeds the net asset value per share before the Plan Agent has completed its purchases, the Plan Agent is permitted to cease purchasing shares and the Fund may issue the remaining shares at a price equal to the greater of (a) net asset value or (b) 95% of the then current market price. In a case where the Plan Agent has terminated open market purchases and the Fund has issued the remaining shares, the number of shares received by the participant in respect of the cash dividend or distribution will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues remaining shares. The valuation date is the dividend or distribution payment date or, if that date is not a New York Stock Exchange trading day, the next preceding trading day. If the Fund should declare an income dividend or capital gains distribution payable only in cash, the Plan Agent will, as agent for the participants, buy Fund shares in the open market, on the New York Stock Exchange or elsewhere, for the participants' accounts on, or shortly after, the payment date.

Participants in the Plan have the option of making additional cash payments to the Plan Agent, semiannually, in any amount from $100 to $3,000, for investment in the Fund's Common Stock. The Plan Agent will use all funds received from participants to purchase Fund shares in the open market on or about February 15 and August 15 of each year. Any voluntary cash payments received more than 30 days prior to these dates will be returned by the Plan Agent and interest will not be paid on any uninvested cash payments. To avoid unnecessary cash accumulations, and also to allow ample time for receipt and processing by the Plan Agent, it is suggested that participants send in voluntary cash payments to be received by the Plan Agent approximately 10 days before February 15 or August 15, as the case may be. A participant may withdraw a voluntary cash payment by written notice, if the notice is received by the Plan Agent not less than 48 hours before the payment is to be invested. A participant's tax basis in his shares acquired through this optional investment right will equal his cash payments to the Plan, including any cash payments used to pay brokerage commissions allocable to his acquired shares.

The Plan Agent maintains all shareholder accounts in the Plan and furnishes written confirmations of all transactions in the account, including information needed by shareholders for personal and tax records. Shares in the account of each Plan participant will be held by the Plan Agent in the name of the participant and each shareholder's proxy will include those shares purchased pursuant to the Plan.

In the case of a shareholder, such as a bank, broker or nominee, that holds shares for others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of shares certified from time to time by the shareholder as representing the total amount registered in the shareholder's name and held for the account of beneficial owners who are to participate in the Plan.

There is no charge to participants for reinvesting dividends or capital gains distributions payable in either shares or cash. The Plan Agent's fees for the handling of reinvestment of such dividends and capital gains distributions will be paid by the Fund. There will be no brokerage charges with respect to shares issued directly by the Fund as a result of dividends or capital gains distributions payable either in stock or in cash. However, each participant will be charged by the Plan Agent a pro rata share of brokerage commissions incurred with respect to the Plan Agent's open market purchases in connection with voluntary cash payments made by the participant or the reinvestment of dividends or capital gains distributions payable only in cash. Brokerage charges for purchasing small amounts of stock for individual accounts through the Plan are expected to be less than the usual brokerage charges for such transactions because the Plan Agent will be purchasing stock for all participants in blocks and prorating the lower commission thus obtainable. Brokerage commissions will vary based on, among other things, the broker selected to effect a particular purchase and the number of participants on whose behalf such purchase is being made. The Fund cannot predict, therefore, whether the cost to a participant who makes a voluntary cash payment will be less than if a participant were to make an open market purchase of the Fund's Common Stock on his own behalf.

The receipt of dividends and distributions in stock under the Plan will not relieve participants of any income tax (including withholding tax) that may be payable on such dividends or distributions.

Experience under the Plan may indicate that changes in the Plan are desirable. Accordingly, the Fund and the Plan Agent reserve the right to terminate the Plan as applied to any voluntary cash payments made and any dividend or distribution paid subsequent to notice of the termination sent to the members of the Plan at least 30 days before the semiannual contribution date, in the case of voluntary cash payments, or the record date for dividends or distributions. The Plan also may be amended by the Fund or the Plan Agent, but (except when necessary or appropriate to comply with applicable law, rules or policies of a regulatory authority) only by at least 30 days' written notice to members of the Plan. All correspondence concerning the Plan should be directed to the Plan Agent, c/o Provident Financial Processing Corporation, 103 Bellevue Parkway, Wilmington, Delaware 19809.

NET ASSET VALUE

Net asset value will be calculated (a) no less frequently than weekly, (b) on the last business day of each month and (c) at any other times determined by the Fund's Board of Directors. Net asset value is calculated by dividing the value of the Fund's net assets (the value of its assets less its liabilities, exclusive of capital stock and surplus) by the total number of shares of Common Stock outstanding. All securities for which market quotations are readily available are valued at the last sales price prior to the time of determination, or, if no sales price is available at that time, at the closing price quoted for the securities (but if bid and asked quotations are available, at the mean between the last current bid and asked prices, rather than the quoted closing price). Forward contracts will be valued at the current cost of covering or offsetting the contracts. Securities that are traded over-the-counter are valued, if bid and asked quotations are available, at the mean between the current bid and asked prices. If bid and asked quotations are not available, then over-the-counter securities will be valued as determined in good faith by the Board of Directors. In making this determination the Board will consider, among other things, publicly available information regarding the issuer, market conditions and values ascribed to comparable companies. In instances where the price determined above is deemed not to represent fair market value, the price is determined in such manner as the Board may prescribe. Investments in short-term debt securities having a maturity of 60 days or less are valued at amortized cost if their term to maturity from the date of purchase was less than 60 days, or by amortizing their value on the 61st day prior to maturity if their term to maturity from the date of purchase when acquired by the Fund was more than 60 days, unless this is determined by the Board of Directors not to represent fair value. All other securities and assets are taken at fair value as determined in good faith by the Board of Directors, although the actual calculation may be done by others.

In connection with the valuation of the Fund's investments in securities that are not publicly traded, there may be a range of values which is reasonable for such investments at any particular time. The Board of Directors has established the following general guidelines for the calculation of fair value of such securities. In the early stages of development, non-publicly traded equity securities typically will be valued at their original cost to the Fund (the "cost method"). The cost method will be utilized until significant developments affecting the portfolio company provide a basis for use of an appraisal valuation (the "appraisal method"). The appraisal method will be based on such factors affecting the company in which the Fund has invested as earnings and net worth, the market prices for similar securities of comparable companies and an assessment of the company's future prospects. In the case of unsuccessful operations, the appraisal may be based on liquidation value. Valuations based on the appraisal method are necessarily subjective. The Board of Directors will also use third party transactions (actual or proposed) in the portfolio company's securities as the basis of valuation (the "private market method"). The private market method will be used only with respect to actual transactions or actual firm offers by independent investors. The fair value of debt securities that are not publicly traded will be determined in good faith. It is expected that the private market method of valuation will be the primary method utilized with respect to these securities. Securities with legal, contractual or practical restrictions on transfer may be valued at a discount from their value determined by the foregoing methods to reflect the effect of such restrictions.

In valuing the Fund's assets, quotations of foreign securities in a foreign currency are converted to U.S. dollar equivalents at the then current currency value. The Fund's obligation to pay any local tax on remittances from an emerging country will become a liability on the record date for a dividend payment and will have the effect of reducing the Fund's net asset value.

The Common Stock has been accepted for trading on the New York Stock Exchange, subject to notification of issuance. In recent periods, shares of closed-end investment companies that invest primarily in equity securities in particular foreign countries have generally traded at a discount from net asset value, but in some cases (particularly if there are limited alternative vehicles for such investment) have traded above net asset value. Among the factors which may be expected to affect whether shares of the Fund trade above or below net asset value are portfolio investment results, the general performance of stock markets in emerging countries and supply and demand for shares of the Fund. The Fund cannot predict whether the Common Stock will trade at, above or below net asset value.

TAXATION

The following is a summary of certain material United States federal income tax considerations regarding the purchase, ownership and disposition of shares in the Fund. Each prospective shareholder is urged to consult his own tax adviser with respect to the specific federal, state, local and foreign tax consequences of investing in the Fund. The summary is based on the laws in effect on the date of this Prospectus, which are subject to change.

United States Federal Income Taxes

The Fund and Its Investments

The Fund intends to qualify and elect to be treated as a regulated investment company for each taxable year under the Code. To so qualify, the Fund must, among other things: (a) derive at least 90% of its gross income in each taxable year from dividends, interest, payments with respect to securities loans and gains from the sale or other disposition of stock or securities or foreign currencies, or other income (including, but not limited to, gains from options, futures or forward contracts) derived with respect to its business of investing in such stock, securities or currencies; (b) derive less than 30% of its gross income in each taxable year from the sale or other disposition of (i) stock or securities held for less than three months, (ii) options, futures or forward contracts (other than options, futures or forward contracts on foreign currencies) held for less than three months and (iii) foreign currencies (or options, futures or forward contracts on such foreign currencies) held for less than three months but only if such currencies (or options, futures or forward contracts) are not directly related to the Fund's principal business of investing in stock or securities (or options or futures with respect to stock or securities); and (c) diversify its holdings so that, at the end of each quarter of the Fund's taxable year, (i) at least 50% of the market value of the Fund's assets is represented by cash, securities of other regulated investment companies, United States government securities and other securities, with such other securities limited, in respect of any one issuer, to an amount not greater than 5% of the Fund's assets and not greater than 10% of the outstanding voting securities of such issuer and (ii) not more than 25% of the value of its assets is invested in the securities (other than United States government securities or securities of other regulated investment companies) of any one issuer or any two or more issuers that the Fund controls and are determined to be engaged in the same or similar trades or businesses or related trades or businesses. The Fund expects that all of its foreign currency gains will be directly related to its principal business of investing in stocks and securities.

As a regulated investment company, the Fund will not be subject to United States federal income tax on its net investment income (i.e., income other than its net realized long- and short-term capital gains) and its net realized long- and short-term capital gains, if any, that it distributes to its shareholders, provided that an amount equal to at least 90% of its investment company taxable income (i.e., 90% of its taxable income minus the excess, if any, of its net realized long-term capital gains over its net realized short-term capital losses (including any capital loss carryovers), plus or minus certain other adjustments as specified in section 852 of the Code) for the taxable year is distributed, but will be subject to tax at regular corporate rates on any income or gains that it does not distribute. Furthermore, the Fund will be subject to a United States corporate income tax with respect to such distributed amounts in any year that it fails to qualify as a regulated investment company or fails to meet this distribution requirement. Any dividend declared by the Fund in October, November or December of any calendar year and payable to shareholders of record on a specified date in such a month shall be deemed to have been received by each shareholder on December 31 of such calendar year and to have been paid by the Fund not later than such December 31, provided that such dividend is actually paid by the Fund during January of the following calendar year.

The Fund intends to distribute annually to its shareholders substantially all of its investment company taxable income. The Board of Directors of the Fund will determine annually whether to distribute any such net realized long-term capital gains in excess of net realized short-term capital losses (including any capital loss carryovers). The Fund currently expects to distribute any excess annually to its shareholders. However, if the Fund retains for investment an amount equal to its net long-term capital gains in excess of its net short-term capital losses and capital loss carryovers, it will be subject to a corporate tax (currently at a rate of 34%) on the amount retained. In that event, the Fund expects to designate such retained amounts as undistributed capital gains in a notice to its shareholders who (a) will be required to include in income for United States federal income tax purposes, as long-term capital gains, their proportionate shares of the undistributed amount, (b) will be entitled to credit their proportionate shares of the 34% tax paid by the Fund on the undistributed amount against their United States federal income tax liabilities, if any, and to claim refunds to the extent their credits exceed their liabilities, if any, and (c) will be entitled to increase their tax basis, for United States federal income tax purposes, in their shares by an amount equal to 66% of the amount of undistributed capital gains included in the shareholder's income.

The Code imposes a 4% nondeductible excise tax on the Fund to the extent the Fund does not distribute by the end of any calendar year at least 98% of its net investment income for that year and 98% of the net amount of its capital gains (both long- and short-term) for the one-year period ending, as a general rule, on October 31 of that year. For this purpose, however, any income or gain retained by the Fund that is subject to corporate income tax will be considered to have been distributed by year-end. In addition, the minimum amounts that must be distributed in any year to avoid the excise tax will be increased or decreased to reflect any underdistribution or overdistribution, as the case may be, from the previous year. The Fund anticipates that it will pay such dividends and will make such distributions as are necessary in order to avoid the application of this tax.

Exchange control regulations may restrict repatriations of investment income and capital or the proceeds of securities sales by foreign investors such as the Fund and may limit the Fund's ability to pay sufficient dividends and to make sufficient distributions to satisfy the 90% and excise tax distribution requirements.

The Fund's transactions in foreign currencies, forward contracts, options and futures contracts (including options and futures contracts on foreign currencies) will be subject to special provisions of the Code that, among other things, may affect the character of gains and losses realized by the Fund (i.e., may affect whether gains or losses are ordinary or capital), accelerate recognition of income to the Fund and defer Fund losses. These rules could therefore affect the character, amount and timing of distributions to shareholders. These provisions also (a) will require the Fund to mark-to-market certain types of the positions in its portfolio (i.e., treat them as if they were closed out) and (b) may cause the Fund to recognize income without receiving cash with which to pay dividends or make distributions in amounts necessary to satisfy the distribution requirements for avoiding income and excise taxes. The Fund will monitor its transactions, will make the appropriate tax elections and will make the appropriate entries in its books and records when it acquires any foreign currency, forward contract, option, futures contract or hedged investment in order to mitigate the effect of these rules and prevent disqualification of the Fund as a regulated investment company.

Passive Foreign Investment Companies

If the Fund purchases shares in certain foreign investment entities, called "passive foreign investment companies" (a "PFIC"), the Fund may be subject to United States federal income tax on a portion of any "excess distribution" or gain from the disposition of such shares even if such income is distributed as a taxable dividend by the Fund to its shareholders. Additional charges in the nature of interest may be imposed on the Fund in respect of deferred taxes arising from such distributions or gains. If the Fund were to invest in a PFIC and elected to treat the PFIC as a "qualified electing fund" under the Code, in lieu of the foregoing requirements, the Fund might be required to include in income each year a portion of the ordinary earnings and net capital gains of the qualified electing fund, even if not distributed to the Fund, and such amounts would be subject to the 90% and calendar year distribution requirements described above.

Legislation currently pending before the U.S. Congress would unify and, in certain cases, modify the anti-deferral rules contained in various provisions of the Code, including the PFIC provisions, related to the taxation of U.S. shareholders of foreign corporations. In the case of a passive foreign company ("PFC"), as defined in the legislation, having "marketable stock," the legislation would require U.S. shareholders owning less than 25% of a PFC that is not U.S.-controlled to mark to market the PFC stock annually, unless such shareholders elected to include in income currently their proportionate shares of the PFC's income and gain. Otherwise, U.S. shareholders would be treated substantially the same as under current law. Special rules applicable to mutual funds would classify as "marketable stock" all stock in PFCs owned by the Fund; however, the Fund would not be liable for tax on income from PFCs that is distributed to shareholders. It is impossible to predict if or when the legislation will become law and, if it is so enacted, what form it will ultimately take.

On March 31, 1992, the Internal Revenue Service released proposed regulations providing a mark-to-market election for regulated investment companies that would have effects similar to the proposed legislation. These regulations would be effective for taxable years ending after promulgation of the regulations as final regulations.

Dividends and Distributions

Dividends of net investment income and distributions of net realized short-term capital gains are taxable to a United States shareholder as ordinary income, whether paid in cash or in shares. Distributions of net long-term capital gains, if any, that the Fund designates as capital gains dividends are taxable as long-term capital gains, whether paid in cash or in shares and regardless of how long a shareholder has held shares of the Fund. Dividends and distributions paid by the Fund (except for the portion thereof, if any, attributable to dividends on stock of U.S. corporations received by the Fund) will not qualify for the deduction for dividends received by corporations. Distributions in excess of the Fund's current and accumulated earnings and profits will, as to each shareholder, be treated as a tax-free return of capital, to the extent of a shareholder's basis in his shares of the Fund, and as a capital gain thereafter (if the shareholder held his shares of the Fund as capital assets).

Shareholders receiving dividends or distributions in the form of additional shares pursuant to the Plan should be treated for United States federal income tax purposes as receiving a distribution in the amount equal to the amount of money that the shareholders receiving cash dividends or distributions will receive, and should have a cost basis in the shares received equal to such amount.

Investors considering buying shares just prior to a dividend or capital gain distribution should be aware that, although the price of shares just purchased at that time may reflect the amount of the forthcoming distribution, those who purchase just prior to a distribution will receive a distribution which nevertheless will be taxable to them.

If the Fund is the holder of record of any stock on the record date for any dividends payable with respect to such stock, such dividends are included in the Fund's gross income not as of the date received but as of the later of (a) the date such stock became ex-dividend with respect to such dividends (i.e., the date on which a buyer of the stock would not be entitled to receive the declared, but unpaid, dividends) or (b) the date the Fund acquired such stock. Accordingly, in order to satisfy its income distribution requirements, the Fund may be required to pay dividends based on anticipated earnings, and shareholders may receive dividends in an earlier year than would otherwise be the case.

Sales of Shares

Upon the sale or exchange of his shares, a shareholder will realize a taxable gain or loss equal to the difference between the amount realized and his basis in his shares. Such gain or loss will be treated as capital gain or loss, if the shares are capital assets in the shareholder's hands, and will be long-term capital gain or loss if the shares are held for more than one year and short-term capital gain or loss if the shares are held for one year or less. Any loss realized on a sale or exchange will be disallowed to the extent the shares disposed of are replaced, including replacement through the reinvesting of dividends and capital gains distributions in the Fund under the Plan, within a period (of 61 days) beginning 30 days before and ending 30 days after the disposition of the shares. In such a case, the basis of the shares acquired will be increased to reflect the disallowed loss. Any loss realized by a shareholder on the sale of a Fund share held by the shareholder for six months or less will be treated for United States income tax purposes as a long-term capital loss to the extent of any distributions or deemed distributions of long-term capital gains received by the shareholder with respect to such share.

Foreign Taxes

Income received by the Fund from sources outside the United States may be subject to withholding and other taxes imposed by countries other than the United States. If the Fund qualifies as a regulated investment company, if certain distribution requirements are satisfied and if more than 50% of the value of the Fund's assets at the close of the taxable year consists of stocks or securities of foreign corporations, the Fund may elect, for United States federal income tax purposes, to treat any foreign income taxes paid by the Fund that can be treated as income taxes under United States income tax principles as paid by its shareholders. The Fund anticipates that it will be able to treat some, but not all, of the foreign taxes it will have to pay as foreign income taxes for United States federal income tax purposes. The Fund expects to qualify for and make this election in some, but not necessarily all, of its taxable years. For any year that the Fund makes such an election, an amount equal to the foreign income taxes paid by the Fund that can be treated as income taxes under United States income tax principles will be included in the income of its shareholders and each shareholder will be entitled (subject to certain limitations) to credit the amount included in his income against such shareholder's United States tax liabilities, if any, or to deduct such amount from such shareholder's United States taxable income, if any. Shortly after any year for which it makes such an election, the Fund will report to its shareholders, in writing, the amount per share of such foreign income taxes that must be included in each shareholder's gross income and the amount which will be available for deduction or credit. In general, a shareholder may elect each year whether to claim deductions or credits for foreign taxes. However, no deductions for foreign taxes may be claimed by noncorporate shareholders (including certain foreign shareholders as described below) who do not itemize deductions. If a shareholder elects to credit foreign taxes, the amount of credit that may be claimed in any year may not exceed the same proportion of the United States tax against which such credit is taken which the shareholder's taxable income from foreign sources (but not in excess of the shareholder's entire taxable income) bears to his entire taxable income. This limitation may be applied separately to certain categories of income and the related foreign taxes.

Backup Withholding

The Fund may be required to withhold, for United States federal income tax purposes, 20% of the dividends and distributions payable to shareholders who fail to provide the Fund with their correct taxpayer identification number or to make required certifications, or who have been notified by the Internal Revenue Service that they are subject to backup withholding. Corporate shareholders and certain other shareholders are or may be exempt from backup withholding. Backup withholding is not an additional tax and any amount withheld may be credited against a shareholder's United States federal income tax liabilities. Additional tax withholding requirements which apply with respect to foreign investors are discussed below.

Foreign Shareholders

Taxation of a shareholder who, as to the United States, is a foreign investor (such as a nonresident alien individual, a foreign trust or estate, a foreign corporation or a foreign partnership) depend, in part, on whether the shareholder's income from the Fund is "effectively connected" with a United States trade or business carried on by the shareholder.

If the foreign investor is not a resident alien and the income from the Fund is not effectively connected with a United States trade or business carried on by the foreign investor, distributions of net investment income and net realized short-term capital gains will be subject to a 30% (or lower treaty rate) United States withholding tax. Furthermore, foreign investors may be subject to an increased United States tax on their income resulting from the Fund's election (described above) to "pass-through" amounts of foreign taxes paid by the Fund, but may not be able to claim a credit or deduction with respect to the foreign taxes treated as having been paid by them. Distributions of net realized long-term capital gains, amounts retained by the Fund which are designated as undistributed capital gains, and gains realized upon the sale of shares of the Fund will not be subject to United States tax unless the foreign investor who is a nonresident alien individual is physically present in the United States for more than 182 days during the taxable year and, in the case of gain realized upon the sale of Fund shares, (i) such gain is attributable to an office or fixed place of business in the United States or (ii) such nonresident alien individual has a tax home in the United States and such gain is not attributable to an office or fixed place of business located outside the United States. However, a determination by the Fund not to distribute long-term capital gains may reduce a foreign investor's overall return from an investment in the Fund, since the Fund will incur a United States federal tax liability with respect to retained long-term capital gains, thereby reducing the amount of cash held by the Fund that is available for distribution, and the foreign investor may not be able to claim a credit or deduction with respect to such taxes.

In general, if a foreign investor is a resident alien or if dividends or distributions from the Fund are effectively connected with a United States trade or business carried on by the foreign investor, then dividends of net investment income, distributions of net short-term and long-term capital gains, amounts retained by the Fund that are designated as undistributed capital gains and any gains realized upon the sale of shares of the Fund will be subject to United States income tax at the rates applicable to United States citizens or domestic corporations. If the income from the Fund is effectively connected with a United States trade or business carried on by a foreign investor that is a corporation, then such foreign investor may also be subject to the 30% (or lower treaty rate) branch profits tax.

The tax consequences to a foreign shareholder entitled to claim the benefits of an applicable tax treaty may be different from those described in this section. Shareholders may be required to provide appropriate documentation to establish their entitlement to the benefits of such a treaty. Foreign investors are advised to consult their own tax advisers with respect to (a) whether their income from the Fund is or is not effectively connected with a United States trade or business carried on by them, (b) whether they may claim the benefits of an applicable tax treaty, and (c) any other tax consequences to them of an investment in the Fund.

Notices

Shareholders will be notified annually by the Fund as to the United States federal income tax status of the dividends, distributions and deemed distributions made by the Fund to its shareholders. Furthermore, shareholders will also receive, if appropriate, various written notices after the close of the Fund's taxable year regarding the United States federal income tax status of certain dividends, distributions and deemed distributions that were paid (or that are treated as having been paid) by the Fund to its shareholders during the preceding taxable year.

Other Taxation

Distributions also may be subject to additional state, local and foreign taxes depending on each shareholder's particular situation.

THE FOREGOING IS ONLY A SUMMARY OF CERTAIN MATERIAL TAX CONSEQUENCES AFFECTING THE FUND AND ITS SHAREHOLDERS. SHAREHOLDERS ARE ADVISED TO CONSULT THEIR OWN TAX ADVISERS WITH RESPECT TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF AN INVESTMENT IN THE FUND.

COMMON STOCK

The authorized capital stock of the Fund is 100,000,000 shares of Common Stock. All shares of Common Stock have equal rights as to dividends and voting privileges and, when issued, will be fully paid and nonassessable. There are no conversion, preemptive or other subscription rights. In the event of liquidation, each share of Common Stock is entitled to its proportion of the Fund's assets after debts and expenses. Shareholders are entitled to one vote per share and do not have cumulative voting rights.

The Fund has no present intention of offering additional shares, except that additional shares may be issued under the Plan. See "Dividends and Distributions; Dividend Reinvestment and Cash Purchase Plan." Other offerings of shares, if made, will require approval of the Fund's Board of Directors. Any additional offering will be subject to the requirement of the 1940 Act that shares not be sold at a price below the then current net asset value (exclusive of underwriting discounts and commissions) except in connection with an offering to existing shareholders or with the consent of a majority of the Fund's outstanding shares.

The Fund's Bylaws provide that if, at any time after the second anniversary of the offering made hereby, shares of the Fund's Common Stock publicly trade for a substantial period of time at a substantial discount from the Fund's then current net asset value per share, the Board of Directors of the Fund will consider, at its next regularly scheduled meeting, taking various actions designed to reduce or eliminate the discount. The actions considered by the Board of Directors may include periodic repurchases of shares. There can be no assurance that share repurchases will be made or that, if made, they will reduce or eliminate the market discount. The Fund does not currently contemplate repurchasing any of its shares. Should any such repurchases be made in the future, it is expected that they would be made out of available cash reserves rather than the proceeds of a sale of portfolio securities and would be made at prices at or below the current net asset value per share. Any such repurchases would cause the Fund's total assets to decrease, which may have the effect of increasing the Fund's expense ratio.

Special Voting Provisions

The Fund has provisions in its Articles of Incorporation and Bylaws that could have the effect of limiting the ability of other entities or persons to acquire control of the Fund, to cause it to engage in certain transactions or to modify its structure. Commencing with the first annual meeting of stockholders, the Board of Directors will be divided into three classes having initial terms of one, two and three years, respectively. At the annual meeting of stockholders in each year thereafter, the term of one class will expire and directors will be elected to serve in that class for terms of three years. This provision could delay for up to two years the replacement of a majority of the Board of Directors. A director may be removed from office only by a vote of the holders of at least 75% of the shares of the Fund entitled to be voted on the matter.

In addition, conversion of the Fund from a closed-end to an open-end investment company requires the affirmative vote of at least 75% of the directors and of the holders of 75% of the shares of the Fund unless approved by at least 75% of the Continuing Directors, as defined below, in which case a majority of the votes entitled to be cast by shareholders of the Fund will be required to approve such conversion. If the Fund were to be converted into an open-end investment company, it could be restricted in its ability to redeem its shares (otherwise than in kind) because, in light of the limited depth of the markets for certain securities in which the Fund may invest, there can be no assurance that the Fund could realize the then market value of the portfolio securities the Fund would be required to liquidate to meet redemption requests. Also, as a subsidiary of a bank holding company, BEA Associates may be prohibited under applicable Federal law from acting as the sponsor or organizer of an open-end investment company.

The affirmative votes of at least 75% of the directors and the holders of at least 75% of the shares of the Fund are required to authorize any of the following transactions:

(i) merger, consolidation or share exchange of the Fund with or into any other person;

(ii) issuance or transfer by the Fund (in one or a series of transactions in any 12-month period) of any securities of the Fund to any other person or entity for cash, securities or other property (or combination thereof) having an aggregate fair market value of $1,000,000 or more, excluding sales of securities of the Fund in connection with a public offering, issuances of securities of the Fund pursuant to a dividend reinvestment plan adopted by the Fund and issuances of securities of the Fund upon the exercise of any stock subscription rights distributed by the Fund;

(iii) sale, lease, exchange, mortgage, pledge, transfer or other disposition by the Fund (in one or a series of transactions in any 12-month period) to or with any person of any assets of the Fund having an aggregate fair market value of $1,000,000 or more, except for portfolio transactions effected by the Fund in the ordinary course of its business (transactions within clauses (i) and (ii) and this clause (iii) each being known individually as a "Business Combination");

(iv) any proposal as to the voluntary liquidation or dissolution of the Fund or any amendment to the Fund's Articles of Incorporation to terminate its existence; and

(v) any shareholder proposal as to specific investment decisions made or to be made with respect to the Fund's assets.

However, in the case of a Business Combination, a 75% shareholder vote will not be required if the transaction is approved by a vote of at least 75% of the Continuing Directors (as defined below) or if certain conditions regarding the consideration paid by the person entering into, or proposing to enter into, a Business Combination with the Fund and various other requirements are satisfied. In such case, a majority of the votes entitled to be cast by shareholders of the Fund will be required to approve such transaction if it is a transaction described in clause (i) or a transaction described in clause (iii) that involves a transfer of substantially all of the Fund's assets with respect to which a shareholder vote is required under applicable state law and no shareholder vote will be required to approve such transaction if it is any other Business Combination. In addition, a 75% shareholder vote will not be required with respect to a transaction described in clause (iv) above if it is approved by a vote of at least 75% of the Continuing Directors, in which case a majority of the votes entitled to be cast by shareholders of the Fund will be required to approve such transaction. The Fund's Bylaws contain provisions the effect of which is to prevent matters, including nominations of directors, from being considered at shareholders' meetings where the Fund has not received sufficient prior notice of the matters.

Reference is made to the Articles of Incorporation and Bylaws of the Fund on file with the Securities and Exchange Commission for the full text of these provisions. See "Further Information." These provisions could have the effect of depriving shareholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund in a tender offer or similar transaction. In the opinion of the Board of Directors, however, these provisions offer several possible advantages. They may require persons seeking control of the Fund to negotiate with its management regarding the price to be paid for the shares required to obtain such control, they promote continuity and stability and they enhance the Fund's ability to pursue long-term strategies that are consistent with its investment objectives. The Board of Directors has determined that the foregoing voting requirements, which are generally greater than the minimum requirements under Maryland law and the 1940 Act, are in the best interests of shareholders generally.

A "Continuing Director" is any member of the Board of Directors of the Fund (i) who is not a person or affiliate of a person who enters or proposes to enter into a Business Combination with the Fund (such person or affiliate, an "Interested Party") and (ii) who has been a member of the Board of Directors of the Fund for a period of at least 12 months (or since the commencement of the Fund's operations, if less than 12 months), or is a successor of a Continuing Director who is unaffiliated with an Interested Party and is recommended to succeed a Continuing Director by a majority of the Continuing Directors then on the Board of Directors of the Fund.

Principal Shareholder

As of the date of this Prospectus, 7,169 shares of Common Stock were outstanding, all of which are owned beneficially and of record by BEA Associates. These shares were issued in respect of BEA Associates' contribution of $100,008 initial capital to the Fund. BEA Associates has represented that these shares were purchased for investment purposes only and that they will be sold only pursuant to a registration statement under the Securities Act of 1933, as amended, or an applicable exemption therefrom.

CUSTODIAN, TRANSFER AND DIVIDEND-PAYING AGENT AND REGISTRAR

Brown Brothers Harriman & Co. will act as the custodian for the Fund's assets. Provident National Bank will act as the Fund's dividend-paying agent, transfer agent and registrar. Rules adopted under the 1940 Act permit the Fund to maintain its securities and cash in the custody of certain eligible banks and securities depositories. Pursuant to those rules, the Fund's portfolio of securities and cash, when invested in securities of emerging country issuers, may be held by its sub-custodians who will be approved by the directors of the Fund in accordance with the rules of the Securities and Exchange Commission.

UNDERWRITING

Under the terms and subject to the conditions contained in the U.S. Underwriting Agreement and the International Underwriting Agreement (collectively referred to as the "Underwriting Agreements"), the U.S. Underwriters named below, for whom Bear, Stearns & Co. Inc., A. G. Edwards & Sons, Inc., Nomura Securities International, Inc. and PaineWebber Incorporated are acting as the representatives (the "U.S. Representatives"), and a syndicate of International Managers named below, for whom Bear, Stearns International Limited, Merrill Lynch International Limited, Nomura International plc, PaineWebber International (U.K.) Ltd. and S. G. Warburg Securities are acting as the representatives (the "International Representatives") (the U.S. Representatives and the International Representatives being hereinafter collectively referred to as the "Representatives"), have severally agreed to purchase, and the Fund has agreed to sell to them, severally, the number of Shares set forth opposite their respective names below:

U.S. Underwriters	Number of U.S. Shares
Bear, Stearns & Co. Inc.	500,250
A. G. Edwards & Sons, Inc.	500,250
Nomura Securities International, Inc.	500,250
PaineWebber Incorporated	500,250
Alex. Brown & Sons Incorporated	47,000
Credit Lyonnais Securities (USA) Inc.	47,000
Deutsche Bank Capital Corporation	47,000
Dillon, Read & Co. Inc.	47,000
Donaldson, Lufkin & Jenrette Securities Corporation	47,000
Goldman, Sachs & Co.	47,000
Kemper Securities Group, Inc.	47,000
Kidder, Peabody & Co. Incorporated	47,000
Lazard Freres & Co.	47,000
Morgan Stanley & Co. Incorporated	47,000
Oppenheimer & Co., Inc.	47,000
Paribas Corporation	47,000
Smith Barney, Harris Upham & Co. Incorporated	47,000
S.G. Warburg & Co. Inc.	47,000
Arnhold and S. Bleichroeder, Inc.	35,000
William Blair & Company	35,000
J.C. Bradford & Co.	35,000
Dain Bosworth Incorporated	35,000
Furman Selz Incorporated	35,000
Ladenburg, Thalmann & Co. Inc.	35,000
Legg Mason Wood Walker, Inc.	35,000
Morgan Keegan & Company, Inc.	35,000
Needham & Company, Inc.	35,000
Piper, Jaffray & Hopwood Incorporated	35,000
Raymond James & Associates, Inc.	35,000
The Robinson-Humphrey Company, Inc.	35,000
Stephens Inc.	35,000
Tucker Anthony Incorporated	35,000
Wheat, First Securities, Inc.	35,000
Brean Murray, Foster Securities, Inc.	23,000
The Chicago Corporation	23,000
Crowell, Weedon & Co.	23,000
Fahnestock & Co. Inc.	23,000
Gruntal & Co., Incorporated	23,000
Interstate/Johnson Lane Corporation	23,000

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U.S. Underwriters	Number of U.S. Shares
Neuberger & Berman	23,000
The Ohio Company	23,000
The Principal/Eppler, Guerin & Turner, Inc.	23,000
Rauscher Pierce Refsnes, Inc.	23,000
Sloate, Weisman, Murray & Co.	23,000
Stifel, Nicolaus & Company, Incorporated	23,000
Sutro & Co. Incorporated	23,000
Wedbush Morgan Securities	23,000
Balis & Zorn, Inc.	17,000
D.A. Campbell Company, Inc.	17,000
First Equity Corporation of Florida	17,000
First Southwest Company	17,000
J.J.B. Hilliard, W.L. Lyons, Inc.	17,000
Josephthal Lyon & Ross Incorporated	17,000
Sanders Morris Mundy Inc.	17,000
U.S. Subtotal	3,625,000

International Managers	Number of International Shares
Bear, Stearns International Limited	580,000
Merrill Lynch International Limited	580,000
Nomura International plc	580,000
PaineWebber International (U.K.) Ltd.	580,000
S. G. Warburg Securities	580,000
James Capel & Co. Limited	340,000
Vestrust Securities Inc.	340,000
Swiss Bank Corporation	45,000
International Subtotal	3,625,000
Total	7,250,000

The Underwriting Agreements provide that the obligations of the several Underwriters to pay for and accept delivery of the Shares are subject to the approval of certain legal matters by Mayer, Brown & Platt and to certain other conditions. The Underwriters are committed to take and pay for all of the Shares if any are taken.

The Underwriters propose to offer part of the Shares directly to the public at the public offering price set forth on the cover page hereof and part to certain dealers at a price that represents a concession not in excess of $0.63 per share of Common Stock.

The Fund has agreed to pay the Underwriters an aggregate of up to $250,000 as partial reimbursement of their expenses incurred in connection with the offering of the Shares. Pursuant to the Underwriting Agreements, the Fund and BEA Associates have agreed to indemnify the several Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended, and where such indemnification is not available, to contribute to payments the Underwriters may be required to make in respect of such liabilities.

The U.S. Underwriters and the International Managers have been granted options by the Fund, exercisable for 30 days from the date of this Prospectus, to purchase up to an aggregate of 1,087,500 additional shares of Common Stock at the public offering price on the cover page hereof, less the underwriting discounts and commissions, solely to cover over-allotments. In the event that the U.S. Underwriters or the International Managers exercise their respective options, each U.S. Underwriter or International Manager (as the case may be) will have a firm commitment, subject to certain conditions, to purchase the number of additional shares of Common Stock proportionate to its initial commitment.

Each International Manager has agreed that, as part of the distribution of the Shares, (a) it is not purchasing any Shares for the account of any United States Person and (b) it has not offered or sold, and will not offer or sell, directly or indirectly, any Shares or distribute this Prospectus in the United States or to any United States Person. The foregoing limitations do not apply to stabilization transactions, to certain other transactions among the International Managers and the U.S. Underwriters pursuant to the Agreement Between U.S. Underwriters and International Managers or to purchases, offers or sales by a U.S. Underwriter who is also acting as an International Manager or by an International Manager who is also acting as a U.S. Underwriter. As used herein, "United States" means the United States of America, its territories, its possessions and other areas subject to its jurisdiction and "United States Person" means any individual who is resident in the United States or any corporation, pension, profit sharing or other trust or other entity organized under or governed by the laws of the United States or of any political subdivision thereof (other than the foreign branch of any United States Person), and shall include any United States branch of a person other than a United States Person.

Pursuant to the Agreement Between U.S. Underwriters and International Managers, sales may be made among the International Managers and the U.S. Underwriters of such number of Shares to be purchased pursuant to the Underwriting Agreements as may be mutually agreed. Unless otherwise agreed between the Representatives, the price of any Shares so sold shall be the initial public offering price less an amount not greater than the selling concession, and the currency of payment shall be U.S. dollars.

Pursuant to the Agreement Between U.S. Underwriters and International Managers, each U.S. Underwriter and International Manager has represented that it has not offered or sold, and has agreed not to offer or sell, any Shares, directly or indirectly, in Canada in contravention of the securities laws of Canada or any province or territory thereof. Each U.S. Underwriter and International Manager has further agreed to send to any dealer who purchases from it any Shares a notice stating in substance that, by purchasing such Shares, such dealer represents and agrees that it has not offered or sold and will not offer or sell, directly or indirectly, any such Shares in Canada in contravention of the securities laws of Canada or any province or territory thereof, and that such dealer will deliver to any other dealer to whom it sells any of such Common Stock a Notice to the foregoing effect.

Pursuant to the Agreement Between U.S. Underwriters and International Managers, each U.S. Underwriter and International Manager has represented and agreed that (i) it has not offered or sold and that it will not offer or sell any Shares in the United Kingdom by means of any document (other than in circumstances which do not constitute an offer to the public within the meaning of the Companies Act 1985 of Great Britain), and (ii) it has complied and will comply with all applicable provisions of the Financial Services Act 1986 with respect to anything done by it in relation to the Shares in, from or otherwise involving the United Kingdom; and furthermore, it has only issued or passed on and will only issue or pass on in the United Kingdom any publication or document received by it in connection with the proposed offer or sale of the shares of Common Stock to persons falling within Article 9(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1988.

The U.S. Underwriters and the International Managers have taken certain actions to discourage short-term trading of Shares during a period of time following the initial offering date. Included in these actions is the withholding of the concession to dealers in connection with Shares which were sold by such dealers and which are repurchased for the account of the U.S. Underwriters or the International Managers during such period. In addition, physical delivery of certificates representing Shares is required to transfer ownership of such Shares.

The Fund has agreed in each of the U.S. Underwriting Agreement and the International Underwriting Agreement not to offer, sell, contract to sell or otherwise dispose of any Shares or any securities convertible into or exchangeable for shares of Common Stock for a period of 120 days after the date of this Prospectus, without the prior written consent of Bear, Stearns & Co. Inc., A. G. Edwards & Sons, Inc., Nomura Securities International, Inc. and PaineWebber Incorporated, as U.S. Representatives, or without the prior written consent of Bear, Stearns International Limited, Merrill Lynch International Limited, Nomura International plc, PaineWebber International (U.K.) Ltd. and

S. G. Warburg Securities, as International Representatives, respectively, provided that the Fund may issue shares of Common Stock under its Dividend Reinvestment and Cash Purchase Plan during such 120-day period.

Prior to the U.S. Offering and the International Offering, there has been no public market for the Common Stock or any other securities of the Fund. Consequently, the initial public offering price has been determined by negotiations among the Fund, BEA Associates and the Underwriters.

In order to satisfy one of the requirements for listing of the Fund's Common Stock on the New York Stock Exchange, the U.S. Underwriters will undertake to sell lots of 100 or more Shares to a minimum of 2,000 beneficial holders.

Bear Stearns Funds Management Inc., an affiliate of Bear, Stearns & Co. Inc. and Bear, Stearns International Limited, serves as the Fund's administrator. See "Management of the Fund—Administrator."

LEGAL MATTERS

With respect to matters of the United States law, the validity of the Shares offered hereby will be passed on for the Fund by Willkie Farr & Gallagher, New York, New York and for the Underwriters by Mayer, Brown & Platt, New York, New York. Willkie Farr & Gallagher also serves as counsel to BEA Associates.

EXPERTS

The statement of assets and liabilities of the Fund set forth below as of June 10, 1992 has been included in this Prospectus in reliance on the report of Coopers & Lybrand, independent accountants, given on the authority of that firm as experts in accounting and auditing.

FURTHER INFORMATION

Further information concerning these securities and their issuer may be found in the Registration Statement of which this Prospectus constitutes a part on file with the Securities and Exchange Commission.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholder of
THE EMERGING MARKETS TELECOMMUNICATIONS FUND, INC.:

We have audited the accompanying statement of assets and liabilities of The Emerging Markets Telecommunications Fund, Inc., as of June 10, 1992. This financial statement is the responsibility of the Fund's management. Our responsibility is to express an opinion on this financial statement based on our audit.

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

In our opinion, the statement of assets and liabilities referred to above presents fairly, in all material respects, the financial position of The Emerging Markets Telecommunications Fund, Inc., as of June 10, 1992, in conformity with generally accepted accounting principles.

COOPERS & LYBRAND

2400 Eleven Penn Center
Philadelphia, Pa.
June 15, 1992

THE EMERGING MARKETS TELECOMMUNICATIONS FUND, INC. (1)
STATEMENT OF ASSETS AND LIABILITIES
JUNE 10, 1992

ASSETS

Cash	$ 100,008
Deferred organization expenses (Note 2)	40,000
Deferred offering costs (Note 2)	865,000
Total assets	$1,005,008

LIABILITIES

Accrued expenses (Note 2)	$ 905,000
Net assets (applicable to 7,169 shares of Common Stock issued and outstanding, $.001 par value; 100 million shares authorized)	$ 100,008
Net asset value per share	$ 13.95

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(1) The Fund was incorporated on February 11, 1992, and has had no operations to date other than matters relating to its organization and registration as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended, and the sale and issuance of 7,169 shares of its Common Stock for $100,008 to BEA Associates. Reports to shareholders will be stated in U.S. dollars.

(2) Costs incurred by the Fund in connection with its organization, estimated at $40,000, will be amortized on a straight-line basis for a five-year period beginning at the commencement of operations of the Fund. Offering expenses, estimated at $865,000, will be payable upon completion of the offering and will be charged to capital upon the commencement of investment operations of the Fund.

No dealer, salesman, or other person has been authorized to give any information or to make any representation not contained in this Prospectus. If given or made, such information or representation must not be relied upon as having been authorized by the Fund or any Underwriter. This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any security other than the shares of Common Stock offered by this Prospectus, nor does it constitute an offer to sell or the solicitation of an offer to buy shares of Common Stock by anyone in any jurisdiction in which such offer or solicitation would be unlawful. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create an implication that there has been no change in the facts as set forth in the Prospectus or in the affairs of the Fund since the date hereof.

TABLE OF CONTENTS

Until July 12, 1992 (25 days after the date of this Prospectus), all dealers effecting transactions in the Common Stock, whether or not participating in this distribution, may be required to deliver a Prospectus. This is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

7,250,000 Shares

The Emerging Markets Telecommunications Fund, Inc.

Common Stock

PROSPECTUS

Bear, Stearns & Co. Inc.

A.G. Edwards & Sons, Inc.

Nomura Securities International, Inc.

PaineWebber Incorporated

June 17, 1992

EMERGING MARKETS RESEARCH

THE EMERGING MARKETS TELECOMMUNICATIONS FUND

BEAR STEARNS

November 16, 1992

Stanley Lanzet (272-6489)
Director of Emerging Markets Research

Liza Vera, CPA (272-9098)
Consultant, Emerging Markets

Brian Barish (272-2431)
Emerging Markets Research

Cassindy Chao (272-5846)
Emerging Markets Research

Bear, Stearns & Co. Inc.
Investment Research
245 Park Avenue
New York, NY 10167
(212) 272-2000

The Emerging Markets Telecommunications Fund (NYSE/ETF-13 3/8)

Range	Net Asset Value	Price	% Diff.	Shares Out.	Float
14 1/2-20	13.02	13 3/8	+2.8%	7,250,000	100%

OVERVIEW

The Emerging Markets Telecommunications Fund is for Long-Term Investors

We recommend The Emerging Markets Telecommunications Fund, Inc. (ETF/NYSE- 13 3/8) is recommended for long-term-oriented investors as an excellent alternative to direct investment in emerging-market securities. The focus of this closed-end fund is toward the especially relevant telecommunications and infrastructure sectors of emerging markets, areas that have performed very well in comparison with more comprehensive indices for developing countries. They usually offer the most direct means of benefiting from the macroeconomic shifts of emerging economies.. Not less than 65% of ETF's assets are to be invested in the equity securities of telecommunications companies in emerging countries. The remainder may be invested in other infrastructure -- for example, electric and gas utilities, oil and gas distributors, and toll-road concessionaires -- in emerging markets (up to 25%) or in developed country telecoms.

Investors have garnered significant returns from emerging markets in recent years. These returns have been greatly magnified by investing in key infrastructure segments such as telecommunications and electric utilities. Yet, many individual investors have been excluded from participating in this lucrative facet of global investing because of high transaction costs, a lack of basic knowledge of the investment alternatives available, the problems associated with monitoring distant localities, and an unwillingness and/or inability to commit enough assets to achieve proper and prudent diversification.

Telecommunication And Infrastructure Are The Best Ways To Play Emerging Markets.

Telecommunications and other infrastructure stocks in emerging markets generally perform well vis-a-vis their own market. In addition to providing direct exposure to the basic reforms taking place in a well-situated developing economy, they also offer the following:

- Inefficient valuations, usually perceived as rather mundane vehicles but not as the above-average growers that they actually are.

- A large underappreciation of the significant benefits to be derived from the change from public to private ownership -- for instance, the focus of the company strongly shifts toward profitability from carrying out the political dictates of the government.

- A means to participate in the incentives created -- for example, a much more favorable regulatory charter -- to fund the substantial capital outlays needed to modernize and expand these necessary services.

- The potential for the earnings of these companies to exceed expectations going forward, reflecting strong demand (higher disposable income, business expansion, and the addressing of existing backlogs), rate hikes, cost efficiencies (the revamping of archaic work practices plus the switch to a new generation of equipment such as from analog to digital telecommunications), and the addition of more value added services; and

- The prospect for investors to benefit from both above-average growth in earnings plus a likely enhancement in valuation.

The fund also offers investors the opportunity to invest in closely held companies or private placements of public companies. Investing early usually substantially boosts the potential return on investment.

Strong Management with BEA

ETF is aptly managed. The fund manager, BEA Associates, is one of the leading international money managers. BEA has 50 years of investment management experience and has approximately $18.4 billion of assets under management, more than $1.3 billion of which are in emerging markets. BEA ranks first in performance by Frank Russel among other international money managers over the past six years.

Recent News

At September 30, 1992, investments in equity securities of telecommunications companies in emerging countries totaled $71,417,593, or 64.36% of the fund's net assets; investment in equity securities of telecommunications companies in developed countries totaled $5,116,865, or 4.61%; investment in equity securities of companies that provide other essential services in the development of an emerging country's infrastructure totaled $17,532,050, or 15.80%; and short-term investment totaled $18,278,993, or 16.57%.

The fund's first two investments in unlisted equity securities were Nortel Inversa S.A. in Argentina and a participation in CANTV in Venezuela.

Note: Bear Stearns & Co., Inc. was one of the underwriters of The Emerging Markets Telecommunications Fund, Inc. The public offering of 7,250,000 shares was done on June 17, 1992, at $15.00 per share.

Investing in Closed-End Country Funds

These funds offer investors the following benefits:

- Professional management. Often, investors cannot devote the necessary time to educate themselves about a new market and/or keep informed as to developments in a particular market, especially if the assets allocated to the market are small relative to their overall holdings.

- Proper diversification, especially if the amount of assets going into a market are too small to be adequately apportioned over many securities.

- The ability to participate in companies and sectors that are still closed to foreign investors, although this factor is declining in importance.

As a group, closed-end funds have historically traded at a discount. Many investors are opting to do their investing in foreign securities through closed-end country funds. In general, we do not recommend paying significant premiums for closed-end funds in markets that are open to direct foreign investment.

Both mutual funds and closed-end funds are portfolios of securities. However, mutual funds continually issue shares to both new and old investors as well as stand ready to purchase shares from existing investors. Therefore, the capitalizations of mutual funds keep changing. Typically, closed-end funds raise money once by issuing a fixed number of shares in an initial public offering. Thereafter, the shares are traded like the common stock of other companies.

Share prices are set differently. Prices for mutual fund shares are derived from the total value of the holdings divided by the number of shares outstanding (how the net asset value is computed). Prices for closed-end shares are established by supply and demand factors. The net asset value of the closed-end funds is determined in the same manner as that of the mutual funds.

The Emerging Markets Telecommunications Fund, Inc.
Statement of Investments
September 30, 1992 (unaudited)

Shares	Description		Value	Percent of Net Assets	Top 10 Equities	Ranking
	INVESTMENTS IN EQUITY SECURITIES OF TELECOMMUNICATION COMPANIES IN EMERGING COUNTRIES–			**64.36%**		
	ARGENTINA–	**11.09%**				
5,000	Nortel Inversa S.A.		1,575,000			
983,000	Telecom Argentina		2,893,800 }			
32,000	Telecom Argentina 144A		956,000 }	–	3,849,800	8
1,748,000	Telefonica Argentina Ord.		5,498,296 }			
43,500	Telefonica Argentina 144ADS		1,386,563 }	–	6,884,859	4
			12,309,658			
	BRAZIL–	**12.78%**				
56,188,200	Telebras ON		879,402 }			
442,400,000	Telebras PN		10,523,443 }	–	11,402,845	1
16,118,500	Telesp PN		2,774,703			
			14,177,548			
	CHILE–	**0.05%**				
99,281	Conatel		57,990			
168,160	Entel		839,349			
134,600	Telefonos de Chile ADR		6,780,475		6,780,475	5
			7,677,813.68			
	HONG KONG–	**4.10%**				
4,308,400	Hong Kong Telecom		4,546,609		4,546,609	7
	ISRAEL–	**4.70%**				
74,000	ECI Telecom Ltd.		2,072,000			
100,800	Tadiran Limited		1,915,200			
111,500	Teledata Comm		1,226,500			
			5,213,700			
	MALAYSIA–	**4.25%**				
859,000	Telecom Malaysia		4,717,699		4,717,699	6
	MEXICO–	**9.87%**				
1,760,000	Telefonos de Mexico Ser. L		3,834,700 }			
1,732,000	Telefonos de Mexico Ser. A		3,759,768 }			
76,000	Telefonos de Mexico ADR		3,363,000 }			
			10,957,469		10,957,469	2
	PHILIPPINES–	**7.69%**				
218,000	Philippine Long Distance Telephone Co.		8,529,250		8,529,250	3
	PORTUGAL–	**0.68%**				
18,300	Cel–Cat		756,453			
	VENEZUELA–	**2.28%**				
5,993	CANTV / Vestcorp Holdings B		2,531,383			
	Subtotal		71,417,583		57,669,005	

The Emerging Markets Telecommunications Fund, Inc.
Statement of Investments
September 30, 1992 (unaudited)

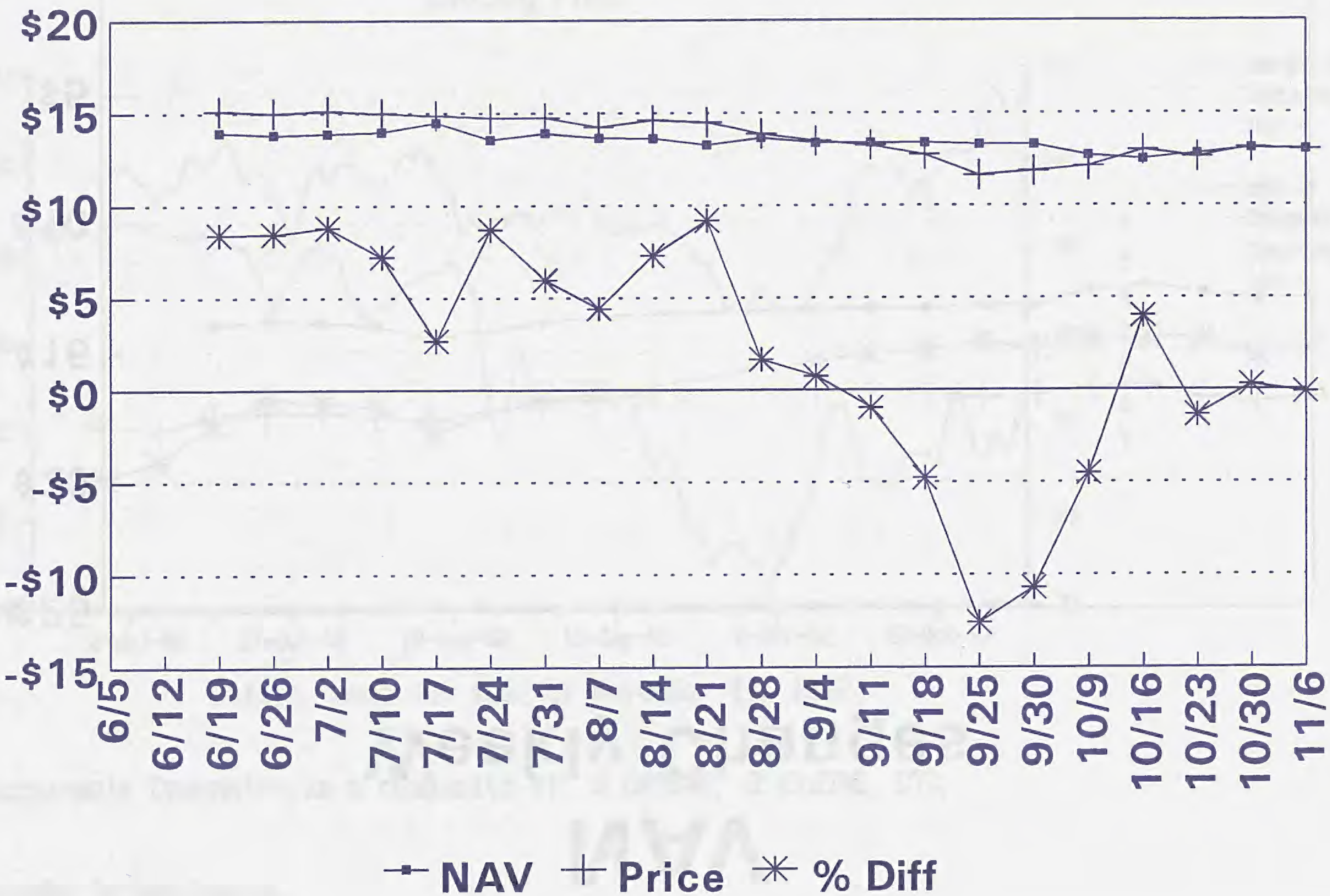
Shares	Description		Value	Percent of Net Assets	Top 10 Equities	Ranking
	INVESTMENTS IN EQUITY SECURITIES OF TELECOMMUNICATION COMPANIES IN DEVELOPED COUNTRIES–			**4.61%**		
	ITALY–	**0.67%**				
909,000	SIP–STA Italiana Telcom SPA		738,340			
	SPAIN–	**0.81%**				
30,000	Telefonica de Espana ADR		900,000			
	UNITED STATES–	**3.13%**				
93,700	Cellular Comm of Puerto Rico–		1,428,925			
1,500,000	Cellular Comm of Puerto Rico Convertible Bond,8.25%, due 08/01/2000–		1,620,000			
71600	Millicom		429,600			
			3,478,525			
	Subtotal		5,116,865			
	INVESTMENTS IN EQUITY SECURITIES OF COMPANIES THAT PROVIDE OTHER ESSENTIAL SERVICES IN THE DEVELOPMENT OF AN EMERGING COUNTRY'S INFRASTRUCTURE–			**15.80%**		
	BRAZIL–	**3.29%**				
446,100,625	Cemig PN		1,284,546			
22,475,000	Electobras de Brazil		2,370,603			
			3,655,149			
	CHILE–	**8.23%**				
152,700	Chilectra 144A ADS		3,702,975		3,702,975	10
316,192	Chilgener		923,433			
119,259	Chilquinta		506,609			
243,815	Elecda		43,371			
239,912	Electricid		464,983			
742,958	Eliqsa		98,627			
800,936	Emelari		80,806			
70,481	Emelsa		555,764			
2,573,371	Endesa De Chile		922,355			
2,626,992	Enersis		931,112			
703,479	Pehvenche		649,969			
1,234,197	Rio Maipo		247,396			
			9,127,401			
	MEXICO–	**3.45%**				
219,000	Empresas ICA Sociedad Cntl ADR		3,832,500		3,832,500	9
	VENEZUELA–	**0.83%**				
213,600	Electricad de Venezuela		917,001			
	Subtotal		17,532,050		7,535,475	
					65,204,480	58.76%

The Emerging Markets Telecommunications Fund, Inc.
Statement of Investments
September 30, 1992 (unaudited)

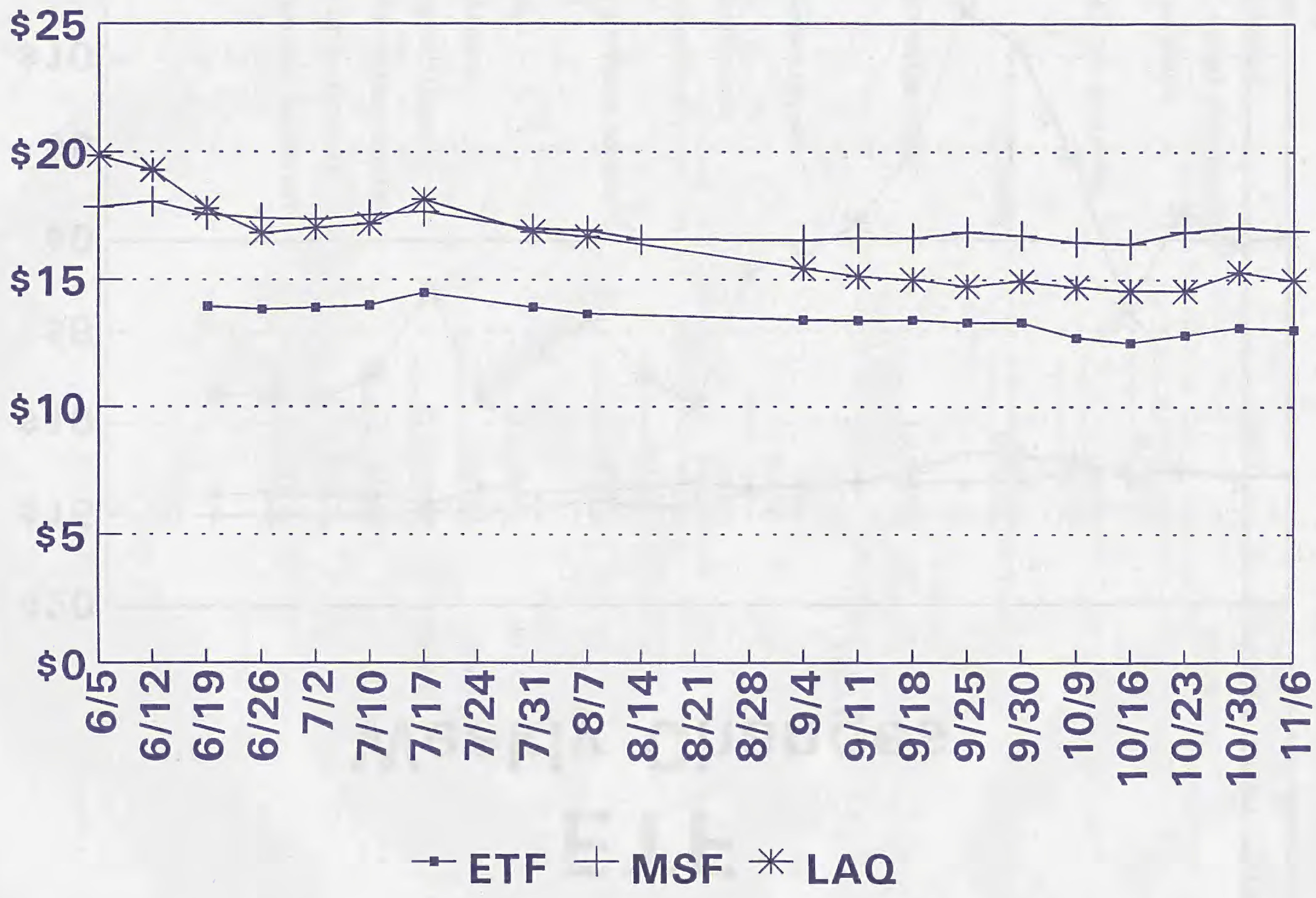
Shares	Description	Value	Percent of Net Assets	Top 10 Equities	Ranking
INVESTMENTS IN SHORT-TERM SECURITIES-			**16.57%**		
5,774,478	CETES, 16.4%, due 10/01/92	18,278,993			
		18,278,993			
105,000	U.S. Treasury bill, 2.76%, due 11/05/92	104,718			
		104,718			
	Subtotal	18,383,711			
	TOTAL INVESTMENTS-	112,450,209	**101.34%**		
CASH & OTHER ASSETS-			**1.42%**		
5,000	Grand Cayman Demand Deposit-	5,000			
284,125,559	Chilean Pesos-	754,507			
	Receivables:				
	Investment Sales Receivable	456,182			
	Interest	309,881			
	Prepaid Organizational Costs	37,852			
	Prepaid Insurance	17,227			
	TOTAL CASH & OTHER ASSETS-	1,580,649			
	TOTAL ASSETS-	114,030,858	**102.76%**		
	TOTAL LIABILITIES-	3,068,388	**-2.76%**		
	TOTAL NET ASSET VALUE	$110,962,470	**100.00%**		
	NET ASSET VALUE PER SHARE	$13.30			
	MARKET VALUE PER SHARE	$11.875			
	MARKET PREMIUM/(DISCOUNT)	-10.71%			

ETF

Weekly Changes



NAV
Weekly Changes



Closing Price

Daily: June 18, 1992 to November 11, 1992

Index of Comparable Companies is a composite of: S: 643646, S: 431536, CTC, PHI

Source: IDD Information Services/Tradeline

BEAR STEARNS

245 Park Avenue
New York, New York 10167
(212) 272-2000

DOMESTIC

ATLANTA, GEORGIA
(404) 842-4000
950 East Paces Ferry Road, N.E.

BOSTON, MASSACHUSETTS
(617) 426-9777
One Federal Street

CHICAGO, ILLINOIS
(312) 580-4000
3 First National Plaza

DALLAS, TEXAS
(214) 754-8300
1601 Elm Street

LOS ANGELES, CALIFORNIA
(213) 201-2600
1800 Century Park East

SAN FRANCISCO, CALIFORNIA
(415) 772-2900
1 Sansome Street

INTERNATIONAL

AMSTERDAM, HOLLAND
Singel 540
(20) 622-4081

GENEVA, SWITZERLAND
30 Rue Du Rhone
(022) 310-8288

HONG KONG
Shun Loong-Bear Stearns Limited
13/F East Tower, Bond Centre
89 Queensway, Central
5-868-3131

Bear Stearns Asia
60/F Bank of China Tower
1 Garden Road, Central
(852) 526-4123

LONDON, ENGLAND
Bear, Stearns International Corp.
Bear, Stearns International Limited
1 Canada Square
(71) 516-6000

PARIS, FRANCE
18 Rue Bayard
(1) 4359-4550

TOKYO, JAPAN
3-8-21 Toranomon
Minato-Ku
(03) 3437-7800

BEAR STEARNS

WITH COMPLIMENTS OF

RICHARD W. BEATTY
ASSOCIATE DIRECTOR
245 PARK AVENUE
NEW YORK, NEW YORK 10167
(212) 272-2359

PROSPECTUS

CALIFORNIA MICROWAVE

2,200,000 Shares

CALIFORNIA MICROWAVE, INC.

Common Stock

All of the shares of Common Stock offered hereby will be sold by California Microwave, Inc. The Company's Common Stock is traded on the over-the-counter market and prices are quoted on the NASDAQ National Market System under the symbol "CMIC." On February 24, 1993, the closing sale price of the Common Stock on the NASDAQ National Market System was $13.375 per share. See "Price Range of Common Stock."

See "Risk Factors" for certain considerations relevant to an investment in the Common Stock.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	Underwriting Discount and Commissions(1)	Proceeds to Company(2)
Per Share	$13.25	$0.70	$12.55
Total(3)	$29,150,000	$1,540,000	$27,610,000

(1) The Company has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended. See "Underwriting."
(2) Before deducting expenses payable by the Company, estimated to be $500,000.
(3) The Company has granted the Underwriters a 30-day option to purchase up to 330,000 additional shares of Common Stock on the same terms and conditions as set forth above, solely to cover over-allotments, if any. If all such shares are purchased, the total Price to Public, Underwriting Discount and Commissions and Proceeds to Company will be $33,522,500, $1,771,000 and $31,751,500, respectively. See "Underwriting."

The shares of Common Stock are offered subject to prior sale, when, as and if delivered to and accepted by the Underwriters and subject to certain other conditions. The Underwriters reserve the right to withdraw, cancel or modify the offer and reject orders in whole or in part. It is expected that delivery of the Common Stock will be made against payment therefor on or about March 4, 1993 at the offices of Bear, Stearns & Co. Inc., 245 Park Avenue, New York, New York 10167.

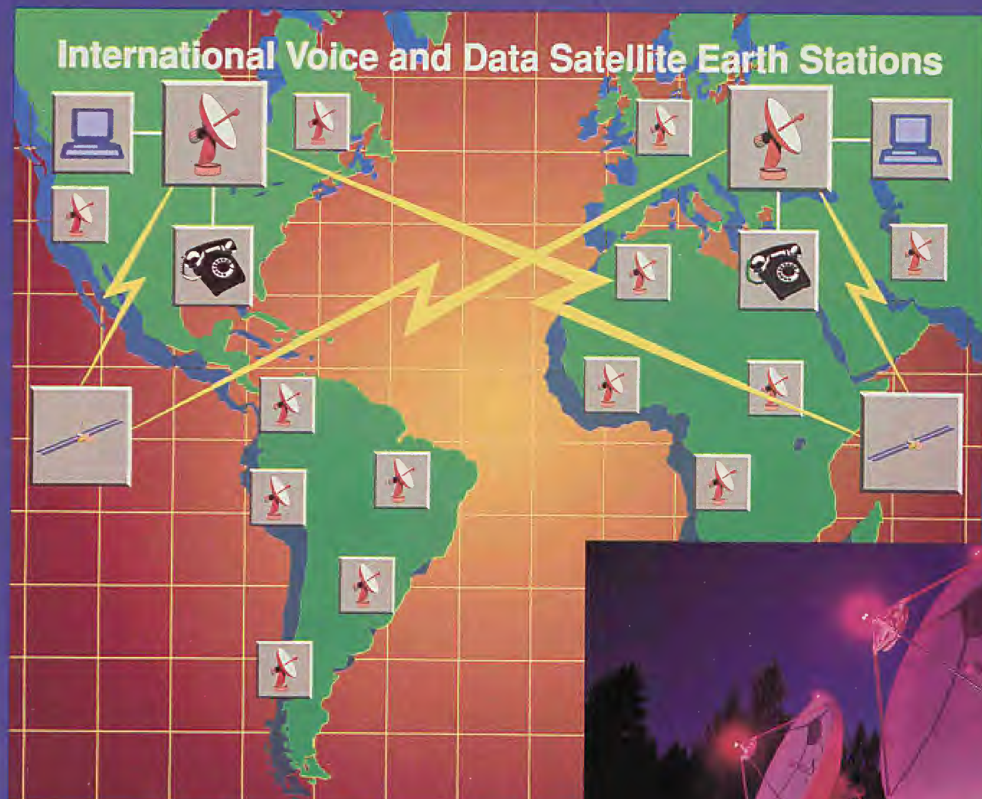
Bear, Stearns & Co. Inc. **Oppenheimer & Co., Inc.**

February 25, 1993

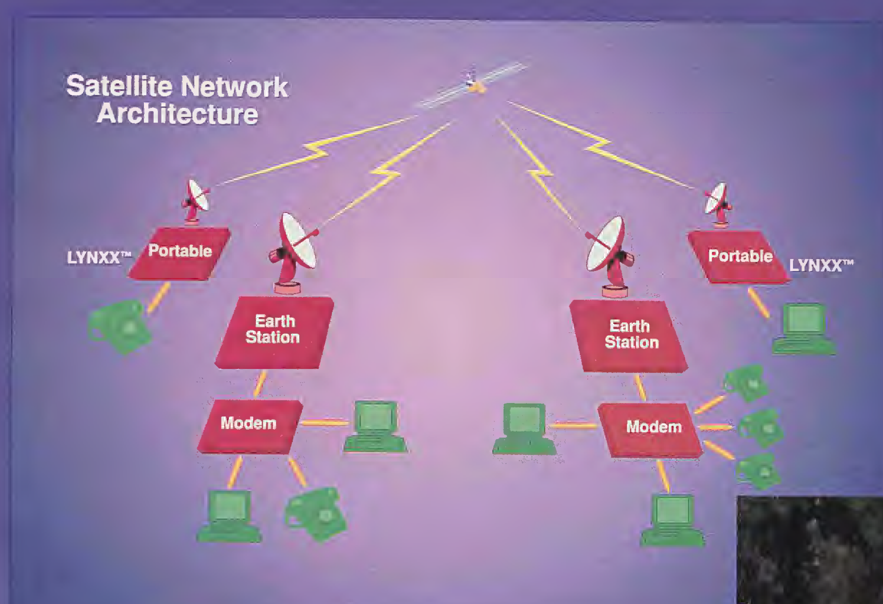
CALIFORNIA MICROWAVE, INC.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE COMMON STOCK OF THE COMPANY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Satellite Earth Stations and Equipment



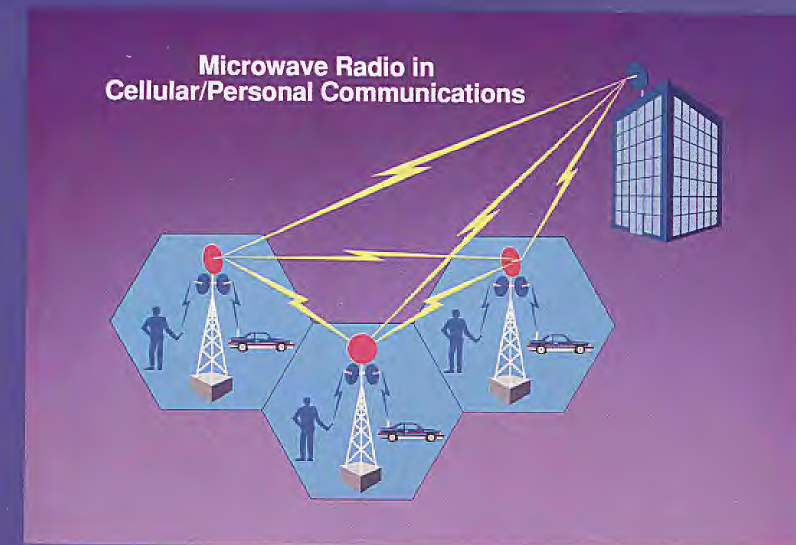
California Microwave's INTELSAT-class satellite earth stations carry a heavy circuit load in the world's telecommunications infrastructure.



California Microwave's LYNXX™ is a 40-pound portable satellite communications earth station.

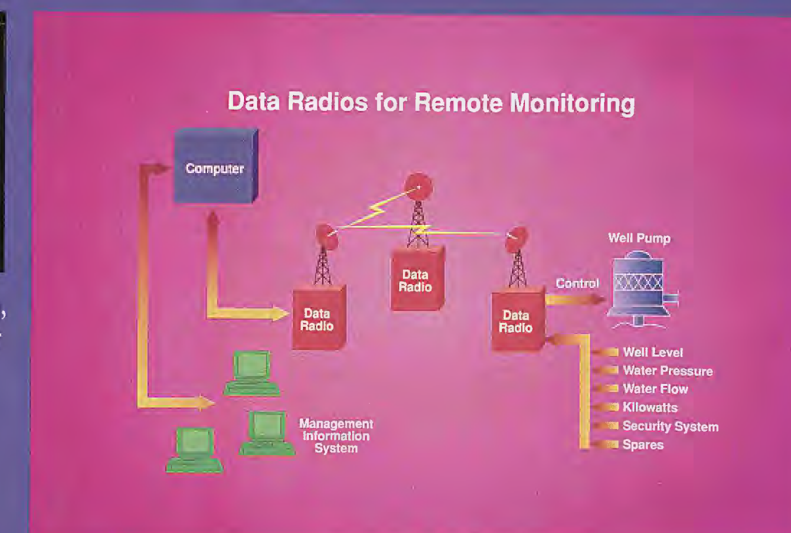
The Company's modems constitute key digital communications equipment in satellite earth stations.

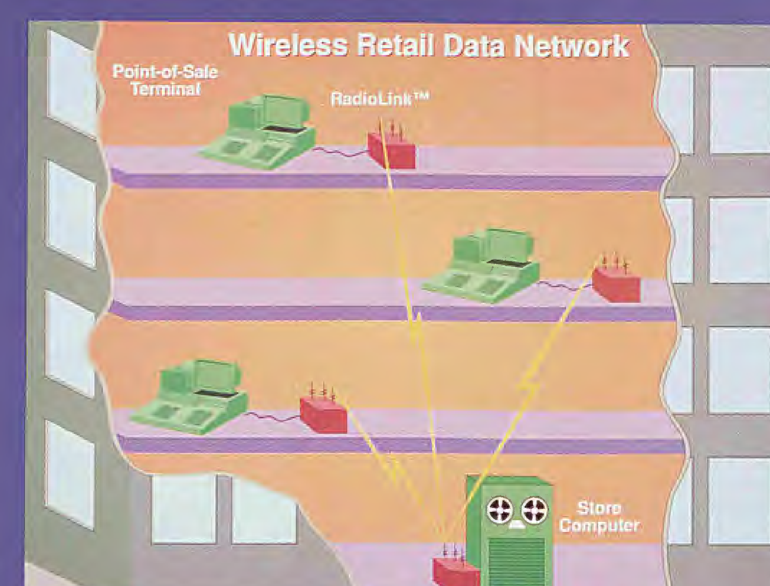
Wireless Products



California Microwave's digital point-to-point microwave radios carry traffic between both personal communications base stations and the public telephone network.

For petroleum production, pipelines and public water and power utilities, the Company's microwave data radios link multiple remote data sites to a central monitoring and control computer.





California Microwave's wireless RadioLink™, here connecting retail point-of-sale terminals with a central store computer, can be installed and operated without a license in the U.S., U.K. and Mexico.

AVAILABLE INFORMATION

The Company is subject to the informational requirements of the Securities Exchange Act of 1934 (the "Exchange Act") and in accordance therewith files reports and other information with the Securities and Exchange Commission (the "Commission"). Such reports, proxy statements and other information can be inspected and copied at the Commission's public reference facilities at Judiciary Plaza, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549 and at the following regional offices of the Commission: 75 Park Place, 14th Floor, New York, New York, 10007 and 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such material also can be obtained at prescribed rates from the Commission's Public Reference Section at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549.

This Prospectus constitutes part of a Registration Statement filed by the Company with the Commission under the Securities Act of 1933, as amended (the "Securities Act"). This Prospectus omits certain of the information contained in the Registration Statement in accordance with the rules and regulations of the Commission. Reference is hereby made to the Registration Statement and related exhibits for further information with respect to the Company and the Common Stock. Statements contained herein concerning the provisions of any document are not necessarily complete and, in each instance, where a copy of such document has been filed as an exhibit to the Registration Statement or otherwise has been filed with the Commission, reference is made to the copy so filed. Each such statement is qualified in its entirety by such reference.

INFORMATION INCORPORATED BY REFERENCE

The following documents filed with the Commission are hereby incorporated by reference in this Prospectus: (1) the Annual Report of the Company on Form 10-K for the fiscal year ended June 30, 1992; (2) the Quarterly Reports of the Company on Form 10-Q for the quarters ended September 30, 1992 and December 31, 1992; (3) the Company's description of its Common Stock Purchase Rights appearing in the Company's Registration Statement on Form 8-A dated August 1, 1989 and filed with the Commission under the Exchange Act; and (4) the Current Report of the Company on Form 8-K dated January 20, 1993.

All reports and other documents subsequently filed by the Company pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this Prospectus and prior to the termination of this offering shall be deemed to be incorporated by reference herein and to be a part hereof from the date of filing of such reports and documents. Any statement incorporated herein shall be deemed to be modified or superseded for purposes of this Prospectus to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

The Company will provide, without charge, to each person to whom this Prospectus is delivered, upon written or oral request of such person, a copy of any or all of the foregoing documents incorporated herein by reference (other than exhibits to such documents, unless such exhibits are specifically incorporated by reference into such document). Requests for such documents should be directed to George L. Spillane, Vice President — Finance, California Microwave, Inc., 985 Almanor Avenue, Sunnyvale, California 94086, 408/720-6228.

PROSPECTUS SUMMARY

The following summary is qualified in its entirety by the more detailed information and Consolidated Financial Statements, including the notes thereto, which appear elsewhere or which are incorporated by reference in this Prospectus. Unless otherwise stated, the information in this Prospectus assumes that the Underwriters' over-allotment option will not be exercised.

The Company

California Microwave, Inc. (the "Company") designs, manufactures and markets sophisticated systems and equipment used worldwide in satellite and wireless communications for the transmission of voice, data and video. The Company applies its expertise in microwave radio technologies to: satellite earth stations and equipment; microwave radios for wireless applications such as cellular and other portable personal communications equipment, and corporate data networks; and electronic intelligence systems.

- *Satellite Communications.* California Microwave is a leader in the design, assembly, integration and installation of satellite earth stations, from the largest international gateway earth stations, through an extensive series of mid-size earth stations, to very small portable earth stations. Earth stations are integrated systems consisting of antennas (1 to 32 meters in diameter), transmitting and receiving equipment, and video, data and telephone system interface equipment. The Company also manufactures certain electronic equipment, such as modems and frequency converters, which are incorporated into earth stations. The Company's line of digital and analog earth stations provides point-to-point and point-to-multipoint transmission of voice, data and video, as well as tracking and command of the satellites themselves. Many of the earth stations and related equipment are incorporated into communications networks designed, installed and integrated by the Company. California Microwave has installed more than 900 major earth stations on a turnkey basis, including more than 100 international digital earth stations for use in over 70 countries. Satellite communications sales represented 58% of total sales for the six months ended December 31, 1992.

- *Wireless.* California Microwave designs, manufactures and markets analog and digital microwave radios and other equipment ("wireless" products) used in land-based point-to-point and point-to-multipoint links for cellular and other portable personal communications and other data networks. The Company is a leading manufacturer of microwave radios for portable electronic news gathering and studio-to-transmitter applications. Its other wireless products include microwave data radios used to connect central computers to remote computer terminals or physical measurement and control devices. The Company believes that wireless is one of the fastest growing areas of the telecommunications industry due to technological advances, regulatory initiatives and the expanding requirements for connectivity between people and computers and other electronic devices. Wireless sales represented 23% of total sales for the six months ended December 31, 1992.

- *Intelligence Systems.* California Microwave integrates airborne and ground-based systems used for electronic and electro-optical intelligence gathering, processing and dissemination. Intelligence sales represented 18% of total sales for the six months ended December 31, 1992.

The Company believes that microwave technology is well-suited for application to many new and emerging markets in the wireless area. Consistent with its strategy of increasing wireless sales, in April 1992 the Company acquired Microwave Radio Corporation ("MRC") for $33 million in cash and certain contingent payments.

The Company sells its products through a variety of channels for use by many of the world's principal providers of telecommunications services. These include AT&T, MCI, British Telecom, INTELSAT signatories such as COMSAT, and telephone companies in many nations, such as Spain, Poland and Thailand. Other users of the Company's products include private networks, such as broadcast and cable television operators, utilities and other major corporations, and municipal, state and national governments. California Microwave believes that it is among the limited number of key suppliers to these entities because of its proven track record of technical performance and reliability, customer support and cost effectiveness.

California Microwave, Inc. was incorporated in California in 1968, and reincorporated in Delaware in 1987.

The Offering

Common Stock offered by the Company	2,200,000 shares
Common Stock to be outstanding after the offering	11,252,787 shares (1)
Use of proceeds	To reduce bank debt.
NASDAQ symbol	CMIC

(1) As of January 20, 1993; excludes 1,341,019 shares subject to outstanding options under the Company's stock option plans with an average exercise price of $11.91 per share and an additional 885,293 shares reserved for future issuance pursuant to the Company's employee stock and stock option plans.

Summary Consolidated Financial Information
(in thousands, except per share data)

	Fiscal Year Ended			Quarter Ended			
	June 30, 1990	June 30, 1991	June 30, 1992	March 31, 1992	June 30, 1992	Sept. 30, 1992	Dec. 31, 1992
Statement of Operations Data(1)(2):							
Sales	$145,851	$177,364	$199,003	$46,450	$57,356	$60,114	$62,742
Operating income (loss)	12,105	13,677	8,619	2,733	(1,242)	4,006	4,223
Net income (loss)	6,642	8,001	5,088	1,734	(1,192)	2,096	2,244
Net income (loss) per share	$ .80	$ .93	$ .56	$ .19	$ (.13)	$ .23	$ .24
Average shares and equivalents	8,416	8,636	9,111	9,119	8,996	9,116	9,363

	December 31, 1992	
	Actual	As Adjusted(3)
Balance Sheet Data:		
Working capital	$ 27,727	$ 54,911
Total assets	160,297	160,097
Total debt, including current maturities	40,697	13,587
Total stockholders' equity	80,823	107,807

(1) In April 1992, the Company acquired MRC for $33 million in cash and certain contingent payments. The acquisition was accounted for as a purchase. The operating results of MRC have been included in operations from the acquisition date.

(2) Results for the quarter ended June 30, 1992 include $1.9 million of certain nonrecurring charges and expenses. In addition, the Company provided reserves for inventory of approximately $900,000 and for accounts receivable of approximately $600,000 during such quarter. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations."

(3) Adjusted to reflect the issuance and sale of the 2,200,000 shares of Common Stock offered hereby and the application of the estimated net proceeds therefrom. See "Use of Proceeds."

RISK FACTORS

The following factors should be considered carefully with the information provided elsewhere or incorporated by reference in this Prospectus in evaluating an investment in the Company's Common Stock.

Fluctuations in Quarterly Results. The Company has experienced and will in the future experience significant fluctuations in sales and operating results from quarter to quarter. Factors that could cause the Company's sales and operating results to vary significantly from period to period include: mix of systems and equipment sold; timing of significant orders and deliveries of new and existing products; fluctuating market demand; price competition; new product introductions by the Company's competitors; fluctuations in foreign currency exchange rates; disruptions in delivery of components or subsystems; political instability; regulatory developments; general economic conditions; and other factors described in this section. In certain of the Company's operations, inventory levels are established, and expenditures are made, based upon forecasted demand rather than on customer orders, and the Company may be limited in its ability to reduce inventory and expenses if such forecasted demand is not realized. In addition, a limited number of customers have accounted for and are likely to continue to account for a substantial portion of the Company's sales, and the loss of any such key customer could have a material adverse effect on the Company's results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Historical Quarterly Results" and "— Results for the Quarter Ending March 31, 1993."

Entry Into New Wireless Markets. The Company believes that microwave technology is well-suited for application to many new and emerging markets in the wireless area and plans to pursue one or more of such applications in the future. There can be no assurance that the Company will be successful in its attempt to enter any new markets. It is likely that any such efforts will face significant competition from other products or systems currently marketed or being developed by the Company's competitors. Moreover, there can be no assurance that the Company's technology will be suitable for adoption in such applications, or that radio frequencies required in connection with any new wireless markets will be available. See "Business — Strategy" and "— Regulation."

Dependence on Component Availability, Subcontractor Performance and Key Suppliers. On-time delivery of the Company's products is dependent upon the availability of quality components and subsystems used by the Company in its products. The Company depends in part upon subcontractors to manufacture and deliver certain items in a timely and satisfactory manner. The Company obtains certain components and subsystems from single, or a limited number of, sources. The Company operates without a substantial inventory of components and subsystems but believes that most components and subsystems are available from existing or alternative suppliers and subcontractors. A significant interruption in the delivery of such items could have a material adverse effect on the Company's results of operations. See "Business — Manufacturing."

Competition and Changing Technology. Competition is intense and increasing among providers of telecommunications equipment and systems. The Company's products compete with other microwave-based telecommunications products and alternative telecommunications transmission media, including copper cable and fiber optic cable. See "Business — Telecommunications Industry Overview." The Company believes that competition in its markets is based primarily on price, performance, reputation, on-time delivery, reliability and customer support. Many of the Company's competitors have significantly greater financial, marketing and operating resources than the Company, as well as broader product lines. In addition, certain of the Company's customers have technological capabilities in the Company's product areas and could choose to replace the Company's products with their own. See "Business — Competition."

The technology underlying the Company's products is subject to change. The Company's continued success will depend in part upon its ability to develop and introduce competitive products and to bring those products to market in a timely manner.

Regulation. Radio communications, including satellite communications, are subject to regulation by United States and foreign laws and international treaty. The Company's equipment must conform to domestic and international requirements established to avoid interference among users of microwave frequencies and to permit interconnection of equipment. In addition, the Company is affected to the extent that domestic and international authorities regulate the allocation of the radio frequency spectrum. Equipment to support new services can be marketed only if permitted by suitable frequency allocations and regulations, and the process of establishing new regulations is complex and lengthy. Failure to make certain changes in the allocation of available spectrum could have a material adverse effect on the Company's future growth. See "Business — Regulation."

U.S. Government Business. The Company's U.S. government business, which accounted for 31% of total sales for the six months ended December 31, 1992, is subject to various risks, including unpredictable reductions in funds available for the Company's projects and contract termination at the convenience of the government. A significant portion of the Company's U.S. government business is also subject to reduction or termination due to government policy changes.

International Sales. International sales represented 40% of total sales for the six months ended December 31, 1992. The Company expects that international sales will continue to grow. These sales expose the Company to certain risks, including the difficulty and expense of staffing and maintaining foreign sales distribution channels, barriers to trade, fluctuations in foreign currency exchange rates, political instability, availability of suitable export financing, export license requirements and other U.S. and foreign regulations that may apply to the export of the Company's products. The Company attempts to reduce the risk of doing business in foreign countries by currency hedging and by seeking contracts denominated in dollars, advance payments and irrevocable letters of credit in its favor.

Organization; Dependence on Key Personnel. The Company is decentralized, which the Company believes has the advantage of fostering responsiveness to particular markets and customers. This structure leaves the Company with less central control over the operations of its divisions and subsidiaries. The Company's success is dependent upon the continued contributions of its key management personnel, including the key management at each of its divisions, some of whom were founders of those organizations. Many of the Company's key personnel, particularly the founders and key engineers of its divisions and subsidiaries, would be difficult to replace and most are not subject to employment or noncompetition agreements. The Company's growth and future success will depend in large part upon its ability to attract and retain highly qualified engineering, sales and marketing personnel. Competition for such personnel from other companies, academic institutions, government entities and other organizations is intense. There can be no assurance that the Company will be successful in hiring or retaining such personnel.

USE OF PROCEEDS

The net proceeds to the Company from the sale of the 2,200,000 shares of Common Stock being offered hereby, after deducting underwriting discounts and estimated expenses, are estimated to be $27.1 million ($31.2 million if the Underwriters' over-allotment option is exercised in full). The Company intends to use the net proceeds of this offering to reduce outstanding indebtedness under the bridge loan facility under its $50 million bank credit agreement which expires on September 30, 1993. On February 24, 1993, $35,000,000 was outstanding under that facility, bearing interest at 5.69% per annum. This indebtedness was incurred primarily in connection with the Company's April 1992 acquisition of MRC. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

PRICE RANGE OF COMMON STOCK

The Company's Common Stock is traded on the over-the-counter market, and prices are quoted on the NASDAQ National Market System under the symbol "CMIC." The following table sets forth the high and low closing sales price of the Company's Common Stock for the periods indicated. At December 31, 1992, the Company had approximately 1,669 stockholders of record.

Fiscal Years Ended June 30,	High	Low
1991		
First Quarter	$ 9⅝	$ 7¼
Second Quarter	8	5⅞
Third Quarter	14	6⅝
Fourth Quarter	18	13⅜
1992		
First Quarter	24⅛	15⅝
Second Quarter	23⅞	18
Third Quarter	18⅜	12
Fourth Quarter	12⅞	8⅞
1993		
First Quarter	14	9¼
Second Quarter	17⅝	10¾
Third Quarter (through February 24, 1993)	18	13⅜

On February 24, 1993, the closing sale price of the Company's Common Stock as reported by NASDAQ was $13.375 per share.

CAPITALIZATION

The following table sets forth the short-term debt and the capitalization of the Company as of December 31, 1992, and as adjusted to give effect to the issuance and sale by the Company of the 2,200,000 shares of Common Stock offered hereby (assuming the over-allotment option is not exercised) and the application of the estimated net proceeds therefrom. See "Use of Proceeds."

	December 31, 1992	
	Actual	As Adjusted(1)
	(in thousands)	
Short-term debt	$35,127	$ 8,017
Long-term debt	$ 5,570	$ 5,570
Stockholders' equity:		
Common Stock, $.10 par value; 29,200,000 shares authorized, 8,999,252 shares issued and outstanding (11,199,252 shares as adjusted) (2)	900	1,120
Capital in excess of par value	28,066	54,956
Retained earnings	53,410	53,284
Unamortized restricted stock plan expense	(1,553)	(1,553)
Total stockholders' equity	80,823	107,807
Total capitalization	$86,393	$113,377

(1) Gives effect to a write-off of approximately $126,000, net of tax benefits, of capitalized loan expenses related to the indebtedness to be repaid with the net proceeds of this offering.

(2) Excludes 1,143,542 shares subject to outstanding options under the Company's stock option plans with an average exercise price of $11.17 per share. Excludes an additional 1,136,305 shares reserved for future issuance pursuant to the Company's employee stock and stock option plans.

SELECTED CONSOLIDATED FINANCIAL INFORMATION

The selected consolidated financial information (other than bookings and backlog) presented below for, and as of the end of, each of the five years in the period ended June 30, 1992, have been derived from the audited consolidated financial statements of the Company, which have been audited by Ernst & Young, independent auditors. The selected consolidated financial information (other than bookings and backlog) presented below for, and as of the end of, the six months ended December 31, 1991 and 1992, have been derived from unaudited consolidated financial statements of the Company. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, which consist only of normal recurring adjustments, necessary for a fair presentation of the financial position and the results of operations for these periods. Operating results for the six months ended December 31, 1992 are not necessarily indicative of the results that may be expected for the full year. This data should be read in conjunction with the Consolidated Financial Statements of the Company contained elsewhere and incorporated by reference in this Prospectus.

	Fiscal Year Ended June 30,					Six Months Ended December 31,	
	1988	1989	1990	1991	1992	1991	1992
	(in thousands, except per share data)						
Statement of Income Data(1)(2)(3):							
Sales	$ 97,150	$125,395	$145,851	$177,364	$199,003	$ 95,197	$122,856
Cost of products sold	75,539	99,364	111,608	136,457	153,246	73,456	91,312
Gross margin	21,611	26,031	34,243	40,907	45,757	21,741	31,544
Expenses:							
Research and development	2,773	2,096	2,600	2,817	5,021	1,601	3,794
Marketing and administration	13,881	15,380	18,901	23,786	31,320	12,684	18,744
Amortization of intangible assets	240	256	637	627	797	328	777
Total expenses	16,894	17,732	22,138	27,230	37,138	14,613	23,315
Operating income	4,717	8,299	12,105	13,677	8,619	7,128	8,229
Interest income (expense), net	202	(403)	(1,573)	(977)	(639)	(25)	(1,344)
Income before income taxes	4,919	7,896	10,532	12,700	7,980	7,103	6,885
Provision for income taxes	1,722	2,764	3,890	4,699	2,892	2,557	2,545
Net income	$ 3,197	$ 5,132	$ 6,642	$ 8,001	$ 5,088	$ 4,546	$ 4,340
Net income per share	$ .40	$ .63	$ .80	$ .93	$ .56	$ .50	$ .47
Average shares and equivalents	8,053	8,167	8,416	8,636	9,111	9,165	9,239
Other Data(1)(2):							
Bookings	$142,961	$146,397	$131,923	$183,462	$202,487	$ 84,701	$162,451
Backlog	97,455	125,432	111,504	118,381	130,232	107,885	169,827

	As of June 30,					As of December 31,	
	1988	1989	1990	1991	1992	1991	1992
	(in thousands)						
Balance Sheet Data(1)(2):							
Working capital	$ 30,295	$ 31,985	$ 38,413	$ 45,911	$ 56,641	$ 51,848	$ 27,727
Total assets	63,352	84,977	89,987	98,481	147,240	95,900	160,297
Total debt, including current maturities	2,230	18,314	14,307	5,230	40,433	3,230	40,697
Total stockholders' equity	43,945	48,173	55,735	67,496	75,285	73,582	80,823

(1) In April 1992, the Company acquired MRC for $33 million in cash and certain contingent payments. The acquisition was accounted for as a purchase. The operating results of MRC have been included in operations from the acquisition date.

(2) In March 1989, the Company acquired EFData Corp. ("EFData") for $5.8 million in cash and common stock. The acquisition was accounted for as a purchase. The operating results of EFData have been included in operations from the acquisition date.

(3) Results for the quarter ended June 30, 1992 include $1.9 million of certain nonrecurring charges and expenses. In addition, the Company provided reserves for inventory of approximately $900,000 and for accounts receivable of approximately $600,000 during such quarter. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations."

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with, and is qualified in its entirety by, the Consolidated Financial Statements and Selected Consolidated Financial Information included elsewhere and incorporated by reference in this Prospectus. Historical results are not necessarily indicative of trends in operating results for any future period.

Overview

During the 1980s, the Company's sales were principally in the systems area. Systems incorporate equipment manufactured by both the Company and others. The Company's strategy includes increasing equipment sales as a proportion of total sales, where it believes the potential for growth in revenue and profits is greater. Consistent with this strategy, the Company has targeted the wireless equipment area and in April 1992 acquired MRC, a manufacturer of digital and analog fixed-link and portable microwave radios. Wireless sales have grown from 7% of total sales in fiscal 1990 to 23% of total sales for the six months ended December 31, 1992, and the Company expects wireless sales to continue to grow as a percentage of total sales. See "Business — Strategy."

The Company's international sales have expanded significantly, from 23% of total sales in fiscal 1990 to 40% of total sales for the six months ended December 31, 1992. This growth has been in both satellite communications and wireless, as investment in telecommunications infrastructure in foreign countries has accelerated. The Company expects international sales to continue to grow and to remain a substantial proportion of its total sales. See "Business — Strategy."

The Company's total gross margins typically reflect a blend of higher gross margin equipment sales combined with lower gross margin systems sales. Gross margins as a percentage of sales varied from 23% to 26% over the three fiscal years ended June 30, 1992 and the six months ended December 31, 1992, as a result of the mix of business and other factors in the respective reporting periods.

Results of Operations

The following table sets forth, for the periods indicated, certain income and expense items expressed as a percentage of the Company's total sales:

	Fiscal Year Ended June 30,			Six Months Ended December 31,	
	1990	1991	1992	1991	1992
Statement of Income Data:					
Sales	100.0%	100.0%	100.0%	100.0%	100.0%
Gross margin	23.5	23.1	23.0	22.8	25.7
Research and development expenses	1.8	1.6	2.5	1.7	3.1
Marketing and administration expenses	13.0	13.4	15.8	13.3	15.3
Amortization of intangible assets	0.4	0.4	0.4	0.3	0.6
Operating income	8.3	7.7	4.3	7.5	6.7
Interest income (expense), net	(1.1)	(0.5)	(0.3)	0.0	(1.1)
Income before income taxes	7.2	7.2	4.0	7.5	5.6
Net income	4.6	4.5	2.6	4.8	3.5

Comparison of the Six Months Ended December 31, 1992 and 1991

Bookings and Backlog. Bookings were $162.5 million and $84.7 million for the six months ended December 31, 1992 and 1991, respectively, representing an increase of 92%. Bookings were up significantly in all three of the Company's principal product areas. Approximately 40% of this increase was in wireless, principally as a result of the acquisition of MRC. Approximately 30% of this increase was in satellite communications as a result of the continued expansion of global data communications markets, and the increased demand for mobile satellite equipment. The remaining 30% of the increase was in intelligence systems, due to the Company's receipt of its largest single order to date, a $30 million multi-year contract.

Backlog was $169.8 million and $107.9 million at December 31, 1992 and 1991, respectively, representing an increase of 57%. Backlog was up significantly in all three of the Company's principal product areas. Backlog at December 31, 1992 included $19.4 million as a result of the acquisition of MRC. Backlog expected to be delivered during the next twelve months declined from 95% at December 31, 1991 to 85% at December 31, 1992, principally as a result of a $30 million multi-year contract.

Sales. Sales were $122.9 million and $95.2 million for the six months ended December 31, 1992 and 1991, respectively, representing an increase of 29%. Approximately 73% of the increase was in wireless, of which MRC contributed $15.3 million. Wireless sales were $27.8 million, representing 23% of total sales for the six months ended December 31, 1992 compared to 8% for the comparable prior year period. Approximately 55% of total sales growth was in international sales, which included substantial international sales of MRC. International sales represented approximately 40% and 33% of total sales for the six months ended December 31, 1992 and 1991, respectively.

Gross Margin. Gross margin was $31.5 million and $21.7 million for the six months ended December 31, 1992 and 1991, respectively, representing an increase of 45%. Gross margin as a percentage of total sales was 25.7% for the six months ended December 31, 1992, compared to 22.8% for the comparable prior year period. The increase was primarily due to the acquisition of MRC, whose sales have relatively higher gross margins, as well as higher gross margins for turnkey satellite earth stations due to an unusually favorable project mix. This increase was offset, in part, by price reductions for certain satellite communications equipment. The Company's project mix varies from quarter to quarter, and the Company does not expect to have as favorable a project mix for the quarter ending March 31, 1993.

In general, gross margins as a percentage of sales for equipment are substantially higher than for turnkey satellite earth station and intelligence system sales. System sales include a relatively high percentage of large subcontracted items to which the Company adds less value and upon which customers allow minimal markup. In addition, engineering costs in turnkey satellite earth stations and intelligence systems are customer-funded and are included in costs of products sold. The Company's strategy includes increasing the proportion of equipment sales.

Research and Development. Research and development expenses were $3.8 million and $1.6 million for the six months ended December 31, 1992 and 1991, respectively, representing an increase of 137%. Research and development expenses as a percentage of total sales were 3.1% for the six months ended December 31, 1992, compared to 1.7% for the comparable prior year period. This increase was due primarily to new product development in satellite communications and wireless equipment, including expenses at MRC, whose sales require relatively higher research and development expenses. In general, engineering expenditures in turnkey satellite earth stations and intelligence systems, which represented 58% and 72% of total sales for the six months ended December 31, 1992 and 1991, respectively, are customer-funded and are included in cost of products sold. The Company anticipates that research and development expenses will continue to increase as equipment sales represent an increasingly higher percentage of total sales.

Marketing and Administration. Marketing and administration expenses were $18.7 million and $12.7 million for the six months ended December 31, 1992 and 1991, respectively, representing an increase of 48%. Marketing and administration expenses as a percentage of total sales were 15.3% for the six months ended December 31, 1992, compared to 13.3% for the comparable prior year period. This increase was due principally to the acquisition of MRC, whose sales require relatively higher marketing and administration expenses, and continued investment in the development of new international and domestic markets for satellite earth stations. In general, equipment sales require relatively higher marketing and administration expenses than system sales. The Company anticipates that marketing and administration expenses will continue to increase as equipment sales represent an increasingly higher percentage of total sales.

Amortization of Intangible Assets. Amortization expenses associated with intangible assets were $0.8 million and $0.3 million for the six months ended December 31, 1992 and 1991, respectively, representing an increase of 137%. This increase was due to the acquisition of MRC. Intangible amortization expenses will increase in fiscal 1993 over fiscal 1992, reflecting the first full year's effect of the MRC acquisition, and may increase further in the future to reflect future contingent payments based on MRC's earnings growth and the related increase in intangible assets.

Operating Income. Operating income was $8.2 million and $7.1 million for the six months ended December 31, 1992 and 1991, respectively, representing an increase of 15%. Operating income as a percentage of total sales was 6.7% for the six months ended December 31, 1992, compared to 7.5% for the comparable prior year period. This decrease in operating income as a percentage of total sales was principally due to: reduced gross margins in satellite communications equipment; increased research and development expenses in satellite communications and wireless equipment; increased marketing and administration expenses for the development of new markets for satellite earth stations; and amortization expenses due to the acquisition of MRC.

Interest Expense (Net). Net interest expense was $1.3 million and $25,000 for the six months ended December 31, 1992 and 1991, respectively. This increase was primarily due to borrowings to finance the acquisition of MRC.

Provision for Income Taxes. Provision for income taxes was $2.5 million and $2.6 million for the six months ended December 31, 1992 and 1991, respectively. These provisions represent effective tax rates of 37% and 36% for the six months ended December 31, 1992 and 1991, respectively.

During the first quarter of fiscal 1993, the Company adopted the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 109 (SFAS 109) "Accounting for Income Taxes." The impact of this adoption is immaterial to the results of operations for the current period and for all prior periods.

Comparison of Fiscal Years 1992, 1991 and 1990

Bookings and Backlog. Bookings were $202.5 million, $183.5 million and $131.9 million in fiscal 1992, 1991 and 1990, respectively, representing year-to-year increases of 10% in 1992 and 39% in 1991. Approximately 50% of the increase over these two years was in satellite communications, principally international, due to the following factors: greatly expanded volume of data communications traffic; impact of deregulation and privatization of communications markets in many countries; and growing investment by developing countries in expanded communications infrastructure. Approximately 30% of the increase over these two years was in intelligence systems, particularly in the new area of small aircraft systems. The remaining 20% of the increase over these two years was in wireless due to increased demand for existing and new products and expansion of the Company's distribution channels. Wireless bookings in 1992 included two months of bookings for MRC ($4.3 million), but do not include $8.4 million of backlog acquired in the purchase of MRC.

Backlog was $130.2 million, $118.4 million and $111.5 million at the end of fiscal 1992, 1991 and 1990, respectively, representing year-to-year increases of 10% in 1992 and 6% in 1991. The proportion of such backlog that was expected to be delivered within 12 months was 95%, 95% and 90% as of the end of fiscal 1992, 1991 and 1990, respectively. Backlog at June 30, 1992 included $6.7 million as a result of the acquisition of MRC.

Sales. Sales were $199.0 million, $177.4 million and $145.9 million in fiscal 1992, 1991 and 1990, respectively, representing year-to-year increases of 12% in 1992 and 22% in 1991. Sales increased in each of the Company's three primary product areas. Approximately 55% of the increase over these two years was in satellite communications, due principally to the factors listed above under "Bookings." Approximately 25% of the increase over these two years was in wireless, which included two months of MRC sales. The remaining 20% of the increase over these two years was in intelligence systems.

Sales to AT&T represented 9%, 12% and 10% of total sales for fiscal 1992, 1991 and 1990, respectively. No other customer accounted for more than 10% of sales in any of these periods; however, the Company's total sales to all departments and agencies of the U.S. Government represented 33%, 37% and 50% of total sales in fiscal 1992, 1991 and 1990, respectively.

International sales represented 35%, 33% and 23% of total sales for fiscal 1992, 1991 and 1990, respectively.

Gross Margin. Gross margin was $45.8 million, $40.9 million and $34.2 million in fiscal 1992, 1991 and 1990, respectively, representing year-to-year increases of 12% in 1992 and 19% in 1991. Gross margin as a percentage of total sales was 23% in all three fiscal years. In 1992, gross margins as a percentage of sales decreased in satellite communications equipment due to price reductions for certain equipment, and in intelligence systems due to the relatively low gross margins as a percentage of sales on certain new U.S. government contracts. These decreases were offset by increased gross margins as a percentage of sales in wireless which included two months' contribution of MRC. In 1991, gross margins as a percentage of sales were relatively stable across the Company's product areas.

Research and Development. Research and development expenses were $5.0 million, $2.8 million and $2.6 million in fiscal 1992, 1991 and 1990, respectively, representing year-to-year increases of 78% in 1992 and 8% in 1991. Research and development expenses as a percentage of total sales were 2.5%, 1.6% and 1.8% in fiscal 1992, 1991 and 1990, respectively. The 1992 increase was due primarily to increased investment in satellite communications and wireless equipment, which included two months' expenses of MRC.

Marketing and Administration. Marketing and administration expenses were $31.3 million, $23.8 million and $18.9 million in fiscal 1992, 1991 and 1990, respectively, representing year-to-year increases of 32% in 1992 and 26% in 1991. Marketing and administration expenses as a percentage of total sales were 15.8%, 13.4% and 13.0% in fiscal 1992, 1991 and 1990, respectively. The 1992 increase resulted primarily from increased expenses associated with the Company's strategy of expanding its wireless operations, as well as increased expenses in satellite communications, where the Company continues to develop new international and domestic markets. These expenses also included $1.9 million of nonrecurring charges and expenses related to a $1.5 million provision for underutilized facilities and payments of $0.4 million in connection with termination of a long-term incentive plan in anticipation of adoption of a new plan. In addition, these expenses included $0.7 million of additions to reserves for accounts receivable. The 1991 increase was due primarily to increased expenses in satellite communications.

Amortization of Intangible Assets. Amortization expenses associated with intangible assets were $0.8 million, $0.6 million and $0.6 million in fiscal 1992, 1991 and 1990, respectively, representing an increase of 27% in 1992. The increase in fiscal 1992 was due to the acquisition of MRC.

Operating Income. Operating income was $8.6 million, $13.7 million and $12.1 million in fiscal 1992, 1991 and 1990, respectively, representing a decrease of 37% in 1992 and an increase of 13% in 1991. Operating income as a percentage of total sales was 4.3%, 7.7% and 8.3% in fiscal 1992, 1991 and 1990, respectively. The decrease in operating income as a percentage of total sales in fiscal 1992 was due principally to: decreased gross margins on satellite communications equipment and on certain new U.S. government contracts; increased research and development expenses in satellite communications and wireless equipment; and increased marketing and administration expenses associated with the Company's strategy of expanding its wireless operations and developing new international and domestic markets in satellite communications. In addition, marketing and administration expenses in fiscal 1992 increased $1.9 million due to certain nonrecurring charges and expenses related to a $1.5 million provision for underutilized facilities and payments of $0.4 million in connection with termination of a long-term incentive plan in anticipation of adoption of a new plan. In addition, these expenses included $0.7 million of additions to reserves for accounts receivable.

Interest Expense (Net). Net interest expense was $0.6 million, $1.0 million and $1.6 million in fiscal 1992, 1991 and 1990, respectively, representing year-to-year decreases of 35% in 1992 and 38% in 1991. Decreases in both years were primarily due to reduced short-term borrowings and increased operating cash flow, partially offset in fiscal 1992 by the effect of two months' interest expense associated with the acquisition of MRC.

Provisions for Income Taxes. Provision for income taxes was $2.9 million, $4.7 million and $3.9 million in fiscal 1992, 1991 and 1990, respectively. This represents an effective tax rate of 36%, 37% and 37% in fiscal 1992, 1991 and 1990, respectively.

Historical Quarterly Results

The following table presents consolidated financial results for each of the last six quarters in the period ended December 31, 1992. These consolidated financial results are unaudited. In the opinion of management, however, they have been prepared on the same basis as the audited consolidated financial information and include all adjustments necessary for a fair presentation of the information set forth therein. The operating results for any quarter are not necessarily indicative of the results that may be expected for any future period.

	Quarter Ended					
	Fiscal 1992				Fiscal 1993	
	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
	(in thousands, except per share data)					
Statement of Operations Data (1) (2):						
Sales	$48,716	$46,481	$46,450	$57,356	$60,114	$62,742
Cost of products sold	38,476	34,980	35,563	44,227	44,535	46,777
Gross margin	10,240	11,501	10,887	13,129	15,579	15,965
Expenses:						
Research and development	526	1,075	1,381	2,039	1,805	1,989
Marketing and administration	6,003	6,681	6,609	12,027	9,379	9,365
Amortization of intangible assets	164	164	164	305	389	388
Total expenses	6,693	7,920	8,154	14,371	11,573	11,742
Operating income (loss)	3,547	3,581	2,733	(1,242)	4,006	4,223
Interest income (expense), net	(26)	1	(23)	(591)	(680)	(664)
Income (loss) before income taxes	3,521	3,582	2,710	(1,833)	3,326	3,559
Provision for income taxes (benefit)	1,268	1,289	976	(641)	1,230	1,315
Net income (loss)	$ 2,253	$ 2,293	$ 1,734	$(1,192)	$ 2,096	$ 2,244
Net income (loss) per share	$ .25	$ .25	$ .19	$ (.13)	$ .23	$ .24
Average shares and equivalents	9,156	9,173	9,119	8,996	9,116	9,363

(1) In April 1992, the Company acquired MRC for $33 million in cash and certain contingent payments. The acquisition was accounted for as a purchase. The operating results of MRC have been included in operations from the acquisition date.

(2) Results for the quarter ended June 30, 1992 include $1.9 million of certain nonrecurring charges and expenses. In addition, the Company provided reserves for inventory of approximately $900,000 and for accounts receivable of approximately $600,000 during such quarter.

The following table sets forth, for the periods indicated, certain income and expense items expressed as a percentage of the Company's total sales:

	Quarter Ended					
	Fiscal 1992				Fiscal 1993	
	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
Statement of Operations Data:						
Sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross margin	21.0	24.7	23.4	22.9	25.9	25.4
Research and development expenses	1.1	2.3	3.0	3.6	3.0	3.2
Marketing and administration expenses	12.3	14.4	14.2	21.0	15.7	14.9
Amortization of intangible assets	0.3	0.3	0.3	0.5	0.6	0.6
Operating income (loss)	7.3	7.7	5.9	(2.2)	6.6	6.7
Interest income (expense), net	(0.1)	0.0	(0.1)	(1.0)	(1.1)	(1.0)
Income (loss) before income taxes	7.2	7.7	5.8	(3.2)	5.5	5.7
Net income (loss)	4.6	4.9	3.7	(2.1)	3.5	3.6

The Company's sales and results of operations are subject to fluctuation from period to period. These fluctuations are caused by a number of factors, including: mix of systems and equipment sold; timing of significant orders and deliveries of new and existing products; fluctuating market demand; price competition; new product introductions by the Company's competitors; fluctuations in foreign currency exchange rates; disruptions in delivery of components or subsystems; political instability; regulatory developments; and general economic conditions. In certain of the Company's operations, inventory levels are established, and expenditures are made, based upon forecasted demand rather than on customer orders, and the Company may be limited in its ability to reduce inventory and expenses if such forecasted demand is not realized. In addition, a limited number of customers have accounted for and are likely to continue to account for a substantial portion of the Company's sales, and the loss of any such key customer could have a material adverse effect on the Company's results of operations in any quarter.

Sales. The Company's sales increased significantly in the fourth quarter of fiscal 1992 primarily as a result of the Company's acquisition of MRC, which contributed two months to that quarter's sales. The Company's sales increased further in the first two quarters of fiscal 1993 due principally to the full effect of MRC and growth in satellite communications equipment sales.

Gross Margin. Gross margin as a percentage of total sales in the first quarter of fiscal 1992 of 21.0% was low due to a high concentration of relatively lower margin turnkey satellite earth station sales. Gross margin as a percentage of sales improved to 24.7% in the second quarter due to higher satellite communications equipment sales relative to turnkey satellite earth station sales. Gross margin as a percentage of sales subsequently decreased to 23.4% in the third quarter primarily as a result of lower average prices for certain satellite communications equipment due to increased competition. In spite of the favorable impact of the acquisition of MRC, whose products have relatively higher gross margins, and improved gross margins on other wireless sales due to increased sales volume, gross margins as a percentage of sales declined to 22.9% in the fourth quarter. This decline was primarily due to lower average prices on satellite communications equipment and inventory write-downs and additions to inventory reserves of $0.9 million taken primarily in the satellite communications area as a result of manufacturing costs incurred. Gross margin as a percentage of sales increased to 25.9% and 25.4% in the first and second quarters of fiscal 1993, respectively, due to increased sales of relatively higher margin satellite communications and wireless equipment and a more favorable project mix in turnkey satellite earth stations and intelligence systems.

Research and Development. Research and development expenses as a percentage of total sales grew over the last six quarters due to increased spending in satellite communications and wireless equipment, including the expenses of MRC for two months in the fourth quarter of fiscal 1992 and the first two quarters of fiscal 1993. Research and development expenses as a percentage of total sales were relatively high in the fourth quarter of fiscal 1992 as the Company accelerated the completion of new product lines in wireless networking and satellite equipment.

Marketing and Administration. Marketing and administration expenses as a percentage of total sales increased from 12.3% in the first quarter of fiscal 1992 to 14.4% in the second quarter due to expansion of the Company's distribution channels for wireless. Marketing and administration expenses as a percentage of sales remained relatively level in the third quarter but increased to 21.0% in the fourth quarter. This increase was due to a number of factors, including the acquisition of MRC, whose sales require relatively higher marketing and administration expenses, and $1.9 million of certain nonrecurring charges and expenses related to a $1.5 million provision for underutilized facilities and payments of $0.4 million in connection with termination of a long-term incentive plan in anticipation of adoption of a new plan. In addition, marketing and administration expenses included $0.6 million of additions to reserves for accounts receivable. Marketing and administration expenses as a percentage of sales were 15.7% and 14.9% in the first and second quarters of fiscal 1993, respectively.

Amortization of Intangible Assets. Amortization of intangible assets increased significantly in the fourth quarter of fiscal 1992 due to the incremental goodwill amortization expense associated with the MRC acquisition.

Interest Expense (Net). Net interest expense increased significantly in the fourth quarter of fiscal 1992 due to borrowings to finance the acquisition of MRC.

Results for the Quarter Ending March 31, 1993

The Company expects that its gross margin as a percentage of sales for the quarter ending March 31, 1993 will be adversely affected by an unfavorable mix in product and project sales. In addition, as a result of this offering, the Company will write off approximately $200,000 of capitalized loan expenses upon prepayment of its $35 million bridge loan, partially offset by the associated reduction in interest expense. Earnings per share will also be negatively impacted by the increased number of shares outstanding as a result of this offering. The aggregate impact of these factors may result in flat or lower earnings per share for such quarter as compared to the quarter ended December 31, 1992.

Liquidity and Capital Resources

At December 31, 1992, the Company had working capital of $27.7 million, including $10.8 million of cash and cash equivalents, compared with working capital of $51.8 million, including $2.4 million of cash and cash equivalents, at December 31, 1991. Net cash provided by operating activities was $8.8 million and $1.7 million for the six months ended December 31, 1992 and 1991, respectively.

In April 1992, the Company entered into a bank credit agreement totaling $50 million, consisting of a $35 million bridge loan facility and a $15 million revolving credit line. The banks providing this facility received a security interest in all of the Company's assets. In April 1992, the Company borrowed the entire $35 million bridge loan facility at an interest rate, fixed for six months, of 6.06%, primarily to finance its purchase of MRC. Subsequent resets of the rate are based on an increasing increment above the London Interbank Offered Rate. The interest rate in effect at December 31, 1992 was 5.69%. In February 1993, the credit agreement was amended to increase the amount of the revolving credit line by $2.5 million. As of December 31, 1992, there were no borrowings outstanding and there were $12.6 million of standby letters of credit outstanding under the revolving credit line in support of certain international contracts. The credit agreement expires in September 1993. The Company plans to use all of the proceeds from the sale of the Common Stock offered hereby to reduce the bridge loan under the credit agreement.

Delivery cycle times have been reduced during the last three fiscal years, and inventory turnover (defined as cost of sales divided by average year-end inventory balances) has increased from 3.3 to 3.6 to 4.2 turns in fiscal 1990, 1991 and 1992, respectively, and to 4.9 turns for the six months ended December 31, 1992. The Company believes that this improvement in inventory turns is due to its increased emphasis on asset management. The Company has experienced few significant collection problems. Average days sales in accounts receivable (calculated based on average year-end balances) typically range from 62 to 73 days.

The Company believes that the net proceeds from the sale of Common Stock offered hereby, together with its current cash position, funds generated from operations and funds available from its existing credit agreement, will be adequate to meet the Company's requirements for working capital, capital expenditures and debt service through the end of the current fiscal year. Following completion of this offering, the Company plans to negotiate a new $20-25 million credit agreement to cover its on-going needs for working capital and letters of credit and to retire that portion of the bridge loan that is not repaid from the proceeds of this offering. There can be no assurance that the Company will be able to extend or replace the current credit agreement or obtain financing from any other source on terms acceptable to the Company.

BUSINESS

California Microwave designs, manufactures and markets sophisticated systems and equipment used worldwide in satellite and wireless communications for the transmission of voice, data and video. The Company applies its expertise in microwave radio technologies to: satellite earth stations and equipment; microwave radios for wireless applications such as cellular and other portable personal communications equipment, and corporate data networks; and electronic intelligence systems.

The Company sells its products through a variety of channels for use by many of the world's principal providers of telecommunications services. These include AT&T, MCI, British Telecom, the International Telecommunications Satellite Organization ("INTELSAT") signatories such as Communications Satellite Corporation ("COMSAT"), and telephone companies in many nations, such as Spain, Poland and Thailand. Other users of the Company's products include private networks, such as broadcast and cable television operators, utilities and other major corporations, and municipal, state and national governments. California Microwave believes that it is among the limited number of key suppliers to these entities because of its proven track record of technical performance and reliability, customer support and cost effectiveness.

Telecommunications Industry Overview

Telecommunications Market. The demand for improved telecommunications is increasing worldwide as emerging economies seek to modernize, and as increasingly information-intensive developed countries introduce new telecommunications services. The telecommunications industry has expanded rapidly during the last decade, principally due to technological advances and regulatory changes in the United States and internationally. Advances in technology have lowered per-unit communications costs, increased product reliability, and encouraged a proliferation of new and enhanced communications products and services. Regulatory initiatives (such as the breakup of the Bell system and the assignment of radio frequency spectrum for cellular telephone services) have enhanced competition, permitted the opening of new markets and provided incentives for the development of new products.

Alternative Transmission Media. Customers for telecommunications equipment must weigh the relative costs and advantages of the four presently available transmission media: copper cable, fiber optic cable, satellite systems and terrestrial microwave radio systems.

- *Copper cable*, the traditional transmission medium most familiar to consumers, is being replaced and supplemented by the other media, particularly for high-volume and long-distance transmissions where it has substantial capacity, cost and reliability limitations.

- *Fiber optic cable* is best suited to high-volume, point-to-point, short- or long-distance links where its advantages — capacity, quality and security — justify the long lead time and high cost to equip and install a network.

- *Satellite systems* are often a preferred medium for transmitting to a large geographical or multipoint area. These systems, which use microwave technology, are well suited for rapid introduction of service in remote areas or where terrestrial alternatives are unavailable, such as mobile, shipboard or military applications. Satellite systems require a sizeable initial capital investment by service providers to build and launch. Once the satellites are in orbit, however, there are substantial incentives to use this capacity, which typically requires continued investment in satellite earth stations.

- *Terrestrial microwave radio systems* can be quickly and easily installed, require relatively low initial capital investment and can be upgraded and expanded over time. There are a wide variety of microwave radios offering different frequencies, modulation techniques (analog or digital), and data transmission capacities. However, microwave radio applications typically require government licensing and frequency coordination in order to prevent signal interference among various users and require a line of sight between the transmitting and receiving antennas. Unavailability of sufficient frequency spectrum has historically inhibited sales in developed countries, although this constraint is being alleviated. See " — Regulation."

Rarely is a complete communications system based solely on one of these media. Transmission is normally routed through a combination of media, each employed where it fits most cost-effectively within the communications network. For example, a microwave radio studio-to-transmitter link used by a television broadcaster may connect to a satellite system used to distribute programs domestically and overseas. In addition, the various media provide routing alternatives for the other media, as in the case of satellite backup facilities for undersea fiber optic cables.

Strategy

California Microwave's strategy is to apply its expertise in microwave technologies to systems and equipment for the satellite communications, wireless and intelligence systems markets. The Company works closely with key customers and potential customers to specify and develop new products and product enhancements that have long-term growth potential. The Company considers its ability to create and maintain long-term customer relationships an important component of its overall strategy in each of its markets.

The Company has concentrated its efforts on sales of systems and equipment used for communications infrastructure rather than on end-user terminals and equipment.

The Company's strategy includes the following key elements:

Maintainance of Strong Position in Satellite Communications and Intelligence Systems Markets. By introducing new products and expanding its marketing efforts and distribution capabilities worldwide, the Company intends to continue to strengthen its position in its markets for satellite communications and intelligence systems.

Wireless Growth. The Company believes that the wireless telecommunications market offers numerous opportunities because of its rapid growth and relatively fragmented nature. Emerging opportunities for the sale of microwave radios include cellular and other portable personal communication systems, mobile data entry, remote data collection and device monitoring and wireless local area networks. Many of these opportunities relate to the portability and mobility requirements of customers.

International Expansion. The Company's systems and equipment are marketed on a worldwide basis. The Company's international sales have expanded significantly in both satellite communications and wireless, and represented 40% of total sales for the six months ended December 31, 1992. International sales are expected to continue to increase due to international infrastructure requirements in developing countries and the emergence of wireless opportunities worldwide.

Acquisitions. The Company intends to continue to enhance its market position through acquisitions of companies or lines of business that complement its existing businesses. Consistent with this strategy, the Company in April 1992 acquired MRC for $33 million in cash and certain contingent payments. In addition, the Company acquired ViaSat Technology Corporation ("ViaSat"), Microwave Data Systems ("MDS") and EFData Corp. ("EFData") in recent years.

Core Technology Focus. Since its founding in 1968, the Company's systems and equipment have been based on microwave radio technologies. The Company's products employ both analog and digital applications of radio frequency technology. Digital technology significantly enhances performance and capacity and facilitates new product developments. The Company has invested significant resources in these technologies and believes its microwave communications technologies provide a solid base for the development of future wireless communications products and services, including new forms of mobile and portable communications systems.

Decentralized Organizational Structure. California Microwave's subsidiaries and divisions are decentralized. The Company believes this organizational structure allows the key entrepreneurial personnel of each division, many of whom are the founders of their divisions, to be responsive to particular markets and customers. Each subsidiary and division typically maintains its own sales, marketing, product development and manufacturing functions.

Products and Markets

The Company's sales are summarized below:

	Fiscal Years Ended June 30,						Six Months Ended December 31,	
	1990	%	1991	%	1992	%	1992	%
	(dollars in millions)							
Sales by Product Area								
Satellite communications	$102	70%	$125	70%	$131	66%	$ 71	58%
Wireless	10	7	14	8	23	12	28	23
Intelligence systems	29	20	32	18	39	19	22	18
Other	5	3	6	4	6	3	2	1
Total	$146	100%	$177	100%	$199	100%	$123	100%
Sales by Customer								
International	$ 34	23%	$ 58	33%	$ 70	35%	$ 49	40%
U.S. government	73	50	66	37	66	33	38	31
U.S. commercial	39	27	53	30	63	32	36	29
Total	$146	100%	$177	100%	$199	100%	$123	100%

Satellite Communications

California Microwave is a leader in the design, assembly, integration and installation of satellite earth stations, from the largest international gateway earth stations, through an extensive series of mid-size earth stations, to very small portable earth stations. Earth stations are integrated systems consisting of antennas (1 to 32 meters in diameter), transmitting and receiving equipment, and video, data and telephone system interface equipment. The Company also manufactures certain electronic equipment, such as modems and frequency converters, which are incorporated into earth stations. Large antennas and certain other equipment are obtained from third parties. The Company's line of digital and analog earth stations provides point-to-point and point-to-multipoint transmission of voice, data and video, as well as tracking and command of the satellites themselves. Many of the earth stations and related equipment are incorporated into communications networks designed, installed and integrated by the Company. The Company's systems are installed and operating in more than 70 countries.

Turnkey Satellite Earth Stations and Networks. The Company, through its subsidiary Satellite Transmission Systems, Inc. ("STS"), is a leading supplier of turnkey satellite transmit/receive earth stations and networks for domestic, international and government applications. The Company is both an equipment supplier and a large-scale network integrator. It has installed more than 900 major earth stations on a turnkey basis, including more than 100 digital earth stations for use by members of the INTELSAT network. Turnkey satellite earth stations typically are completed in six to fifteen months.

Transportable, Mobile, Portable and Other Satellite Earth Stations. The Company, through its subsidiaries STS and ViaSat, manufactures a variety of transportable, mobile, portable and other satellite earth stations. Most have modular designs, which reduce equipment costs, installation costs and delivery lead times, and accommodate a wide variety of capacity, frequency band or other customer requirements.

Transportable and mobile earth stations are typically used for rapid deployment to supply broadcast and voice communications where telephone service may be non-existent or temporarily unavailable. For example, the Company's earth stations were used in operation Desert Storm and in the aftermath of Hurricane Gilbert. Recently, the Company, through its ViaSat subsidiary, introduced the world's first portable International Maritime Satellite Organization ("INMARSAT") B terminal which is used for high-speed data and voice transmission and is marketed under the trademark "Lynxx." In October 1992, the Company announced receipt of contracts totalling $9 million from Westinghouse to develop and produce satellite earth stations and ground equipment for a satellite system under development to support cellular communications in rural areas in the United States and Canada.

Satellite Earth Station Equipment. Through various of its subsidiaries and divisions, California Microwave manufactures a broad line of electronic equipment used in earth stations. The products are used extensively in the Company's own earth stations and are also sold in volume to other earth station suppliers and to operators of communication networks to upgrade existing earth stations. EFData is a leading producer of high speed (up to 155 million bits per second) digital modems used to connect private or public telephone lines to satellite communications networks. Since 1988, EFData has delivered approximately 6,000 satellite modems for use in INTELSAT systems, satellite backup facilities for undersea fiber optic cable, and for many private network applications. STS manufactures a range of frequency converters used in satellite earth stations, and proprietary computer-based monitor and control systems.

The Company's principal satellite communications products are summarized in the following table:

Satellite Communications			
PRODUCTS	**APPLICATION**	**TYPICAL PRICE RANGE**	**SELECTED CUSTOMERS OR END USERS**
Turnkey Satellite Earth Stations and Networks			
International Gateways	Provides direct voice, data, video and facsimile services internationally (11-32 meter antenna)	$1,000,000 to $5,000,000	AT&T, British Telecom, COMSAT, MCI, Romania Ministry of Communications, Telefonica (Spain)
Networks	Provides voice, data, video and facsimile services for corporations, telephone companies and governments domestically	$5,000,000 to $15,000,000	AT&T, Tenneco Oil, U.S. Government, Acumen (Thailand), Satelnet (Argentina), Telespazio (Italy), Samsung (Korea)
Video Uplinks	Transmits television signals	$500,000 to $2,000,000	Hughes Communications, New York Teleport, British Telecom, KDD (Japan)
Very Small Aperture Terminal ("VSAT") Hubs	Transmits data used by retailers, car dealers and hotels in VSAT networks	$500,000 to $2,000,000	Hughes Network Systems, AT&T Tridom
Mobile Shore Stations	Transmits voice and data to land mobile and shipboard terminals in INMARSAT network	$1,000,000 to $5,000,000	Hughes Network Systems, Satcom S.A. (Portugal), VSNL (India)
Tracking, Telemetry and Command Earth Stations	Tracks, monitors and controls satellite during launch and in orbit	$1,000,000 to $5,000,000	AT&T, GTE, INTELSAT, COMSAT
Transportable, Mobile, Portable and Other Satellite Earth Stations			
SCAMP	3.5-9 meter antenna earth stations with electronics package on antenna for international data and VSAT network hubs	$100,000 to $400,000	CBS, Reuters, U.S. Government, Teleinformatica (Italy), Telefonica (Spain)
FAST	1.8-2.4 meter antenna "fly-away" earth stations for transmitting voice and high-speed data (up to 2 megabits/second)	$100,000 to $300,000	U.S. Government, CBS, Midwest Video (CNN)
PSAT	1.2 meter antenna earth stations for transmitting voice and low-speed data (256 kilobits/second), typically for emergency communications	$50,000 to $100,000	Chevron, AMOCO, ABC
Lynxx™	40 lb. complete earth station providing voice and data using INMARSAT-B service	$40,000 to $50,000	(Confidential)
CSAT/KSAT	1.8-6 meter antenna smaller capacity earth stations using C- and Ku- bands for remote transmission of voice and data	$20,000 to $100,000	Hughes Network Systems, Satelnet (Argentina), U.S. Government
Satellite Earth Station Equipment			
High Speed Modems	For connecting telephone lines to international satellite networks; optical fiber back-up; and private networks	$5,000 to $80,000	AT&T, GTE, MCI, Sprint, British Telecom
Frequency Converters	Key component in earth stations for converting frequencies	$8,000 to $50,000	AT&T, MCI, Telefonica (Spain), U.S. Government, Communications Authority of Thailand, Singapore Telecomunications
Monitor and Control Systems	PC-based color graphics monitor and control system for networks and earth stations	$5,000 to $75,000	British Telecom, COMSAT, MCI, Reuters, U.S. Government

Wireless

California Microwave designs, manufactures and markets analog and digital microwave radios and other equipment ("wireless" products) used in land-based point-to-point and point-to-multipoint links for cellular and other portable personal communications and other data networks. The Company is a leading manufacturer of microwave radios for portable electronic news gathering and studio-to-transmitter applications. Its other wireless products include microwave data radios used to connect central computers to remote computer terminals or physical measurement and control devices. The Company believes that wireless is one of the fastest growing areas of the telecommunications industry due to technological advances, regulatory initiatives and the expanding requirements for connectivity between people and computers and other electronic devices.

Cellular and Portable Personal Communications. In 1992, the Company, through its MRC subsidiary, introduced short-range digital microwave radio systems for worldwide applications in cellular and portable personal communications networks and systems. Since July 1992, the Company has received significant orders for two major users in the United Kingdom for approximately 1,500 digital microwave radios to interconnect microcells in new cellular and personal communications systems. The majority of these orders are for MRC's new 38 GHz radios, the first such radio to receive regulatory approval in the United States and the United Kingdom. In the United Kingdom, MRC sells its digital radios through Northern Telecom Europe, a subsidiary of Northern Telecom Limited.

Television Broadcast. MRC is a leading supplier of analog microwave radios to U.S. and international broadcast and cable television markets for use principally in portable electronic news gathering and studio-to-transmitter applications.

Wireless Data Networking. The Company, through its MDS division, manufactures point-to-point and point-to-multipoint microwave data radios. MDS point-to-point radios are used to extend the reach of a communications system in areas where low capacity, multi-channel voice or data communications links are required. Point-to-multipoint radio systems are used principally to connect central computers to remote computer terminals or to physical measurement and control devices. Typical applications include remote monitoring and automated operation of oil and gas production and distribution, water/wastewater treatment systems, and control of electric utility power generation facilities. For example, it is neither practical nor economical to monitor oil well production by running telephone lines between oil wells and computers or by sending personnel to monitor the wells around-the-clock. Approximately 50,000 MDS data radios have been sold.

The Company, through its Wireless Networking division, manufactures radio systems which offer users a license-free, wireless method of transmitting data. Recently revised U.S. and United Kingdom regulations provide for unlicensed transmission in certain bands of the microwave frequency spectrum, thereby avoiding the necessity of obtaining an FCC license to operate certain communications devices. The use of unlicensed radios is currently subject to regulations which require coexistence with licensed users also operating in the same frequency band. RadioLink™ complies with these regulations and permits unlicensed, highly reliable wireless data transmission within buildings, building-to-building, and throughout metropolitan areas. RadioLink is available in both indoor and outdoor versions. More than 1,300 RadioLink units have been sold in the United Kingdom, Mexico and the United States, principally to interconnect computers with point-of-sale terminals.

MRC manufactures a short-range microwave radio terminal that provides point-to-point connection of local area networks. Typical users include companies operating multiple local area networks within a metropolitan area.

The Company's principal wireless products are summarized in the following table:

Wireless			
PRODUCTS	**APPLICATION**	**TYPICAL PRICE RANGE**	**SELECTED CUSTOMERS OR END USERS**
Cellular and Portable Personal Communications			
Short-distance digital microwave radio (23 and 38 GHz)	Cell-to-cell interconnections	$8,000 to $12,000	Mercury PCN (U.K.), Vodafone (U.K.)
Television Broadcast			
Analog radios (2-40 GHz)	Links mobile television news vans to studios	$8,000 to $20,000	ABC, CBS, NBC, CNN, FOX, C-SPAN
(2-23 GHz)	Studio-to-transmitter links	$25,000 to $100,000	PBS, BBC, Prime Television and Southern Cross Broadcasting (Australia)
Wireless Data Networking			
Licensed Networks: Analog and digital radios (2-40 GHz)	Private networks for telephone company bypass, interconnecting local area networks, educational TV, teleconferencing.	$10,000 to $60,000	AT&T, FAA, Bell Canada, City of Los Angeles, U.S. Government
Analog and digital data radios for point-to-point and point-to-multipoint (450 and 900 MHz)	Remote monitoring, data collection	$1,000 to $7,000	Mobil, Phillips Petroleum, Florida Power & Light, PG&E, Georgia Power
Unlicensed Data Networks: RadioLink™ (915 MHz and 2.4 GHz)	In-building and outdoor computer and data networking	$2,000 to $4,000	Marks & Spencer (U.K.), Mexican Customs Brokers Association

Intelligence Systems

The Company participates in selected areas of the U.S. government market which are closely related to the Company's commercial technological and product base. In recent years, as U.S. defense spending has declined, the Company has competed effectively by offering adaptations of its technologies and commercially available "off-the-shelf" products at significantly less cost to the government than would usually be the case under custom, military specification procurement procedures. The Company integrates airborne and ground-based systems used for electronic and electro-optical computer-based intelligence gathering, processing and dissemination. These systems include advanced radio communications hardware and both special-purpose and off-the-shelf computers and software. The Company maintains and upgrades these systems throughout their useful lives, which can be a decade or more. Recently, the Company developed a series of products with secure, portable, ruggedized suitcase-sized packaging that incorporate key intelligence information collection, processing and analysis capabilities contained in its larger systems.

The Company also designs and develops state-of-the-art multisensor imaging systems and sophisticated electronic intelligence collection systems which it integrates into inexpensive commercial aircraft. In fiscal 1991, the Company received contracts totaling $19.6 million as a prime contractor for the U.S. Army's Air Reconnaissance Low ("ARL") program. The ARL program employs both imagery and signal intelligence sensors mounted on deHavilland-7 aircraft. These sensors collect information which can be immediately transmitted to designated receiving locations. The ARL aircraft can be rapidly deployed anywhere in the world. The Company is near completion of its first ARL contracts and expects to make final delivery of the aircraft to the Army in 1993. Additionally, the Company expects to bid for follow-on ARL contracts involving additional aircraft over the next 12 months.

The Company recently introduced its new airborne intercept and direction finding and geo-location system. The Company believes that this system locates signals from over a wide range of frequencies more rapidly and accurately than do other systems.

The Company's intelligence projects typically involve multi-year, multi-million dollar contracts. In addition, the Company sells subsystems and other equipment to U.S. government agencies on a short-term delivery basis. The price of a project depends on a number of factors, including the amount of development involved, quantities ordered, maintenance requirements and whether an aircraft is to be modified and supplied by the Company in connection with the contract.

Sales, Marketing and Customer Support

California Microwave directs its sales and marketing efforts toward major users of its systems and equipment through a well-established international distribution network. The sales and marketing strategy of the Company varies with the particular market served and involves direct sales by the Company's own sales force, sales through representatives, value-added resellers, or a combination of the foregoing. The Company also has entered into sales distribution agreements with respect to certain of its satellite communications and wireless products.

The Company considers its ability to create and maintain long-term customer relationships an important component of its overall strategy in each of its markets. Relationships with customers are established and maintained by the Company's product area managements and their technical and marketing staffs. The Company's strategy also includes its commitment to provide ongoing customer support for its systems and equipment. This support involves providing direct access to the Company's engineering staff or trained technical representatives located throughout the world to resolve technical or operational problems.

The Company has expanded its international sales significantly and has sold products in over 70 countries. The Company intends to continue to expand its marketing efforts and distribution channels worldwide.

Manufacturing

Manufacturing operations consist principally of assembly and testing of electronic systems built from fabricated parts, printed circuits and electronic components. Both manual and various automated methods are employed, depending primarily upon production volume. The Company employs formal Total Quality

Management programs and other training programs, and is in the process of qualifying for International Standards Organization quality procedure registration programs.

Electronic components and raw materials used in the Company's products are generally obtained from a large number of suppliers. Some components are standard items and others are manufactured to the Company's specifications by subcontractors. The Company obtains certain components and subsystems from single, or a limited number of, sources. The Company operates without a substantial inventory of components and subsystems but believes that most components and subsystems are available from existing or alternative suppliers and subcontractors. A significant interruption in the delivery of such items could have a material adverse effect on the Company's results of operations. See "Risk Factors — Dependence on Component Availability, Subcontractor Performance and Key Suppliers."

Competition

California Microwave is engaged in a highly competitive business and the number of potential customers for the Company's products is limited. Many of the Company's competitors have significantly greater financial, marketing and operating resources than the Company, as well as broader product lines. In addition, certain of the Company's customers have technological capabilities in the Company's product areas and could choose to replace the Company's products with their own. The Company's major competitors by product area include: NEC Corporation and Scientific-Atlanta, Inc. — satellite communications; Motorola, Inc. and Digital Microwave Corporation — wireless; ESL, Inc. (a subsidiary of TRW Inc.) and E-Systems, Inc. — intelligence.

The Company believes that competition in its markets is based primarily on price, performance, reputation, on-time delivery, reliability and customer support. The Company believes that it has the ability to develop, produce and install turnkey satellite earth stations, and to deliver related equipment, faster than many of its competitors. In the intelligence area, the Company believes that it has the ability to solve customers' problems with proprietary solutions and to offer cost-effective approaches using commercially available products. See "Risk Factors — Competition."

Research and Development

Research and development expenses were $5.0 million, $2.8 million and $2.6 million in fiscal 1992, 1991 and 1990, respectively, representing 2.5%, 1.6% and 1.8% of total sales, respectively, for the same periods. Research and development expenses were $3.8 million and $1.6 million for the six months ended December 31, 1992 and 1991, respectively, representing 3.1% and 1.7% of total sales, respectively, for the same periods. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Research and Development."

The Company obtains customer funding for research and development where possible to adapt the Company's basic technology to specialized customer requirements. Most research and development expenses in turnkey satellite earth stations and intelligence systems are customer-funded and are included in cost of products sold. Since the Company expects to emphasize equipment sales, particularly in the wireless area, it expects research and development expenditures to increase.

Patents and Licenses

Due to the rapidly changing nature of technology in the Company's business, patents and licenses have been of substantially less significance in the Company's business than have been the timely application of its technology and the design, development and marketing capabilities of its personnel.

Employees

At December 31, 1992, California Microwave had 1,348 employees, 701 of whom were engaged in production and production support, 404 in research and development and other engineering support, 107 in marketing and 136 in general and administration functions. None of the employees is represented by a labor union. The Company believes that its employee relations are good.

Regulation

Radio communications, including satellite communications, are subject to regulation by United States and foreign laws and international treaty. The Company's equipment must conform to domestic and international requirements established to avoid interference among users of microwave frequencies and to permit interconnection of equipment.

The use of microwave signals depends upon the availability of frequencies that permit interference-free operation. In many developed countries, the unavailability of frequency spectrum has historically inhibited the growth of microwave systems. However, two factors are alleviating this problem. First, the proliferation of fiber optics for high capacity systems has reduced the demand for microwave frequencies for such systems, thus freeing up frequency spectrum for new types of services, particularly for portable or mobile communications. Second, many government regulatory agencies are reallocating frequencies from one type of use to another, thus providing incentive for new communications services. Current regulatory efforts by international and national regulatory authorities are directed at providing microwave frequencies for new portable wireless personal communications services. Equipment to support these new services can be marketed only if permitted by suitable frequency allocations and regulations, and the process of establishing new regulations is complex and lengthy. See "Risk Factors—Regulation."

MANAGEMENT

The following table sets forth certain information on the directors and executive officers of the Company as of January 20, 1993.

Name	Age	Position
Philip F. Otto	51	Chairman of the Board, President, Chief Executive Officer and Director
Gilbert F. Johnson	61	President-Government Group and Director
David E. Hershberg	55	President-Satellite Communications Group and Satellite Transmission Systems, Inc. and Director
George L. Spillane	58	Vice President-Finance, Chief Financial Officer and Secretary
E. Russell Hardy	52	Vice President of the Company and President-Sunnyvale Products Division
H. Gary Vandemark	50	Vice President of the Company and President-Wireless Networking Division
Kenneth A. Miller	48	Vice President of the Company and Executive Vice President-Satellite Transmission Systems, Inc.
Paul H. Jacobs	50	Vice President of the Company and President-Microwave Data Systems Division
Michael L. Foster	46	Vice President-Financial Planning and Treasurer
Lanny B. Myers	55	Vice President-Controller
Fredrick P. Collins	52	Vice President of the Company and Chief Executive Officer-Microwave Radio Corporation
Dr. Robert L. Carrel	59	Director
Dr. Edward E. David, Jr.	67	Director
Arthur H. Hausman	69	Director
Dr. Robert A. Helliwell	72	Director
Dr. David B. Leeson	55	Director
Thomas D. Sege	66	Director

PHILIP F. OTTO rejoined the Company as President of the Wireless Products Group in January 1992, became President and Chief Executive Officer of the Company in March 1992 and Chairman of the Board in January 1993. He served as Executive Vice President, Chief Financial Officer and a Director of General Cellular Corporation, a cellular telecommunications company, from 1989 to 1991. Subsequent to Mr. Otto's employment by General Cellular Corporation, that corporation negotiated a "pre-packaged" plan of reorganization under Chapter 11 that involved the infusion of additional capital. He also served as President of Netline Communications Corporation, a telecommunications software company, in 1988; as a consultant to the telecommunications industry from 1986 to 1988; and as Chief Executive Officer of Telco Systems, Inc., a fiber optics telecommunications company, from 1981 to 1986. Mr. Otto served as Chief Financial Officer of the Company from 1975 to 1980, was a director of the Company from 1976 to 1985 and was an Executive Vice President of the Company from 1979 to 1981.

GILBERT F. JOHNSON became the Company's President and Chief Operating Officer in 1985 and President of the Government Group in 1991.

DAVID E. HERSHBERG became President — Government Communications Systems Division in 1986, an Executive Vice President of the Company in 1988, and President of the Satellite Communications Group in 1991. He is President of the Company's subsidiary, Satellite Transmission Systems, Inc., which he founded.

GEORGE L. SPILLANE has served as Vice President — Finance and Chief Financial Officer of the Company since November 1980 and as Secretary of the Company since October 1981.

E. RUSSELL HARDY has been President of the Sunnyvale Products Division (formerly the Defense Products Division) and a Vice President of the Company since August 1985.

H. GARY VANDEMARK has served as President of the Wireless Networking Division and a Vice President of the Company since July 1988, prior to which he served as Vice President/General Manager of microwave products since 1984.

KENNETH A. MILLER has been a Vice President of the Company since 1989. Mr. Miller has been Executive Vice President of the Company's subsidiary, Satellite Transmission Systems, Inc., since 1987.

PAUL H. JACOBS has been a Vice President of the Company since July 1990. Mr. Jacobs founded, and since 1985 has been the President of, the Company's Microwave Data Systems division.

MICHAEL L. FOSTER became a Vice President of the Company in October 1990 after serving as Staff Vice President since 1983.

LANNY B. MYERS became a Vice President of the Company in July 1991 after serving as Corporate Controller since 1979.

FREDRICK P. COLLINS became a Vice President of the Company in April 1992. Mr. Collins has been Chief Executive Officer and Chief Technologist of Microwave Radio Corporation, which he co-founded, since 1986.

DR. ROBERT L. CARREL was a co-founder of Electrospace Systems, Inc. and served as its Executive Vice President from 1970 until 1989 and as its President and Chairman from 1989 until his retirement from that company in 1990. He is a Director of Equitable Bancshares, Inc., MultiTechnology Services, Inc. and Terresearch, Inc.

DR. EDWARD E. DAVID, JR. served as President of Exxon Research and Engineering Company from 1977 to 1986 and has served as President of EED, Inc. since 1976. Dr. David serves on the Boards of Directors of Compression Labs, Inc., Intermagnetics General Corporation, and Protein Polymer Technologies, Inc. He is a U.S. representative to the NATO Science Committee and a member of the Bellcore Advisory Council.

ARTHUR H. HAUSMAN served as President and Chief Executive Officer of Ampex Corporation from 1971 through 1980 and as its Chairman of the Board, President and Chief Executive Officer from 1981 through 1982 and as Chairman of the Board from 1983 through 1987 when he became Chairman of the Board Emeritus. He is a Director of TCI International, Inc., Drexler Technology, Inc. and California Amplifier, Inc.

DR. ROBERT A. HELLIWELL has been a Professor of Electrical Engineering at Stanford University since 1946.

DR. DAVID B. LEESON, founder of the Company, was Chief Executive Officer of the Company from its inception in 1968 until March 1992 and was Chairman of the Board from the Company's inception until January 1993. He commenced service as a consultant to the Company under a three-year consulting agreement in January 1993.

THOMAS D. SEGE was Chief Executive Officer and President of Varian Associates, Inc. from 1981 until 1989, Chairman of that company from 1984 until 1989 and Vice Chairman of that company from 1989 to 1990. He continues to serve as a member of the Board of Directors of Varian Associates, Inc.

DESCRIPTION OF COMMON STOCK

The Company is authorized to issue 29,200,000 shares of Common Stock, par value $.10 per share. The holders of Common Stock of the Company are entitled to receive dividends as and when declared by the Board of Directors out of funds legally available therefor, and in the event of liquidation, dissolution or winding up of the Company, to share ratably in all assets remaining after payment of liabilities. The holders of the Common Stock are entitled to one vote for each share of such stock held of record by them and may cumulate votes in the election of directors. The holders of Common Stock have no preemptive or conversion rights and are not subject to further calls or assessments by the Company. There are no redemption or sinking fund provisions applicable to the Common Stock. The Common Stock currently outstanding is, and the Common Stock to be outstanding upon completion of this offering will be, fully paid and nonassessable.

In 1989, the stockholders approved a rights agreement pursuant to which the Company distributed to its stockholders the right to buy, for $35, one share of Common Stock for each share of Common Stock held by such stockholders. The rights will only become exercisable if a person or group acquires 20% or more of the Common Stock or announces an offer to acquire 30% or more of the Common Stock. In the event the Company is acquired, or upon the occurrence of certain other events, each right may under certain circumstances entitle the holder to purchase, for $35, $70 worth of Common Stock. Until such events occur, the rights are redeemable at any time by the Company for $.01 per right. The rights agreement expires in July 1999.

Chemical Trust Company of California is the Transfer Agent and the Registrar of the Company's Common Stock.

UNDERWRITING

The Underwriters named below (the "Underwriters"), for whom Bear, Stearns & Co. Inc. and Oppenheimer & Co., Inc. are acting as representatives (the "Representatives"), have severally agreed, subject to the terms and conditions of the Underwriting Agreement, to purchase from the Company the number of shares of Common Stock set forth opposite their respective names below. The Underwriters are committed to purchase and pay for all such shares if any are purchased.

Underwriters	Number of Shares
Bear, Stearns & Co. Inc.	557,500
Oppenheimer & Co., Inc.	557,500
Alex. Brown & Sons Incorporated	50,000
BT Securities Corporation	50,000
A.G. Edwards & Sons, Inc.	50,000
Hambrecht & Quist Incorporated	50,000
Kemper Securities, Inc.	50,000
Merrill Lynch, Pierce, Fenner & Smith Incorporated	50,000
Montgomery Securities	50,000
Robertson, Stephens & Company	50,000
S.G. Warburg & Co. Inc.	50,000
Cowen & Company	40,000
Dain Bosworth Incorporated	40,000
Legg Mason Wood Walker Inc.	40,000
Needham & Company, Inc.	40,000
Piper, Jaffray & Hopwood Incorporated	40,000
Raymond James & Associates, Inc.	40,000
The Robinson-Humphrey Company, Inc.	40,000
Rothschild, Inc.	40,000
Tucker Anthony Incorporated	40,000
Crowell, Weedon & Co.	25,000
First Analysis Securities Corp.	25,000
First Equity Corporation of Florida	25,000
Gabelli & Company, Inc.	25,000
Johnson Rice & Company	25,000
C.J. Lawrence Inc.	25,000
Punk, Ziegel & Knoell	25,000
Seidler Amdec Securities Inc.	25,000
Sutro & Co. Incorporated	25,000
Van Kasper & Company	25,000
William K. Woodruff & Company, Incorporated	25,000
Total	2,200,000

The Representatives have advised the Company that they propose initially to offer the Common Stock to the public on the terms set forth on the cover page of this Prospectus. The Underwriters may allow selected dealers a concession of not more than $.40 per share, and the Underwriters may allow, and such dealers may reallow, a concession of not more than $.10 per share to certain other dealers. After the public offering, the price and the concessions and reallowances to dealers may be changed by the Representatives. The Common Stock is offered subject to receipt and acceptance by the Underwriters and to certain other conditions, including the right to reject orders in whole or in part.

The Company has granted an option to the Underwriters, exercisable during the 30-day period after the date of this Prospectus, to purchase up to a maximum of 330,000 additional shares of Common Stock to cover over-allotments, if any, at the same price per share as the initial 2,200,000 shares to be purchased by the Underwriters. To the extent the Underwriters exercise this option, each of the Underwriters will be committed, subject to certain conditions, to purchase such additional shares in approximately the same proportion as set forth in the above table. The Underwriters may purchase such shares only to cover over-allotments made in connection with this offering.

The Underwriting Agreement provides that the Company will indemnify the Underwriters against certain liabilities, including civil liabilities under the Securities Act, or will contribute to payments the Underwriters may be required to make in respect thereof.

The Company has agreed not to issue, sell, offer or agree to sell, grant any option for the sale of, or otherwise dispose of, directly or indirectly, any shares of Common Stock or any securities convertible into or exercisable or exchangeable for Common Stock or any rights to acquire Common Stock, or any interest in such rights, other than pursuant to the Company's existing employee stock plans, for a period of 90 days after the date of this Prospectus, without the prior written consent of the Representatives.

All directors and all executive officers of the Company owning Common Stock have agreed with the Underwriters not to issue, sell, offer or agree to sell, grant any option for the sale of, or otherwise dispose of, any shares of Common Stock owned by them for a period of 90 days after the date of this Prospectus, without the prior written consent of the Representatives.

LEGAL MATTERS

The validity of the Common Stock offered hereby will be passed upon for the Company by Howard, Rice, Nemerovski, Canady, Robertson & Falk, A Professional Corporation, San Francisco, California. Certain legal matters will be passed upon for the Underwriters by Latham & Watkins, San Francisco, California.

EXPERTS

The consolidated financial statements of California Microwave, Inc. appearing or incorporated by reference in this Prospectus and Registration Statement have been audited by Ernst & Young, independent auditors, to the extent indicated in their reports thereon also appearing elsewhere herein and in the Registration Statement or incorporated by reference. Such consolidated financial statements have been included herein or incorporated herein by reference in reliance upon such reports given upon the authority of such firm as experts in accounting and auditing.

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF ERNST & YOUNG, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
California Microwave, Inc.

We have audited the accompanying consolidated balance sheets of California Microwave, Inc., at June 30, 1991 and 1992, and the related consolidated statements of income, stockholders' equity and cash flows for each of three years in the period ended June 30, 1992. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of California Microwave, Inc. at June 30, 1991 and 1992, and the consolidated results of its operations and its cash flows for each of the three years in the period ended June 30, 1992, in conformity with generally accepted accounting principles.

ERNST & YOUNG

Palo Alto, California
August 14, 1992

CALIFORNIA MICROWAVE, INC.

CONSOLIDATED STATEMENTS OF INCOME

Three years ended June 30, 1992

(Dollars in thousands except per share amounts)

	1990	1991	1992
Sales	$145,851	$177,364	$199,003
Cost of products sold	111,608	136,457	153,246
Gross margin	34,243	40,907	45,757
Expenses:			
Research and development	2,600	2,817	5,021
Marketing and administration	18,901	23,786	31,320
Amortization of intangible assets	637	627	797
Total expenses	22,138	27,230	37,138
Operating income	12,105	13,677	8,619
Interest (expense)	(1,756)	(1,082)	(908)
Interest income	183	105	269
Income before income taxes	10,532	12,700	7,980
Provision for income taxes	3,890	4,699	2,892
Net income	$ 6,642	$ 8,001	$ 5,088
Average shares and equivalents (thousands)	8,416	8,636	9,111
Net income per share	$ .80	$ .93	$ .56

See accompanying Financial Review

CALIFORNIA MICROWAVE, INC.

CONSOLIDATED BALANCE SHEETS

June 30, 1991 and 1992

(Dollars in thousands)

	1991	1992
Assets		
Current assets:		
Cash and cash equivalents	$ 3,902	$ 4,323
Short-term investments	301	381
Accounts receivable, less $407 allowance for doubtful accounts ($57 in 1991)	33,565	46,032
Inventories	36,411	36,906
Prepaid expenses	487	648
Total current assets	74,666	88,290
Property, plant and equipment, at cost	34,437	42,125
Less accumulated depreciation	20,739	22,789
Net property, plant and equipment	13,698	19,336
Net intangible assets of businesses acquired, less accumulated amortization of $3,274 ($2,477 in 1991)	9,240	34,804
Other assets	877	4,810
	$98,481	$147,240
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	$ 3,000	$ 127
Accounts payable	13,237	15,198
Accrued income taxes	2,700	479
Other accrued liabilities	9,818	15,845
Total current liabilities	28,755	31,649
Long-term debt	2,230	40,306
Stockholders' equity:		
Common stock, $.10 par value, 29,200,000 shares authorized: 8,855,226 shares outstanding in 1992 (8,575,315 in 1991)	858	885
Capital in excess of par value	23,336	26,689
Retained earnings	43,982	49,070
Unamortized restricted stock plan expense	(680)	(1,359)
Total stockholders' equity	67,496	75,285
	$98,481	$147,240

See accompanying Financial Review

CALIFORNIA MICROWAVE, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Three years ended June 30, 1992
(Dollars in thousands)

	Common Stock	Junior common stock	Capital in excess of par value	Retained earnings	Un-amortized restricted stock plan expense	Notes receivable from stockholders	Total stockholders' equity
Balance, June 30, 1989	$794	$ 9	$18,597	$29,339	$ (326)	$(240)	$48,173
Common stock issued under:							
Stock option and purchase plans	12		709				721
Restricted stock plan	4		364		(169)		199
Net income				6,642			6,642
Balance, June 30, 1990	810	9	19,670	35,981	(495)	(240)	55,735
Common stock issued under:							
Stock option and purchase plans	37		3,063				3,100
Restricted stock plan	5		402		(185)		222
Acquisition of Microwave Data Systems, Inc.	6		497				503
Junior common stock repurchases		(9)	(296)			240	(65)
Net income				8,001			8,001
Balance, June 30, 1991	858	—	23,336	43,982	(680)	—	67,496
Common stock issued under:							
Stock option and purchase plans	21		2,301				2,322
Restricted stock plan	6		1,052		(679)		379
Net income				5,088			5,088
Balance, June 30, 1992	$885	$—	$26,689	$49,070	$(1,359)	$ —	$75,285

See accompanying Financial Review

CALIFORNIA MICROWAVE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three years ended June 30, 1992

(Dollars in thousands)

	1990	1991	1992
Operating activities:			
Net income	$ 6,642	$ 8,001	$ 5,088
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	4,265	4,251	5,133
Loss (gain) on equipment retired	239	(38)	126
Write-down of investments		200	100
Net effect of changes in:			
Accounts receivable	4,571	(6,581)	(9,751)
Inventories	(10,200)	2,603	6,066
Prepaid expenses	(23)	(64)	(119)
Accounts payable	636	3,232	74
Accrued income taxes	503	1,601	(577)
Other accrued liabilities	255	1,650	2,905
Net cash provided by (used in) operating activities	6,888	14,855	9,045
Investing activities:			
Capital expenditures	(3,890)	(3,355)	(8,024)
Businesses purchased net of cash acquired		(1,890)	(33,490)
Proceeds from sale of assets	606	282	5
Unexpended plant and equipment funds			(3,322)
Other	292	116	(679)
Net cash provided by (used in) investing activities:	(2,992)	(4,847)	(45,510)
Financing activities:			
Net borrowings (repayments) under lines of credit	(4,007)	(8,077)	
Payments on long-term obligations		(1,000)	(3,000)
Proceeds from issuance of long-term debt			38,203
Proceeds from issuance of common stock	698	1,819	1,683
Net cash provided by (used in) financing activities	(3,309)	(7,258)	36,886
Net increase (decrease) in cash and cash equivalents	587	2,750	421
Cash and cash equivalents at beginning of year	565	1,152	3,902
Cash and cash equivalents at end of year	$ 1,152	$ 3,902	$ 4,323
Supplemental disclosure of cash flow information			
Cash paid during the year for:			
Interest	$ 1,820	$ 1,078	$ 576
Income taxes	3,387	3,098	4,581

See accompanying Financial Review

FINANCIAL REVIEW

Operations Summary

Bookings, sales and year-end backlog were at record levels, however net income declined by 36% to $5.1 million, or $.56 per share, in fiscal 1992. Sales of $199 million were 12% higher than the $177.4 million recorded in fiscal 1991. Export sales were up 20% and accounted for 35% of total shipments in 1992.

Net income per share was down 40% from the $.93 earned in 1991. The increase in gross margins was more than offset by increased expenses and additions to reserves, the largest of which relates to the Company's Sunnyvale, California, facilities.

In April 1992, the Company completed the acquisition of Microwave Radio Corporation (MRC) for $33 million in cash and up to $11 million of contingent payments, payable in cash or California Microwave stock, based on MRC's future performance. MRC contributed $6 million of profitable sales to the Company in May and June. With the addition of MRC, the Wireless Products Group, the Company's fastest growing business area, is expected to represent some 25% of Company sales in fiscal 1993.

The accompanying consolidated financial statements include the accounts of all subsidiaries. All significant intercompany transactions have been eliminated.

Bookings and Backlog (unaudited)

New orders booked, which totaled $202.5 million, were up 10% from the 1991 level of $183.5 million. Bookings growth was concentrated in the satellite ground system and wireless areas. Wireless orders, including two months of MRC orders, were up to $25 millon, a 108% increase. Orders for satellite communications products represented about $136 million, or 67% of total 1992 bookings. The area of largest growth in the satellite area was the U.S. government sector in which orders rebounded strongly, more than doubling from depressed levels in 1991. In 1990, total orders booked were $131.9 million. In 1992, no single order accounted for 10% or more of total bookings. In 1991, initial orders for a new U.S. government intelligence system generated 11% ($20 million) of total bookings. In 1990, order releases against a U.S. government satellite communications system contract accounted for 13% of bookings. Year-end backlog was $130.2 million, 10% higher than a year ago and 17% above the backlog at June 30, 1990. Fiscal 1992 bookings do not include $8.4 million of backlog acquired in the purchase of MRC.

Sales

The Company operates in one industry — the manufacture of electronics equipment for communications, including telephone, data, control, detection, ranging and surveillance. Sales in 1992 increased $21.6 million, or 12%, following growth of $31.5 million, or 22% in 1991. Exports, principally satellite communications terminals and equipment, contributed the majority of the growth in sales in both years. A breakdown of sales, by product class and by market sector for the last three years, is shown below. Sales to American Telephone and Telegraph Company represented 9%, 12% and 10% of sales, respectively, in 1992, 1991 and 1990.

	1990	1991	1992
	(Dollars in thousands)		
Satellite communications products	$101,747	$124,600	$130,582
	70%	70%	66%
Intelligence systems	28,537	32,034	38,714
	20%	18%	19%
Wireless and other products	15,567	20,730	29,707
	10%	12%	15%
Total	$145,851	$177,364	$199,003
Export sales	$ 34,229	$ 58,019	$ 69,700
	23%	33%	35%
U.S. government sales	73,022	66,526	66,683
	50%	37%	33%
U.S. commercial sales	38,600	52,819	62,620
	27%	30%	32%
Total	$145,851	$177,364	$199,003

Export sales by geographic area were as follows:

	1990	1991	1992
	(Dollars in thousands)		
Europe	$14,677	$23,563	$27,882
Asia	6,663	21,644	21,943
Africa and Middle East	8,217	4,819	9,024
Latin America	4,333	6,083	9,381
Other	339	1,910	1,470
	$34,229	$58,019	$69,700

The Company's export sales are project-related and vary between geographic areas from year to year.

Generally, sales are recorded at the time individual items are delivered. Sales on certain long-term, small quantity, high unit-value contracts are recognized at the completion of significant protect milestones (generally contract line items), subject to the constraint that cumulative contract sales cannot exceed the amount permitted to be billed to the customer.

Gross Margin

Gross margins were 23% in each of the last three years. Higher 1992 margins on satellite system sales were offset by lower margins on satellite equipment sales and relatively low margins on certain new U.S. government contracts in the intelligence system area. The gross margin experienced over the last three years represents a mixture of results because equipment manufacturing generally yields gross margins of 35% to 45% while turnkey system projects typically generate gross margins in the 10% to 20% range.

Expenses

Investment in company-funded research and development (R&D) was over 2% of sales in 1992 after being under 2% for several years. The 1992 addition was concentrated in the satellite equipment and wireless product areas. Most engineering expenditures in the system business areas, which represent approximately 70% of Company sales, are customer-funded and are included in costs of products sold. Company-funded research and development is expected to increase by more than 50% in fiscal 1993.

Marketing and administration expense, which represented 16% of sales in 1992 compared to 13%, in 1991 and 1990, increased by $7.5 million, or 32%, following a 26% increase in 1991. Most of the 1992 increase was in support of the Company's strategy for substantial future expansion in the wireless area. Significant increases in marketing expenses also occurred in both 1992 and 1991 in the satellite communications business area where the Company continues to develop new export and domestic markets. Provision for underutilized facilities added $1.5 million to 1992 costs.

Interest expense declined significantly in the first nine months of 1992, due to the impact of improved inventory turnover in 1991 and 1992, which enabled the Company to pay off its short-term bank debt. With the borrowing of $35 million to finance the acquisition of MRC, interest expense increased to $621,000 in the fourth quarter.

Income Taxes

The provision (credit) for income taxes consists of the following:

	1990	1991	1992
	(Dollars in thousands)		
Federal	$3,090	$ 3,820	$ 2,162
State	800	879	730
	$3,890	$ 4,699	$ 2,892
Deferred portion	$1,210	$(1,272)	$(1,357)
Effective rate	37%	37%	36%

The tax rate in 1992 is lower than in 1991 and 1990 due to the impact of growing export sales on foreign sales corporation (FSC) tax benefits. The differences between the statutory income tax rates and the effective income tax rates over the past three years relate primarily to FSC benefits offset by state income taxes.

Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," was issued in February 1992. Adoption of this Standard is required for fiscal years beginning after December 15, 1992; however, early adoption is permitted. The Company is currently analyzing the new standard with respect to the method and timing of adoption and its impact on the financial statements. This standard is not expected to have a material impact on the Company's financial statements.

The sources of the deferred (prepaid) component of the provision for income taxes for the past three years are as follows:

	1990	1991	1992
	(Dollars in thousands)		
Excess tax over (under) book depreciation	$ 225	$ (127)	$ (68)
Long-term contract accounting for tax purposes	1,200	(663)	
Inventory valuation	406	25	(731)
Excess facilities provision			(434)
Accruals not currently deductible for income tax purposes	(23)	(222)	(408)
State income taxes	(335)	(137)	(97)
Other	(263)	(148)	381
	$1,210	$(1,272)	$(1,357)

Financial Position

Liquidity

In April 1992, the Company completed the acquisition of MRC for $33 million in cash, all of which was borrowed under a new bank credit agreement totaling $50 million. This credit agreement expires in September 1993 and the Company plans, before that date, to replace this debt with equity or other long-term financing. Until then, the Company believes that its current cash position, funds generated from operations and funds available from the credit agreement will be adequate to meet the Company's requirements for working capital, capital equipment expenditures and debt service.

The Company had net cash flow from operations of $9.0 million in 1992. Most of this cash was used to fund a record level, $8.0 million, of capital expenditures — mostly for new office, laboratory, manufacturing, and aircraft hangar facilities in Florida, Maryland and Arizona. In June 1992, the Company also sold $2.8 million of industrial development bonds, the proceeds of which will be used to build a new manufacturing facility in Rochester, New York. At June 30, 1992, this $2.8 million was included in Other assets in the accompanying consolidated balance sheets. The land for this project was purchased in June 1992 and financed for twenty years by the seller.

Cash equivalents consist of highly liquid investments with maturities of three months or less. The Company's short-term investments are carried at cost which approximates market. The Company invests its excess cash principally in commercial paper of highly rated large industrial companies and bankers' acceptances and certificates of deposits of large banks. Generally, these investments mature within 90 days. The Company has not experienced losses related to these investments.

The Company follows the policy of reinvesting all earnings to finance expansion of its business, has paid no cash dividends and has no current plans to do so.

The Company manufactures and sells communications products and systems to the U.S. government and large commercial customers, principally domestic and foreign telephone companies and major common carriers. The Company generally requires no collateral, but frequently requires letters of credit from its foreign customers. In 1992, the Company expensed $694,000 for its provision for doubtful accounts.

Inventories are recorded at the lower of cost or market. Project inventories are transferred to cost of products sold at the time revenue is recognized, based on the estimated total manufacturing costs and total contract prices under each contract. Losses on contracts are recognized in full when the losses become determinable. The cost of other inventories is based on standard costs which have approximated actual costs as determined by the first-in, first-out method.

Inventories were as follows:

	1991	1992
	(Dollars in thousands)	
Projects in process	$27,105	$20,534
Less progress billings	5,888	4,014
	21,217	16,520
Work-in-process and finished goods	8,388	12,374
Raw materials and parts	6,806	8,012
	$36,411	$36,906

Other accrued liabilities consisted of the following:

	1991	1992
	(Dollars in thousands)	
Salaries, bonuses and commissions	$4,720	$ 3,420
Vacations	2,068	2,854
Other payroll related	800	1,433
Excess facilities provision	175	1,450
Product warranties	470	860
Advance payments	340	3,369
Other	1,245	2,459
	$9,818	$15,845

Capital Resources and Commitments

All of the buildings occupied by the Company, except for the Company-owned Hauppauge, New York, and Melbourne, Florida, facilities are under operating leases which expire in one to nine years. Certain of these leases contain escalation clauses. Total lease expense for the past three years was: 1990-$2,023,000; 1991-$2,035,000; 1992-$2,320,000. Lease commitments exclusive of property taxes, which are payable by the Company, will be due as follows: 1993-$2,569,000; 1994-$1,985,000; 1995-$1,623,000; 1996-$1,610,000; 1997-$1,610,000; 1998 through 2002-$1,254,000.

The Company intends to finance these commitments through working capital generated from internal sources.

The amount, at cost, and straight-line depreciable lives of property, plant and equipment, are shown below.

	Life (yrs)	1991	1992
		(Dollars in thousands)	
Land		$ 950	$ 1,693
Buildings	30	4,735	5,934
Test equipment and machinery	3-10	19,622	22,847
Office equipment	5-10	6,217	7,998
Vehicles	3-5	966	1,282
Leasehold improvements	Term of lease	1,947	2,371
		$34,437	$42,125

Acquisitions

In April 1992, the Company acquired all the shares of Microwave Radio Corporation (MRC) for $33 million in cash. Additional payments of up to $11 million, payable in cash or stock, at the Company's option, will be made contingent upon MRC's earnings exceeding certain target levels over the 27 months ending June 30, 1994. The acquisition was accounted for as a purchase transaction and accordingly, the acquired assets and liabilities were recorded at their estimated fair value at the date of acquisition. The operating results of MRC have been included in the Consolidated Statements of Income from the acquisition date. The excess of the purchase price over the valuation of the net assets acquired is being amortized on a straight line basis over thirty years. The additional $11 million payments, if any, will be accounted for as additional excess purchase price and will be amortized over the remaining life of the purchased intangibles related to the MRC acquisition.

The effect of the acquisition of MRC on the Consolidated Statements of Cash Flows for the year ended June 30, 1992, was as follows:

	(Dollars in thousands)
Working capital acquired (excluding cash)	$ 4,164
Property, plant and equipment	1,806
Advances to MRC	1,151
Excess of purchase price over value of net assets acquired	26,369
Total cash price, net of cash received	$33,490

The following proforma combined results for 1991 and 1992 are as if the acquisition had been consummated on July 1 for each period. The 1991 amounts combine MRC for its year ended September 28, 1991; therefore, each year contains the three-month period ended September 28, 1991, during which MRC had sales of $8,328,000 and net income of $1,097,000.

	Year Ended June 30	
	1991	1992
	(Dollars in thousands except per share amounts) (Unaudited)	
Sales	$207,568	$224,649
Income before income taxes	14,287	9,180
Net income	8,508	5,455
Net income per share	.99	.60
Average shares outstanding (thousands)	8,636	9,111

The proforma results, which are based upon certain assumptions and estimates which the Company believes are reasonable, do not purport to be indicative of results that actually would have occurred had the acquisition closed on July 1, 1990 and 1991 and are not intended to be a projection for future results.

In June 1991, the Company's wholly-owned subsidiary, Satellite Transmission Systems, Inc., acquired certain assets of ViaSat Technology Corporation and obtained five-year covenants not to compete from its two founders for $335,000 in cash. Acquired assets were recorded at their estimated value at the date of acquisition and the excess purchase price is being amortized over five years.

In November 1990, the Company acquired the minority interest in Microwave Data Systems, Inc. (MDS) for $1.2 million in cash and $1.0 million in stock and stock options. This acquisition was accounted for as a purchase transaction and the Company is amortizing the resulting excess purchase price over twenty years. Intangible assets resulting from acquisitions made prior to 1990 are being amortized over periods ranging from five to thirty years.

Debt

Debt at June 30, 1991 and 1992 consisted of the following:

	1991	1992
	(Dollars in thousands)	
Bank term loans	$3,000	$35,000
City of Rochester, NY, loan		403
Industrial development bonds		
— Suffolk County, NY	2,230	2,230
— Monroe County, NY		2,800
Total debt outstanding	$5,230	$40,433
Current portion of above	$3,000	$ 127

Long-term debt maturing in each of the next five years is as follows: 1993 — $127,000; 1994 — $35,278,000; 1995 — $388,000; 1996 — $288,000; 1997 — $399,000.

In April 1992, the Company obtained a $50 million committed bank credit facility consisting of a $35 million bridge loan and a $15 million revolving credit line. The banks providing this facility received a security interest in all of the Company's assets. Borrowings under the facility are due and payable on September 30, 1993. On April 20, 1992, the Company borrowed the entire $35 million bridge loan to finance the purchase of MRC. This borrowing was at an interest rate of 6.06%. As of June 30, 1992, there were no borrowings and $9.6 million of standby letters of credit outstanding under the revolving credit line. The standby letters of credit support certain export contracts. Interest rates for borrowing under this facility are determined at the time of each advance, but will not exceed the bank's base rate plus (a) 200 basis points on the bridge loan and (b) 50 basis points on revolving loans. This credit facility requires a commitment fee of ½ percent per year on the unused amount of the commitment.

In June 1992, the Company borrowed $2.8 million in twenty-year industrial development bonds and received a $403,425 twenty-year loan from the city of Rochester, N.Y. These transactions will finance a new facility for the Company's MDS division. Both of the industrial development bonds listed in the above table bear interest at a floating rate, based upon prevailing market conditions, which is redetermined every seven days. The average interest rate in effect on June 30, 1992, was 2.8%. The Suffolk County bonds are scheduled to be repaid in fifteen annual installments commencing in November 1993, while the Monroe County bonds are scheduled for repayment in twenty annual installments beginning June 1993. Both bonds may be prepaid at any time, without penalty, and are backed by letters of credit. The city of Rochester loan bears an interest rate of 6.5% and requires monthly repayments. Both the bonds and the city loan are secured by mortgages on the properties involved.

All of the above credit agreements contain similar covenants requiring the Company to maintain certain financial ratios.

The maximum amount of interest-bearing debt during 1992 was $41,230,000 and the average amount borrowed was $11,014,000 at an average interest rate of 6.3%. Comparable figures for 1991 and 1990 were $18,980,000 and $24,838,000 maximum borrowing, $11,835,000 and $18,240,000 average borrowing, and 8.8% and 9.5% average rates.

Common Stock

In October 1989, the stockholders approved a rights agreement under which there was distributed to the Company's stockholders the right to buy, for $35, one share of common stock for each share of common stock held by such stockholders. The rights will only become exercisable if a person or group acquires 20% or more of the Company's common stock or announces an offer to acquire 30% or more of the Company's common stock. In the event the Company is acquired, or upon the occurrence of certain other events, each right may under certain circumstances entitle the holder to purchase, for $35, $70 worth of common stock. Until such events occur, the rights are redeemable at any time by the Company for $.01 per right.

Stock options have been granted to officers and key employees under the Company's stock option plans at fair market value at the date of grant. Most options currently outstanding become exercisable in annual installments of 25%, beginning one year after date of grant. Options granted under the current 1986 Stock Option Plan expire after ten years. In October 1991, the stockholders approved an increase of 600,000 in the number of shares covered by the plan. A summary of activity for fiscal 1992 under the plan is presented below:

	Shares Available For Grant	Options Outstanding	Option Price Per Share
June 30, 1991	111,623	722,108	$0.49 - $10.00
Additional authorized	600,000		
Granted	(334,400)	334,400	$9.75 - $21.00
Exercised		(159,246)	$4.50 - $10.00
Canceled	25,166	(25,166)	$4.50 - $16.88
June 30, 1992	402,389	872,096	$0.49 - $21.00
Exercisable, June 30, 1992		206,539	$0.49 - $10.00

In July 1992, the board of directors approved, subject to stockholders' approval, a new 1992 Stock Option Plan, which covers 600,000 shares.

Stock grants have been made to officers and other key employees under restricted stock plans at no charge to the employees. These grants generally vest 20% per year, beginning one year after the date of issue. The fair market value of the shares, at grant date, is charged to compensation expense over the five-year period. Compensation expense relating to this plan for the past three years was: 1990 — $199,000; 1991 — $222,000; 1992 — $379,000.

A summary of activity in the restricted stock plans is as follows:

	Shares Available For Grant	Non-Vested Shares
June 30, 1991	112,100	101,900
Granted	(65,000)	65,000
Canceled	600	(600)
Vested		(28,000)
June 30, 1992	47,700	138,300

In July 1992, the board of directors approved, subject to stockholders' approval, a new 1992 Restricted Stock Plan, which covers 250,000 shares.

The Company has an employee stock purchase plan under which employees may purchase shares, subject to certain limitations, at no less than 85% of the lower of the fair market value of the shares at the beginning or end of a six-month purchase period. In October 1991, the stockholders approved an increase of 200,000 in the number of shares covered by the plan. During the year, 56,265 shares were issued for $491,000 leaving 251,688 shares reserved for future issuances.

Net income (loss) per share is based on the weighted average number of shares outstanding including dilutive common stock equivalents.

Significant Accounting Policies

The Company's significant accounting policies are described in the Financial Review under the following headings:

Accounting Policy	*Report Heading*
Consolidation	Operations Summary
Revenue recognition	Sales
Cost of products sold	Liquidity
Research and development	Expenses
Income taxes	Income Taxes
Net income per share	Common Stock
Cash equivalents	Liquidity
Inventories	Liquidity
Fixed assets	Capital Resources and Commitments
Intangible assets of businesses acquired	Acquisitions

CALIFORNIA MICROWAVE, INC.

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
Six months ended December 31, 1991 and 1992
(Dollars in thousands except per share amounts)

	1991	1992
Sales	$95,197	$122,856
Cost of products sold	73,456	91,312
Gross margin	21,741	31,544
Expenses:		
Research and development	1,601	3,794
Marketing and administration	12,684	18,744
Amortization of intangible assets	328	777
Total expenses	14,613	23,315
Operating income	7,128	8,229
Interest (expense)	(180)	(1,455)
Interest income	155	111
Income before income taxes	7,103	6,885
Provision for income taxes	2,557	2,545
Net income	$ 4,546	$ 4,340
Average shares and equivalents (thousands)	9,165	9,239
Net income per share	$ .50	$ .47

See accompanying notes.

CALIFORNIA MICROWAVE, INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	June 30, 1992	December 31, 1992 (Unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 4,323	$ 10,807
Short-term investments	381	422
Accounts receivable, less allowance for doubtful accounts of $407 at June 30, 1992 and $463 at December 31, 1992	46,032	51,200
Inventories	36,906	38,230
Prepaid expenses	648	972
Total current assets	88,290	101,631
Property, plant and equipment, at cost	42,125	46,959
Less accumulated depreciation	22,789	25,540
Net property, plant and equipment	19,336	21,419
Net intangible assets of businesses acquired, less accumulated amortization of $3,274 at June 30, 1992 and $4,051 at December 31, 1992	34,804	34,027
Other assets	4,810	3,220
	$147,240	$160,297
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	$ 127	$ 35,127
Accounts payable	15,198	23,723
Accrued income taxes	479	23
Other accrued liabilities	15,845	15,031
Total current liabilities	31,649	73,904
Long-term debt	40,306	5,570
Stockholders' equity:		
Common stock, $.10 par value, 29,200,000 shares authorized: 8,855,226 shares outstanding at June 30, 1992 and 8,999,252 shares outstanding at December 31, 1992	885	900
Capital in excess of par value	26,689	28,066
Retained earnings	49,070	53,410
Unamortized restricted stock plan expense	(1,359)	(1,553)
Total stockholders' equity	75,285	80,823
	$147,240	$160,297

See accompanying notes.

CALIFORNIA MICROWAVE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Six-month periods ended December 31, 1991 and 1992
(Dollars in thousands)

	1991	1992
Operating activities:		
Net income	$ 4,546	$ 4,340
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,408	3,984
Loss (gain) on equipment retired	90	8
Net effect of changes in:		
Accounts receivable	(5,030)	(5,168)
Inventories	6,383	(1,324)
Prepaid expenses	(33)	(324)
Accounts payable	(3,819)	8,525
Accrued income taxes	(542)	(456)
Other accrued liabilities	(2,306)	(814)
Net cash provided by (used in) operating activities	1,697	8,771
Investing activities:		
Capital expenditures	(2,526)	(4,862)
Proceeds from sale of assets	125	9
Unexpended plant and equipment funds		1,472
Other	(157)	(136)
Net cash provided by (used in) investing activities:	(2,558)	(3,517)
Financing activities:		
Payments on long-term obligations	(2,000)	
Proceeds from issuance of common stock	1,373	966
Proceeds from issuance of long-term debt		264
Net cash provided by (used in) financing activities	(627)	1,230
Net increase (decrease) in cash and cash equivalents	(1,488)	6,484
Cash and cash equivalents at beginning of year	3,902	4,323
Cash and cash equivalents at end of period	$ 2,414	$10,807
Supplemental disclosure of cash flow information		
Cash paid during the six months for:		
Interest	$ 178	$ 1,637
Income taxes	3,099	3,059

See accompanying notes.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(unaudited)

Note 1 — Basis of Presentation

The information at December 31, 1992 and for the six month periods ended December 31, 1991 and 1992 is unaudited, but includes all adjustments (consisting only of normal recurring adjustments) which the management of California Microwave, Inc. believes are necessary for fair presentation of the results for the periods presented. Interim results are not necessarily indicative of results for a full year. These Consolidated Interim Financial Statements should be read in conjunction with the Audited Consolidated Financial Statements for the year ended June 30, 1992 included in this Prospectus.

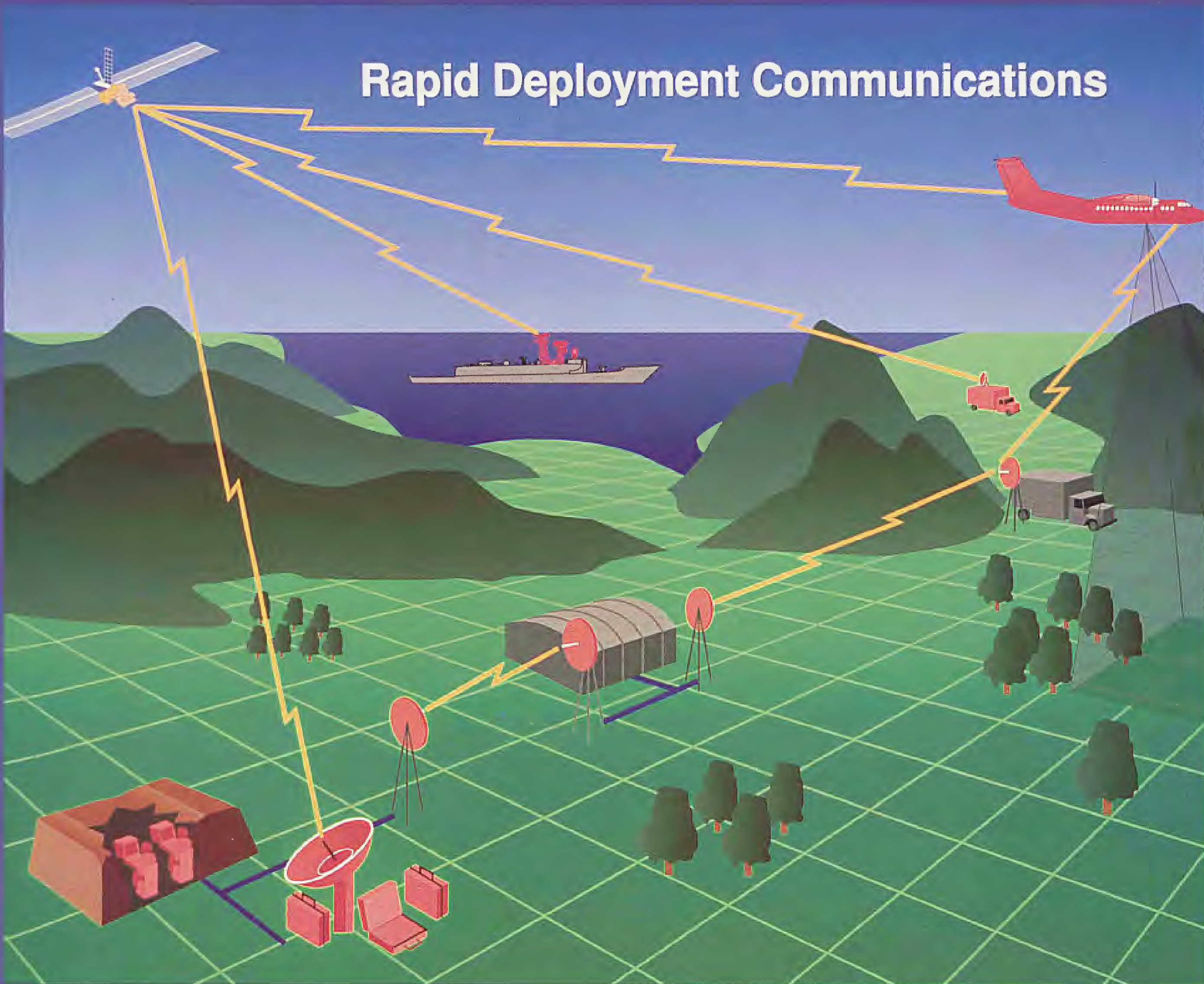
Note 2 — Inventories

	June 30, 1992	December 31, 1992
Projects in process	$20,534	$19,782
Less progress billings	4,014	4,440
	16,520	15,342
Work-in-process and finished goods	12,374	12,655
Raw materials and parts	8,012	10,233
	$36,906	$38,230

Note 3 — Income Taxes

During the first quarter of the year ending June 30, 1993, the Company adopted the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 109 (SFAS 109) "Accounting for Income Taxes." The impact of this adoption is immaterial to the results of operations of the current period and of all prior periods.

Government Systems



California Microwave communications and intelligence systems for the U.S. government are based on the Company's proven commercial equipment and technology.

No dealer, salesman or other person has been authorized to give any information or to make any representations other than those contained or incorporated by reference in this Prospectus in connection with the offering described herein, and, if given or made, such information or representation must not be relied upon as having been authorized by the Company or by any Underwriter. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, any securities other than the registered securities to which it relates, or an offer to sell, or a solicitation of an offer to buy, in any jurisdiction in which it is unlawful to make such offer or solicitation. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof or that the information contained herein is correct as of any time subsequent to the date hereof.

TABLE OF CONTENTS

2,200,000 Shares

CALIFORNIA MICROWAVE

Common Stock

PROSPECTUS

Bear, Stearns & Co. Inc.

Oppenheimer & Co., Inc.

February 25, 1993

BEAR STEARNS

WITH COMPLIMENTS OF

RICHARD W. BEATTY
ASSOCIATE DIRECTOR
245 PARK AVENUE
NEW YORK, NEW YORK 10167
(212) 272-2359

As filed with the Securities and Exchange Commission on March 11, 1993

Registration No. 33-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

MFS COMMUNICATIONS COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware	4813	47-0714388
(State or other jurisdiction of incorporation)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

3555 Farnam Street
Omaha, Nebraska 68131
(402) 271-2890

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

Terrence J. Ferguson, Esq.
Senior Vice President, Secretary and General Counsel
MFS Communications Company, Inc.
3555 Farnam Street
Omaha, Nebraska 68131
(402) 271-2890

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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Washington, D.C. 20036
(202) 887-4000

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ☐

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price Per Share(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, $.01 par value	9,775,000	$19.00	$185,725,000	$58,039

(1) Includes 1,275,000 shares which may be sold pursuant to the Underwriters' over-allotment option.
(2) Estimated solely for purposes of determining the registration fee.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Subject to Completion
March 11, 1993

Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any State in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such State.

Prospectus

MFS

8,500,000 Shares

MFS Communications Company, Inc.

Common Stock
($.01 par value)

All of the shares of Common Stock offered hereby (the "Shares") are being sold by MFS Communications Company, Inc. (the "Company"). Prior to the offering of Shares (the "Offering"), there has been no public market for the Common Stock. It is currently estimated that the initial public offering price of the Common Stock will be between $16.00 and $19.00 per Share. See "Underwriting" for information relating to the factors considered in determining the initial public offering price.

The Common Stock has been approved for trading on the NASDAQ National Market System under the symbol "MFST."

Prospective Investors should consider carefully matters discussed under the caption "Risk Factors."

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	Underwriting Discount	Proceeds to Company(1)
Per Share	$	$	$
Total (2)	$	$	$

(1) Before deducting expenses payable by the Company, estimated to be $.

(2) The Company has granted the Underwriters a 30-day option to purchase up to 1,275,000 additional shares of Common Stock at the Price to Public, less the Underwriting Discount, solely to cover over-allotments, if any. If the Underwriters exercise this option in full, the total Price to Public, Underwriting Discount and Proceeds to Company will be $, $ and $, respectively. See "Underwriting."

The Shares are offered subject to receipt and acceptance by the Underwriters, to prior sale and to the Underwriters' right to reject any order in whole or in part and to withdraw, cancel or modify the offer without notice. It is expected that delivery of the Shares will be made at the office of Salomon Brothers Inc, Seven World Trade Center, New York, New York, or through the facilities of The Depository Trust Company, on or about , 1993.

Salomon Brothers Inc **Bear, Stearns & Co. Inc.**

The date of this Prospectus is , 1993.

MFS National Network

Network Features

- Enhanced Telecommunications Services for Business and Government End Users
- 100% Digital Fiber Optics
- Route Diversity
- Back-Up Electronics
- Network Reliability in Excess of 99.99%
- Twenty Four-Hour Monitoring
- Superior Customer Service

● Metropolitan Areas Served
★ Network Operations Control Center

The Company intends to furnish its stockholders with annual reports containing consolidated financial statements audited by independent certified public accountants and with quarterly reports containing unaudited financial information for each of the first three quarters of each fiscal year following the end of such quarter.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SHARES OFFERED HEREBY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH TRANSACTIONS MAY BE EFFECTED ON THE NASDAQ NMS, IN THE OVER-THE-COUNTER MARKET OR OTHERWISE. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

PROSPECTUS SUMMARY

The following summary is qualified in its entirety by the more detailed information and consolidated financial statements (including the notes thereto) appearing elsewhere in this Prospectus. Unless otherwise indicated, all share and per share data in this Prospectus have been adjusted to reflect a recapitalization of the shares of the Company's common stock, $.01 par value per share (the "Common Stock"), effected in the first quarter of 1993 (the "Recapitalization"). In addition, unless otherwise indicated, all information contained in this Prospectus assumes that the Underwriters' over-allotment option will not be exercised.

See "Glossary" for definitions of certain terms used in this Prospectus.

The Company

MFS Communications Company, Inc. is the largest provider of local competitive access telecommunications services in the United States. As an integrated telecommunications company, the Company provides a wide range of high quality voice, data and other enhanced services and systems specifically designed to meet the requirements of communications-intensive business and government end users. The Company was established in 1987 to take advantage of the rapidly growing advanced telecommunications market which emerged as a result of ongoing technological, competitive and regulatory changes. The Company's strategy is to become the primary provider of telecommunications services to business and government end users nationwide by combining service, which is more flexible and responsive than service offered by other existing providers, with the ability to meet specialized communications needs. The Company's telecommunications services are provided primarily over the Company's digital fiber optic networks which employ advanced, fault-tolerant electronics and dual path architectures to ensure reliable and secure telecommunications. The Company has an active program to expand its fourteen existing metropolitan area networks and to develop new networks in other metropolitan areas throughout the United States.

The Company believes it is well positioned to continue its development as a leading nationwide business communications provider due to its existing fiber optic networks and its extensive experience in designing, deploying and operating advanced telecommunications networks for business and government end users. The Company, through its subsidiary, MFS Telecom, Inc. ("MFS Telecom"), currently serves fourteen metropolitan areas across the United States: New York City, Los Angeles, Chicago, San Francisco, Philadelphia, Boston, Washington, D.C., Dallas, Houston, Minneapolis, Baltimore, Pittsburgh, Atlanta and northern New Jersey. At the end of 1992, the Company provided service to over 600 communications-intensive users, including many of the nation's largest corporations and government agencies. At the end of 1992, the Company's networks covered approximately 850 route miles and included approximately 38,500 miles of optical fiber. For the quarter ended December 31, 1992, the Company's twelve metropolitan area networks which operated for the full year each generated positive earnings before interest, income taxes, depreciation and amortization (EBITDA), before corporate allocations.

The Company's networks are designed to support a wide range of enhanced communications services, provide increased network reliability and, in many cases, reduce end user costs. The Company believes that the direct connection to end user customers provided by its networks establishes a platform that can be used to offer additional enhanced voice, data and video services. New customers typically begin by purchasing a small portion of their telecommunications needs from the Company, as an alternative or backup to the local exchange carrier (the "LEC"). Over time, the Company believes it has consistently increased its share of its customers' total telecommunications purchases as a result of the reliability and quality of the Company's networks, prompt customer service, competitive pricing and ongoing development of new service offerings.

In 1992, the Company developed two new service offerings which benefit from the substantial capacity of the Company's existing fiber optic networks. The Company, through its subsidiary, MFS Datanet, Inc. ("MFS Datanet"), offers high-speed data communications services, including an innovative service designed to connect geographically separate local area networks ("LANs") at the same native speed and protocol at which each LAN operates. The Company believes that data traffic will become an increasing portion of overall telecommunications traffic and that it is among the first entities to offer a complete end-to-end interstate data transmission service at native LAN speeds and protocols. The Company provides its data transmission services either over its own networks or over circuits purchased or leased from others. Beginning in the third quarter of 1993, the Company intends to offer high-speed data communications services among all metropolitan areas in which the Company currently has networks. In addition, through its subsidiary, MFS Intelenet, Inc. ("MFS Intelenet"), the Company intends to provide a single source for telecommunications services to small and medium sized businesses, with quality and pricing levels comparable to those achieved by larger communications users. The Company intends to begin providing this comprehensive telephone service over its New York City network in the third quarter of 1993. The Company believes that currently there is no provider of such comprehensive services utilizing its own local networks.

To date, the Company has generally been limited to providing special access services (high capacity circuits used to connect customer locations with long distance carriers) and private line services (high capacity circuits used to connect two or more customer locations) to corporations and government agencies physically located on the Company's networks. As a result of rulings announced in September 1992 (the "Interconnection Decisions") by the Federal Communications Commission (the "FCC"), the Company believes it will be able to offer interstate special access services to virtually every business and government end user in the metropolitan areas which the Company elects to serve. The Interconnection Decisions allow the Company to interconnect with and utilize networks owned by the Bell operating companies (the "BOCs") and other large LECs. The Company expects that the Interconnection Decisions, which were in response to an initiative filed by the Company, and future state and federal pro-competitive regulatory rulings, together with increasing customer demand, will create more opportunities to introduce new services, expand the Company's networks and address a larger customer base. See "Business—Government Regulation."

The Company, through its subsidiary, MFS Network Technologies, Inc. ("MFS Network Technologies"), provides network systems integration services. MFS Network Technologies designs, engineers, develops and manages the installation of the Company's fiber optic networks and network expansions. As a result, the Company believes that its networks are of higher quality and are completed more quickly and at lower cost than would be possible using outside sources. The Company also offers its network systems integration services and, in certain cases, turn-key facilities management to third parties, providing independent single source solutions to complex multi-discipline communications needs. The Company's network systems integration projects include remote interactive learning facilities, security systems and combined cable television-telephone networks. The Company is also actively developing communications components for intelligent vehicle highway systems in a venture with Texas Instruments, Incorporated. See "Business—Network Systems Integration and Facilities Management Services."

The Company operates through its subsidiaries in two business segments: telecommunications services, through MFS Telecom, MFS Intelenet and MFS Datanet, and network systems integration and facilities management services, through MFS Network Technologies.

The Company is a wholly owned subsidiary of Kiewit Diversified Group, Inc. ("KDG"), which is a wholly owned subsidiary of Peter Kiewit Sons', Inc. ("PKS"). See "Certain Transactions" and "Security Ownership of Certain Beneficial Owners and Management." As used in this Prospectus, the term the "Company" refers to MFS Communications Company, Inc. and its subsidiaries, unless otherwise indicated or the context otherwise requires.

Summary Financial and Other Data

(dollars in thousands)

	Fiscal Year Ended				
	1988	1989	1990(1)	1991(2)	1992
Statement of Operations Data:					
Revenue:					
Telecommunications services	$ —	$ 397	$ 8,951	$ 23,158	$ 47,585
Network systems integration and facilities management services	—	—	1,721	14,065	61,122
Total	—	397	10,672	37,223	108,707
EBITDA(3)	(3,053)	(16,393)	(14,889)	(15,169)	8,773
Loss from operations	(3,068)	(18,307)	(22,879)	(26,930)	(11,771)
Net loss	(2,901)	(17,765)	(30,931)	(28,244)	(13,129)
Statistical and Other Data(4):					
Accumulated KDG investment(5)	$ 3,119	$ 66,512	$125,109	$242,329	$404,043
Metropolitan areas served	—	8	9	12	14
Networks in service(6)	—	8	9	14	21
Circuits in service(7)	—	60,483	173,958	465,420	589,130
Buildings connected	—	128	226	695	1,107
Fiber miles(8)	546	5,780	10,359	22,982	38,595
Route miles(9)	3	49	127	373	858

	December 31, 1992	
	Actual	As Adjusted(10)
Balance Sheet Data:		
Working capital	$ 43,140	$210,535
Total assets	363,299	530,694
Long-term debt, less current maturities	169	169
Minority interest(11)	7,762	7,762
Additional paid-in capital	404,033	570,936
Accumulated deficit	(105,580)	(105,580)
Stockholder's equity	298,516	465,911

(1) Reflects the acquisition as of April 1, 1990 of 80% of the common stock of Chicago Fiber Optic Corporation ("MFS Chicago"), which owns the Company's network in Chicago. The Company now owns 90% of MFS Chicago. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries."

(2) Reflects the acquisition as of October 17, 1991 of 85% of the common stock of Institutional Communications Company ("MFS/ICC"), which owns the Company's network in the Washington, D.C. metropolitan area.

(3) EBITDA consists of earnings (loss) before interest, income taxes, depreciation and amortization. EBITDA is provided since it is a measure commonly used in the industry. It is presented to enhance an understanding of the Company's operating results and is not intended to represent cash flow for the periods indicated. See the Consolidated Statements of Cash Flows contained elsewhere in this Prospectus.

(4) Information presented as of the end of the period indicated. Includes statistical data for the Chicago network which the Company managed prior to its acquisition by the Company as described in Note 1 above.

(5) Consists of advances and paid-in capital from KDG. In 1991, an aggregate of approximately $110.3 million of such advances was contributed by KDG to the Company's equity. Subsequent to December 31, 1992, and prior to completion of the Offering, KDG contributed an additional $30.0 million to the Company's equity as part of the Recapitalization.

(6) Includes metropolitan area networks and significant expansions of these networks (where an expansion exceeded $2.0 million in capital expenditures).

(7) All circuits have been expressed as voice grade equivalent circuits.

(8) Fiber miles refers to the number of route miles installed (excluding pending installations) along a telecommunications path multiplied by the number of fibers along that path.

(9) Route miles refers to the number of miles of the telecommunications path in which the fiber optic cables are installed.

(10) Adjusted to give effect to the Recapitalization and the sale of 8,500,000 Shares offered hereby (at an assumed initial public offering price of $17.50 per Share). See "Capitalization" and Note 15 to the Consolidated Financial Statements.

(11) The Company's networks are owned through subsidiaries, five of which have minority stockholders. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries" and Note 2 to the Consolidated Financial Statements.

The Offering

Common Stock offered hereby	8,500,000 Shares
Common Stock outstanding	
Before the Offering	41,700,000 Shares(1)
After the Offering	50,200,000 Shares(1)
Use of Proceeds	For expenditures related to the expansion of the Company's existing fiber optic networks and services and the development of new networks and services, which expansion may also involve acquisitions. See "Use of Proceeds."
Proposed NASDAQ NMS Symbol	MFST

(1) Excludes 6,000,000 shares of Common Stock issuable upon exercise of options granted under the Company's 1992 Stock Plan. See "Management—Executive Compensation—Compensation Under Plans—1992 Stock Plan."

Risk Factors

PROSPECTIVE INVESTORS SHOULD CONSIDER CAREFULLY CERTAIN FACTORS RELATING TO AN INVESTMENT IN THE COMPANY. SEE "RISK FACTORS."

RISK FACTORS

Prospective investors should consider carefully, together with the other information contained in this Prospectus, the following factors:

Operating Losses

The development of the Company's businesses and the installation and expansion of its networks require significant expenditures, a substantial portion of which is incurred before the realization of revenues. These expenditures, together with the associated early operating expenses, result in negative cash flow until an adequate customer base is established. Certain of the expenditures are expensed as incurred, while certain other expenditures are capitalized. See "Management's Discussion and Analysis of Financial Condition and Results of Operations." The Company reported loss from operations of approximately $22.9 million, $26.9 million and $11.8 million for the years ended December 1990, 1991 and 1992, respectively. Although its revenues have increased substantially in each of the last three years, the Company has incurred significant increases in expenses associated with the development and expansion of its fiber optic networks, services and customer base. There can be no assurance that the Company will achieve or sustain profitability in the future.

Significant Capital Requirements

Expansion of the Company's existing networks and services and the development of new networks and services will require significant capital expenditures. While the Company believes that it will be able to meet its capital needs for the foreseeable future, there can be no assurance that it will be successful in producing sufficient cash flow or raising sufficient debt or equity capital on terms that it will consider acceptable. Failure to generate sufficient funds may require the Company to delay or abandon some or all of its expansion or expenditures, which could have a material adverse effect on the Company's growth. See "Use of Proceeds" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Competition

To date, the Company generally has been limited to providing special access and private line services. In each of the metropolitan areas served or to be served by the Company's networks, the services offered by the Company compete or will compete principally with the special access and private line services offered by the LEC serving that area. LECs have long-standing relationships with their customers, have the potential to subsidize competitive services from monopoly service revenues and benefit from state and federal regulations that, the Company believes, favor the LECs over the Company. While the Interconnection Decisions provide increased business opportunities to the Company, the Interconnection Decisions also provide the LECs with an increased degree of flexibility to price interstate special access services within certain central offices at the time the LECs provide interconnection to their networks. If the LECs elect to lower their rates, this action may adversely affect revenues of competitive access providers ("CAPs"), including the Company, because they would put downward pressure on certain special access rates which CAPs can charge. If future regulatory decisions afford the LECs increased pricing flexibility or other regulatory relief, such decisions could have a material adverse effect on the Company.

In most of the metropolitan areas in which the Company operates, the Company faces competition from at least one other CAP whose network offers substantially similar special access and private line services at competitive prices. The Company also may face competition from potential market entrants, including other CAPs, cable television companies, electric utilities, long distance carriers, microwave carriers, wireless telephone system operators and private networks built by large end users.

The Company faces competition in its network systems integration and facilities management business from equipment manufacturers, BOCs, long distance carriers and numerous smaller firms.

The Company also faces competition in its recently established MFS Datanet business which offers data communications services for LANs and other data systems, and expects to face competition in its planned offering of MFS Intelenet services to small and medium sized businesses. LECs, long distance carriers and others compete with the Company's data communications services and will compete with the Company's small and medium sized business services.

Many of the Company's competitors and potential competitors have financial, personnel and other resources substantially greater than those of the Company. See "Business—Competition."

Regulation

The Company is subject to varying degrees of federal, state and local regulation. The Company is not subject to price cap or rate of return regulation, nor is it currently required to obtain FCC authorization for installation or operation of its network facilities. The Company had not been required to file tariffs at the FCC for domestic service, but as a result of a recent court decision, the Company is now required to file interstate tariffs on an ongoing basis. Challenges to these tariffs by third parties may cause the Company to incur substantial legal and administrative expenses. The Company's subsidiaries that provide intrastate service are generally subject to certification and tariff filing requirements by state regulators. Although the trend in federal and state regulation appears to favor increased competition, no assurance can be given that changes in current or future regulations adopted by the FCC or state regulators or legislative initiatives would not have a material adverse effect on the Company. See "Business—Government Regulation."

Risks of Expansion and Implementation

The Company is engaged in the expansion and development of its networks and services. The Company expects such expansion and development to accelerate following the Offering. The expansion and development of the Company's networks will depend on, among other things, the Company's ability to assess markets, design fiber network backbone routes, install facilities and obtain rights-of-way, building access and any required government authorizations and/or permits and the implementation of the Interconnection Decisions, all in a timely manner, at reasonable costs and on satisfactory terms and conditions. As a result, there can be no assurance that the Company will be able to expand its existing networks or install new networks. If the Company is not able to expand its networks or install new networks, there will be a material adverse effect on the Company's growth.

In 1992, the Company formed MFS Datanet and MFS Intelenet. There can be no assurance that either of these businesses will be successful. The Company's inability to manage effectively its expansion into these new businesses or services could have a material adverse effect on the Company. See "Business—Telecommunications Services—Services—Data Transmission Services," "—Integrated Telemanagement Services" and "—Government Regulation."

Rapid Technological Changes

The telecommunications industry is subject to rapid and significant changes in technology. While the Company believes that for the foreseeable future these changes will neither materially affect the continued use of fiber optic cable nor materially hinder the Company's ability to acquire necessary technologies, the effect of technological changes on the businesses of the Company cannot be predicted.

Dependence on Key Personnel

The Company's businesses are managed by a small number of key executive officers, the loss of certain of whom could have a material adverse effect on the Company. The Company believes that its future success will depend in large part on its continued ability to attract and retain highly skilled and qualified personnel. See "Management."

Variability of Quarterly Operating Results

As a result of the significant expenses associated with the expansion and development of its networks and services, the Company anticipates that its operating results could vary significantly from period to period and such variability could adversely affect the Company's results of operations. See "Business—Telecommunications Services." In addition, the Company's network systems integration and facilities management revenues are and generally will continue to be dependent upon a small number of large projects. Accordingly, these revenues are likely to vary significantly from period to period, and such variability could adversely affect the Company's results of operations. See "Business—Network Systems Integration and Facilities Management Services."

Government Contracts

In 1990, 1991 and 1992, the Company's contracts for network systems integration and facilities management services with federal and state government departments and agencies accounted for a substantial portion of MFS Network Technologies' third party revenues. A significant reduction in government funding for projects the Company is performing or the termination of these projects could have a material adverse effect on the Company's results of operations.

Control by Principal Stockholder; Potential Conflicts

After the Offering, KDG, a wholly owned subsidiary of PKS, will own approximately 83.1% of the outstanding shares of Common Stock. As a result, KDG will have the ability to elect the entire board of directors of the Company (the "Board of Directors") and control the direction and future operations of the Company. Certain of the Company's directors are also directors of KDG and certain of its affiliates. The chief executive officer of the Company will devote an insignificant amount of his time to the development of new ventures (including selected telecommunications opportunities that do not compete with the Company) for KDG, PKS and their other affiliates. See "Management."

The Company and PKS will enter into a noncompetition agreement (the "Noncompetition Agreement") as of the closing of the Offering. There is no assurance that PKS will not compete with the Company in areas not addressed by the Noncompetition Agreement. See "Certain Transactions—Intercompany Agreements—Noncompetition Agreement."

The Company and PKS and its affiliates expect to engage in future intercompany transactions, the terms of which will be determined through negotiations between the Company and PKS or its affiliates. PKS has provided the Company and certain of its subsidiaries with certain services used in their businesses, including accounting, computer time sharing, risk management and insurance, legal, and cash management. Following the Offering, PKS will continue to provide similar services to the Company and its subsidiaries. Either party may terminate all or any of the services provided to the Company upon 90 days written notice. The Company believes that the discontinuance of any or all of these services will not have a material adverse effect on the Company's results of operations. See "Management," "Certain Transactions" and "Security Ownership of Certain Beneficial Owners and Management."

Absence of Prior Public Market

Prior to the Offering, there has been no public market for the shares of Common Stock, and there can be no assurance that an active trading market for the Shares will develop or be sustained. The initial public offering price of the Shares will be determined through negotiations with the Representatives of the Underwriters. There can be no assurance that future market prices for the

Shares will equal or exceed the initial public offering price set forth on the cover page of this Prospectus. The market prices of securities of growth companies similar to the Company have historically been highly volatile. Future announcements concerning the Company or its competitors, including quarterly results, technological innovations, services or government legislation or regulation, may have a significant impact on the market price of the Shares. See "Underwriting."

Shares Eligible for Future Sale

Sales of substantial numbers of shares of Common Stock in the public market following the Offering could adversely affect the market price of the Shares. Following expiration of the 360-day lock-up agreement with the Underwriters, 30,000,000 of the 41,700,000 shares of Common Stock owned by KDG will be eligible for sale pursuant to the provisions of Rule 144 under the Securities Act. KDG has advised the Company that it currently intends to hold the shares of Common Stock owned by it for the foreseeable future. However, no assurance can be given that KDG will not decide, based upon then prevailing market and other conditions, to dispose of all or a portion of its investment in the Company. KDG has the right, pursuant to the terms of a registration rights agreement, to require the Company to register its shares of Common Stock under the Securities Act. In addition, the Company intends to register 6,000,000 shares of Common Stock for issuance upon exercise of options granted to its employees under the Company's 1992 Stock Plan. Options to acquire approximately 700,000 shares of Common Stock will become exercisable upon the closing of the Offering. See "Management—Executive Compensation—Compensation Under Plans—1992 Stock Plan," "Certain Transactions—Intercompany Agreements—Registration Rights Agreement," "Security Ownership of Certain Beneficial Owners and Management" and "Shares Eligible for Future Sale."

Dilution of Shares

Persons purchasing Shares will incur immediate and substantial dilution in net tangible book value per Share. See "Dilution."

THE COMPANY

The Company is a Delaware corporation and a wholly owned subsidiary of KDG, which is a wholly owned subsidiary of PKS. See "Certain Transactions" and "Security Ownership of Certain Beneficial Owners and Management." The principal offices of the Company are located at 3555 Farnam Street, Omaha, Nebraska 68131. The telephone number is (402) 271-2890.

USE OF PROCEEDS

The net proceeds from the Offering (at an assumed initial public offering price of $17.50 per Share) are estimated to be $137,395,000 ($158,230,000 if the Underwriters' over-allotment option is exercised in full). The Company intends to use substantially all of the net proceeds from the Offering for expenditures relating to the expansion of its existing fiber optic networks and services and the development of new networks and services, which expansion may also involve acquisitions. Up to $8.25 million of the net proceeds from the Offering may be used to finance the acquisition of a company that operates a fiber optic network in the Washington, D.C. metropolitan area contiguous to the Company's Washington, D.C. metropolitan area network. The Company has no agreement, agreement in principle, understanding or arrangement with any person to acquire or effect any material acquisition. See "Business—Telecommunications Services—The Networks" and "—Business Growth and Expansion." Pending such use, the net proceeds to the Company will be invested in short-term, investment grade securities.

The principal purposes of the Offering are to fund the Company's growth, create a public market for the Common Stock and facilitate future access by the Company to public capital markets.

DILUTION

At December 31, 1992, as adjusted for the Recapitalization, the net tangible book value of the Company was $253.0 million or $6.07 per share of Common Stock. Net tangible book value per share represents the Company's net worth less intangible assets of $75.5 million divided by 41,700,000 shares of Common Stock. After giving effect to the Recapitalization and the sale by the Company of 8,500,000 Shares pursuant to the Offering (at an assumed initial public offering price of $17.50 per Share) and after deducting the underwriting discount and expenses of the Offering (estimated at $11.4 million), the pro forma net tangible book value of the Company at December 31, 1992, would have been $390.4 million, or $7.78 per share of Common Stock. Such amount represents an immediate increase in pro forma net tangible book value of $1.71 per share of Common Stock to the existing stockholder and an immediate dilution to new investors of $9.72 per share of Common Stock. The following table illustrates the dilution in pro forma net tangible book value per share to new investors:

Assumed initial public offering price per Share		$17.50
Net tangible book value per Share before the Offering	$6.07	
Increase in net tangible book value per Share attributable to net proceeds of the Offering	1.71	
Pro forma net tangible book value per Share after the Offering		7.78
Dilution to new investors		$ 9.72

The following table sets forth at December 31, 1992, on a pro forma basis, the difference between the existing stockholder and the purchasers of Shares in the Offering (at an assumed initial public offering price of $17.50 per Share), with respect to the number of Shares purchased from the Company, the total consideration paid and the average price per Share paid:

	Shares Purchased		Total Consideration		Average Price
	Number	Percent	Amount	Percent	Per Share Paid
Existing stockholder(1)	41,700,000	83.1%	$434,043,000	74.5%	$10.41
New investors	8,500,000	16.9	148,750,000	25.5	17.50
Total..............................	50,200,000	100.0%	$582,793,000	100.0%	

(1) Adjusted to give effect to the Recapitalization. Excludes the issuance of 6,000,000 shares of Common Stock issuable upon exercise of options granted under the Company's 1992 Stock Plan at an exercise price of $12.05 per share. If these options are exercised, there will be further dilution to the new investors. See "Management—Executive Compensation—Compensation Under Plans—1992 Stock Plan." A portion of the total consideration for the shares owned by KDG relates to the assumption by KDG of the Company's contingent liability for the deferred purchase price related to the MFS Chicago acquisition. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries." Since the amount of this liability is not yet ascertainable, no value has been ascribed to this liability for purposes of this table.

CAPITALIZATION

The following table sets forth at December 31, 1992 the actual capitalization of the Company and the capitalization of the Company as adjusted to reflect the issuance of 8,500,000 Shares pursuant to the Offering (at an assumed initial public offering price of $17.50 per Share). This table should be read in conjunction with the Selected Consolidated Financial Data and the Consolidated Financial Statements and notes thereto included elsewhere in this Prospectus.

	December 31, 1992	
	Actual	As Adjusted(1)
	(dollars in thousands)	
Long-term debt, net of current portion	$ 169	$ 169
Minority interests(2)	7,762	7,762
Stockholders' equity		
Common Stock, $ .01 par value, 125,000,000 shares authorized, 100 shares issued and outstanding and 50,200,000 shares as adjusted (3)	10	502
Additional paid-in capital	404,033	570,936
Foreign currency adjustment	53	53
Accumulated deficit	(105,580)	(105,580)
Total stockholders' equity	298,516	465,911
Total capitalization	$ 306,447	$473,842

(1) Also adjusted to give effect to the Recapitalization. See Note 15 to the Consolidated Financial Statements.

(2) The Company's networks are owned through subsidiaries, five of which have minority stockholders. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries" and Note 2 to the Consolidated Financial Statements.

(3) Excludes 6,000,000 shares of Common Stock issuable upon exercise of options granted under the Company's 1992 Stock Plan. See "Management—Executive Compensation—Compensation Under Plans—1992 Stock Plan."

DIVIDEND POLICY

The Company has not paid any cash dividends on its Common Stock. The Company intends to retain future earnings, if any, to finance the development and expansion of its businesses and, therefore, does not anticipate paying any dividends in the foreseeable future. The decision whether to pay dividends will be made by the Board of Directors in light of conditions then existing, including the Company's results of operations, financial condition and requirements, business conditions and other factors. Because the Company's principal assets are its investments in the equity securities of its subsidiaries, its cash flow and consequent ability to pay dividends will be dependent upon the earnings of its subsidiaries, the distribution of those earnings to the Company and other business considerations of the subsidiaries. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries."

SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements and the notes thereto included elsewhere in this Prospectus.

The selected consolidated financial data for each of the years in the period 1989 to 1992 have been derived from audited historical consolidated financial statements. The selected consolidated financial data for fiscal year 1988 have been derived from unaudited consolidated financial statements. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly the consolidated financial position of the Company at December 31, 1988 and the results of operations for the year ended December 31, 1988.

The development and acquisition by the Company of its networks and services during the periods reflected in the Selected Consolidated Financial Data materially affect the comparability of that data from one period to another. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	Fiscal Year Ended				
Statement of operations data:	1988	1989	1990(1)	1991(2)	1992
	(dollars in thousands, except per share data)				
Revenue:					
Telecommunications services	$ —	$ 397	$ 8,951	$ 23,158	$ 47,585
Network systems integration and facilities management services	—	—	1,721	14,065	61,122
Total	—	397	10,672	37,223	108,707
Costs and expenses:					
Operating expenses	—	5,259	13,971	33,963	76,667
Depreciation and amortization	15	1,914	7,990	11,761	20,544
General and administrative expenses	3,053	11,531	11,590	18,429	23,267
	3,068	18,704	33,551	64,153	120,478
Loss from operations	(3,068)	(18,307)	(22,879)	(26,930)	(11,771)
Other income (expense), net (3)	167	542	(8,052)	(1,314)	(792)
Loss before income taxes	(2,901)	(17,765)	(30,931)	(28,244)	(12,563)
Provision for income taxes	—	—	—	—	(566)
Net loss	$(2,901)	$(17,765)	$(30,931)	$ (28,244)	$ (13,129)
Pro forma loss per share (4)					$ (0.30)
Pro forma number of shares (4)					43,568,571
Other data:					
EBITDA (5)	$(3,053)	$(16,393)	$(14,889)	$ (15,169)	$ 8,773
Accumulated KDG investment (6)	3,119	66,512	125,109	242,329	404,043
Balance sheet data:					
Networks and equipment, net	$ 2,761	$ 27,061	$ 73,698	$140,904	$ 206,698
Total assets	5,076	53,284	102,959	204,819	363,299
Long-term debt, less current maturities	—	—	17,849	7,659	169
Advances from affiliate (7)	2,898	54,898	110,251	—	—
Minority interest (8)	2,694	169	—	7,403	7,762
Additional paid-in capital (6)	211	11,604	14,848	242,319	404,033
Accumulated deficit	(2,901)	(20,666)	(51,597)	(79,841)	(105,580)
Stockholder's equity (6)	(2,680)	(9,052)	(36,739)	162,538	298,516

(1) Reflects the acquisition as of April 1, 1990 of 80% of the common stock of MFS Chicago, which owns the Company's network located in Chicago. The Company now owns 90% of MFS Chicago. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries."

(2) Reflects the acquisition as of October 17, 1991 of 85% of the common stock of MFS/ICC, which owns the Company's network located in the Washington, D.C. metropolitan area.

(3) Reflects the assumption of $23.6 million principal amount of debt in connection with the acquisition of MFS Chicago in April 1990, in addition to interest charged on advances from KDG through 1990. The Company recorded interest expense in respect of such advances of $1.8 million and $7.2 million in 1989 and 1990, respectively. Other income also includes management fees from MFS Chicago prior to the April 1990 acquisition of $1.4 million and $0.1 million in 1989 and 1990, respectively.

(4) See Note 2 to the Consolidated Financial Statements, which describes the calculation of pro forma loss per share.

(5) EBITDA consists of earnings (loss) before interest, income taxes, depreciation and amortization. EBITDA is provided since it is a measure commonly used in the industry. It is presented to enhance an understanding of the Company's operating results and is not intended to represent cash flow for the periods. See the Consolidated Statements of Cash Flows contained elsewhere in this Prospectus.

(6) Consists of advances and paid-in capital from KDG. In 1991, all of such advances aggregating $110.3 million was contributed by KDG to the Company's equity. Subsequent to December 31, 1992, and prior to completion of the Offering, KDG contributed an additional $30.0 million to the Company's equity as part of the Recapitalization.

(7) Consists of advances from KDG. In 1991, an aggregate of approximately $110.3 million of advances was contributed by KDG to the Company's equity.

(8) The Company's networks are owned through subsidiaries, five of which have minority stockholders. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries" and Note 2 to the Consolidated Financial Statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

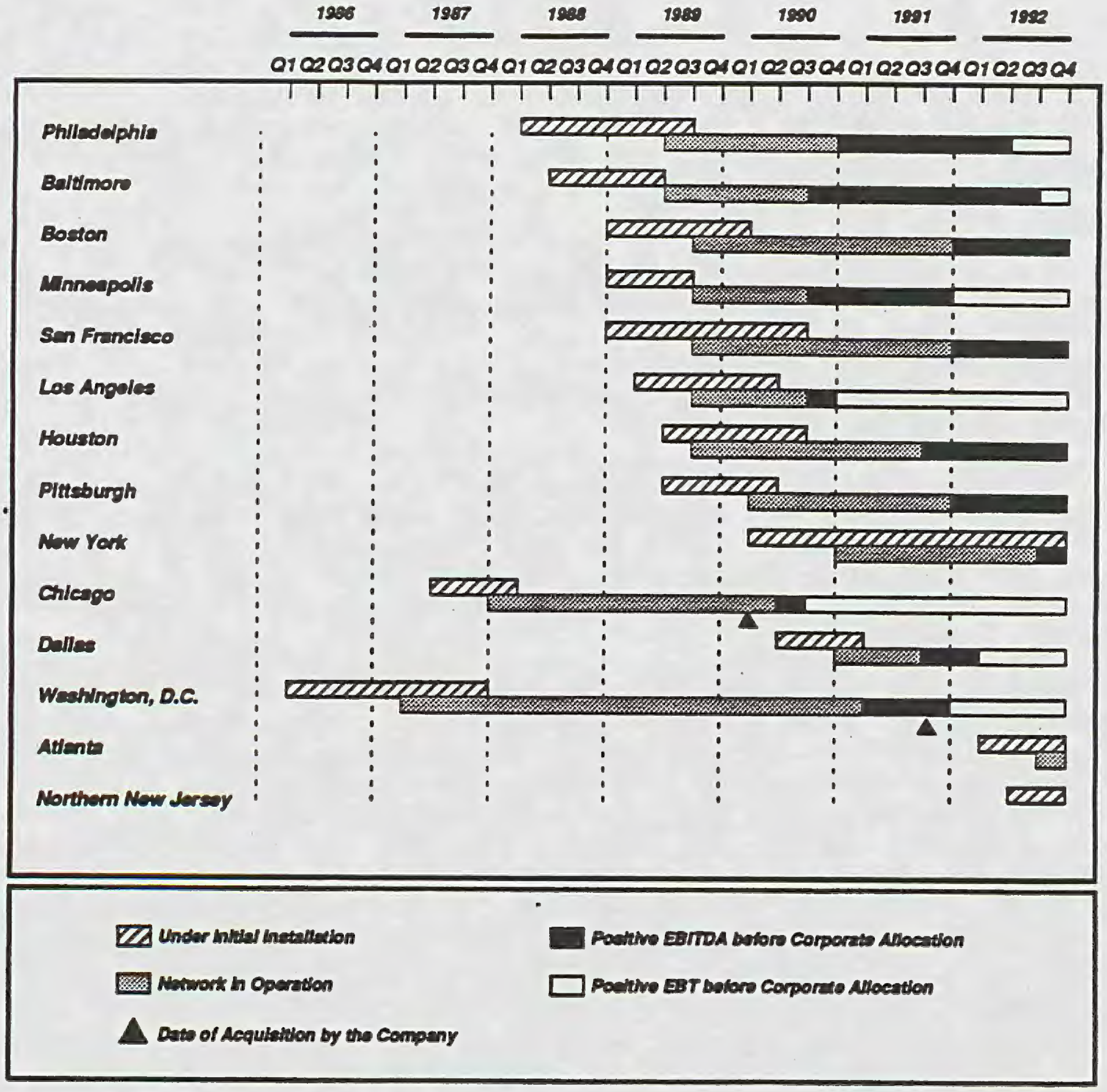
The Company was founded in 1987 and commenced operations in 1988. The Company operates in two business segments, telecommunications services and network systems integration and facilities management services. For certain segment information, see Note 14 to the Consolidated Financial Statements. Operating results of MFS Datanet and MFS Intelenet services prior to the fourth quarter of 1992 have been immaterial. The Company's growth, including its capital expenditure requirements, acquisition financing and working capital, has been funded by KDG to date.

Telecommunications Services. The Company owns and operates digital fiber optic telecommunications networks in fourteen metropolitan areas across the United States. These networks provide dedicated special access and private line services to business and government users. The Company's rapid growth from early 1988 through December 1992, as reflected in the Consolidated Financial Statements, resulted principally from the initial installation or acquisition, and subsequent expansion, of the Company's digital fiber optic telecommunications networks in an increasing number of major metropolitan areas.

The development of the Company's businesses and the installation and expansion of its networks require significant expenditures, a substantial portion of which is incurred before the realization of revenues. These expenditures, together with the associated early operating expenses, result in negative cash flow until an adequate customer base is established. As this customer base grows, incremental revenues are added with minimal additional expense, providing significant contributions to cash flow.

As shown below, for the quarter ended December 31, 1992, the Company's twelve metropolitan area networks which operated for the full year each generated positive earnings before interest, income taxes, depreciation and amortization (EBITDA), before corporate allocations. Such corporate allocations include costs incurred for centralized management and technical services provided to the individual metropolitan area networks. After varying lengths of time, seven of the Company's metropolitan area networks have also attained positive earnings from operations, before corporate allocations. EBITDA is provided since it is a measure commonly used in the industry. It is presented to enhance an understanding of the Company's operating results and is not intended to represent cash flow for the periods indicated. See the Consolidated Statement of Cash Flows contained elsewhere in this Prospectus. During 1992, the telecommunications services segment achieved positive EBITDA of $2.1 million.

The following table illustrates the historical trends of the Company's networks, by metropolitan area, from installation towards profitability.



The above table includes MFS Chicago and MFS/ICC from their original dates of installation and operation. The Consolidated Financial Statements include MFS Chicago and MFS/ICC from their respective date of acquisition.

The Company is currently expanding its existing networks in the metropolitan areas of Los Angeles, Chicago, Philadelphia, Boston, Washington, D.C., Dallas, Houston and Baltimore. The Company intends to continue to expand existing networks and develop new networks for the foreseeable future. The costs associated with the initial installation or expansion of the networks, including development, installation, certain pre-operating costs and early operating expenses, are significant and result in negative cash flow until an adequate customer base is established. The exact amounts and timing of these expenditures are subject to a variety of factors which may vary greatly by market and be beyond the control of the Company.

The installation or expansion of a network typically takes 6-12 months, depending on the size and complexity of the network; however, the Company generally begins to realize revenue from the new or expanded network 2-3 months before installation is fully complete. These time frames are influenced by a variety of factors, including obtaining rights-of-way and necessary governmental approvals.

Capital expenditures for the initial purchase and installation of fiber optic cable and high-speed electronics transmission equipment are expected to average $3-6 million per expansion or new network development. Actual costs may vary significantly from this range. The Company also incurs ongoing capital expenditures in both existing and new networks which are directly related to the installation of new revenue producing circuits. These costs typically range from $.75-$1.50 of capital expenditure per $1.00 of incremental annual revenue, though actual costs may vary from this range based on the specific type of circuit installed and the location of the customer.

In addition to capital expenditure requirements, upon commencement of the installation phase of a network, the Company begins to incur direct operating costs for such items as salaries and office rent. As network installation progresses, the Company incurs right-of-way costs, increased sales and marketing expenses (including sales commissions) and, in certain markets, franchise fees paid to local governments based on revenue. Certain direct pre-operating costs for new networks are capitalized until the network begins to realize revenue and are expensed as incurred thereafter.

The Company also incurs significant development costs before the installation or expansion of a network. MFS Development Company ("MFS Development"), a division of the Company, functions as the Company's development arm in analyzing the expansion of existing networks, the installation of networks in new metropolitan areas and the development of new service offerings. Development costs, which include preliminary network layout and design, legal and regulatory authorizations and the negotiation of long-term right-of-way agreements for the installation of fiber optic cable and of access to customer locations, are capitalized during the expansion period and are amortized over future periods beginning at the time the networks are placed in service.

Through MFS Datanet, the Company offers high-speed data communications services to business and government users. MFS Datanet uses the Company's networks in buildings where the Company already provides special access and private line services, requiring significantly less capital expenditures because data communications customers can, to a certain extent, utilize existing fiber optic networks, electronics and building equipment rooms. As a result of the initial market reception to MFS Datanet's high-speed data communications services, the Company expects to offer these services among all metropolitan areas in which the Company has networks in the third quarter of 1993.

Through MFS Intelenet, the Company will offer a single source for telecommunications services to small and medium sized businesses. By utilizing its existing networks and facilities, the Company will minimize capital expenditures for transmission facilities. However, significant capital costs will be incurred for switching equipment, equipment maintained at customer locations and additional building wiring costs.

The Company incurred $4.1 million of expenses during 1992, primarily during the fourth quarter, relating to the development of MFS Datanet and MFS Intelenet and expects similar costs in significantly higher amounts to be incurred on a quarterly basis during 1993.

Network Systems Integration and Facilities Management Services. The Company, through MFS Network Technologies, designs, engineers, develops and manages the installation of the Company's new fiber optic networks and network expansions. Prior to 1991, most of the Company's network systems integration and facilities management efforts were focused on the design, development, engineering and installation of the Company's telecommunications networks. Beginning in 1991, the Company began to offer network systems integration and facilities management services to third parties. Network systems integration and facilities management revenues have been characterized by significant revenues concentrated in a relatively small number of large projects for third parties. MFS Network Technologies has engaged in numerous projects for various third parties with contract values ranging from under $1.0 million to approximately $90.0 million.The Company recognizes revenue based upon the amount of its network systems integration services performed. The amount of the Company's network systems integration and facilities management services performed can vary on a quarterly basis depending upon individual customer contract requirements.

Results of Operations

The following table presents revenue, operating income (loss) and EBITDA from each of the Company's reportable business segments for the periods indicated:

	Fiscal Year Ended		
	1990	1991	1992
Revenue:			
Telecommunications services	$ 8,951	$ 23,158	$ 47,585
Network systems integration and facilities management services	1,721	14,065	61,122
Total	$ 10,672	$ 37,223	$108,707
Operating income (loss):			
Telecommunications services	$(22,424)	$(24,373)	$ (18,426)
Network systems integration and facilities management services	(311)	(2,551)	6,287
Total	$(22,735)	$(26,924)	$ (12,139)
EBITDA:			
Telecommunications services	$(14,604)	$(12,746)	$ 2,106
Network systems integration and facilities management services	(285)	(2,423)	6,667
Total	$(14,889)	$(15,169)	$ 8,773

Year Ended 1992 vs. Year Ended 1991

Company revenue increased from $37.2 million in 1991 to $108.7 million in 1992, representing an increase of $71.5 million or 192%. Telecommunications services revenue increased from $23.2 million in 1991 to $47.6 million in 1992, an increase of $24.4 million or 105%. The increase in revenue primarily reflects increased services provided on networks in New York City and Dallas which commenced operations in early 1991 and a full year of results for the Washington, D.C. metropolitan area network which was acquired in October 1991. The balance of the telecommunications services revenue increase resulted from continued market growth of other networks. The Atlanta network became operational during the fourth quarter of 1992, but generated insignificant revenues. Monthly recurring revenue increased from $3.4 million in 1991 to $4.4 million in 1992, an increase of $1.0 million or 29.4%. Monthly recurring revenue represents monthly service charges billable to telecommunications services customers as of the last day of the year indicated, but excludes non-recurring revenues for certain one-time services, such as installation fees or equipment charges.

Third party revenue from services offered by the Company's network systems integration and facilities management segment increased from $14.1 million in 1991 to $61.1 million in 1992, an increase of $47.0 million or 333%. The increase resulted primarily from network systems integration projects for the State of Iowa, Minnesota Equal Access Network Services, Inc. ("MEANS") and the United Kingdom joint venture. Services that MFS Network Technologies provided to MFS Telecom, which are eliminated from revenue and cost in the Consolidated Financial Statements, amounted to $21.1 million in 1991 as compared to $32.9 million in 1992.

Operating expenses increased from $34.0 million in 1991 to $76.7 million in 1992, an increase of $42.7 million or 126%. Telecommunications services operating expenses increased from $20.9 million or 90% of segment revenue in 1991 to $27.9 million or 59% of segment revenue in 1992, an increase of $7.0 million or 33%. This increase is associated primarily with metropolitan network operations in Washington, D.C., New York City and Dallas. Telecommunications services operating expenses consist of costs associated directly with network operations, including salaries, sales commissions and related employee benefits, rent expense, right-of-way fees and other network costs. Network systems integration and facilities management services operating expenses increased from $13.1 million in 1991 to $48.8 million in 1992, an increase of $35.7 million or 273%. This increase primarily reflects costs associated with an increased number of projects.

Depreciation and amortization expense increased from $11.8 million in 1991 to $20.5 million in 1992, an increase of $8.7 million or 74%. Telecommunications services accounted for substantially all of such depreciation and amortization expense. The acquisition of the Washington, D.C. metropolitan area network in October 1991 and the installation of new networks in New York City and Dallas accounted for a significant portion of the increase. The balance of the increase reflected primarily depreciation on an expanded fixed asset base in all of the other Company networks.

General and administrative expenses increased from $18.4 million in 1991 to $23.3 million in 1992, an increase of $4.9 million or 27%. Telecommunications services general and administrative expenses increased from $15.0 million in 1991 to $17.6 million in 1992, an increase of $2.6 million or 17%. Decreases in various general and administrative expenses were offset by $4.1 million incurred during 1992, primarily in the fourth quarter, in developing high-speed data communications services through MFS Datanet and integrated, single-source telecommunications services through MFS Intelenet. These costs negatively impacted 1992 operating results for the telecommunications services segment. Network systems integration and facilities management services general and administrative expenses increased from $3.4 million in 1991 to $5.7 million in 1992, an increase of $2.3 million or 68%. The increase primarily reflects additional employee and consultant costs associated with the segment's growth.

Other expense decreased from $1.3 million in 1991 to $0.8 million in 1992, a decrease of 38%, resulting primarily from the $0.8 million decrease in interest expense. The interest expense reduction resulted from the Company's repayment of bank loans that had been assumed as part of the 1990 acquisition of 80% of the common stock of MFS Chicago. Interest-bearing debt to third parties was reduced from $20.5 million at December 28, 1990 to less than $0.2 million at December 31, 1992.

Prior to 1992, the Company and its individual operating subsidiaries generated net operating losses and, accordingly, incurred no income tax expense. The 1992 provision for income taxes resulted from state income tax liabilities incurred on profitable operations in certain states.

Backlog. The network systems integration and facilities management services segment had third party backlog of $74 million at December 31, 1992. The remaining portion of the project for the State of Iowa accounted for the majority of the Company's backlog at December 31, 1992. Management estimates that most of the contract backlog at December 31, 1992 will be earned for services to be performed in 1993. Backlog consists of firm contracts less revenue recognized to date by the Company.

Year Ended 1991 vs. Year Ended 1990

Revenue increased from $10.7 million in 1990 to $37.2 million in 1991, an increase of $26.5 million or 248%. Telecommunications services revenue increased from $9.0 million in 1990 to $23.2 million in 1991, an increase of $14.2 million or 158%. The increase in revenue primarily reflects increased revenues from new networks commencing operations in New York City and Dallas, as well as increased services provided on networks in Chicago and Pittsburgh, which commenced operation in 1990. Approximately

20% of the telecommunications services revenue increase in 1991 resulted from the acquisition in the fourth quarter of a majority interest in the Washington, D.C. metropolitan area network. Monthly recurring revenue increased from $1.1 million in 1990 to $3.4 million in 1991, an increase of $2.3 million or 209%.

Third party revenue from services offered by the Company's network systems integration and facilities management segment increased from $1.7 million in 1990 to $14.1 million in 1991, an increase of $12.4 million or 729%. Most of the increase resulted from network systems integration projects performed for the State of Iowa and MEANS. In May 1991, the Company became a fifty percent partner in a joint venture to perform network systems integration services for customers in the United Kingdom. Services that MFS Network Technologies provided to MFS Telecom, which are eliminated from revenue and cost in the Consolidated Financial Statements, amounted to $19.1 million in 1990 as compared to $21.1 million in 1991.

Operating expenses increased from $14.0 million in 1990 to $34.0 million in 1991, an increase of $20.0 million or 143%. Telecommunications services operating expenses increased from $12.4 million or 138% of segment revenue in 1990 to $20.9 million or 90% of segment revenue in 1991, an increase of $8.5 million or 69%. This increase was associated primarily with the metropolitan area network operations in Washington, D.C., New York City and Dallas, plus a full year of operating expenses for networks in Pittsburgh and Chicago. Prior to 1990, no pre-operating costs of a metropolitan area network were deferred because the Company was in a development stage and recoverability of these costs was uncertain. During 1990, the Company began deferring these costs and amortizing the expense over a five-year period. The effect of this change was to decrease operating expenses by approximately $2.0 million in 1990. Network systems integration and facilities management services operating expenses increased from $1.6 million in 1990 to $13.1 million in 1991, an increase of $11.5 million or 719%. This increase resulted primarily from the State of Iowa, MEANS and the United Kingdom projects.

Depreciation and amortization expense increased from $8.0 million in 1990 to $11.8 million in 1991, an increase of $3.8 million or 48%. The networks in Washington, D.C., New York City and Dallas accounted for a significant portion of the 1991 increase in depreciation and amortization expense. The increase also reflects the impact of the inclusion of the Chicago and Pittsburgh networks for an entire year in 1991 and a moderately higher fixed asset base to depreciate. At the beginning of 1991, the Company made a prospective change to extend the lives of certain network components and equipment. The change was adopted to present the Company's financial position and results of operations in conformity with practices generally applied in the telecommunications industry. The change had the effect of reducing depreciation expense that would have otherwise been recorded by $3.6 million.

General and administrative expenses increased from $11.6 million in 1990 to $18.4 million in 1991, an increase of $6.8 million or 59%. Telecommunications services general and administrative expenses increased from $11.2 million in 1990 to $15.0 million in 1991, an increase of $3.8 million or 34%. Most of the increase resulted from administering the growth of telecommunications services, including higher administrative salary and benefit costs, increased outside consultant fees, increased travel expense and slightly higher marketing and advertising costs. Network systems integration and facilities management services general and administrative expenses increased from $0.4 million in 1990 to $3.4 million in 1991, an increase of $3.0 million or 750%. This increase reflects additional costs incurred in 1991 to offer services to third parties and develop its market.

Other expense decreased from $8.1 million in 1990 to $1.3 million in 1991, a decrease of $6.8 million or 84%, resulting primarily from a decrease of $7.6 million in interest expense. The debt assumed as a result of the Company's acquisition of 80% of the common stock of MFS Chicago, along with increased advances from KDG to fund the continued expansion of the Company into new metropolitan areas and general working capital requirements, accounted for a substantial portion of the interest expense in 1990. At the beginning of 1991, KDG contributed to the equity of the Company amounts that had previously been recorded as interest-bearing advances. The interest-bearing advances, used to finance working capital and network and equipment capital requirements, aggregated $110.3 million at December 29, 1990. Interest expense was further reduced in September 1991 when the Company repaid $11.7 million of bank loans that had been assumed as part of the 1990 acquisition of MFS Chicago.

Backlog. The project for the State of Iowa and the Company's share of the United Kingdom joint venture accounted for most of the Company's $112.0 million third party backlog at December 28, 1991.

Summary of Operations by Quarter

The following table presents unaudited quarterly operating results for 1990, 1991 and 1992. The Company believes that all necessary adjustments have been included in the amounts stated below to present fairly the quarterly results when read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere in this Prospectus. Results of operations for any particular quarter are not necessarily indicative of results of operations for a full year or predictive of future periods.

	1990				1991			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
	(dollars in thousands)							
Revenue:								
Telecommunications services	$ 445	$ 2,324	$ 2,760	$ 3,422	$ 3,859	$ 4,701	$ 5,323	$ 9,275
Network systems integration and facilities management services	—	80	101	1,540	519	1,485	4,630	7,431
Total	445	2,404	2,861	4,962	4,378	6,186	9,953	16,706
Loss from operations	(4,267)	(7,439)	(5,310)	(5,863)	(6,634)	(6,063)	(6,512)	(7,721)
Other income (expense)	(1,009)	(2,155)	(2,183)	(2,705)	(280)	(628)	(304)	(102)
Provision for income taxes	—	—	—	—	—	—	—	—
Net loss	(5,276)	(9,594)	(7,493)	(8,568)	(6,914)	(6,691)	(6,816)	(7,823)
EBITDA	(2,199)	(5,630)	(2,537)	(4,523)	(3,772)	(4,255)	(3,410)	(3,732)

	1992			
	1st	2nd	3rd	4th
	(dollars in thousands)			
Revenue:				
Telecommunications services	$10,923	$11,026	$12,339	$13,297
Network systems integration and facilities management services	12,705	13,442	15,583	19,392
Total	23,628	24,468	27,922	32,689
Loss from operations	(4,177)	(1,877)	(1,393)	(4,324)
Other income (expense)	(245)	(279)	(279)	11
Loss before income taxes	(4,422)	(2,156)	(1,672)	(4,313)
Provision for income taxes	(20)	(200)	(220)	(126)
Net loss	(4,442)	(2,356)	(1,892)	(4,439)
EBITDA	362	3,225	3,946	1,240

Telecommunications services revenue has increased every quarter from 1990 through December 31, 1992, primarily due to the Company's increasing customer base that has resulted from the installation and acquisition of new networks, the major expansion of existing networks and increased services provided over existing networks. Significant increases in telecommunications services revenue in 1990 resulted from the April 1990 acquisition of 80% of the common stock of MFS Chicago and in 1991 from the October 1991 acquisition of 85% of the common stock of MFS/ICC. Operations in the first quarter of 1992 were positively impacted by continued market growth of the Company's metropolitan area networks, primarily in New York City and the Washington D.C. as compared to results of operations of earlier periods. Telecommunications services revenue growth slowed during the second quarter of 1992 as a result of a discontinuance of service to a major customer who filed for bankruptcy protection. During 1992, the Company's revenue growth was negatively affected by certain volume and term discounts negotiated by the LECs with major long distance carriers. The Company has responded to these volume and term discounts by concentrating on marketing to end users and by challenging these discounts at the FCC. See "Business—Competition."

The increased loss in the fourth quarter of 1992 resulted primarily from costs incurred in developing MFS Datanet's high-speed data communications services and MFS Intelenet's integrated single-source telecommunications services. Early 1993 quarterly results will be negatively impacted by the continued development of the high-speed data communications and integrated single-source telecommunications services, the initial start-up of the Atlanta and northern New Jersey networks and the expansion activities.

Liquidity and Capital Resources

At December 31, 1992, the Company had total assets of $363.3 million. The Company's current assets of $81.1 million, including cash and marketable securities aggregating $58.8 million, exceeded current liabilities of $38.0 million, providing working capital of $43.1 million. Network and equipment, net of depreciation, comprise $206.7 million of total assets. Intangible assets totalling $75.5 million were recorded primarily as a result of the acquisition of MFS Chicago in 1990, of MFS/ICC in 1991 and of the remaining 20% of MFS Telecom's common stock from minority stockholders for $27.0 million in 1992. As a result of the acquisition of the balance of the MFS Telecom common stock, MFS Telecom has become a wholly owned subsidiary of the Company.

The Company's total assets have increased from $5.0 million at the end of 1988 to $363.3 million at December 31, 1992. This growth has been funded to date by capital contributions from KDG. The Company's growth has required significant capital investments. The Company made capital expenditures on new networks and equipment and network acquisitions of $92.4 million in 1991 and $83.2 million in 1992. The Company intends to continue expansion of its existing markets and development into new metropolitan areas. The Company is continually engaged in evaluating and discussing with third parties possible expansion opportunities through acquisitions of existing networks. However, the Company has no agreement, agreement in principle, understanding or arrangement with any person to acquire or to effect any material acquisition. See "Business—Telecommunication Services—Business Growth and Expansion." The Company is currently engaged in the development of the MFS Datanet and MFS Intelenet businesses and the expansion of several of its existing networks.

The Company requires capital, part of which will be provided by the sale of the Shares, to fund the future building, expansion or acquisition of networks and the development of new services. The Company has currently approved network expansions and budgeted ongoing capital expenditures in excess of $100 million for 1993. The Company also expects during the course of 1993 to approve additional network expansions and expenditures for new service offerings, which would require significant further capital expenditures.

While the Company expects expansion and development of its business to continue, if management concludes the Company's goals could be better achieved by reducing its expansion and development activities, significantly less capital would be required. The Company had less than $0.2 million of total debt at December 31, 1992. The Company is negotiating a revolving credit facility in the amount of $75.0 million to serve as a potential source of liquidity to fund future cash requirements. The Company believes that the $58.8 million in cash and marketable securities, the KDG contribution of $30.0 million in the first quarter of 1993, the proceeds of the sale of the Shares from the Offering, internally generated cash flow and the proposed credit facility will be sufficient to meet cash requirements of the Company for at least the next twelve months.

From time to time, the Company has had discussions with other communications entities concerning the establishment of possible strategic relationships, including transactions involving substantial acquisitions, combinations and equity investments in the Company or one of its subsidiaries. While the Company presently has no such plans or proposals, it will consider appropriate opportunities to establish strategic relationships.

As of January 1, 1993, the Company and PKS entered into a tax sharing agreement (the "Tax Sharing Agreement"), pursuant to which the Company will continue to be included in PKS's consolidated income tax returns as long as PKS owns 80% or more of the Company, as defined by the Internal Revenue Service. The Company will pay amounts equal to the income taxes that the Company would have to pay if it were to file its own income tax returns. The Company will recognize tax benefits on losses incurred as if it filed its own tax returns as long as the Company is included in PKS's tax returns, except that the Company will not be entitled to carry forward losses from taxable periods ending prior to January 1, 1993. As a result of the Tax Sharing Agreement, the Company recognized a deferred tax liability of $12.6 million in 1992.

Effects of Newly Issued Accounting Standards

The Company adopted SFAS 109, "Accounting for Income Taxes," in 1992. SFAS 109 requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the Company's financial statements or income tax returns. Under this method, deferred tax liabilities and assets are determined, based, in part, on income tax rates in effect for the year in which financial statement and tax basis differences are expected to reverse. If income tax rates are increased, as currently being considered by Congress and the current administration, the Company may be required to record additional income tax expense to reflect its increased deferred tax liability.

Effects of Inflation

Within the Company's relatively short operating history, inflation has not had a significant impact on Company operations. However, there can be no assurance that inflation will not have a material impact on the Company's operations in the future.

BUSINESS

Introduction

The Company is the largest provider of local competitive access telecommunications services in the United States. As an integrated telecommunications company, the Company provides a wide range of high quality voice, data and other enhanced services and systems specifically designed to meet the requirements of communications-intensive business and government end users. The Company was established in 1987 to take advantage of the rapidly growing advanced telecommunications market which emerged as a result of ongoing technological, competitive and regulatory changes. The Company's strategy is to become the primary provider of telecommunications services to business and government end users nationwide by combining service, which is more flexible and responsive than service offered by other providers, with the ability to meet specialized communications needs. The Company's telecommunications services are provided primarily over the Company's digital fiber optic networks which employ advanced, fault tolerant electronics and dual path architectures to ensure reliable and secure telecommunications. The Company has an active program to expand its fourteen existing metropolitan area networks and to develop new networks in other metropolitan areas throughout the United States.

The Company believes it is well positioned to continue its development as a leading nationwide business communications provider due to its existing fiber optic networks and its extensive experience in designing, deploying and operating advanced telecommunications networks for business and government end users. The Company, through MFS Telecom, serves fourteen metropolitan areas across the United States: New York City, Los Angeles, Chicago, San Francisco, Philadelphia, Boston, Washington, D.C., Dallas, Houston, Minneapolis, Baltimore, Pittsburgh, Atlanta and northern New Jersey. At the end of 1992, the Company provided service to over 600 communications-intensive users, including many of the nation's largest corporations and government agencies. At the end of 1992, the Company's networks covered approximately 850 route miles and included approximately 38,500 miles of optical fiber. For the quarter ended December 31, 1992, the Company's twelve metropolitan area networks which operated for the full year each generated positive earnings before interest, income taxes, depreciation and amortization (EBITDA), before corporate allocations.

The Company's networks are designed to support a wide range of enhanced communications services, provide increased network reliability and, in many cases, reduce end user costs. The Company believes that the direct connection to end user customers provided by its networks establishes a platform that can be used to offer additional enhanced voice, data and video services. Because its fiber optic cables have substantial additional capacity, the Company can use its existing networks to provide telecommunications services, in addition to special access and private line services, at only incremental facilities costs. By continuing to expand its services, the Company seeks to become the primary provider of telecommunications services to its customers. New customers typically begin by purchasing a small portion of their telecommunications needs from the Company, as an alternative or backup to the LEC. Over time, the Company believes it has consistently increased its share of its customers' total telecommunications purchases as a result of the reliability and quality of the Company's networks, prompt customer service, competitive pricing and new service offerings. The Company is continuously evaluating network expansion opportunities and the offering of additional enhanced communications services.

In 1992, the Company developed two new service offerings which benefit from the substantial capacity of the Company's existing fiber optic networks. Through MFS Datanet, the Company offers high-speed data communications services, including an innovative service designed to connect geographically separate LANs at the same native speed and protocol at which each LAN operates. Using emerging technologies, including asynchronous transfer mode (ATM), the data communications service provided by the Company converts data to a different format, transmits it between locations and reconverts it at the receiving end. The Company believes that data traffic will become an increasing portion of overall telecommunications traffic and that it is among the first entities to offer a complete end-to-end interstate data transmission service at native LAN speeds and protocols. The Company provides its data transmission services either over its own networks or over circuits purchased or leased from others. Beginning in the third quarter of 1993, the Company intends to offer high-speed data communications services among all metropolitan areas in which the Company currently has networks.

The Company developed its MFS Intelenet services in response to the demand by small and medium sized businesses for single source telecommunications services. As a result of the divestiture by American Telephone and Telegraph Company ("AT&T") of its local telephone system in 1984 (the "Divestiture"), increased competition has brought a large number of new entrants to the telecommunications services market, presenting customers with numerous new choices in services. Unlike larger businesses, small and medium sized businesses typically cannot afford to employ a dedicated staff to make telecommunications decisions. To assist such businesses, the Company intends to provide a single source for telecommunications services, with quality and pricing levels comparable to those achieved by larger communications users. The Company expects to begin providing this comprehensive telephone service over its New York City network in the third quarter of 1993. The Company believes that currently there is no provider of such comprehensive services utilizing its own local networks.

To date, the Company generally has been limited to providing special access services (high capacity circuits used to connect customer locations with long distance carriers) and private line services (high capacity circuits used to connect two or more customer locations) to corporations and to government agencies located on-net (i.e., physically located on the Company's networks). As a result of the Interconnection Decisions, the Company believes it will be able to offer interstate special access services to virtually every business and government end user in the metropolitan areas which the Company elects to serve that are off-net (i.e., not physically located on the Company's networks). The Interconnection Decisions allow the Company to interconnect with and utilize networks owned by the BOCs and other large LECs. The Company expects that the Interconnection Decisions and future state and federal pro-competitive regulatory rulings, together with increasing customer demand, will create more opportunities to introduce new services, expand the Company's networks and address a larger customer base. See "—Government Regulation."

The Company, through MFS Network Technologies, designs, engineers, develops and manages the installation of the Company's fiber optic networks and network expansions. As a result, the Company believes that its networks are of higher quality and are completed more quickly and at lower cost than would be possible using outside sources. The Company also offers its network systems integration services and, in certain cases, turn-key facilities management to third parties, providing independent single source solutions to complex multi-discipline communications needs. The Company's network systems integration projects include remote interactive learning facilities, security systems and combined cable television-telephone networks. The Company is also actively developing communications components for intelligent vehicle highway systems in a venture with Texas Instruments, Incorporated. See "—Network Systems Integration and Facilities Management Services."

The Company operates through its subsidiaries in two business segments: telecommunications services, through MFS Telecom, MFS Intelenet and MFS Datanet, and network systems integration and facilities management services, through MFS Network Technologies. For certain segment information, see Note 14 to the Consolidated Financial Statements.

Industry History

AT&T, sometimes referred to as the Bell System prior to the Divestiture, largely monopolized telephone service in the United States until technological developments began to make it economically possible for companies (primarily entrepreneurial enterprises) to compete for segments of the telephone business. In most cases, the Bell System reacted by refusing to allow new competitive equipment or service providers to interconnect with its network. However, government intervention has increasingly required the Bell System and its successors to allow these new market entrants to access and utilize their networks to provide competing services. See "—Government Regulation."

The present structure of the telecommunications market resulted largely from the Divestiture. As part of the Divestiture, seven local exchange holding companies were created to offer services in geographically defined areas called local access transport areas ("LATAs"). These regional Bell operating companies were separated from the long distance provider, AT&T, resulting in the creation of two distinct market segments: local exchange and long distance. The Divestiture provided for direct, open competition in the long distance segment. As of the end of the third quarter of 1992, approximately 38 percent of the nation's long distance market had been captured by AT&T's competitors.

Competition in the local exchange market was not provided for by the Divestiture. Several factors served to promote competition in the local exchange market, including (i) customer desire for an alternative to the LEC monopoly, which desire grew rapidly and was spurred in part by the development of competitive activities in the long distance market; (ii) technological advances in the transmission of data and video requiring greater capacity and reliability levels than copper-based LEC networks were able to accommodate; (iii) a monopoly position and rate of return-based pricing structure which provided little incentive for the LECs to upgrade their networks; (iv) the development of fiber optics and digital electronic technology, which combined the ability to economically build a network with the ability to transmit data and video at high speeds and greatly increased capacity; and (v) the significant fees, called "access charges," long distance carriers were required to pay to the LECs to access the LEC networks.

The first competitors in the local exchange market, designated as "competitive access providers" or "CAPs" by the FCC, were established in the mid-1980's. In New York City, Chicago and Washington, D.C., newly formed companies (the latter two were subsequently acquired and expanded by the Company) provided non-switched services known as special access and private line by installing fiber optic facilities connecting long distance carriers' points of presence ("POPs") within a metropolitan area and, in some cases, connecting end users (primarily large businesses and government agencies) with long distance carriers. CAPs used the substantial capacity and economies of scale inherent in fiber optic cable to offer customers service that was generally less expensive and of higher quality than could be obtained from the LECs due in part to the LECs' more antiquated copper-based facilities. In addition, CAPs offered shorter installation and repair intervals and improved reliability in comparison to the LECs.

Signal transmissions carried over digital fiber optic networks are superior in many respects to older analog transmissions carried over copper wire and by microwave, which continue to be used in varying amounts by the LECs. Fiber optic digital telecommunications systems generally offer faster and more accurate transmissions for all data and voice communications than analog telecommunications systems or digital transmission systems using copper wire. Fiber optic networks also generally require less maintenance than copper wire or microwave facilities of comparable transmission capacity, thereby decreasing operating costs. Electronic and optical equipment transmits and receives the flow of information over the fiber optic cables. These devices, and not the fiber itself, determine the quantity of information that can be transmitted over the fiber (i.e., the bandwidth). Thus, to provide higher bandwidth service requires a change in electronics, not in the fiber optic cables. As a result of technological advances in these devices, the utilization of the fiber and thus of the CAPs' networks has increased, and the amount of capital required to provide incremental bandwidth has decreased. In addition, fiber optic cable, unlike traditional copper wire or microwave, is immune from electromagnetic and radio interference and is much less susceptible to adverse weather conditions.

Most of the early CAPs were entrepreneurial enterprises which operated limited networks in the central business districts of major cities in the United States where the highest concentration of voice and data traffic, including long distance carrier to long distance carrier traffic, is found. Initially, CAPs offered three varieties of special access and private line services:

- Long distance carrier to long distance carrier connections (special access), which use high capacity lines to transmit traffic between facilities of a long distance carrier or to transmit traffic from one long distance carrier to another long distance carrier;
- End user to long distance carrier connections (special access), which generally use medium to high capacity lines to connect businesses to long distance carriers; and
- End user to end user connections (private line), which generally use low to medium capacity lines by businesses to connect that end user's local offices.

As a result of significant ongoing access charges paid by the long distance carriers to the LECs, early CAP revenues were predominantly derived by connecting long distance carrier POPs. While long distance carriers have high volume requirements and have utilized CAPs as alternative access providers, they are more price sensitive and change service providers more readily than do end users. Unlike most other CAPs, the Company's network deployment strategy is to connect end user customers and long distance carriers' POPs at the initial stage. By connecting end user customers at the early stages of a network, the Company believes that it develops a strong end user customer base and, therefore, can sell additional services to this same customer base at low incremental facilities costs. Publicly available data and an industry report indicate that high capacity carrier-to-carrier sales still constitute a majority of the revenues of other CAPs.

As CAPs proliferated during the latter part of the 1980's, regulators in some states and at the federal level issued rulings which favored competition and promised to open markets to new entrants. These rulings allowed CAPs to offer a number of new services, including, in certain states, a broad range of local exchange services. An industry report indicates that approximately 45 companies have been organized to provide CAP services, primarily in single markets. The Company is the larger of the two companies that have evolved as industry leaders serving multiple markets.

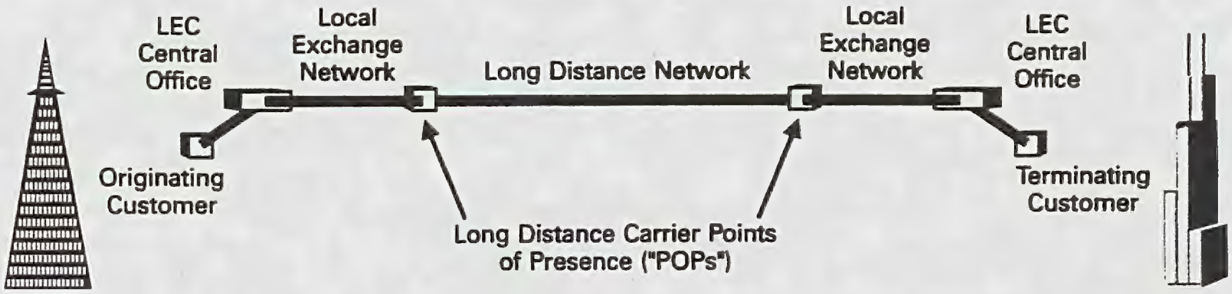
The Company expects the trend toward increased competition and deregulation of the telecommunications industry to continue. As competition in the local exchange market proceeds, the Company believes that a fundamental division between the needs of business and residential communications users will drive the creation of differentiated telecommunications services and service providers. The Company believes that communications-intensive business and government users have distinct telecommunications service requirements, including maximum reliability, consistent high quality transmissions, capacity for high-speed data transmission, responsive customer service and continuous attention to service enhancement and new service development. The Company believes that it maintains significant advantages over its competitors as a result of the Company's (i) focus on business and government end users; (ii) expertise in developing highly reliable, advanced digital fiber optic networks which offer substantial additional transmission capacity; (iii) centralized, real-time network monitoring and control provided by the Company's advanced network operations control center (the "NOCC") located in Oakbrook Terrace, Illinois; (iv) emphasis on providing comprehensive and responsive customer service; (v) economic benefits as a national, multi-service operator and (vi) ongoing development of new services, which improve, enhance or reduce the cost of communications services for business and government end users.

Telecommunications Services Market

Overview. The traditional national market for telecommunications services can be divided into two basic groups: local exchange services and long distance services. In 1991, local exchange services accounted for revenues of $86.5 billion and long distance services generated revenues of $55.3 billion. Revenues for both local exchange and long distance services include revenues received for local access charges.

Long Distance Services. A long distance telephone call can be envisioned as consisting of three segments. Starting with the originating customer, the call travels along a local exchange network to a long distance carrier's POP. At the POP, the call is combined with other calls and sent along a long distance network to a POP on the terminating customer's local network. The call is then sent from this POP along a local network to the terminating customer. Long distance carriers provide only the connection between the two local networks, and pay access charges to LECs for originating and terminating calls.

The following diagram illustrates the typical long distance call:



The long distance markets for telephone services in the United States produced approximately $55.3 billion in revenues in 1991. The long distance service market has experienced increased competition since the late 1970's, and new entrants have obtained a combined market share of approximately 38 percent. MCI Communications Corporation ("MCI"), the first and largest competitor to AT&T, has a market share of approximately 15 percent. Since the Divestiture and the advent of competition, service levels have improved, product offerings have increased and long distance service prices have generally been reduced, all of which have resulted in increased consumer demand and significant market growth. During the period 1984 through 1991, the long distance market has grown from approximately $39.0 billion to approximately $55.3 billion, outpacing growth rates achieved for local exchange services over the same period. While the Company is not a provider of long distance services, certain services provided by MFS Datanet and MFS Intelenet may involve long distance service.

Local Exchange Services. A local call is one that does not require the services of a long distance carrier. In general, the local exchange carrier connects end user customers within a LATA and also provides the local portion of most long distance calls.

The local exchange markets for telephone services in the United States produced approximately $86.5 billion in revenues in 1991. Local exchange carriers generate revenue from end user customers and from long distance carriers, which must pay access charges for the use of local networks. Before the entrance of CAPs, local exchange markets operated with virtually no competition.

The markets for local exchange services consist of a number of distinct service components. These service components are defined by specific regulatory tariff classifications including: (i) *local network services,* which generally include basic dial tone charges and private line services; (ii) *network access services,* which consist of access charges received by local exchange carriers from long distance carriers for the local portion of long distance telephone calls; and (iii) *long distance network services,* which include the variable portion of charges received by local exchange carriers for intraLATA long distance calls. Set forth below is a chart describing the components of these tariff classifications, revenues derived in 1991 and the nature of the services provided.

Local Exchange Market

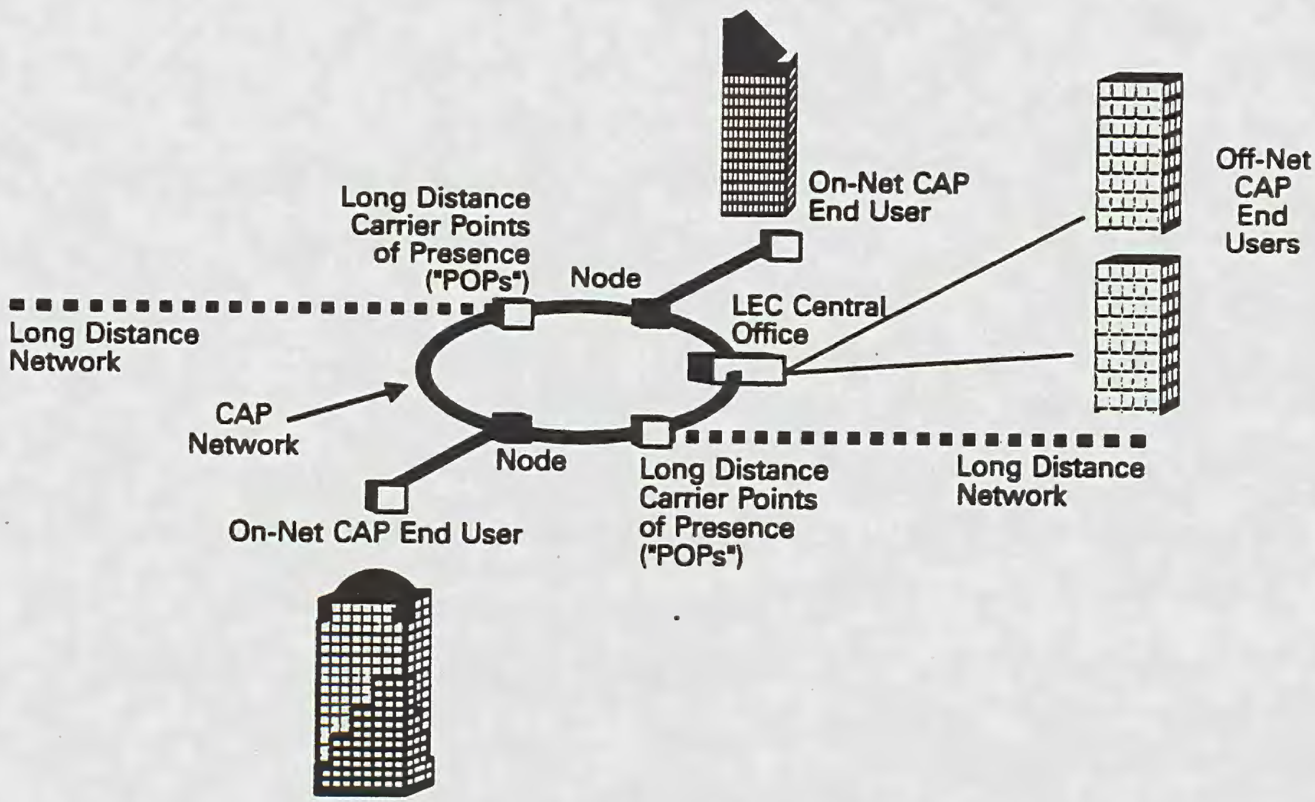
Tariff Classification	1991 Revenues* (in billions)	
Local Network Services		
Private Line Services	$ 1.0	Dedicated point-to-point connection (Intrastate, IntraLATA)
Basic Local Service	27.6	Basic dial tone and local calling services (Intrastate, IntraLATA, switched)
Other Services	9.5	Public pay phone, customer premises equipment, special calling features
Subtotal	38.1	
Network Access Services		
Special Access Services	2.5	Dedicated point-to-point connection for long distance carriers (Interstate, InterLATA)
State Access Services	6.4	Long distance access (Intrastate, IntraLATA, InterLATA, switched and dedicated)
Switched Access Service	11.0	Long distance access (Interstate, InterLATA)
End User Services	5.9	Federal subscriber line charges for basic dial tone service (Interstate, InterLATA, switched)
Subtotal	25.8	
Long Distance Network Services	13.3	Long distance (variable) message charges (Intrastate, IntraLATA)
Other	9.3	Varied
Total	$86.5	

* The market data contained in this chart have been derived from the Preliminary Statistics of Communications Common Carriers released by the FCC on September 10, 1992. The local exchange market includes voice and data services provided by all FCC reporting local exchange carriers.

Prior to the Interconnection Decisions, CAPs could compete effectively only for special access and private line services to customers in buildings physically connected (i.e., on-net) to separate, privately owned CAP networks. As a result, while the market for special access and private line services (excluding intrastate special access, which is included in "State Access Services" on the previous chart) totalled approximately $3.5 billion nationwide in 1991, an industry report has estimated that the areas physically reached by CAPs in 1991 was limited to approximately $500 million.

The Interconnection Decisions permit CAPs to interconnect their networks with the LEC networks. Interconnection enables CAPs to increase significantly the number of customers and markets served without physically expanding the CAPs' networks, because CAPs now have the option to access customers by either leasing facilities from a LEC or installing network extensions, depending on the relative cost. As a result, the Company believes it will be able to offer interstate special access services to virtually every business and government user in the metropolitan areas which the Company elects to serve.

The following diagram illustrates a CAP local network:



In response to a Company initiative, the FCC has also proposed to allow competition in the interstate switched access market. The switched access market consists of charges paid by long distance carriers to the LECs for the origination or completion of interstate switched long distance calls on local exchange networks. If approved, these proposals will encourage the development of competitive interstate switched access markets that would permit CAPs to provide the transport function of switched access services. In its Interconnection Decisions, the FCC estimated that approximately $4.2 billion of the total $11.0 billion annual interstate switched access market in 1991 was attributable to the switched transport category of this market.

In addition to the FCC's rulings and proposals, several states, including New York, Illinois and Michigan, have encouraged increased competition in various aspects of the intrastate local exchange market. The intrastate local exchange market consists of intrastate access services and basic local exchange services. Intrastate access services consist of charges paid to permit origination and termination of intrastate long distance calls on the local exchange network. In 1991, intrastate access services accounted for $6.4 billion in revenues nationwide. The majority of state initiatives have thus far been limited to intrastate private line and special access services.

The interstate and intrastate special access and private line services that have been opened to competition and the transport function of switched access services that is proposed to be opened, consist principally of services provided to business and government users. The remaining local exchange services that generally have not been opened to competition (except in certain states) include, among other services, basic local services and end user services. The provision of basic local service to business and government customers by CAPs will, in general, require certain significant regulatory changes. In the largest single market, New York City, however, CAPs have been authorized to provide essentially all of the local exchange telecommunications services. As a result, the Company has recently announced its intention to provide, through MFS Intelenet, a facilities-based single source for telecommunications services to small and medium sized businesses in New York City, utilizing the Company's existing network. In addition, in Chicago, the Company is currently allowed to offer services similar to those it may provide in New York, utilizing a combination of the Company's network and the resale of LEC services. MFS Intelenet will consider offering its services in other metropolitan areas as regulatory and market developments allow.

The Company believes that the current trend toward enhanced competition both at the federal and state levels will continue to open to competition an increasing portion of the $86.5 billion local exchange market and may stimulate growth in this market. The Company intends to pursue selected opportunities to provide services to business and government customers that may result from these continued regulatory changes.

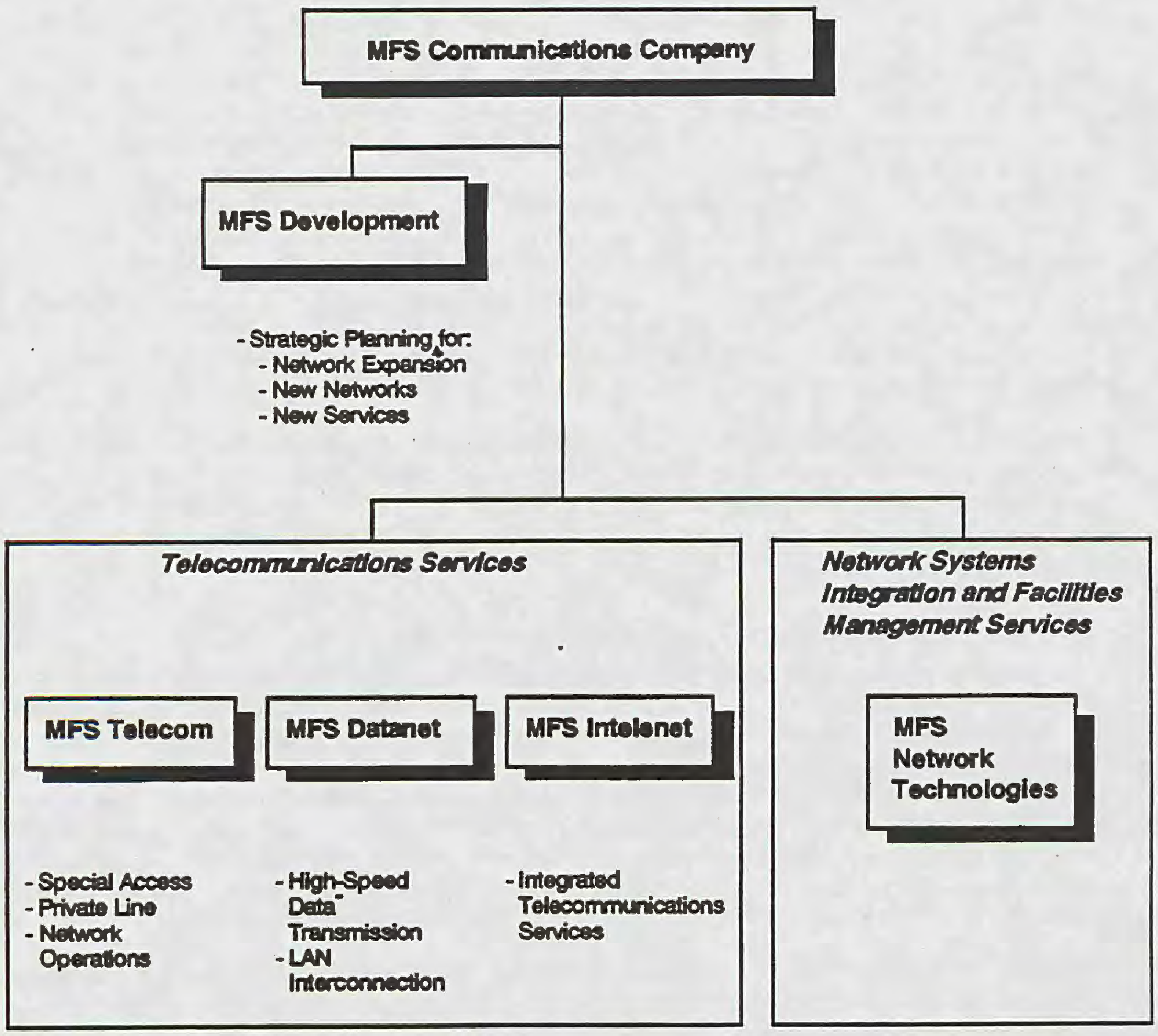
Network Systems Integration and Facilities Management Services Market

The network systems integration market consists of the design, engineering, development and installation of communications networks and systems for a wide variety of end users, including telecommunications companies and other business and government users. The facilities management market consists of management, operations, maintenance and staffing of communications networks and systems. The network systems integration and facilities management market is an early stage, rapidly growing market due to technological developments, primarily fiber optics and electronics, which allow for more efficient transmission of data, voice and video traffic. While the Company believes that network systems integration and facilities management provide significant opportunities, the Company is unable to estimate with any degree of certainty the size of the potential market.

At March 1, 1993, in addition to its contract backlog, the Company had submitted proposals for possible network systems integration and facilities management projects that had an estimated total value of approximately $487 million. There can be no assurance that the Company will be successful with respect to any proposal that it submits. In addition, there can be no assurance that once a proposal is accepted that a definitive agreement will be reached between the Company and the sponsor of the project. Many of the proposals considered by the Company are subject to the availability and receipt of government funding. There can be no assurance that such funding will be available to the sponsors of the projects. There also can be no assurance that projects such as the projects that the Company is currently evaluating will be available in the future.

The Company

The Company operates in two business segments: telecommunications services and network systems integration and facilities management services. The Company is organized as a holding company and conducts operations through four independent operating subsidiaries: MFS Telecom, MFS Intelenet, MFS Datanet and MFS Network Technologies. The Company believes that this structure assures the highest possible focus on customer service and profitability and serves to create an entrepreneurial atmosphere for the employees at each of the operating subsidiaries. The organizational structure of the Company is as follows:



Telecommunications Services

The Company's strategy is to become the primary provider of telecommunications services to business and government end users nationwide by combining service, which is more flexible and responsive than service offered by other providers, with the ability to meet specialized communications needs. The Company provides communications-intensive users with a high quality, cost-effective alternative to the LEC. Currently, the Company provides special access and private line services through its MFS Telecom subsidiary and LAN interconnection services and other data communications services through its MFS Datanet subsidiary. Another subsidiary, MFS Intelenet, is expected to provide a single source for telecommunications services to small and medium sized businesses in certain markets during 1993. The Company believes that the direct connection to end user customers provided by its networks establishes a platform that can be used to offer additional enhanced voice, data and video services. The Company's principal services are currently offered primarily over its digital fiber optic telecommunications networks.

The Networks

The Company has networks in fourteen major metropolitan areas: New York City, Los Angeles, Chicago, San Francisco, Philadelphia, Boston, Washington, D.C., Dallas, Houston, Minneapolis, Baltimore, Pittsburgh, Atlanta and northern New Jersey.

Significant features of the networks include:

- Backbones which are 100 percent fiber optic and digitally based, allowing for high-speed, quality transmission of voice, data and video telecommunications;
- Route diversity for disaster protection by generally using two geographically separate paths for telecommunications traffic between any points on the network backbone;
- Back-up electronics for high-speed circuits which become operational in the event of failure of the primary components;
- Network reliability with availability exceeding 99.99 percent;
- Transmission accuracy with typical bit error rates below 10^{-12}; and
- Twenty four-hour monitoring by the NOCC.

The NOCC provides the Company a single nationwide point of contact for network monitoring, troubleshooting and dispatching. The NOCC provides a wide range of network surveillance functions for each transmission circuit. System alarms are usually detected within seconds, and equipment problems occurring anywhere on the network can be tested from the NOCC. The Company believes that the NOCC surveillance equipment is sufficiently precise that circuit troubles on the network backbone are often detected by its technicians, diagnosed and reported to the customer before the customer has even noticed a problem.

The Company's networks are constructed to access cost-effectively areas of significant end user telecommunications traffic, as well as most long distance carriers. The construction period of a new network varies depending upon the scope of the activities, such as the number of backbone route miles to be installed, the initial number of buildings targeted for connection to the network backbone and the general deployment of the network backbone. Construction is planned to allow revenue generating operations to commence prior to the completion of the entire network backbone. After installing the network backbone, extensions to additional buildings and expansions to other areas of a metropolitan area are evaluated, based on detailed assessments of market potential. The Company is currently expanding its existing networks in Los Angeles, Chicago, Philadelphia, Boston, Washington, D.C., Dallas, Houston and Baltimore and evaluating further expansion of other existing networks and the development of new metropolitan area networks. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The Company's networks consist of fiber optic cables which typically contain between 12 and 144 fiber strands, each of which is capable of providing many telecommunications lines or "circuits." A single pair of glass fibers on the Company's networks can currently transmit 32,256 simultaneous voice conversations, whereas a typical pair of copper wires (commonly used by LECs) can currently carry a maximum of 24 digitized simultaneous voice conversations. The Company expects that continuing developments in compression technology and multiplexing equipment will increase the capacity of each fiber, thereby providing more capacity at relatively low incremental cost.

Office buildings are connected by network backbone extensions to one of a number of physical rings of fiber optic cable, which originate and terminate at the Company's central node. Signals are sent through a network backbone to the central node simultaneously on both primary and alternate protection paths. Most buildings served have a discrete Company presence (referred to as a "remote hub") located in the building. Within each building, Company-owned internal wiring connects the remote hub to the customer premises. Customer equipment is connected to Company-provided electronic equipment generally located in the remote hub where customer transmissions are digitized, combined and converted to an optical signal. The traffic is then transmitted through the network backbone to the Company's central node where originating traffic can be reconfigured for routing to its ultimate destination on the network.

The Company locates its remote hub electronic equipment either in a room leased from the building owner or on a customer's premises. Leasing space from a building owner enables the Company to share electronic equipment among multiple customers, causes little disruption for customers during installation and maintenance and allows the Company to introduce new services rapidly and at low incremental cost. For these reasons, the Company believes that leasing or otherwise controlling equipment rooms in buildings served is desirable and has therefore chosen, where possible, to conclude such arrangements. When the Company is unable to lease space from the building owner, the Company generally utilizes space provided by the customer at no cost to the Company.

The Company's network backbones are installed in conduits owned by the Company or leased from third parties. The Company leases conduit or pole space from entities such as utilities, railroads, long distance carriers, state highway authorities, local governments and transit authorities. These arrangements are generally for multi-year terms with renewal options and are nonexclusive. Where economically feasible, the Company purchases or installs its own conduits. Approximately 40 percent of the Company's route miles of cable are contained in conduit that the Company has installed or purchased.

Cancellation of any of the Company's material right-of-way agreements could have an adverse effect on the Company's business in that metropolitan area and could have a material adverse effect on the Company. The Company believes that such a cancellation is unlikely and, in the event of a cancellation, that the Company would have sufficient notice to arrange for alternatives to the routes in question.

Services

The Company provides business and government customers with a variety of advanced telecommunications services. The Company's services utilize existing technologies and are provided primarily over the Company's fiber optic networks. The Company intends to increase its service offerings in response to customer demand and as regulatory developments permit.

Special Access and Private Line Services. The Company's special access and private line telecommunications services, which consist of both primary circuits and back-up protection, can be grouped into three general categories:

- Special access circuits connecting business and government end users to long distance carriers;

- Special access circuits connecting long distance carrier facilities; and
- Private line circuits between end user facilities.

The Company's customers typically contract for special access and private line services at a variety of standardized transmission speeds over dedicated circuits. The standard circuit capacity classifications include DS-0, DS-1 and DS-3 service. Each of these transmission services can be provided using the same type of fiber optic cable, but offers different bandwidth (capacity), depending on the individual needs of the customers. The greater the bandwidth, the greater the amount of information which can be transmitted through the network. Through multiplexing, the Company can provide a wide range of transmission capacities.

The lowest capacity telephony circuit generally offered by the Company is a voice grade line. This analog signal is digitized in accordance with industry standards to a 64 kilobit per second format termed a "DS-0." By combining 24 DS-0s, the signal can be multiplexed to the DS-1 level, which has a capacity of 1.544 megabits (million bits) per second. DS-1 service is generally used for higher capacity voice and data applications by medium to large companies. Twenty-eight DS-1 signals are, in turn, combined to form one DS-3 signal, which has a capacity of 45 megabits per second. DS-3 service permits aggregation of 672 DS-0s and is used for very high capacity applications, primarily for communications-intensive users and long distance carriers.

In certain states, the Company is permitted to offer intrastate special access services through interconnection with the LEC central office facilities. This interconnection enables the Company to offer services to companies off-net through the use of both Company and LEC facilities. By providing services involving interconnection with the LEC central office, the Company can also manage customers' on-net and off-net special access and private line services, allowing customers a single point of contact and billing for all their dedicated access needs. The Company believes that its ability to offer these interconnection services to businesses not physically located on its networks will be materially enhanced when the Interconnection Decisions are implemented. The Interconnection Decisions will allow the Company to resell the LEC circuit for that portion of the transmission not physically located on the Company's networks. To the extent that the LEC transports telecommunications traffic from the end user to the LEC central office, such traffic may be subject to the shortcomings, if any, in the LEC's network (e.g., the lack of route diversity or redundant electronics in the LEC's network). See "—Government Regulation."

Data Transmission Services. The Company formed MFS Datanet in 1992 to offer high-speed data communications services to business and government users. The Company believes that data traffic will become an increasing portion of overall telecommunications traffic and that it is among the first entities to offer complete end-to-end interstate data transmission services, which permit LAN connectivity at native LAN speeds and protocols. An industry report indicates that the number of LANs is increasing rapidly and that a significant number have out of building connections. MFS Datanet currently provides data transmission services within New York City, Los Angeles, Chicago, Boston, Washington, D.C., Houston, Minneapolis and Atlanta. MFS Datanet is in the process of linking its individual metropolitan area networks with leased long distance transmission capacity and currently provides customer service among New York City, Chicago, Boston and Washington, D.C. Beginning in the third quarter of 1993, MFS Datanet expects to offer high-speed data communications services among all metropolitan areas in which the Company currently has networks.

MFS Datanet's high-speed data communications services permit businesses to transport data between buildings, even if located in different metropolitan areas served by the Company, and between personal computers or workstations on such LANs. These services allow personal computers and workstations on one LAN to communicate with personal computers and workstations on another LAN at the same speed at which these LANs operate. The provision of LAN interconnection services in buildings where the Company offers special access and private line services provides capital and operating efficiencies because several subscribers within the same building can use the same fiber optic electronics. LAN interconnection services represent an additional means of obtaining revenues from the same fiber optic network used to provide special access and private line services to buildings physically connected to the network.

MFS Datanet services are offered at a variety of capacities to allow customers to choose the level which meets their needs. In addition to high-speed LAN interconnection, MFS Datanet offers data communications for mainframe computer channel extension, high-speed remote file backup, file transfer and a variety of other purposes.

It is anticipated that MFS Datanet's services and products will be utilized for applications such as:

- Customers in multiple locations can work together, sharing data and programs in real-time, despite being geographically separated;
- Multi-location businesses can enable communications between employees using the full power of LAN-based groupware;
- Customers in financial institutions and users of sophisticated management information systems can share data and programs in real-time;
- Customers in the medical field can make diagnostic evaluations in real-time from data such as CAT scans and X-rays generated by imaging equipment located in another location; and
- Customers can reduce staffing costs by handling all systems support and upgrade tasks from a single site.

Integrated Telecommunications Services. The Company recently formed MFS Intelenet to provide a single source for comprehensive telecommunications services to small and medium sized businesses that cannot typically afford to employ a dedicated staff, with quality and pricing levels comparable to those achieved by larger communications users. Since the Divestiture, organizations have been faced with an increasing variety of choices in telecommunications products, services and providers. While large organizations have generally responded by developing in-house staffs to manage these choices, the Company believes small and medium sized businesses may lack the resources to devote full time staff to this task.

MFS Intelenet plans to offer a package of basic communications services including:

- Intercom calling, utilizing MFS Intelenet supplied handsets. Such intercom calling will feature abbreviated (i.e., four digit) dialing, call forwarding, call waiting and conference calling. In cases where the customer wishes to retain its key or PBX systems, MFS Intelenet will offer access to any desired intercom calling features, as well as access to the complete range of other non-intercom MFS Intelenet services;
- Local calling services utilizing a combination of Company-owned fiber optic based facilities and facilities procured from the LEC;
- Long distance calling services using carriers selected by MFS Intelenet or its customers;
- Moving, adding and changing customer equipment and wiring accomplished by Company-provided technicians; and
- Maintaining customer-owned equipment.

The Company intends to offer this basic services package at a competitive price. In addition to the basic services package, MFS Intelenet intends to provide additional enhanced services at extra cost including:

- Voice mail, specialized call accounting to assist customers in their own billing requirements, 800 number services and travel and calling charge cards; and

- Consulting services provided in conjunction with MFS Network Technologies to assist customers in utilizing communications technologies such as automatic call distribution, caller ID, local/wide area networking and third party database access.

Currently, only New York enables non-LECs, including the Company, to provide all of the integrated telecommunications services proposed by MFS Intelenet. The Company plans to begin offering MFS Intelenet services to customers located on or near its fiber optic network in New York City in the third quarter of 1993. In addition, in Chicago, the Company is currently allowed to offer services similar to those it may provide in New York, utilizing a combination of the Company's network and the resale of LEC services. There can be no assurance that any other state will allow the Company to provide competitive local calling telephone services to the extent currently permitted by New York. MFS Intelenet will consider offering its services in other metropolitan areas as regulatory and market developments allow.

Business Growth and Expansion

As a result of the demand for an alternative to the LEC monopoly and recent procompetitive rulings, the Company believes that there currently exists a significant market opportunity for the Company to further develop its position as a leading provider of telecommunications services to business and government end users. The Company believes that it maintains significant advantages over its competitors as a result of the Company's (i) focus on business and government end users; (ii) expertise in developing highly reliable, advanced digital fiber optic networks which offer substantial additional transmission capacity; (iii) centralized, real-time network monitoring and control provided by the Company's NOCC; (iv) emphasis on providing comprehensive and responsive customer service; (v) economic benefits as a national, multi-service operator and (vi) ongoing development of new services, which improve, enhance or reduce the cost of communications services for business and government end users.

With the proceeds of the Offering, the Company intends to continue the expansion of its existing networks and services and to accelerate the deployment of new networks and services. The Company believes it can economically offer its current telecommunications services to a large number of markets not currently served by the Company, including both expansions of the Company's existing metropolitan area networks and the development of new metropolitan area networks. As the Company increases its service offerings (including the potential offering of MFS Intelenet services) and as regulatory developments permit, the Company believes that a significant number of additional markets will become economically attractive. Due to competitive advantages the Company believes it enjoys over other CAPs, the Company believes it is not precluded from markets already served by an existing CAP. Nonetheless, the Company believes that there are considerable advantages to being the first alternative provider of business and government telecommunications services to the LEC in any particular market.

The Company is currently expanding its existing metropolitan area networks in Los Angeles, Chicago, Philadelphia, Boston, Washington, D.C., Dallas, Houston and Baltimore and is evaluating further expansion of other existing networks. The Company has completed internal reviews of a significant number of additional metropolitan areas in the United States and expects to develop detailed plans for certain of such markets in the foreseeable future. In addition, the Company is evaluating the feasibility of installing a network in London, England to serve the needs of the city's financial services institutions.

The Company believes that its continued growth will depend, in part, upon its ability to continue to penetrate and gain access to the business and government end user market, to generate additional revenue from end users already connected to its networks, to expand its existing networks, to build networks in new markets and to benefit from continued favorable regulatory developments. The Company's efforts to both expand its networks and develop new services are provided by MFS Development, which performs detailed market studies, cost estimates, identification of rights-of-ways, permits, government authorizations, network design and, in concert with MFS Network Technologies, assesses new equipment technologies.

The Company is continuously evaluating network expansion opportunities and the offering of additional enhanced communications services for business and government end users. On March 1, 1993, the Company signed a letter of intent to acquire a company which operates a network in the Washington, D.C. metropolitan area contiguous to the Company's Washington, D.C. metropolitan area network. This company provides classified and unclassified communications services to the federal government and also provides certain systems integration services. The purchase price will be a maximum of $8.25 million, depending on the satisfaction of certain conditions, and will be paid either in cash or the Company's securities (which could include Common Stock). The closing of this acquisition is subject to the satisfaction of a number of conditions, including completion of due diligence and execution of a definitive purchase agreement.

Network Systems Integration and Facilities Management Services

Through MFS Network Technologies, the Company designs, develops and manages the installation of the Company's new fiber optic networks and network expansions. As a result of the buying power and experience provided by MFS Network Technologies, the Company believes that its networks are of higher quality and are completed more quickly and at a lower cost than would otherwise be the case. MFS Network Technologies has designed and managed the construction of all but one of the Company's networks.

MFS Network Technologies also provides services to third parties. The Company believes that the advantages of its buying power and experience enable the Company to offer these services at competitive rates. In addition, providing these services to third parties creates an additional source of revenue and profit for the Company.

Services provided by MFS Network Technologies include:

- Development activities consisting of site and route selection, rights-of-way identification and acquisition, licensing and other legal and regulatory assistance;
- Design and engineering including preliminary design, technology assessment and selection, preparation of detail drawings and specifications and procurement of engineered equipment and material;
- Project management involving project planning and scheduling, contractor selection, contract administration, quality assurance and control, testing of the installed system and start-up management; and
- Support services including operations and maintenance support, facilities management, engineering studies, financial analyses and/or other special support assistance.

MFS Network Technologies was engaged in a number of significant third party projects, including the design, engineering and installation of PBX and key telephone equipment, electronic security systems (such as intrusion detection, closed circuit television and electronic entry control systems), communications networks for rapid transit systems and microwave networks to monitor and control high voltage transmission lines. In addition, MFS Network Technologies has contracted with the State of Iowa to design, engineer, furnish and install over 2,500 route miles of optical fiber and associated electronics for a two-way interactive voice, data and video transmission network. The network will connect over 100 end points linking all counties in the state and will be used for remote interactive learning facilities and other voice, data and teleconferencing applications. The total estimated contract value is in excess of $90.0 million, of which $52.2 million had been recognized at December 31, 1992. MFS Network Technologies is also engaged in the implementation of combined cable television-telephone networks in Cambridge, England and Edinburgh, Scotland. The Cambridge franchise is part of Cambridge Cable, Ltd., a subsidiary of Comcast Cable and Singapore Telephone, and the Edinburgh franchise is part of the TeleWest Communications Group, a joint venture of Telecommunications Inc. and U S West, Inc.

MFS Network Technologies is also applying its network systems integration and facilities management capabilities to develop solutions for an emerging market generally referred to as intelligent vehicle highway systems ("IVHS"). IVHS systems consist of sensors and other communications systems imbedded in or adjacent to roadways which detect, monitor and communicate with suitably equipped vehicles at full highway speed. IVHS systems are expected to evolve to provide a number of other functions, including vehicle collision avoidance, incident detection and hazardous waste and other sensitive material tracking along with various advanced traveller information services.

On December 15, 1992, Texas Instruments, Incorporated and MFS Network Technologies announced the execution of an exclusive co-development agreement, pursuant to which MFS Network Technologies secured exclusive rights to the Texas Instruments Registration and Identification System ("TIRIS" ™), a radio frequency identification technology, for use in IVHS systems. The California Private Transportation Company, L.P. ("CPTC"), one of whose general partners is KDG, holds a franchise from the State of California Department of Transportation to study, finance, design, construct and operate a privately owned toll road on State Route 91 connecting Orange and Riverside Counties. CPTC selected MFS Network Technologies to provide various IVHS subsystems for the project. Work on the project will commence once financing is obtained by CPTC.

Backlog. The network systems integration and facilities management services segment had third party backlog of $74 million at December 31, 1992. A substantial portion of the backlog is related to federal, state or local government contracts. Although some of these contracts are subject to cancellation and/or to a revision of funding, the Company believes that it is adequately protected for all incurred costs and the reasonable costs of termination. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Customers and Marketing

Telecommunications Services. The Company's marketing activities are directed toward business and government users. Sales and marketing activities are conducted by direct sales and marketing forces in each metropolitan area and by national account managers. In addition, the Company markets its services through advertisements, trade journals, media relations, direct mail and participation in trade conferences. The Company's customers include financial services companies, governmental departments and agencies and academic, scientific and other major institutions, each of which has a significant volume of traffic and/or requirements for extremely reliable telecommunications, as well as the long distance carriers. At the end of 1992, the Company provided service to over 600 customers, including many of the nation's largest corporations.

The Company's customers typically sign a twelve-month service agreement which is usually converted into a month-to-month agreement at the end of the term. Certain customers have entered into longer term agreements. Customer billings are divided into recurring and non-recurring charges (including one time installation charges).

During 1992, the top ten customers for the telecommunications services segment accounted for approximately 55% of its total recurring revenue. Although a significant portion of total monthly recurring revenues is derived from long distance carriers, a considerable percent of these long distance carrier revenues is derived from end users that have specified a Company application. Long distance carrier POP to POP revenues are currently less than 25% of telecommunications services revenues. The Company believes that the loss of a long distance carrier as a customer would not necessarily result in the loss of all of the revenues associated with such long distance carrier. However, the loss of one or more of the top ten customers could have a material adverse effect on this segment of the Company.

Network Systems Integration and Facilities Management Services. MFS Network Technologies' third party customers include major local and long distance carriers, cable television operators, agencies of the federal government, state governments and large corporations. During 1992, the State of Iowa accounted for 42% of the Company's consolidated revenues. The Company's network systems integration and facilities management revenues are and will continue to be dependent upon a small number of large projects. Accordingly, these revenues are likely to vary significantly from period to period.

Competition

Telecommunications Services. To date, the Company has generally been limited to providing special access and private line services to corporations and to a variety of government agencies. In each of its markets, the Company faces significant competition for the special access and private line telecommunications services it offers from the LECs, which currently dominate their local telecommunications markets. The LECs have longstanding relationships with their customers and provide those customers with various transmission and switching services that the Company, in many cases, is not currently allowed by regulators to offer. The Company has sought and will continue to seek to achieve parity with the LECs in order to provide local telecommunications services, including access to equipment rooms, rights-of-way and comparable treatment with respect to the imposition of franchise fees. The Company continues to challenge, before federal and state regulators, many advantages which exist because of the LECs' historical status. There can be no assurance that the Company will succeed in these endeavors. See "—Government Regulation."

Existing competition for private line and special access services is based primarily on the quality and reliability of the network facilities, customer service, response to customer needs, service features and price, and is not based on any proprietary technology. As a result of the comparatively recent installation of its fiber optic networks, the Company's dual path architectures and the state-of-the-art technology used in its networks, the Company may, in some cases, have cost and service quality advantages over some currently available LEC networks. Moreover, because of its customer service orientation, the Company believes that it provides more attention and responsiveness to its customers than do its LEC competitors.

Although the LECs are generally subject to greater pricing and regulatory constraints than CAPs, LECs are achieving increasing pricing flexibility for their private line and special access services as a result of, among other things, the Interconnection Decisions. If the LECs lower rates, there would be downward pressure on certain special access rates CAPs charge, which pressure may adversely affect CAP profitability. However, the Company believes this effect will be more than offset by the increased revenues available as a result of access to off-net customers provided through interconnection. In addition, the Company believes that lower rates for special access will benefit other services offered, or planned to be offered, by the Company through MFS Datanet and MFS Intelenet, which utilize leased circuits to provide value-added services.

The Company also faces competition in most markets in which it operates from one or more CAPs operating fiber optic networks. The Company believes that Teleport Communications Group, Inc. offers certain services in eight of the fourteen metropolitan areas in which the Company currently offers CAP services. In addition to the LECs and the CAPs, potential competitors capable of offering private line and special access services include cable television companies, electric utilities, long distance carriers, microwave carriers, wireless telephone system operators and private networks built by large end users.

The Company does not believe that it currently competes directly with any cable television company, except through CAPs owned by cable television companies. These CAPs possess certain advantages over other CAPs in the provision of competitive access services resulting from certain rights in favor of the cable television companies to use third party rights-of-way and to obtain building access at advantageous costs, and possible cost advantages as a result of statutorily-prescribed limits on the amounts that electric utilities and LECs may charge cable companies for use of utility-owned poles and conduits. The Cable Act of 1984, as amended, generally prohibits cross-ownership of cable companies and telephone companies within the same local service territory. The FCC, however, has interpreted this provision to prohibit only such cross-ownership involving dominant providers of local exchange services possessing monopoly control over bottleneck facilities. This interpretation has been appealed to the United States Court of Appeals for the District of Columbia Circuit.

Although the Company believes that no single competitor currently offers high-speed interstate LAN interconnection services over its own local facilities, potential competitors for these services include stand-alone data transmission entities, as well as LECs, other CAPs, cable television companies and all of the other entities identified as potential competitors for the Company's private line and special access services.

MFS Intelenet will compete with the LECs, equipment vendors and installers, long distance providers and telecommunications management companies. Although no single competitor offers integrated telecommunications services over its own local facilities, each of these types of competitors currently provides some or all of the services MFS Intelenet plans to offer. Because of certain advantages relative to quality control, network maintenance and cost savings resulting from MFS Intelenet's plans to use the Company's existing fiber optic networks, MFS Intelenet believes that it may enjoy certain advantages with respect to certain of its competitors.

Many of the Company's competitors have financial, personnel and other resources significantly greater than those of the Company.

Network Systems Integration and Facilities Management Services. MFS Network Technologies' primary network systems integration and facilities management competitors are the BOCs, long distance carriers, equipment manufacturers and major independent telephone companies. In certain circumstances, MFS Network Technologies may compete with regional and local firms for small integration and installation projects. In the IVHS market, MFS Network Technologies believes it may compete with specific manufacturers and several of the aerospace defense contractors that have indicated an intention to shift to commercial markets.

Government Regulation

Overview. The Company's services are subject to varying degrees of federal, state and local regulation. The FCC exercises jurisdiction over all facilities of, and services offered by, telecommunications common carriers to the extent those facilities are used to provide, originate or terminate interstate or international communications. The state regulatory commissions retain jurisdiction over the same facilities and services to the extent they are used to originate or terminate intrastate communications. The Company believes that the vast majority of the Company's present telecommunications services are subject only to FCC jurisdiction.

The Company actively seeks to initiate regulatory reform at the federal and state levels to open additional telecommunications markets to competition, such as the local exchange market and the switched access transport market (i.e., switched traffic between the LEC central office and the long distance carrier POP). The Company believes that there are several regulatory trends that suggest that a further expansion of the markets in which it might compete is attainable. These include:

- The FCC's continued focus on efforts to expand the markets subject to competition. Having opened interstate, interLATA service to competition, the Interconnection Decisions are intended to create the opportunity for expanded competition for access services.
- The increased recognition of the importance of the telecommunications and information infrastructure to economic competitiveness at the state, federal and international levels.

- The emergence of procompetitive regulatory regimes in a growing number of states.

The Company believes its present and planned services are subject to the following regulatory structures:

- Interstate special access, private line and switched access services provided to large business and government customers are subject to streamlined federal regulation, including tariffing. To the extent any such services may be provided on an intrastate basis, the provision of such services is subject to varying levels of state regulation, frequently requiring certification and tariffing.
- High-speed data communications services connecting LANs and for other applications, as currently configured by the Company, are deemed "enhanced services" which presently are not regulated at the state or federal level.
- Integrated single source telecommunications services for small and medium sized businesses involve the provision of local intrastate, interstate and international services. The regulation of the provision of interstate and intrastate special access, private line and switched access services for these customers is subject to the same regulatory structures as for the Company's large business and government customers. The resale of international service requires FCC certification and tariffing. The competitive provision of local services, where permitted, is subject to varying state regulations, including certification and tariffing.

Federal Regulation. The allocation of jurisdiction between federal and state regulators over dedicated circuits that carry both interstate and intrastate traffic (including private line and special access services) poses difficult definitional questions. Under current FCC practice, however, private line, non-switched telecommunications services are considered jurisdictionally interstate (subject to FCC jurisdiction) unless more than ninety percent (90%) of the traffic is intrastate in nature. The FCC has not ruled specifically as to the jurisdictional nature of the Company's traffic. At present, the Company's service offerings include dedicated interstate telecommunications services and services that are treated as jurisdictionally interstate services. The Company believes that these include virtually all service between a long distance carrier's POP and a POP of that long distance carrier or another long distance carrier, and between an end user and a long distance carrier POP.

Under the Communications Act of 1934, as amended (the "Communications Act"), the Company believes that states may not lawfully bar a telecommunications carrier from offering interstate service that is permitted under FCC policies, and therefore, the Company believes that CAPs may construct and operate transmission facilities in any state for the origination and termination of interstate traffic.

The Company believes that, based upon its lack of market power and lack of control of essential monopoly facilities, it is subject to the FCC's scheme of streamlined regulation for nondominant carriers. The FCC has, however, never specifically ruled as to whether the Company qualifies as a nondominant carrier. The services of nondominant carriers have been subject to relatively limited federal regulation by the FCC. This residual degree of regulation has consisted largely of the filing of periodic reports with the FCC concerning the Company's interstate circuits and deployment of network facilities. Moreover, the Company must offer its interstate services on a non-discriminatory basis, at just and reasonable rates, and remains subject to FCC complaint procedures with respect to such practices.

For its current offering of services as a nondominant carrier, the Company is not subject to rate regulation by the FCC and may install and operate facilities for the transmission of interstate communications without prior FCC authorization. Based on a long standing FCC policy that eliminated the requirement that nondominant carriers file tariffs for domestic interstate services, the Company has not historically filed such tariffs. The United States Court of Appeals for the District of Columbia Circuit, however, recently ruled that the FCC's policy permitting nondominant carriers not to file tariffs is unlawful. The Company believes that the FCC is considering whether to seek Supreme Court review of the ruling. In the interim, the Company has filed a tariff with the FCC for its interstate services. On February 19, 1993, the FCC adopted a Notice of Proposed Rulemaking to establish streamlined tariff filing requirements for nondominant carriers. On March 1, 1993, NYNEX Corporation ("NYNEX") and Bell Atlantic Corporation ("Bell Atlantic") petitioned the FCC to reject the Company's tariff. Shortly after the decision by the United States Court of Appeals finding the FCC's tariff forbearance policy unlawful, Bell Atlantic filed a complaint with the FCC against the Company and eight other CAPs for offering service without filing a tariff. The complaint seeks injunctive relief, damages and penalties. On January 4, 1993, the Company filed an answer to the complaint and a motion to dismiss based on the FCC's forbearance policy. While the outcome of these proceedings cannot be predicted at this time, the Company does not believe that any action taken or expected to be taken by the FCC with respect to new tariff requirements on nondominant carriers would have a material adverse effect on the Company's businesses.

Rates for interstate services offered by LECs must be filed with the FCC and are subject to challenge under FCC rules. The LECs cannot offer services on a discriminatory basis and their rates must be just and reasonable. The Company has challenged numerous LEC tariffs under this statutory standard. The Company's likelihood of prevailing in such challenges, as a general proposition, is difficult to determine. The Company has recently challenged various special access pricing practices of all the BOCs and GTE Corporation relating to special access services the Company offers to long distance carriers in competition with the LECs. As part of the FCC's consideration of the Company's expanded local equal access interconnection petition initially filed in 1989, the Company argued that the LECs were systematically offering excessive volume and term discounts which are unlawful and intended to capture such customers' special access traffic for long periods of time before interconnection became effective. The Interconnection Decisions required certain LECs to provide cost support for the most steeply discounted rates for special access usually purchased by long distance carriers and other larger customers. Based on its review of those submissions, the FCC will determine whether additional action is appropriate. The Interconnection Decisions also provide LEC customers with the opportunity to discontinue certain LEC long-term contracts, without being subject to full termination liabilities, within 90 days of the availability of interconnection arrangements in any given LEC office, thereby allowing an existing LEC customer to take services from the Company without incurring full termination liabilities.

Legislation. There were several proposed legislative initiatives introduced and considered in the last Congress that are likely to be reintroduced and further considered in 1993 by Congress. Some of these proposals, if reintroduced and enacted, could impact the businesses of the Company.

One category of such legislation involves enacting into law various of the restrictions on the BOCs' lines of business contained in the Modified Final Judgment which resulted in the Divestiture. Legislation has been considered that would in certain instances strengthen the limits on BOC activity, with respect to the provision of long distance service, information services and the manufacture of equipment. Several bills, seeking to restrict BOC entry into these lines of business, condition such entry on the ability of entities, such as the Company, to enter the local exchange market and obtain a prescribed degree of market penetration. In addition, other legislation seeks to lessen these restrictions on BOC activity. To the extent any enacted legislation enhances the BOCs' ability to utilize their existing resources on an unregulated basis and enter new lines of business, such legislation could have a material adverse effect on the Company.

Legislation had also been introduced that would have eliminated the current restriction on cross-ownership of cable television and telephone companies. Permitting such cross-ownership could increase competition for the Company from cable television companies.

Another category of legislation introduced involves the encouragement of the development of interstate fiber optic "highways." To the extent that such legislation requires LEC deployment of fiber optic networks in an expedited manner and provides that such deployment be financed by ratepayers, such legislation could have a material adverse effect on the Company. Similarly, unless such legislation, or the implementing regulations issued by the FCC, require LECs to provide CAPs access to such facilities, LEC control of such networks could enhance their dominant position in the markets served by the Company. To the extent such legislation or associated regulations require that access be provided to the Company and similarly situated entities, such legislation may enhance the Company's competitive position and significantly reduce the capital necessary for the Company to expand its systems.

Various versions of these laws and other communications related laws have been proposed by members of Congress. However, since the last Congress did not act on any of these proposals, it is impossible to predict with any certainty whether any of these proposals will be reintroduced or enacted and, therefore, to predict any possible impact of such proposals on the Company.

The Company believes that its provision of high-speed data transmission services to connect LANs and for other applications would generally be deemed "enhanced service offerings" (as defined by the FCC). Enhanced service offerings provided by nondominant carriers, such as MFS Datanet, are not subject to tariff or other regulatory requirements by the FCC and, to date, no state has sought to exercise jurisdiction over these services offered on an intrastate basis. The offering of these services by MFS Datanet has not been specifically considered or reviewed by any regulatory agency.

The provision of integrated single source telecommunication services for small and medium sized businesses involves the provision of local, intrastate, interstate and international services. For purposes of federal regulation, the provision of interstate services for these customers should be subject to the same regulatory structure described for large customers. The resale of international service provided by certificated carriers requires certification from the FCC under Section 214 of the Communications Act and the filing of a tariff with the FCC. On December 2, 1992, MFS Intelenet filed a Section 214 application to resell international services. The application is pending, and based on existing precedent, the Company believes that MFS Intelenet will obtain these FCC approvals.

Interconnection Decisions. In 1989, the Company filed a petition with the FCC to mandate interconnection with the LECs' networks for interstate special access services on a cost-effective basis, preferably physically at the LECs' central offices. The Company also asked the FCC to require the LECs to offer special and switched access service on an unbundled basis.

The Company filed its petition based upon its belief that interconnection would allow the Company to offer service throughout a local area by allowing the Company to resell the services of the LEC for that portion of the transmission not physically located on the Company's network. The unbundling of tariff elements is necessary since the LECs, under current tariffs, charge the same amount regardless of whether all or a portion of access services are purchased by the Company. For example, the Company could provide the local transport segment of switched access between a LEC central office or wire center and a long distance carrier POP. However, LEC tariffs for switched access services include this transport element as a bundled part of the rate for switched access. A long distance carrier seeking to use the Company for the transport segment would therefore, in effect, have to buy that service twice. The Company believes that it should be able to purchase only those severable portions of LEC access services that it actually needs and uses. The Company believes that unbundling is an economic prerequisite to effective competition for switched access services.

In May 1991, the FCC adopted a Notice of Proposed Rulemaking proposing to implement interconnection for interstate special access services under certain terms and conditions and initiated a Notice of Inquiry to investigate interconnection, as well as disaggregation and unbundling for switched access services.

On September 17, 1992, the FCC voted to require the BOCs and all but one of the Tier 1 LECs (those having in excess of $100 million in gross annual revenues) to provide interconnection in LEC central offices and serving wire centers to any CAP, long distance carrier or end user seeking such interconnection for the provision of interstate special access services. With certain exceptions, such as the unavailability of space, a state regulatory commission policy to the contrary or an agreement by both parties to implement virtual collocation, the FCC required the LECs to offer interconnectors physical collocation in the LEC central offices at cost-based rates. In addition, at the same time the FCC proposed rules requiring interconnection for interstate switched access services. Under these rules, the Company expects to be able to expand significantly the number of customers to which it can offer interstate special access services by being able to reach through interconnection virtually every business customer in its metropolitan service areas. The FCC required the LECs to file interconnection tariffs by February 16, 1993 and based upon this submission date, these tariffs are scheduled to become effective May 17, 1993. For those states in which LECs already had operational interconnection agreements for intrastate services or similar arrangements, at least in certain central offices, or in which a tariff for such services was pending at the time of the order (e.g., New York, Illinois, Pennsylvania and Massachusetts), the FCC required the LECs to file interim tariffs on November 18, 1992. These tariffs became effective on December 9, 1992. As a result, the Company was provided with expanded business opportunities for interstate special access services for its operations in New York, Illinois, Pennsylvania and Massachusetts.

In connection with its decision to require interconnection, the FCC provided LECs with a degree of increased pricing flexibility for special access services selectively on a specific central office by central office basis. Once a collocation tariff is in effect and a competitor has taken service under the tariff, the LEC will be allowed, within specified ranges, to charge different rates for special access services in different zones based on the traffic densities of central offices within those zones.

More specifically, the LECs, subject to FCC approval, are permitted to implement a system of traffic density-related rate zones. Each LEC central office is assigned to one of the zones. The LEC is required to demonstrate to the FCC that the assignment of each central office to a zone reflects cost-related characteristics, such as traffic density or some measure of traffic through each office. To the extent that LECs are provided increased flexibility to lower their rates, the Company's ability to compete for certain services may be adversely affected. The Company believes that any such adverse effect will be more than offset by the increased revenues available as a result of access to off-net customers provided through interconnection.

No assurance can be given that any benefits expected to be realized by the Company as a result of the Interconnection Decisions will, in fact, be realized or as to the timing of any such benefits. Motions for reconsideration of various aspects of the Interconnection Decisions have been filed with the FCC as have motions to stay and appeals to the United States Court of Appeals for the District of Columbia Circuit. Although on December 19, 1992, the motions to stay at the FCC were denied, and similar motions to stay were denied by the Court of Appeals on January 19, 1993, the Company is unable to predict at this time the likelihood of success of the petitions for reconsideration and the appeals.

Prior to the Interconnection Decisions, regulatory commissions in several states had approved intrastate interconnection tariffs or similar arrangements between LECs and CAPs under various pricing terms and conditions and at various rates. The Company has also entered into an agreement with Bell Atlantic under which interconnection will be offered at certain central offices in Maryland, Pennsylvania, New Jersey, the District of Columbia and Virginia for intrastate services to the extent permitted by state regulation. A tariff was filed pursuant to this agreement in Pennsylvania on October 1, 1992, which became effective on November 30, 1992.

Pursuant to these various state interconnection arrangements, the Company currently has operational interconnection arrangements in six central offices in New York City, four central offices in Boston and in one central office in Chicago. Based upon what the Company deemed unacceptable and excessive payments specified in the LEC tariff rates, the Company has not previously pursued intrastate interconnection in California or with Illinois Bell Telephone Company in Illinois.

New York has adopted the most far-reaching interconnection order in the United States. As a result, the Company has the ability to collocate and interconnect the Company's network with the New York Telephone Company network to provide intrastate switched transport service on an unbundled basis from New York Telephone Company central offices to long distance carriers' POPs for intrastate long distance service. In addition, the Company may utilize such interconnection arrangements to offer various local switched services in the New York City metropolitan market.

State Certification. A small percentage of the Company's circuits may be classified as intrastate and therefore subject to state regulation. The Company expects that as its business and product lines expand, the Company plans to be offering more intrastate service. In all states where certification is required, except the District of Columbia, the Company's operating subsidiary is certificated as a common carrier. In all other states, the Company operates with the appropriate state regulatory authorization. The Company currently holds one or more certificates of public convenience and necessity ("CPCN") in California, Colorado, Connecticut, Florida, Georgia, Illinois, Maryland, Massachusetts, Minnesota, Missouri, New Jersey, New York, Ohio, Pennsylvania and Virginia. These CPCNs vary in the scope of the intrastate services permitted, ranging from the Company's certification in New York which permits the Company to provide all services, including local and long distance switched services, to the Company's certificates in Connecticut and Georgia, which the respective Commissions contend are limited to providing intrastate service to long distance carriers to allow them to connect POPs for intrastate, interLATA service. The Company is in the process of seeking to expand the scope of its intrastate certification in various jurisdictions, a process which will depend upon regulatory action and, in some cases, legislative action in the individual states.

A predecessor of the Company provided service in the District of Columbia prior to the time certification was required by the District of Columbia Public Service Commission. At the time the Commission began to require certification, it authorized the Company's predecessor to continue to provide the intrastate services to the customers it was then serving in the District of Columbia. Intrastate service to additional customers was prohibited. A certification proceeding is currently pending in the District of Columbia. In addition, the Company's Texas subsidiaries are not certificated, but rather, as required by applicable state regulation, are registered with the Texas Public Utility Commission as nondominant carriers to provide intrastate services.

In most states, the Company is required to file tariffs setting forth the terms, conditions and prices for services which are classified as intrastate. In some states, the Company's tariff can list a range of prices for particular services, and in others, such prices can be set on an individual customer basis.

The Company is not subject to price cap or to rate of return regulation in any state.

Several states, sometimes in connection with the authorization or expansion of intrastate competition, have provided varying degrees of regulatory flexibility for the LECs. The flexibility is characterized by relaxing the requirement to provide advanced notice of price changes for competitive services, establishing a range in which the LEC has increased freedom in determining rates, and in some cases, authorizing the LEC to enter into individual customer contracts for specified services. Because the LECs continue to control bottleneck monopoly elements of the local exchange network, the Company believes that this flexibility presents opportunities for the LECs to engage in cross-subsidization between competitive and non-competitive services. The Company has, and expects to continue to, aggressively protect its interests before state regulatory commissions.

To the extent MFS Intelenet proposes to resell intrastate switched or special access services as part of its service offerings, it will also be subject to state certification and tariff requirements, which vary by state. MFS Intelenet plans to commence offering this service in New York, which has authorized multiple telecommunications carriers, in addition to the LECs, to provide all forms of telecommunications services throughout New York and has specifically authorized competitive local switched service. The New York Public Service Commission recently approved the Company's application to resell all telephone services in New York. The Company does not anticipate any significant delay in the certification of MFS Intelenet to provide these services as a facilities-based provider. Certain other jurisdictions permit non-LECs to provide a number of the services proposed to be offered by MFS Intelenet. Any expansion of services by MFS Intelenet to other states will need to be evaluated on a state-by-state basis, taking into account the various state regulatory and legislative requirements. There can be no assurance that any other state will allow the Company to provide competitive local calling services to the extent permitted in New York.

Local Government Authorizations. The Company is required to obtain street opening and construction permits to install and expand its fiber optic networks. In some of the metropolitan areas where the Company provides network services, MFS Telecom's subsidiaries pay license or franchise fees based on a percent of gross revenues. There is no assurance that certain cities that do not impose fees will not seek to impose fees, nor is there any assurance that, following the expiration of existing franchises, fees will remain at their current levels. In many markets, the LECs, as well as certain other CAPs, are excused from paying such franchise fees or pay fees that are materially lower than those required to be paid by the Company.

If any of the existing franchise or license agreements were terminated prior to their expiration dates and the Company were forced to remove its fiber from the streets or abandon its network in place, such termination would have a material adverse effect on the Company's subsidiary in that metropolitan area and could have a material adverse effect on the Company.

Employees

At December 31, 1992, the Company employed 565 full-time employees, of whom 316 were employed by the telecommunications segment, 217 were employed by the network systems integration and facilities management segment and 32 were members of the Company's headquarters staff (including MFS Development).

Properties

The Company's physical properties include leases of space for offices, storage and equipment rooms. The Company currently leases approximately 300,000 square feet of office, equipment room and general storage space. Additional equipment rooms will be leased as networks are expanded. Of these amounts, the network services integration and facilities management segment uses approximately 50,000 square feet of this office space, with the balance of the space used by the telecommunications services segment and administrative staff. The Company considers its properties to be adequate for its present and foreseeable requirements. The Company leases certain office space from PKS. See "Certain Transactions—Intercompany Agreements—Office Lease."

Legal Proceedings

Except as described above in "Government Regulation," the Company is not a party to any pending legal proceedings material to its financial condition or results of its operations.

MANAGEMENT

Directors and Executive Officers

Set forth below are the names, ages and positions of the directors and executive officers of the Company:

Name	Age	Position
James Q. Crowe (1)(2)	43	Chairman of Board and Chief Executive Officer
Royce J. Holland (1)	44	President and Chief Operating Officer, Director
R. Douglas Bradbury	42	Senior Vice President, Treasurer and Chief Financial Officer
Terrence J. Ferguson	50	Senior Vice President, Secretary and General Counsel
Ronald R. Beaumont	44	Senior Vice President
Albert L. Fenn, Jr.	50	Senior Vice President
Andrew D. Lipman	41	Senior Vice President
Kevin P. Moersch	39	Senior Vice President
Kevin J. O'Hara	32	Senior Vice President
Kirby G. Pickle	36	Senior Vice President
Philip D. Hamlin	46	Vice President and Chief Engineer
Howard Gimbel (2)	61	Director
Richard R. Jaros (3)	40	Director
Robert E. Julian (3)	53	Director
David C. McCourt (2)	36	Director
Ronald W. Roskens	61	Director
Walter Scott, Jr. (1)	61	Director
Kenneth E. Stinson (2)	50	Director
Michael B. Yanney (3)	59	Director

(1) Member of Executive Committee
(2) Member of Compensation Committee
(3) Member of Audit Committee

Directors of the Company are elected annually at the annual meeting of shareholders. The next annual meeting of shareholders is scheduled for May 1994. Officers of the Company are elected annually by the Board of Directors. The next election of officers will be at the first meeting of the Board of Directors following the next annual election of directors.

The Audit Committee reviews the services provided by the Company's independent auditors, consults with the independent auditors on audits and proposed audits of the Company and reviews the need for internal auditing procedures and the adequacy of internal controls. The Compensation Committee determines executive compensation and stock option awards. The Executive Committee exercises, to the maximum extent permitted by law, all powers of the Board of Directors between board meetings, except those functions assigned to specific committees. The Board of Directors may establish additional committees from time to time.

Certain of the Company's directors are also directors of KDG, PKS and certain of their affiliates. In addition, Mr. Crowe will devote an insignificant portion of his time to the development of new ventures for KDG, PKS and their other affiliates. See "Certain Transactions—Intercompany Agreements—Noncompetition Agreement." None of the executive officers has an employment agreement with the Company.

Mr. Crowe has been the senior executive officer of the Company since its inception. He has served as Chairman of the Board of the Company since 1988, Chief Executive Officer since November 1991 and was President (January 1988-June 1989 and April 1990-January 1992). Mr. Crowe has also served as President and Vice President of Kiewit Industrial Co., which is involved in large industrial construction projects, such as independent power projects, cogeneration facilities, and until 1988, telecommunications projects. Prior to joining PKS in 1986, Mr. Crowe was employed by Morrison-Knudsen Corporation, a major construction and engineering company based in Boise, Idaho, where he held the position of Group Vice President with responsibility for the electric power market. Mr. Crowe is a director of California Energy Company, Inc., a geothermal energy producer, which is partially owned by PKS.

Mr. Holland has been a Director and the President and Chief Operating Officer of the Company since January 1992. He has been the Chairman and Chief Executive Officer of MFS Intelenet since November 1992. He was the President and Chief Executive Officer of MFS Telecom between April 1990 and November 1992. He was previously the President (June 1989-April 1990) and Vice President (February 1988-May 1989) of the Company. Before joining the Company, Mr. Holland held various management positions with Energy Factors, Inc., an independent power company based in San Diego, California and Morrison-Knudsen Corporation.

Mr. Bradbury has been the Treasurer and Chief Financial Officer of the Company since January 1992 and Senior Vice President since September 1992. Formerly, Mr. Bradbury was Senior Vice President-Corporate Affairs for MFS Telecom. Before joining the Company in 1988, he was Executive Vice President and Chief Operating Officer at American Pioneer Telephone, Inc., a regional long distance carrier based in Orlando, Florida, and a Vice President of Manufacturers Hanover Trust Company in New York City and Milan, Italy.

Mr. Ferguson has been responsible for the legal affairs of the Company since its inception. He was elected Senior Vice President in September 1992, General Counsel in January 1992 and Secretary in November 1991. Before joining the Company in October 1992, Mr. Ferguson was employed as an attorney by PKS.

Mr. Beaumont has been Senior Vice President of the Company since September 1992 and President and Chief Executive Officer of MFS Telecom since November 1992. He joined MFS Telecom as Senior Vice President of Operations and Engineering and had general management responsibilities over MFS Telecom's Southern Division, comprising seven metropolitan area networks. From 1987, Mr. Beaumont was Executive Vice President of MFS/ICC prior to its acquisition by MFS Telecom in October 1991.

Mr. Fenn has served as Senior Vice President of the Company since September 1992 and as President of MFS Datanet since January 1992. Before joining the Company, Mr. Fenn was Vice President of Business Development and Planning for British Telecom North America, Inc., Senior Vice President of BT Tymnet, a leading public data network and President of McDonnell Douglas Network Systems Company.

Mr. Lipman has been Senior Vice President of the Company since September 1992 and has been Senior Vice President for Legal and Regulatory Affairs of MFS Telecom since July 1989. He is also a partner in the Washington, D.C. law firm of Swidler & Berlin, Chartered and heads that firm's telecommunications practice. Mr. Lipman has been engaged in the private practice of law and has performed legal services for the Company since 1988.

Mr. Moersch has served as Senior Vice President of the Company since September 1992, as President of MFS Network Technologies since January 1989 and previously as Vice President of MFS Network Technologies. Before joining MFS Network Technologies, he was Vice President of Core-Mark International, Inc., a Canadian distribution holding company, and Chief Executive Officer of ASI Telesystems, Inc. and other Core-Mark subsidiaries.

Mr. O'Hara has been Senior Vice President of the Company since October 1992 and is the President of MFS Development. From 1990 to 1992, he was a Vice President of MFS Telecom, with successive responsibilities for engineering/construction, network services and strategic development. Prior to joining MFS Telecom, he was the area manager for MFS Network Technologies with responsibility for the installation of the MFS Telecom networks. Prior to joining the Company, Mr. O'Hara held various construction management positions with PKS.

Mr. Pickle has been Senior Vice President of the Company since September 1992 and President and Chief Operating Officer of MFS Intelenet since November 1992. Previously, he was Senior Vice President of Sales and Marketing of MFS Telecom, and had general management responsibilities over MFS Telecom's Northern Division, comprising six metropolitan area networks. Prior to joining MFS Telecom in January 1991, he was Vice President of Marketing/Business Development for Sprint Corporation, and has held other sales, customer service and marketing positions with Sprint Corporation, MCI Communications Corporation and American Telephone and Telegraph Company.

Mr. Hamlin has been Vice President and Chief Engineer of the Company since December 1991. He served as the Director of Engineering of the Company from 1987 to December 1991. Prior to joining the Company in 1988, Mr. Hamlin held various engineering and construction management positions with Morrison-Knudsen Corporation.

Mr. Gimbel has been a Director of the Company since January 1992, a Director of MFS Telecom from 1989 to 1992 and a Director and the Treasurer of MFS Chicago since 1988. Since April 1990, Mr. Gimbel has performed real estate and building access services under a consulting agreement with MFS Chicago. He served as Treasurer of MFS Telecom from 1988 to 1989. He has been a partner at B. G. Management Co., a real estate management and sales business, and President of Health Consultants, Inc. since January 1988. Mr. Gimbel is also a founder of both MFS Telecom and MFS Chicago.

Mr. Jaros has been a Director of the Company since January 1992. He has been the President and Chief Operating Officer and a Director of California Energy Company, Inc., which is partially owned by PKS, since January 1992. Mr. Jaros was a Vice President of PKS from September 1990 to August 1992 and a Vice President of KDG from 1986 to 1990.

Mr. Julian has been a Director of the Company since January 1992. For more than the last five years, Mr. Julian has been the Chief Financial Officer and a Director of PKS. Mr. Julian was elected Executive Vice President of PKS in 1991 and prior to that served as a Vice President of PKS.

Mr. McCourt has been a Director of the Company since January 1992, a Director of MFS Telecom since July 1990 and a Director and President of Metropolitan Fiber Systems/McCourt, Inc., a subsidiary of MFS Telecom, since 1988. Mr. McCourt is the President and Chief Executive Officer of McCourt Communications Company, Inc., a privately owned company engaged in the design and construction of cable television and telecommunications systems in Boston, Massachusetts and President and Chief Executive Officer of McCourt Fiber Network, Inc., a telecommunications business in Boston, Massachusetts.

Mr. Roskens has been a Director of the Company since March 1993. He is currently the President of Action International, Inc., a forum to promote international cooperation. Mr. Roskens was the Administrator of the U.S. Agency for International Development, Washington, D.C., from 1990 to 1992, and was President of the University of Nebraska from 1977 to 1990. He is a director of ConAgra, Inc.

Mr. Scott has been a Director of the Company since January 1992. He has been the Chairman of the Board and President of PKS for more than the last five years. He also is a Director of Berkshire Hathaway Inc., Burlington Resources Inc., California Energy Company, Inc., Canadian Imperial Bank of Commerce, ConAgra, Inc., FirsTier Financial, Inc. and Valmont Industries, Inc.

Mr. Stinson has been a Director of the Company since January 1992. He has been an Executive Vice President of PKS since 1991 and a Director of PKS since prior to 1988. He has been the President of Kiewit Construction Group Inc., an affiliate of PKS, since 1992 and a Director of such company since prior to 1988. In addition, Mr. Stinson served as President of Kiewit Coal Properties, an affiliate of PKS, from 1989 to 1992 and a Director of such company since prior to 1988.

Mr. Yanney has been a Director since March 1993. Mr. Yanney has been the Chairman and Chief Executive Officer of America First Companies, Omaha, Nebraska, since 1984. From 1977 until 1984, Mr. Yanney was principally engaged in the ownership and management of commercial banks. Mr. Yanney also serves as a Director of Burlington Northern, Inc., Forest Oil Corporation and Lozier Corporation.

Compensation Committee Interlocks and Insider Participation. During 1992, Messrs. Crowe, Holland, Gimbel and Stinson served on the Company's Compensation Committee. Messrs. Crowe and Holland are employees of the Company. Mr. Gimbel has a consulting agreement with a Company subsidiary. See "Certain Transactions—Minority Interests in MFS Telecom Subsidiaries." Mr. Crowe serves on the Compensation Committee of the Board of Directors of California Energy Company, Inc., and Mr. Jaros, an executive officer of that corporation, is a Director of the Company.

Executive Compensation

Summary Compensation Table. The following table shows compensation paid to, deferred or accrued for the benefit of, the Company's Chief Executive Officer and each of the four remaining most highly compensated executive officers (collectively, the "Executive Group") for all services rendered to the Company during the fiscal year ended December 31, 1992:

Summary Compensation Table

Name and Principal Position	Year	Salary	Bonus	Long-term compensation-Awards-Options (#)
James Q. Crowe Chief Executive Officer	1992	$270,250	$175,000	831,015
Royce J. Holland Chief Operating Officer	1992	193,077	110,000	420,304
Ronald R. Beaumont Senior Vice President	1992	182,598	65,000	170,000
Albert L. Fenn, Jr. Senior Vice President	1992	178,500	72,800	170,000
Kirby G. Pickle Senior Vice President	1992	166,461	60,000	163,934

No member of the Executive Group received any other annual compensation, restricted stock awards, stock appreciation rights ("SARs"), long-term incentive performance ("LTIP") payouts or other compensation for the fiscal year ended December 31, 1992.

Option/SAR Grant Table. The following table provides information on options granted to the Executive Group during fiscal 1992. There were no SAR grants during 1992.

Option Grants in Last Fiscal Year

Name	Individual Grants: Options Granted (#) (1)	% of Total Options Granted to Employees in Fiscal Year	Exercise Price ($/Sh)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (2): 5%	10%
James Q. Crowe	831,015	13.9%	$12.05	11/23/2002	$6,299,094	$15,955,488
Royce J. Holland	420,304	7.0	12.05	11/23/2002	3,185,904	8,069,837
Ronald R. Beaumont	170,000	2.8	12.05	11/23/2002	1,288,600	3,264,000
Albert L. Fenn, Jr.	170,000	2.8	12.05	11/23/2002	1,288,600	3,264,000
Kirby G. Pickle	163,934	2.7	12.05	11/23/2002	1,242,620	3,147,533

(1) Each member of the Executive Group was issued nonqualified stock options effective November 23, 1992 with an exercise price of $12.05. None of the options is exercisable until the earlier of (i) November 24, 1994 and (ii) the completion of an initial public offering (including the expiration of any lock-up period specified by the underwriters of that initial public offering). These options vest as follows: 25% on November 24, 1993, 50% on November 24, 1994, 60% on November 24, 1995, 75% on November 24, 1996 and 100% on November 24, 1997. The options expire on the tenth anniversary of the grant date, November 23, 2002. Additional provisions of these stock options are described below under "—Compensation Under Plans —1992 Stock Plan." See "Shares Eligible for Future Sale."

(2) These columns illustrate the hypothetical appreciation of the stock options under the assumption that each option, with a base value of $12.05, appreciates at the rate of 5% or 10%, respectively, compounded annually for ten years (that is, until the option's expiration date on November 23, 2002).

Option/SAR Exercises. The following table provides information on options/SARs exercised during fiscal 1992 by the Executive Group and the value of such officer's unexercised options/SARs as of the end of such fiscal year:

Aggregated Option/SAR Exercises
and Fiscal Year-End Option/SAR Value Table

Name	Shares Acquired on Exercise (#)	Value Realized	Number of Unexercised Options/SARs at FY-End (#): Exercisable	Unexercisable	Value of Unexercised In-the-Money Options/SARs FY-End ($): Exercisable	Unexercisable
James Q. Crowe	5,000 PKS Units(1)	$ 227,500	—	831,015	N/A	N/A
Royce J. Holland	—	—	—	420,304	N/A	N/A
Ronald R. Beaumont .	—	—	—	170,000	N/A	N/A
Albert L. Fenn, Jr. ...	—	—	—	170,000	N/A	N/A
Kirby G. Pickle	—	—	—	163,934	N/A	N/A

(1) Represents amounts paid in 1992 by the Company in full satisfaction of PKS SARs granted to Mr. Crowe in 1988. Mr. Crowe holds no other PKS SARs.

Directors Compensation. Directors of the Company who are employees or consultants of the Company and its affiliates will receive no directors fees. Non-employee directors will be paid an annual directors fee of $15,000, plus $500 per day for attendance at each Board of Directors meeting and meetings of committees of the Board of Directors. In addition, all Directors are reimbursed for their reasonable travel expenses incurred in attending these meetings.

Compensation Under Plans

1992 Stock Plan. On November 23, 1992, the Board of Directors adopted the 1992 Stock Plan (the "1992 Stock Plan"), which authorizes the grant of incentive stock options, qualified stock options, restrictive shares, SARs, bonuses of Company stock and other types of stock awards and cash to officers, directors, employees and consultants of the Company and its subsidiaries. Under the 1992 Stock Plan, the Company may grant 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 (the "Code"), or options that are not intended to qualify as incentive stock options. A total of 6,000,000 shares of Common Stock may be issued upon the exercise of options granted under the 1992 Stock Plan.

The 1992 Stock Plan is administered by the Compensation Committee of the Board of Directors. Subject to the provisions of the 1992 Stock Plan, the Compensation Committee has authority to select the employees to whom options are granted and to determine the terms of each option, including (i) the number of shares of Common Stock covered by the option; (ii) when the option becomes exercisable; (iii) the option exercise price, which, in the case of incentive stock options, must be at least 100% of the fair market value of the Common Stock on the date of grant; and (iv) the duration of the option (which may not exceed ten years). All options are nontransferable other than by will or the laws of descent and distribution. Options that are forfeited can be reissued by the Company.

As of November 23, 1992, the Company granted nonqualified stock options to over 400 employees who had commenced their employment prior to July 1, 1992. Currently, options to purchase all of the 6,000,000 shares of Common Stock available for issuance under the 1992 Stock Plan are outstanding. All of these options have an exercise price of $12.05 per share. In determining the fair market value of the options as of November 23, 1992, the Board of Directors relied upon a variety of factors and analyses, including a valuation of the Company completed by an independent third party.

401(k) Plan. In 1993, the Board of Directors adopted the MFS Communications Company, Inc. 401(k) Plan (the "401(k) Plan"), which is intended to qualify under Section 401(k) of the Code. All employees of the Company and its subsidiaries regularly scheduled to work at least 1,000 hours per year are eligible to participate in the 401(k) Plan. Each eligible employee may elect to contribute to the 401(k) Plan, through payroll deductions, up to a stated percentage of his or her salary, limited to $8,728 in 1992. The Company may make matching contributions on behalf of participating employees, but to date has not done so. Amounts credited to an employee's account are distributed to the employee at the earliest of (i) the employee reaching normal retirement age; (ii) the termination of his or her employment with the Company; (iii) the termination of the 401(k) Plan and (iv) a requested withdrawal due to hardship. Under Section 401(k) of the Code, neither employee nor Company contributions to the 401(k) Plan are taxable to the employee until such amounts are distributed to the employee, and Company contributions are tax-deductible by the Company within certain limits prescribed by the Code.

CERTAIN TRANSACTIONS

Upon completion of the Offering, PKS will own, through its wholly owned subsidiary, KDG, approximately 83.1% of the Company's outstanding Common Stock (approximately 81.0% if the over-allotment option is exercised in full). PKS will continue to maintain effective control over the Company and its operations, including the election of its Board of Directors, election of officers, dividend policy and other material matters.

Minority Interests in MFS Telecom Subsidiaries

While eight of MFS Telecom's subsidiaries are wholly owned, MFS Telecom owns less than all of the outstanding stock of its remaining five subsidiaries, as set forth below:

Subsidiary	% Owned By MFS Telecom
Metropolitan Fiber Systems of Houston, Inc. ("MFS Houston")	86.75%
MFS/ICC	85.00
Metropolitan Fiber Systems/McCourt, Inc. ("MFS/McCourt")	82.50
MFSA Holding, Inc. (Atlanta) ("MFS Atlanta")	80.00
MFS Chicago	90.00

Each of these subsidiaries has entered into a Management Services Agreement with MFS Telecom and at least one Engineer, Procure and Construct Contract ("EPC Contract") with MFS Network Technologies. In each case, the minority stockholders have the right to representation on the subsidiary's board of directors, and MFS Telecom has a right of first refusal in the event the minority stockholders desire to transfer their stock. MFS Telecom has supplied funds to each of these subsidiaries for construction, expansion, general operations or retirement of debt and may continue to supply funds for the foreseeable future.

Several of the minority stockholders have the right to cause MFS Telecom to purchase their stock in the subsidiary. In the case of MFS/ICC, beginning in 1996, the minority stockholder may put all of its MFS/ICC securities to MFS Telecom, and MFS Telecom may call all of the minority stockholder's securities, in each case at the fair market value of the securities to be sold, without allowing any minority ownership discount. In the case of MFS/McCourt, either the minority stockholder or MFS Telecom may exercise a buy/sell option. The offeror must offer to purchase the offeree's shares at an offeror-specified price. The offeree must elect to be either a buyer or seller at either the offered price or an appraised price. In the case of MFS Atlanta, commencing in February 1995, each minority stockholder may put his shares to MFS Telecom at an appraised price, and commencing in February 1997, MFS Telecom may call all of each minority stockholder's shares at an appraised price. In the case of MFS Chicago, MFS Telecom has no obligation to buy back stock of the minority stockholder to increase its shareholdings above the current 90% holding.

In April 1990, MFS Telecom, MFS Chicago and the MFS Chicago minority stockholders including Mr. Gimbel, a director of the Company, entered into a Stock Purchase Agreement (the "Stock Purchase Agreement"), pursuant to which MFS Telecom was to own 80% of the outstanding MFS Chicago common stock. Pursuant to the Stock Purchase Agreement, MFS Telecom purchased 12,395.23 (5.62%) shares of MFS Chicago common stock from Mr. Gimbel, leaving him with 0.51% of such shares outstanding. Payment for such shares will be made by KDG, without recourse to the Company, in July 1993 following an appraisal of the fair market value of the MFS Chicago common stock as of April 1993. See Note 15 to the Consolidated Financial Statements. In addition, in each of 1990, 1991 and 1992, MFS Telecom loaned $133,333 to each of Mr. Gimbel and two other MFS Chicago minority stockholders, under notes secured by their 1993 payment rights. These loans bear interest at a rate of LIBOR plus 2% (adjusted annually) and are due, together with interest thereon, in July 1993.

MFS Telecom and the MFS Chicago minority stockholders also entered into a stockholders agreement in connection with the April 1990 stock purchase transaction. Promissory notes made by MFS Chicago and held by MFS Chicago minority stockholders, including that of Mr. Gimbel, were exchanged in April 1990 for new notes (the "Subordinated Stockholder Notes"). The Subordinated Stockholder Notes provided for interest at the rate of LIBOR plus two percent. Such notes were paid by MFS Chicago (using funds advanced by MFS Telecom) in September 1992, including $784,172 paid to Mr. Gimbel. Under the stockholders agreement, MFS Telecom may, but has not elected to, require the MFS Chicago minority stockholders to share in making additional loans in proportion to the MFS Chicago minority stockholders' share of the combined MFS Telecom/MFS Chicago minority stockholders' stock ownership.

In addition, in 1990, MFS Chicago entered into a consulting agreement with Mr. Gimbel, under which he provides management and other advice to MFS Chicago in return for a monthly fee of $5,000, an automobile allowance, health insurance coverage and reimbursement of expenses. The agreement expires August 1, 1993, but is automatically extended unless terminated by either party upon thirty days notice. Either party may terminate the agreement before August 1, 1993 upon thirty days notice, but if so terminated by MFS Chicago, MFS Chicago must pay Mr. Gimbel $5,000 for each month remaining between the time of termination and August 1, 1993.

While certain of the obligations of MFS Telecom to the minority stockholders of its subsidiaries can be readily quantified, those relating to the fair market value of the stock of the subsidiaries cannot be quantified at present. KDG has agreed to pay the fair market value of the MFS Chicago common stock of the minority stockholders which is to be appraised as of April, 1993, pursuant to the Stock Purchase Agreement, without recourse to the Company.

Payment of Dividends. The minority stockholders are entitled to share ratably in any dividends paid on the common stock of these MFS Telecom subsidiaries, and upon the liquidation, dissolution or winding up of these subsidiaries, in the net assets after payment of all debts and other liabilities, including any liabilities to MFS Telecom. As of December 31, 1992, the following amounts were owed to MFS Telecom, either in the form of preferential payments on shares of preferred stock held by MFS Telecom or indebtedness of such subsidiaries to MFS Telecom:

Subsidiary	Amount Due MFS Telecom
MFS Chicago	$46.1 million
MFS Houston	20.5 million
MFS/McCourt	22.2 million
MFS Atlanta	9.4 million
MFS/ICC	6.0 million

While MFS Telecom is entitled to receive these amounts, no assurance can be made that these amounts will be paid to MFS Telecom or as to the timing of any payments. Such payments will depend, among other things, on the earnings of such subsidiaries.

Intercompany Agreements

Policy Statement. The Company believes that the terms upon which the services described below will be provided will be no less favorable than the Company or the subsidiary could obtain from unaffiliated third parties. The Company has adopted a policy that all future transactions between the Company and its officers, directors, PKS and other affiliates must be on terms no less favorable to the Company than could be obtained from unaffiliated third parties.

Registration Rights Agreement. The Company and KDG will enter into a Registration Rights Agreement (the "Registration Rights Agreement") as of the closing of the Offering, which, among other things, will provide that upon the request of KDG, the Company will register under the Securities Act any of the shares of Common Stock currently held by or acquired in the future by KDG, for sale in accordance with KDG's intended method of disposition thereof (a "Demand Registration"). KDG will have the right to request three Demand Registrations. KDG also will have the right, which it may exercise at any time and from time to time in the future, to include the shares of Common Stock held by it in certain other registrations of common equity securities of the Company initiated by the Company on its own behalf or on behalf of its stockholders. KDG's rights under the Registration Rights Agreement are transferable by KDG. In addition, KDG has agreed to pay its pro rata share of all costs and expenses in connection with each registration of its shares of Common Stock.

Noncompetition Agreement. The Company and PKS will enter into the Noncompetition Agreement as of the closing of the Offering. The Noncompetition Agreement will provide, among other things, that until the earlier to occur of (i) the tenth anniversary of the date of the Noncompetition Agreement and (ii) the date on which PKS ceases to own at least 30% of the issued and outstanding shares of Common Stock, PKS will not, and will cause its subsidiaries and affiliates, other than the Company, not to compete directly or indirectly with the Company and its subsidiaries for the provision of telecommunications services to business or government users. In addition, PKS will not, and will cause its subsidiaries not to compete against the Company and its subsidiaries in the network systems integration and facilities management businesses with certain limited exceptions. The Company and PKS have agreed that for purposes of PKS' covenant not to compete, telecommunications services to business and government customers and network systems integration and facilities management services are defined as described in this Prospectus. PKS is permitted to have investments in entities that may compete with the Company, as long as the investment does not represent more than a 10% stake in the entity. PKS has also agreed to refrain from soliciting any employee of the Company to leave the Company's employ. The Company and PKS also have agreed that PKS and its subsidiaries, other than the Company, may engage in construction and construction management contracts, including contracts relating to the telecommunications industry.

Tax Sharing Matters. For federal income tax purposes, the Company has been included in the affiliated tax group of which PKS is the common parent. The Company has also been included in certain state and local tax returns of PKS or its subsidiaries.

The Company and KDG have entered into the Tax Sharing Agreement beginning with the 1993 tax year which will continue as long as the Company is included in the PKS consolidated group (generally, as long as KDG owns 80% of the stock of the Company, in terms of voting power and value). The Company will first compute its tax liability as if it and its subsidiaries were a separate consolidated tax group. If this computation results in a tax liability, the Company will pay an amount equal to the computed liability to KDG. The Company will recognize tax benefits on losses incurred subsequent to January 1, 1993 only to the extent that the Company can utilize those benefits on a separate return basis.

Administrative Services Agreement. The Company and KDG have entered into an Administrative Services Agreement dated September 30, 1992, under which KDG will provide or procure from other PKS affiliates certain administrative services. The services to be provided to the Company include accounting, tax, legal, information processing, financial/treasury, risk management/insurance and other administrative services. Either party may terminate all or particular services upon 90 days prior notice to the other. The annual fee for these services will be $900,000 in 1993, subject to adjustment for actual services utilized. The Company and its subsidiaries paid PKS $213,725, $518,307 and $850,000 in 1990, 1991 and 1992, respectively, under similar agreements. The increase in payments from 1990 to 1992 is attributable to the growth of the Company during this period and its corresponding increased demand for services of the type provided by PKS.

As a function of the Administrative Services Agreement and to replace a prior Financial Services Agreement (described below), commencing January 1, 1993, the Company established a separate banking account with FirsTier Bank, N.A., Omaha, Nebraska. The business of the Company and of its subsidiaries will be conducted through this account, which will be managed by the PKS treasury department under the direction of the Company. The net proceeds of the Offering will be deposited into this account. The Company has established investment guidelines whereby the PKS treasury department will invest such funds in short-term, investment grade securities. Such funds and investments will not be commingled with other funds and investments of PKS.

Office Lease. The Company has entered into a lease with PKS dated October 1, 1992 to rent approximately 16,000 square feet of office space in the Kiewit Plaza office building in Omaha, Nebraska. The rent is based on market rates for comparable office space in Omaha and rent charged to unaffiliated tenants in the building. The Company has occupied space in the Kiewit Plaza building since 1988. The total basic rent was $118,663, $153,658, and $219,484 in 1990, 1991 and 1992, respectively. The annual rent for 1993 will be approximately $260,000.

Aircraft Expense. PKS owns several aircraft which are chartered from time to time by the Company. For the use of such aircraft, the Company paid PKS $117,127, $240,373 and $231,177 in 1990, 1991 and 1992, respectively.

Insurance Program Expenses. PKS purchases insurance policies and undertakes self-insurance and risk management programs for its combined subsidiaries. Each subsidiary is charged with its proportionate share of the aggregate premiums for property, excess liability and fidelity insurance policies and the fixed costs of PKS' casualty insurance program. The Company and its subsidiaries paid PKS $578,731, $549,456 and $694,983 in 1990, 1991 and 1992, respectively.

Terminated PKS-Company Agreements.

Financial Services Agreements. The Company and MFS Network Technologies each entered into a Financial Services Agreement with a PKS affiliate (which has since merged into PKS) in May 1988. Under these arrangements, the cash and short-term financing of PKS subsidiaries were managed by the PKS treasury department. As a fee for cash management services, PKS charged 0.875% of the month-end account balance. PKS waived the fees chargeable to the Company beginning January 1, 1991. These financial services agreements were terminated effective December 31, 1992.

Equipment Leasing. MFS Network Technologies entered into an equipment lease in January 1990 with CMF Leasing Co., a partnership composed of PKS construction subsidiaries. Vehicles and equipment used in the Company's network systems integration and facilities management operations were leased from CMF Leasing Co. The equipment lease was terminated on November 1, 1992, when MFS Network Technologies purchased certain items for $160,000 from CMF Leasing Co.

Relationships with Certain Directors and Executive Officers

Mr. Lipman, Senior Vice President of the Company, is a partner in the law firm of Swidler & Berlin, Chartered, of Washington, D.C. The firm provides legal services to the Company and was paid fees of approximately $500,000, $1.2 million and $2.3 million in 1990, 1991 and 1992, respectively. Mr. Lipman has an arrangement with the Company under which he is expected to devote a substantial portion of his time to the Company's legal/regulatory matters.

Mr. Gimbel, a Director of the Company, and his wife were paid $5,535,000 by the Company in September 1992 in exchange for their shares of MFS Telecom in connection with the Company's purchase of the shares of MFS Telecom common stock held by minority stockholders. Mr. Gimbel, a founder of MFS Telecom and MFS Chicago and a member of the board of directors of MFS Chicago and the Company entered into a confidentiality, noncompete and nondisclosure agreement in connection with the purchase of such shares, pursuant to which agreement Mr. Gimbel was paid $1,000,000. In addition, MFS Telecom purchased MFS Chicago shares from Mr. Gimbel in April 1990, loaned $400,000 to Mr. Gimbel, paid off certain notes to Mr. Gimbel and has a consulting agreement with him. See "—Minority Interests in MFS Telecom Subsidiaries."

Mr. McCourt, a Director of the Company, is the Chairman and Chief Executive Officer of McCourt Communications Company, Inc. Mr. McCourt is the Chairman of McCourt Cable and Communications Limited ("McCourt Cable"), the entity installing certain combined cable television-telephone systems in the United Kingdom, and the managing partner of McCourt/Kiewit International Partnership, which is constructing the Cambridge Cable Project. McCourt Cable has a 50% interest in such partnership; the other 50% partner is a subsidiary of MFS Network Technologies. In 1992, a corporation controlled by Mr. McCourt received approximately $85,000 for management services rendered to the partnership. Mr. McCourt was the Chairman and Chief Executive Officer of McCourt Cable Systems, Inc. during 1989-1990, when that company acted as a subcontractor to MFS Network Technologies in the construction of the initial Boston network. The initial telecommunications network in the Boston central business district was constructed under an EPC Contract by MFS Network Technologies. The Boston network is currently being expanded by MFS Network Technologies under another EPC Contract. McCourt Communications Company, Inc., controlled by Mr. McCourt, is a subcontractor to MFS Network Technologies on the project.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The Company. As of March 8, 1993, no director of the Company, no member of the Executive Group and no officer of the Company beneficially owned (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934) any shares of Common Stock, other than Mr. Hamlin, Vice President and Chief Engineer of the Company, who has vested options to purchase 13,681 shares of Common Stock, which represents less than 1% of the outstanding shares of Common Stock. KDG, immediately before the Offering, will own all of the outstanding shares of Common Stock. After the Offering, KDG will own approximately 83.1% of the outstanding common stock (approximately 81.0% if the over-allotment option is exercised in full). The address of KDG, a wholly owned subsidiary of PKS, is 1000 Kiewit Plaza, Omaha, Nebraska 68131.

PKS. Set forth below is certain information regarding the beneficial ownership of equity securities of PKS as of March 10, 1993 as to (a) each director of the Company, (b) each member of the Executive Group and (c) all officers and directors of the Company as a group. PKS has three classes of common stock: Class B Construction & Mining Group Nonvoting Restricted Redeemable Convertible Exchangeable Common Stock (none of which is beneficially owned by management), Class C Construction & Mining Group Restricted Redeemable Convertible Exchangeable Common Stock (Class C), and Class D Diversified Group Convertible Exchangeable Common Stock (Class D).

Name	Number of Class C Shares	Percent of Class C Shares	Number of Class D Shares	Percent of Class D Shares
Walter Scott, Jr.	1,941,000	12.2%	2,410,857	12.1%
Kenneth E. Stinson	486,183	3.1	46,143	*
Robert E. Julian	294,892	1.9	269,892	1.4
James Q. Crowe	86,007	*	56,007	*
Richard R. Jaros	19,900	*	19,900	*
Royce J. Holland	19,000	*	9,000	*
David C. McCourt	—	—	—	—
Howard Gimbel	—	—	—	—
All directors and executive officers as a group (17 persons)	2,915,544	18.3	2,857,361	14.4

(*) Less than 1% of the outstanding shares of the class.

DESCRIPTION OF CAPITAL STOCK

The authorized capital stock of the Company consists of 125,000,000 shares of Common Stock, $.01 par value per share, and 1,000,000 shares of preferred stock, $.01 par value per share (the "Preferred Stock").

Common Stock

Holders of Common Stock are entitled to one vote for each share held on all matters submitted to a vote of stockholders and do not have cumulative voting rights. Accordingly, holders of a majority of the shares of Common Stock entitled to vote in any election of directors may elect all of the directors standing for election. Holders of Common Stock are entitled to receive ratably such dividends, if any, as may be declared by the Board of Directors out of funds legally available therefor, subject to any preferential dividend rights of outstanding Preferred Stock. Upon the liquidation, dissolution or winding up of the Company, the holders of Common Stock are entitled to receive ratably the net assets of the Company available after the payment of all debts and other liabilities and subject to the prior rights of any outstanding Preferred Stock. Holders of Common Stock have no preemptive, subscription, redemption or conversion rights. All the outstanding shares of Common Stock are, and the shares of Common Stock to be sold in the Offering when issued and paid for will be, fully paid and non-assessable. The rights, preferences and privileges of holders of Common Stock are subject to, and may be adversely affected by, the rights of the holders of shares of any series of Preferred Stock that the Company may designate and issue in the future.

Preferred Stock

Under the terms of the Company's Restated Certificate of Incorporation (the "Restated Certificate"), the Board of Directors is authorized, subject to any limitations prescribed by law, without stockholder approval, to issue such shares of Preferred Stock in one or more series. Each such series of Preferred Stock shall have such rights, preferences, privileges and restrictions, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation privileges, as shall be determined by the Board of Directors.

The purpose of authorizing the Board of Directors to issue Preferred Stock and determine its rights and preferences is to eliminate delays associated with a stockholder vote on specific issuances. The issuance of Preferred Stock, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, a majority of the outstanding voting stock of the Company. The Company has no present plans to issue any shares of Preferred Stock.

Delaware Law and Certain Charter and By-Law Provisions

The Company is subject to the provisions of Section 203 of the General Corporation Law of Delaware (the "DGCL"). Section 203 prohibits a publicly-held Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. A "business combination" includes mergers, asset sales and other transactions resulting in a financial benefit to the interested stockholder. Subject to certain exceptions, an "interested stockholder" is a person who, together with affiliates and associates, owns, or within three years did own, 15% of the corporation's voting stock.

The Restated Certificate contains certain provisions permitted under the DGCL relating to the liability of directors. The provisions eliminate a director's liability for monetary damages for a breach of fiduciary duty, except in certain circumstances involving wrongful acts, such as the breach of a director's duty of loyalty or acts or omissions which involve intentional misconduct or a knowing violation of law. Further, the Restated Certificate and the Company's By-Laws contain provisions to indemnify the Company's directors and officers to the fullest extent permitted by the DGCL, including payment in advance of a final disposition of a director's or officer's expenses and attorneys' fees incurred in defending any action, suit or proceeding. The Company believes that these provisions will assist the Company in attracting and retaining qualified individuals to serve as directors.

Transfer Agent and Registrar

The Transfer Agent and Registrar for the Common Stock is Continental Stock Transfer and Trust Company.

SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of the Offering, the Company will have outstanding 50,200,000 shares of Common Stock. Of these shares, the 8,500,000 Shares sold in the Offering will be freely tradeable without restriction or further registration under the Securities Act, except for any Shares purchased by an "affiliate" of the Company, which will be subject to the limitations of Rule 144 ("Rule 144") under the Securities Act.

Immediately following the Offering, KDG will own 41,700,000 shares of Common Stock, representing approximately 83.1% of the then outstanding shares of Common Stock. The Company, KDG and the Company's directors and executive officers have agreed not to offer, sell, contract to sell or otherwise dispose of, directly or indirectly, or announce an offering of, any shares of Common Stock, including any such shares beneficially or indirectly owned or controlled by any of them, or any securities convertible into, or exchangeable or exercisable for, shares of Common Stock for a period of 360 days from the consummation of the Offering without the prior written consent of the Representatives of the Underwriters, except for certain private sales to purchasers who agree to be bound by the Underwriters' lock-up.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated) who has beneficially owned his or her restricted securities (as that term is defined in Rule 144) for at least two years from the date such securities were acquired from the Company or an affiliate of the Company would be entitled to sell within any three-month period a number of shares that does not exceed the greater of (i) one percent of the then outstanding shares of the Common Stock (approximately 502,000 shares of Common Stock immediately after the Offering) and (ii) the average weekly trading volume of the common stock during the four calendar weeks preceding a sale by such person. Sales under Rule 144 are also subject to certain manner-of-sale provisions, notice requirements and the availability of current public information about the Company. Under Rule 144, however, a person who has held shares for a minimum of three years from the later of the date such securities were acquired from the Company or an affiliate of the Company and who is not, and for the three months prior to the sale of such shares has not been, an affiliate of the company, is free to sell such shares without regard to the volume, manner-of-sale and certain other limitations contained in Rule 144. Following expiration of the 360-day lock-up agreement with the Underwriters, 30,000,000 of the 41,700,000 shares of Common Stock owned by KDG will be eligible for sale pursuant to Rule 144.

Immediately following the Offering, the Company intends to register under the Securities Act the 6,000,000 shares of Common Stock issuable upon the exercise of options granted pursuant to the 1992 Stock Plan. Options to acquire approximately 700,000 shares of Common Stock will become exercisable upon the closing of the Offering. See "Management—Executive Compensation—Compensation Under Plans—1992 Stock Plan".

Prior to the Offering, there has been no established market for the Common Stock and no predictions can be made about the effect, if any, that market sales of shares of Common Stock or the availability of such shares for sale will have on the market price prevailing from time to time. Nevertheless, sales of substantial amounts of Common Stock in the public market may have an adverse impact on the market for the Shares.

UNDERWRITING

Subject to the terms and conditions set forth in an underwriting agreement among the Company and the Underwriters (the "Underwriting Agreement"), the Company has agreed to sell to each of the Underwriters named below, and each of the Underwriters, for whom Salomon Brothers Inc and Bear Stearns & Co. Inc. are acting as representatives (the "Representatives"), has severally agreed to purchase the number of Shares set forth opposite its name below:

Underwriter	Underwriting Commitment
Salomon Brothers Inc	
Bear, Stearns & Co. Inc.	
Total	8,500,000

In the Underwriting Agreement, the several Underwriters have agreed, subject to the terms and conditions set forth therein, to purchase all Shares offered hereby (other than the shares of Common Stock covered by the Underwriters' over-allotment option described below) if any such Shares are purchased. In the event of a default by any Underwriter, the Underwriting Agreement provides that, in certain circumstances, the purchase commitments of the nondefaulting Underwriters may be increased or the Underwriting Agreement may be terminated.

The Company has been advised by the Representatives that the Underwriters initially propose to offer the Shares to the public at the public offering price set forth on the cover page of this Prospectus and to certain dealers at such price less a concession not in excess of $ per Share. The Underwriters may allow, and such dealers may re-allow, a concession not in excess of $ per Share to other dealers. After the initial public offering, the public offering price and such concessions may be changed from time to time by the Underwriters.

The Company has granted to the Underwriters an option, exercisable during the 30-day period after the date of this Prospectus, to purchase up to 1,275,000 additional shares of Common Stock at the same price per Share as the initial 8,500,000 Shares to be purchased by the Underwriters. The Underwriters may exercise such option only to cover over-allotments in the sale of Shares that the Underwriters have agreed to purchase. To the extent that the Underwriters exercise such option, each of the Underwriters will have a firm commitment, subject to certain conditions, to purchase the same proportion of additional shares of Common Stock subject to the option as the number of Shares to be purchased and offered by such Underwriter in the above table bears to the total number of Shares initially offered by the Underwriters hereby.

The Underwriting Agreement provides that the Company will indemnify the Underwriters against certain liabilities and expenses, including liabilities under the Securities Act of 1933, as amended (the "Securities Act"), or contribute to payments the Underwriters may be required to make in respect thereof.

The Company, KDG and the Company's directors and executive officers have agreed not to offer, sell, contract to sell or otherwise dispose of, directly or indirectly, or announce an offering of, any shares of Common Stock, including any such shares beneficially or indirectly owned or controlled by any of them, or any securities convertible into, or exchangeable or exercisable for, shares of Common Stock for a period of 360 days from the consummation of the Offering without prior written consent of the Representatives, except for certain private sales to purchasers who agree to be bound by the Underwriters' lock-up. See "Shares Eligible for Future Sale."

The Underwriters do not intend to confirm sales to any accounts over which they exercise discretionary authority.

Prior to the Offering, there has been no public market for the Common Stock of the Company. The initial public offering price for the Shares has been determined by negotiation among the Company and the Representatives. Among the factors considered in determining the public offering price are the Company's financial and operating history and condition, its prospects and the prospects for its industry in general, the management of the Company, the market prices of securities for comparable companies and the general condition of the securities market at the time of the Offering. There can be no assurance, however, that the price at which the Shares will sell in the public market after the Offering will not be lower than the price at which they are sold by the Underwriters.

From time to time, Salomon Brothers Inc has rendered investment banking and advisory services to PKS and the Company for which it has received customary fees and expenses.

LEGAL MATTERS

The validity of the Shares offered hereby and certain other legal matters in connection with the Offering are being passed upon for the Company by Willkie Farr & Gallagher, New York, New York. Certain regulatory matters are being passed upon for the Company by Swidler & Berlin, Chartered, Washington, D.C. Andrew D. Lipman, an executive officer of the Company, is a member of Swidler & Berlin, Chartered. Certain legal matters in connection with the Offering are being passed upon for the Underwriters by Akin, Gump, Strauss, Hauer & Feld, L.L.P., Washington, D.C.

EXPERTS

The Consolidated Financial Statements of the Company as of December 28, 1991 and December 31, 1992 and for each of the years in the three-year period ended December 31, 1992 included in this Prospectus and the related schedules included elsewhere in the Registration Statement have been included in reliance upon the reports of Coopers & Lybrand, independent certified public accountants, appearing herein and elsewhere in the Registration Statement, and upon the authority of said firm as experts in accounting and auditing.

AVAILABLE INFORMATION

The Company has filed with the Securities and Exchange Commission (the "Commission") a Registration Statement on Form S-1 under the Securities Act, with respect to the Shares. For the purposes hereof, the term "Registration Statement" means the original Registration Statement and any and all amendments thereto, including the schedules and exhibits to such original Registration Statement or any such amendment. This Prospectus does not contain all of the information set forth in the Registration Statement, to which reference hereby is made. Each statement made in this Prospectus concerning a document filed as an exhibit to the Registration Statement is qualified in its entirety by reference to such exhibit for a complete statement of its provisions. Any interested party may inspect the Registration Statement, without charge, at the public reference facilities of the Commission at its principal office at Judiciary Plaza, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549, and at its regional offices in Chicago (Northwestern Atrium Center, Suite 1400, 500 West Madison Street, Chicago, Illinois 60661), and in New York (Seven World Trade Center, 13th Floor, New York, New York 10048). Any interested party may obtain copies of all or any portion of the Registration Statement at prescribed rates from the Public Reference Section of the Commission at its principal office at Judiciary Plaza, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549.

GLOSSARY

Access charges—The fees paid by long distance carriers to LECs for originating and terminating long distance calls on their local networks.

ATM (asynchronous transfer mode)—An information transfer standard that is one of a general class of packet technologies that relay traffic by way of an address contained within the first five bytes of a standard fifty-three byte-long packet or cell. The ATM format can be used by many different information systems, including LANs, to deliver traffic at varying rates, permitting a mix of data, voice and video.

CAP (competitive access provider)—A company that provides its customers with an alternative to the LEC for local transport of private line and special access telecommunications services.

Central offices—The switching centers or central switching facilities of the LECs.

Collocation—The ability of a CAP such as the Company to connect its network to the LEC's central offices. Physical collocation occurs when a CAP places its network connection equipment inside the LEC's central offices. Virtual collocation is an alternative to physical collocation pursuant to which the LEC permits a CAP to connect its network to the LEC's central offices at competitive prices, even though the CAP's network connection equipment is not physically located inside the central offices.

Dedicated—Telecommunications lines dedicated or reserved for use by particular customers along predetermined routes (in contrast to telecommunications lines within the LEC's public switched network).

Digital—A method of storing, processing and transmitting information through the use of distinct electronic or optical pulses that represent the binary digits 0 and 1. Digital transmission and switching technologies employ a sequence of these pulses to represent information as opposed to the continuously variable analog signal. The precise digital numbers preclude any distortion (such as graininess or snow in the case of video transmission, or static or other background distortion in the case of audio transmission).

Diverse routing—A telecommunications network configuration in which signals are transported simultaneously along two different paths so that if one cable is cut, traffic can continue in the other direction without interruption to its destination. The Company's networks generally provide diverse routing.

DS-0, DS-1, DS-3—Standard telecommunications industry digital signal formats, which are distinguishable by bit rate (the number of binary digits (0 and1) transmitted per second). DS-0 service has a bit rate of 64 kilobits per second. DS-1 service has a bit rate of 1.544 megabits per second and DS-3 service has a bit rate of 45 megabits per second.

Facilities Management—Management, operation, maintenance, staffing and support of telecommunications networks or systems.

FCC—Federal Communications Commission.

Fiber mile—The number of route miles installed (excluding pending installations) along a telecommunications path multiplied by the number of fibers along that path. See the definition of "route mile" below.

Groupware—Software which enables a number of individuals to transmit electronic mail, scheduling information, data of common interest and other information over LANs connecting personal computers and workstations.

Interconnection Decisions—Rulings by the FCC announced in September, 1992, which require the BOCs and most other LECs to provide interconnection in LEC central offices to any CAP, long distance carrier or end user seeking such interconnection for the provision of interstate special access services and proposes similar interconnection as well as price disaggregation (unbundling) for switched access services.

Long distance carriers (interexchange carriers)—Long distance carriers provide services between local exchanges on an interstate or intrastate basis. A long distance carrier may also be a long distance resale company.

Kilobit—One thousand bits of information. The information-carrying capacity (i.e., bandwidth) of a circuit may be measured in "kilobits per second."

LANs (local area networks)—The interconnection of computers for the purpose of sharing files, programs and various devices such as printers and high-speed modems. LANs may include dedicated computers or file servers that provide a centralized source of shared files and programs.

Local exchange—A geographic area determined by the appropriate state regulatory authority in which calls generally are transmitted without toll charges to the calling or called party.

LECs (local exchange carrier)—A company providing local telephone services.

Megabit—One million bits of information. The information-carrying capacity (i.e., bandwidth) of a circuit may be measured in "megabits per second."

Multiplexing—An electronic or optical process that (i) combines a number of lower speed transmission lines into one high-speed line by splitting the total available bandwidth into narrower bands (frequency division) or by allotting a common channel to several different transmitting devices one at a time in sequence (time division).

Network Systems Integration—Involves the creation of a turnkey telecommunications network including (i) route and site selection and obtaining rights of way and legal authorizations to install the network; (ii) design and engineering of the system, including technology and vendor assessment and selection, determining fiber optic circuit capacity, and establishing reliability/flexibility standards; and (iii) project and construction management, including contract negotiations, purchasing and logistics, installation as well as testing and construction management.

POPs (points of presence)—Locations where a long distance carrier has installed transmission equipment in a service area that serves as, or relays calls to, a network switching center of that long distance carrier.

PUC (public utility commission)—A state regulatory body, established in most states, which regulates utilities, including telephone companies providing intrastate services.

Private line—A private, dedicated telecommunications connection between different locations (excluding long distance carrier POPs).

Public switched network—That portion of a LEC's network available to all users generally on a shared basis (i.e., not dedicated to a particular user). Traffic along the public switched network is switched at the LEC's central offices.

Redundant electronics—A telecommunications facility using two separate electronic devices to transmit a telecommunications signal so that if one device malfunctions, the signal may continue without interruption.

Route mile—The number of miles of the telecommunications path in which fiber optic cables are installed.

Special access services—The lease of private, dedicated telecommunications lines or "circuits" along the network of a LEC or a CAP (such as the Company), which lines or circuits run to or from the long distance carrier POPs. Examples of special access services are telecommunications lines running between POPs of a single long distance carrier, from one long distance carrier POP to the POP of another long distance carrier or from an end user to its long distance carrier POP. Special access services do not require the use of switches.

Switch—A device that opens or closes circuits or selects the paths or circuits to be used for transmission of information. Switching is a process of interconnecting circuits to form a transmission path between users.

Switched access transport services—Transportation of switched traffic along dedicated lines between the LEC central offices and long distance carrier POPs.

Switched traffic—Telecommunications traffic along the public switched network. This traffic is switched at the LEC's central offices.

Voice grade equivalent circuit—One DS-0. One voice grade equivalent circuit is equal to 64 kilobits of bandwidth.

MFS COMMUNICATIONS COMPANY, INC. AND SUBSIDIARIES

Index to Consolidated Financial Statements

REPORT OF INDEPENDENT ACCOUNTANTS

(Italicized language to be deleted prior to the effective date of the Prospectus.)

When the recapitalization referred to in Note 15 to the Consolidated Financial Statements has been consummated, we will be in a position to render the following report:

To the Stockholder and Board of Directors
MFS Communications Company, Inc.

We have audited the accompanying consolidated balance sheets of MFS Communications Company, Inc. and Subsidiaries as of December 28, 1991 and December 31, 1992 and the related consolidated statements of operations, changes in stockholder's equity, and cash flows for each of the three years in the period ended December 31, 1992. 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 includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of MFS Communications Company, Inc. and Subsidiaries as of December 28, 1991 and December 31, 1992, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1992 in conformity with generally accepted accounting principles.

As discussed in Note 3, the Company restated the consolidated financial statements to retroactively reflect the changes in the method of computing depreciation in 1990 and, in 1992, changed its method of accounting for income taxes.

COOPERS & LYBRAND

Omaha, Nebraska
February 26, 1993

MFS COMMUNICATIONS COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three Years Ended December 31, 1992
(dollars in thousands, except per share amounts)

	1990	1991	1992
Revenue	$ 10,672	$ 37,223	$108,707
Costs and expenses:			
Operating expenses	13,971	33,963	76,667
Depreciation and amortization	7,990	11,761	20,544
General and administrative expenses	11,590	18,429	23,267
	33,551	64,153	120,478
Loss from operations	(22,879)	(26,930)	(11,771)
Other income (expense):			
Interest income	816	277	334
Interest expense	(9,188)	(1,619)	(788)
Other	320	28	(338)
Total other income (expense)	(8,052)	(1,314)	(792)
Loss before income taxes	(30,931)	(28,244)	(12,563)
Provision for income taxes	—	—	(566)
Net loss	$(30,931)	$(28,244)	$ (13,129)
Pro forma loss per common and common equivalent share			$ (0.30)

The accompanying notes are an integral part of the Consolidated Financial Statements.

MFS COMMUNICATIONS COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 28, 1991 and December 31, 1992
(dollars in thousands, except per share amounts)

	1991	1992
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,360	$ 12,825
Marketable securities	—	45,965
Accounts receivable	6,441	16,128
Costs and earnings in excess of billings on uncompleted contracts	10,080	971
Deferred income taxes	—	1,142
Other current assets	4,266	4,102
Total current assets	22,147	81,133
Networks and equipment, net	140,904	206,698
Other assets, net	41,768	75,468
Total assets	$204,819	$363,299
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 504	$ 22
Accounts payable	7,454	14,838
Due to affiliates, net	8,197	4,030
Accrued cost and billings in excess of revenue on uncompleted contracts	612	12,309
Other current liabilities	4,255	6,794
Total current liabilities	21,022	37,993
Long-term debt	7,659	169
Other noncurrent liabilities	6,197	5,107
Deferred income taxes	—	13,752
Minority interest	7,403	7,762
Stockholder's equity:		
Common stock of $.01 par value. Authorized 125,000,000 shares; issued 100 shares	10	10
Additional paid-in capital	242,319	404,033
Foreign currency adjustment	50	53
Accumulated deficit	(79,841)	(105,580)
Total stockholder's equity	162,538	298,516
Total liabilities and stockholder's equity	$204,819	$363,299

The accompanying notes are an integral part of the Consolidated Financial Statements.

MFS COMMUNICATIONS COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY

For the Three Years Ended December 31, 1992
(dollars in thousands)

	Common Stock	Additional Paid-in Capital	Foreign Currency Adjustment	Accumulated Deficit	Total
Balance at December 31, 1989	$10	$ 11,604	$—	$ (20,666)	$ (9,052)
Contribution from parent	—	3,244	—	—	3,244
Net loss	—	—	—	(30,931)	(30,931)
Balance at December 29, 1990	10	14,848	—	(51,597)	(36,739)
Capitalization of parent advances	—	110,251	—	—	110,251
Contribution from parent	—	117,220	—	—	117,220
Foreign currency adjustment	—	—	50	—	50
Net loss	—	—	—	(28,244)	(28,244)
Balance at December 28, 1991	10	242,319	50	(79,841)	162,538
Contribution from parent	—	161,714	—	—	161,714
Deemed distribution to parent	—	—	—	(12,610)	(12,610)
Foreign currency adjustment	—	—	3	—	3
Net loss	—	—	—	(13,129)	(13,129)
Balance at December 31, 1992	$10	$404,033	$53	$(105,580)	$298,516

The accompanying notes are an integral part of the Consolidated Financial Statements.

MFS COMMUNICATIONS COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Years Ended December 31, 1992
(dollars in thousands)

	1990	1991	1992
Cash flows from operating activities:			
Net loss	$(30,931)	$ (28,244)	$(13,129)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	7,990	11,761	20,544
Deferred interest on debt	729	644	523
Changes in assets and liabilities, net of effects from acquisitions:			
Accounts receivable and other current assets	(4,451)	(10,544)	(252)
Other liabilities	(1,032)	4,418	21,055
Net cash provided by (used in) operating activities	(27,695)	(21,965)	28,741
Cash flows from investing activities:			
Purchases of network and equipment	(39,140)	(51,210)	(80,010)
Acquisition of businesses, excluding cash acquired	—	(41,201)	(3,161)
Acquisition of minority interest in subsidiary	—	—	(27,000)
Purchases of marketable securities	—	—	(45,970)
Increase in deferred costs and other	(1,818)	(1,196)	(7,687)
Other	(167)	102	(1,116)
Net cash used in investing activities	(41,125)	(93,505)	(164,944)
Cash flows from financing activities:			
Principal payments on debt	(3,168)	(13,824)	(9,879)
Advances (repayments) from (to) affiliates	55,352	7,417	(4,167)
Capital contributions from parent	3,244	117,220	161,714
Net cash provided by financing activities	55,428	110,813	147,668
Net increase (decrease) in cash and cash equivalents	(13,392)	(4,657)	11,465
Cash and cash equivalents, beginning of year	19,409	6,017	1,360
Cash and cash equivalents, end of year	$ 6,017	$ 1,360	$ 12,825
Supplemental cash flow disclosures:			
Cash paid during the year for interest	$ 8,118	$ 1,643	$ 580
Supplemental disclosures of noncash investing and financing activities:			
Capital contributions by parent from conversion of debt to equity	$ —	$110,251	$ —
Deemed distribution to parent for utilization of net operating losses	$ —	$ —	$ 12,610

The accompanying notes are an integral part of the Consolidated Financial Statements.

MFS COMMUNICATIONS COMPANY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

1. Organization:

The consolidated financial statements include the accounts of MFS Communications Company, Inc. ("MFS", formerly Kiewit Communications Company, Inc.) and its majority owned subsidiaries (the "Company"). MFS was incorporated on July 17, 1987 in Delaware and is a wholly owned subsidiary of Kiewit Diversified Group Inc. ("KDG"), which is a wholly owned subsidiary of Peter Kiewit Sons', Inc. ("PKS"). To date, the Company has operated primarily through two of its subsidiaries, MFS Telecom, Inc. ("MFS Telecom") and MFS Network Technologies, Inc. ("MFS Network Technologies"). The Company has funded its activities through capital contributions by KDG through December 31, 1992.

MFS Telecom, a competitive access provider incorporated in 1988, provides private line and special access services to major businesses, governmental entities and long distance carriers in major metropolitan areas of the United States. MFS obtained a 50% common stock interest in MFS Telecom in May 1988 and increased its common stock interest in MFS Telecom to 80% in 1989, and to 100% in 1992.

MFS Network Technologies, a wholly owned network systems integrator, was incorporated in 1988. MFS Network Technologies' operations to date include the design, engineering, development and installation of telecommunications networks and systems for third parties and for all but one of MFS' fiber optic networks. In some of its third party projects, MFS Network Technologies also provides facilities management services. MFS Network Technologies is a participant in a joint venture that provides network systems integration services to customers in the United Kingdom.

Where appropriate, items within the consolidated financial statements and notes thereto have been reclassified from previous years to conform to current year presentation.

During 1992, the Company changed its fiscal year from one ending on the last Saturday in December to one ending on December 31. There were 52 weeks in each of the fiscal years 1990 and 1991 and 53 weeks in the fiscal year 1992.

2. Summary of Significant Accounting Policies:

(a) Principles of Consolidation:

The consolidated financial statements of the Company include the accounts of all of its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

In 1991, KDG contributed all issued and outstanding shares of MFS Network Technologies common stock to the Company. Accordingly, the transaction has been accounted for retroactively at historical cost in a manner similar to the pooling of interests method.

(b) Recognition of Revenue:

The Company recognizes revenue on telecommunications services in the month the related service is provided. Network systems integration revenue is recognized on the percentage-of-completion method of accounting. Under the percentage-of-completion method, an estimated percentage for each contract, as determined by the Company's engineering estimate based on the amount of work performed, is applied to total estimated profit. Provisions for losses are recognized on uncompleted contracts when they become known. Claims for additional revenue are recognized in the

2. Summary of Significant Accounting Policies:—(Continued)

period when settled. Revisions in cost and profit estimates during the course of the work are reflected in the accounting period in which the facts which require the revision become known.

(c) Classification of Current Assets and Liabilities:

In accordance with industry practice, amounts realizable and payable under network systems integration contracts which may extend beyond one year are includable in current assets and liabilities. A one-year time period is used as the basis for classification of all other current assets and liabilities.

(d) Networks and Equipment:

The networks and equipment are stated at cost. Various costs are capitalized during the installation and expansion of the networks. Provisions for depreciation are computed using straight-line methods over estimated useful lives beginning in the year an asset is put into service.

Electronic and related equipment, leasehold improvements, and furniture and office equipment are stated at cost. Leasehold improvements primarily consist of extensions off the network to customer locations. Depreciation is computed using primarily straight-line methods over the estimated useful lives of the assets.

At the beginning of 1991, the Company made a prospective change in the useful lives of certain components of networks and equipment. The estimated useful lives of certain network components were increased from 15 years to 20 or 25 years. Estimated useful lives were increased from 5 years to 7.5 years for certain electronics and from 7 years to 10 years for certain furniture and office equipment. These changes were adopted to present the Company's financial position and results of operations in conformity with practices generally applied in the telecommunications industry. The changes had the effect of reducing depreciation expense by approximately $3,600 in 1991.

(e) Intangible Assets

Costs incurred in developing new networks or expanding existing networks, including network design, negotiation of rights-of-way and obtaining legal/regulatory authorizations are deferred and amortized over five years.

Costs incurred to obtain access to buildings are deferred by the Company and amortized over 15 years. Costs incurred to obtain city franchises are deferred by the Company and amortized over the initial term of the franchise.

Pre-operating costs represent substantially all nondevelopment costs incurred during the pre-operating phase of a newly-constructed network. No pre-operating costs were deferred prior to 1990 because the Company was in the development stage and recoverability of such costs was uncertain. Pre-operating costs in 1990 and thereafter are deferred by the Company and amortized over 5-year periods commencing with the start of operations.

Goodwill is being amortized primarily over periods of 40 years from the dates of acquisition.

The costs of rights-of-way and a customer list obtained in business acquisitions are being amortized over estimated useful lives of 20 to 25 years and 7 years, respectively.

2. Summary of Significant Accounting Policies:—(Continued)

(f) Income Taxes:

The Company is included in the consolidated income tax returns of PKS. Income taxes are recognized as if the Company files its own income tax returns on a separate return basis.

In 1992, the Company adopted Statement of Financial Accounting Standards No. 109 ("SFAS 109"), "Accounting for Income Taxes", which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The adoption of SFAS 109 had no cumulative effect on the Consolidated Statement of Operations in 1992 because of significant net operating loss carryforwards.

(g) Minority Interest:

The Company has recorded the entire loss of other than wholly owned subsidiaries where the loss applicable to the minority interest exceeds the minority interest in such subsidiaries' equity.

(h) Translation of Foreign Financial Statements:

Assets and liabilities are translated into U.S. dollars at year-end exchange rates. Revenues and expenses are translated using the average rates of exchange for the period. Gains or losses resulting from foreign currency translation are recorded as adjustments to stockholder's equity.

(i) Cash Equivalents:

Cash equivalents generally consist of highly liquid debt instruments purchased with a maturity of three months or less.

(j) Marketable Securities:

Marketable securities are being carried at lower of cost or market.

(k) Financial Instruments:

Financial instruments which potentially subject the Company to concentration of credit risk consist principally of marketable securities and accounts receivable. At December 31, 1992, marketable securities consist of investment grade bonds issued by three corporations. Concentrations of credit risk with respect to accounts receivable are limited due to the dispersion of the Company's customer base among different industries and geographic areas and remedies provided by terms of contracts and statutes.

2. Summary of Significant Accounting Policies:—(Continued)

(l) Pro Forma Loss Per Share:

Pro forma loss per share has been computed using the number of shares of common stock and common stock equivalents outstanding after giving effect to the recapitalization (See Note 15). The number of shares used in computing pro forma loss per share was 43,568,571 in 1992. Pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 83, stock options granted with exercise prices below the assumed initial public offering price of $17.50 per share during the twelve-month period preceding the date of the initial filing of the Registration Statement have been included in the calculation of common stock equivalent shares, using the treasury stock method, as if they were outstanding for all of 1992.

3. Accounting Changes:

In 1990, the Company changed its accounting policy to depreciate network and equipment using the straight-line method. The new method of depreciation was adopted to present the Company's financial position and results of operations in conformity with the methods generally applied in the telecommunications industry. The Company retroactively restated its financial statements to reflect this change in connection with a proposed initial public offering. The effect of the change was to reduce the net loss for 1990 by $3,525.

In 1992, the Company changed its method of accounting for income taxes (see Note 2(f)).

4. Acquisitions:

In April 1990, the Company acquired 80% of the voting stock of Chicago Fiber Optic Corporation, now doing business as Metropolitan Fiber Systems of Chicago, Inc. ("MFS Chicago"). The acquisition was accounted for as a purchase. A portion of the cost of the stock acquired is based upon the fair market value of MFS Chicago in April 1993. Construction of the MFS Chicago network was completed in 1988; accordingly, the book value of assets and liabilities approximated their fair values at the date of acquisition. Liabilities assumed of $26,154 exceeded assets and therefore, the net deficit plus the consideration paid totaling $12,145 has been recorded as goodwill. Results of operations of MFS Chicago are included in the Company's consolidated results of operations since April 1, 1990.

During 1991, the Company acquired an additional 10% of the voting stock of MFS Chicago for a deferred purchase price based upon the MFS Chicago fair market value as of April 1993. The total contingent liability associated with the purchase of MFS Chicago will be assumed by KDG without recourse to the Company (see Note 15). The deferred purchase price will be recorded as additional goodwill and a capital contribution by KDG.

In October 1991, the Company acquired 85% of the voting stock of Institutional Communications Company, now doing business as Metropolitan Fiber Systems/Institutional Communications Company ("MFS/ICC"), for $41,201 in cash. MFS/ICC provides digital fiber optic telecommunications services to long distance carriers, governmental entities and major businesses in the District of Columbia and surrounding areas in Virginia and Maryland. The acquisition was accounted for as a purchase, and accordingly, the purchase price was allocated to the assets acquired and the liabilities assumed, as follows:

4. Acquisitions:—(Continued)

Assets:	
Receivables	$ 1,153
Other current assets	2,037
Networks and equipment	26,221
Rights-of-way	9,100
Customer list	4,900
Goodwill	11,850
Liabilities:	
Accounts payable	(761)
Accrued expenses	(2,600)
Long-term debt	(806)
Other noncurrent liabilities	(2,466)
Minority interest	(7,427)
	$41,201

Results of operations of MFS/ICC are included in the Company's consolidated results of operations since the date of acquisition.

The following unaudited pro forma information shows the results of the Company as though the above mentioned acquisitions occurred as of the beginning of the immediately preceding year in which the companies were acquired. These results include certain adjustments, primarily increased amortization, and are not necessarily indicative of what the results would have been had the acquisitions been made as of those dates or results that will occur in the future.

	1990	1991
Revenue	$ 21,746	$ 48,563
Loss before extraordinary item	(33,444)	(27,063)
Net loss	(33,444)	(26,120)

During 1992, the Company acquired certain assets of Boston Fiber Optic Company and the stock of Metrex Corporation for a total of $3,161. The effect on the Company's operations as a result of these acquisitions was not significant.

5. Disclosures about Fair Value of Financial Instruments:

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents:

The carrying amount approximates fair value because of the short maturity of those instruments.

Marketable Securities:

The fair values of the investments are estimated based on quoted market prices for those or similar investments and approximates cost.

6. Networks and Equipment:

Networks and equipment consists of the following:

	1991	1992
Telecommunications networks	$ 60,207	$ 88,267
Electronic and related equipment	62,911	97,173
Leasehold improvements	20,758	31,288
Furniture and office equipment	6,072	9,724
Network-in-progress	9,803	16,791
	159,751	243,243
Less accumulated depreciation	(18,847)	(36,545)
	$140,904	$206,698

7. Other Assets:

Other assets consist of the following:

	1991	1992
Deferred development and preoperating costs	$ 4,757	$12,525
Goodwill	25,471	52,471
Rights-of-way	9,100	10,580
Customer list	4,900	4,900
Other noncurrent assets	—	302
	44,228	80,778
Less accumulated amortization	(2,460)	(5,310)
	$41,768	$75,468

During 1992, the Company acquired the remaining 20% of MFS Telecom's stock held by minority shareholders. The purchase price was $27,000 and has been reflected in the consolidated balance sheet as goodwill.

8. Long-term Debt:

Long-term debt consists of the following:

	1991	1992
Subordinated notes and deferred interest	$7,146	$ —
Other notes payable	1,017	191
	8,163	191
Less current portion	(504)	(22)
	$7,659	$169

Interest on the subordinated notes accrued at various rates ranging from 9% to 12%. Scheduled maturities of long-term debt are as follows:

1993	$ 22
1994	154
1995	15
	$191

9. Income Taxes:

The Company is included in the consolidated income tax returns of PKS. Income taxes are recognized on a separate return basis as if the Company files its own income tax returns. Payments the Company received for tax benefits generated by the Company prior to 1992 of approximately $5,000 have been reflected as capital contributions.

The Company and its parent entered into the Tax Sharing Agreement pursuant to which the parent has agreed to indemnify the Company against federal, state or local income tax liabilities of the consolidated or combined group of which the parent is the common parent for taxable periods beginning on or after January 1, 1993 during which the Company is a member of such group. In addition, pursuant to the Tax Sharing Agreement, for all taxable periods beginning on or after January 1, 1993, the Company will pay to the parent amounts equal to the taxes that the Company would otherwise have to pay if it were to file separate federal, state or local income tax returns, except that the Company will not be entitled to carry forward certain net operating losses generated prior to January 1, 1993. The adoption of the Tax Sharing Agreement resulted in an increase in the net deferred tax liability of $12,610 with no offsetting benefit from the net operating losses utilized by KDG. This amount has been reflected in the Consolidated Financial Statements as a deemed distribution to KDG. The Company will recognize tax benefits on losses incurred subsequent to January 1, 1993 only to the extent the Company can utilize those benefits on a separate return basis.

Substantially all of the Company's loss before income taxes is derived from United States sources.

Income tax expense for 1992 consists of the following:

	Federal	State	Total
Current	$—	$566	$566

The actual income tax expense differs from the "expected" income tax benefit (computed by applying the U.S. federal corporate tax rate of 34% to loss before income taxes) as follows:

Federal income tax benefit at statutory rate	$(4,272)
Unutilized tax benefit due to net operating losses	3,904
Goodwill amortization	368
State income taxes	566
	$ 566

The components of the net deferred tax liability as of December 31, 1992 were as follows:

Deferred tax liabilities:	
Deferred charges	$ 2,970
Accumulated depreciation	11,255
Total deferred tax liabilities	14,225
Deferred tax assets	1,615
Net deferred tax liability	$12,610

10. Related Party Transactions:

During 1990, the Company incurred interest expense of $7,230 relating to interest-bearing advances made by the Company's parent. Interest on the advances accrued at 7/8 of 1% above the three-month London Interbank Offered Rate. In 1991, an aggregate of $110,251 of such advances was contributed by KDG to the Company's capital.

The Company incurred expense for administrative services provided by an affiliate as follows:

1990	$214
1991	518
1992	850

Certain employees of the Company were participants in the PKS profit sharing and long-term incentive plans. Expenses incurred for the three years ended December 31, 1992 under these plans were not significant.

11. Commitments and Contingencies:

Under the terms of stockholder agreements, from time to time, minority stockholders in certain subsidiaries have the option to put shares to the Company at a purchase price equal to an appraised value of such shares.

The Company has issued standby letters of credit to various city governmental agencies and building lessors, amounting to approximately $9,800 at December 31, 1992. It is management's belief that the underlying obligations will be met in the normal course of business without material adverse effect on the Company's financial position. The Company is obligated under rights-of-way and franchise agreements with various entities for the use of their rights-of-way for the installation of its telecommunications systems. Certain of these agreements provide for minimum payments based on the Company's financial performance. Also, the Company is leasing premises under various operating leases which, in addition to rental payments, require payments for insurance, maintenance, property taxes and other executory costs related to the leases. The lease agreements have various expiration dates and renewal options through 2006.

11. Commitments and Contingencies:—(Continued)

Rent expense under lease agreements was $2,702 in 1990, $4,664 in 1991 and $5,927 in 1992. At December 31, 1992, minimum annual payments under these commitments are as follows:

Year	Franchise and Rights-of-Way Agreements	Operating Leases
1993	$1,888	$ 5,432
1994	1,480	6,174
1995	1,480	5,863
1996	1,001	5,657
1997	430	5,248
Thereafter	3,877	17,609

12. Incentive Compensation Rights Plan:

MFS Telecom had an incentive compensation plan, under which rights were granted to individual employees at the discretion of MFS Telecom's Board of Directors. On November 23, 1992, the MFS Telecom Board of Directors terminated the plan. As of that date, a total of 694,616 rights under the plan were outstanding. MFS Telecom has acquired all outstanding rights for $1.00 per right.

13. Stock Plan:

On November 23, 1992, the Board of Directors adopted the 1992 Stock Plan, which authorizes, among other things, the grant of options at not less than 100% of the fair market value at the date of the option grant. On that date an aggregate of 6,000,000 shares of Common Stock were reserved for the exercise of nonqualified stock options that have been granted under the 1992 Stock Plan at an exercise price of $12.05. The number of shares and exercise price reflect the recapitalization described in Note 15. The Compensation Committee of the Board of Directors administers the 1992 Stock Plan. The options vest over a five year period. Certain non-executive employees have received credit for years of past service. As of December 31, 1992, options for 273,131 shares of Common Stock are vested and exercisable, subject to the provisions of the 1992 Stock Plan.

14. Segment Industry Data:

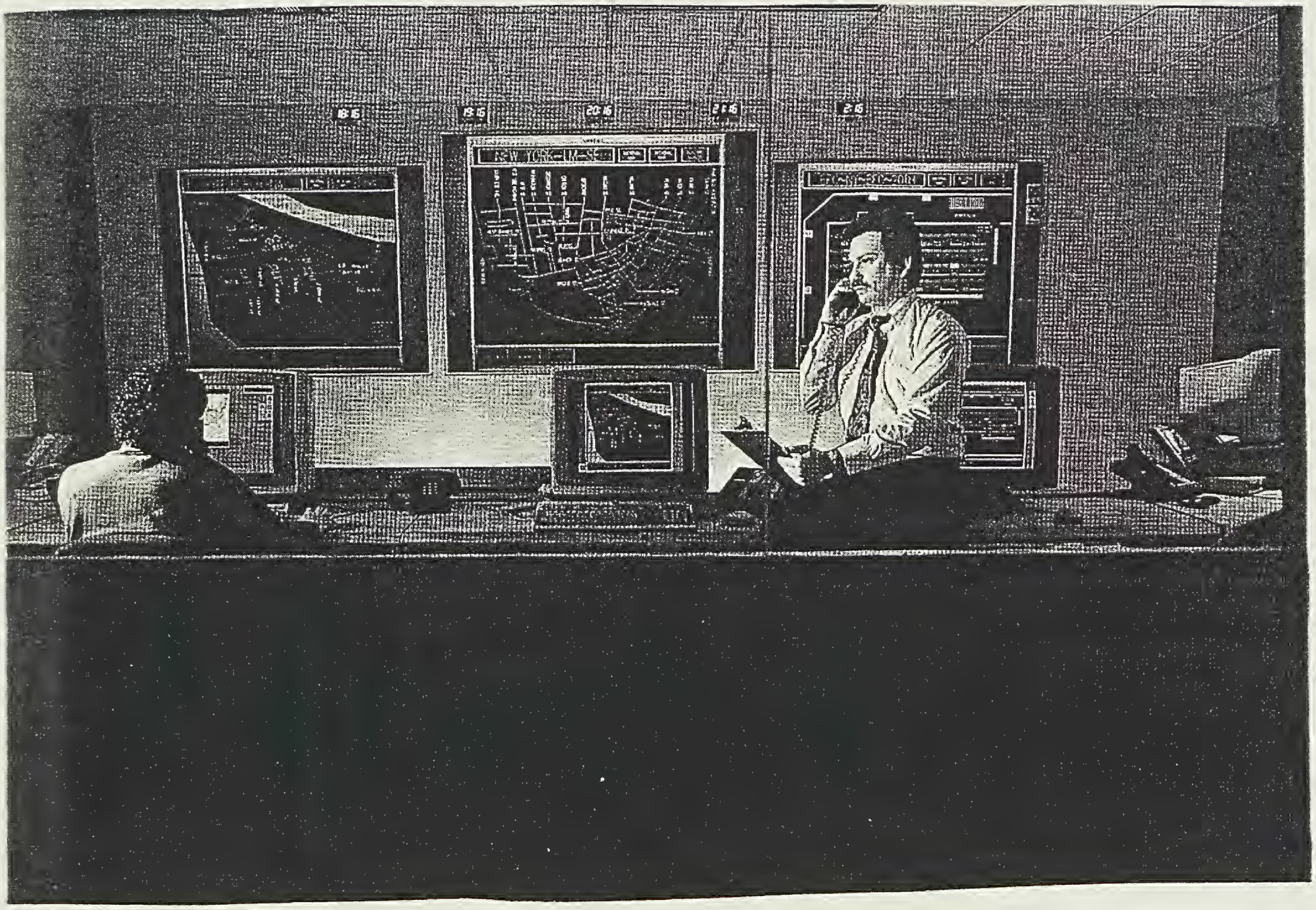
The Company operates in two reportable segments primarily within the United States; telecommunications services and network systems integration and facilities management services. A summary of the Company's operations by industry follows:

	1990	1991	1992
Revenue:			
Telecommunications services	$ 8,951	$ 23,158	$ 47,585
Network systems integration and facilities management	20,873	35,147	94,007
Intersegment activity	(19,152)	(21,082)	(32,885)
	$ 10,672	$ 37,223	$108,707
Operating income (loss):			
Telecommunications services	$ (22,424)	$ (24,373)	$ (18,426)
Network systems integration and facilities management	(311)	(2,551)	6,287
	(22,735)	(26,924)	(12,139)
Interest expense, net	(8,372)	(1,342)	(454)
Unallocated income	176	22	30
Loss before income taxes	$ (30,931)	$ (28,244)	$ (12,563)
Identifiable assets:			
Telecommunications services	$ 96,121	$190,241	$339,488
Network systems integration and facilities management	13,023	18,003	33,043
Intersegment activity	(6,185)	(3,425)	(9,232)
	$102,959	$204,819	$363,299
Capital expenditures:			
Telecommunications services	$ 39,133	$ 50,577	$ 79,036
Network systems integration and facilities management	7	633	974
	$ 39,140	$ 51,210	$ 80,010
Depreciation and amortization:			
Telecommunications services	$ 7,964	$ 11,633	$ 20,164
Network systems integration and facilities management	26	128	380
	$ 7,990	$ 11,761	$ 20,544

The Company generated 42% of its revenue from a contract with the Department of General Services—State of Iowa, during 1992, relative to a network systems integration project.

15. Recapitalization:

As of September 30, 1992, the Company increased authorized common shares from 1,000 to 125,000,000 and reduced the par value of the common shares from $100 to $.01 per share. Subsequent to September 30, 1992, KDG made additional capital contributions to the Company including $30,000 in the first quarter of 1993. KDG also agreed to assume the contingent liability for the deferred purchase price related to the MFS Chicago acquisition (see Note 4). As a result of these transactions and a recapitalization of KDG's shares outstanding as of September 30, 1992, the Company agreed to issue 41,700,000 shares of common stock to KDG in exchange for contributions and the assumption of the contingent liability by KDG. Pro forma per share information for 1992 reflects this recapitalization of the Company.



Network Operations Control Center in Oakbrook Terrace, Illinois

No dealer, salesperson or any other person has been authorized to give any information or to make any representations other than those contained in this Prospectus in connection with the offer made by this Prospectus and, if given or made, such information or representations must not be relied upon as having been authorized by the Company or by any of the Underwriters. Neither the delivery of this Prospectus nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of the Company since the date hereof. This Prospectus does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to anyone to whom it is unlawful to make such offer or solicitation.

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Until , 1993, all dealers effecting transactions in the Common Stock, whether or not participating in this distribution, may be required to deliver a Prospectus. This delivery requirement is in addition to the obligation of dealers to deliver a Prospectus when acting as Underwriters and with respect to their unsold allotments or subscriptions.

8,500,000 Shares

MFS Communications Company, Inc.

Common Stock
($.01 par value)

Salomon Brothers Inc

Bear, Stearns & Co. Inc.

Prospectus

Dated , 1993