DICKSTEIN SHAPIRO MORIN & OSHINSKY LLP
2101 L Street NW • Washington, DC 20037-1526
Tel (202) 785-9700 • Fax (202) 887-0689
Writer's Direct Dial: (202) 833-5017
E-Mail Address: FurmanV@dsmo.com

June 2, 2000

VIA FEDERAL EXPRESS

K. David Waddell, Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

Re: - Birch Telecom of the South, Inc. (Docket No. 00-00341)

Dear Mr. Waddell:

On behalf of Birch Telecom of the South, Inc. ("Birch"), we hereby submit an original and thirteen (13) copies of Birch's responses to a May 5, 2000 data request from Mr. Darrell Whitis of the Tennessee Regulatory Authority's ("TRA") staff.

Birch responses are as follows:

Administrative Requirements

Birch has attached hereto as Exhibit A an organizational chart reflecting its corporate structure. Because Birch is a newly-formed corporation, it has not as yet been involved in any mergers or acquisitions.

Technical Qualifications

1. As stated in its application, Birch requests authority to provide interexchange and local exchange telecommunications services on a statewide basis in the State of Tennessee through the use of resale as well as its own facilities. With respect to its local exchange operations, Birch initially intends to provide service to customers in BellSouth's exchange areas in the State of Tennessee, but plans in the future to enter into agreements with other incumbent local exchange carriers to permit Birch to provide local exchange service in additional service areas within the state. Although Birch's initial operations in the State of Tennessee will be in BellSouth's exchange areas, Birch requested in its application authority to provide resold and facilities-based local exchange services on a statewide basis at this time, to afford Birch the

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1177 Avenue of the Americas • 41st Floor • New York, New York 10036-2714
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http://www.dsmo.com

flexibility to easily and quickly expand its operations and/or install its own facilities in additional as Birch deems necessary or desirable consistent with its business plans. Authorizing Birch to provide facilities-based local exchange services on a statewide basis at this time is in the public interest, because it will eliminate the need for the TRA and Birch to engage in repeated (and essentially redundant) "site-by-site" review proceedings, thereby conserving both the TRA's and Birch's resources.

2. As stated above, Birch requests authority to provide interexchange and local exchange telecommunications services on a statewide basis in the State of Tennessee through the use of resale as well as its own facilities. With respect to its local exchange operations, Birch intends to resell the local exchange telecommunications services of BellSouth in BellSouth's exchange areas throughout the State of Tennessee, and also to provide facilities-based service using its unbundled network element platform ("UNE-P") strategy in various as-yet-undetermined locations in Tennessee. Birch may also in the future deploy its own switches for the provision of local exchange service as Birch deems necessary or desirable consistent with its business plans. As stated above, although Birch's initial operations in the State of Tennessee will be in BellSouth's exchange areas, Birch requested in its application authority to provide resold and facilities-based local exchange services on a statewide basis at this time, to afford Birch the flexibility to easily and quickly expand its operations and/or install its own facilities in additional areas as Birch deems necessary or desirable consistent with its business plans.

3. As stated on page 6 of its application, Birch's Tennessee customers will not be required to purchase Customer Premises Equipment ("CPE") that would not be compatible with BellSouth or other ILEC systems, should a Birch customer decide to return to BellSouth or another ILEC.

Financial Qualifications

1. As stated in its application, Birch intends to provide services to its customers through a combination of leased and owned network facilities and resold services. Birch will use an UNE-P strategy, and will lease substantially all of the unbundled network elements necessary to provide service to customers from incumbent telephone companies. A three-year Capital Costs budget, which includes information regarding the cost of the equipment, network, switches, and unbundled network elements to be deployed by Birch is attached hereto as Exhibit B.

   As stated in its application, Birch will rely on the financial resources of its parent corporation, Birch Telecom, Inc., to fund its Tennessee operations. Birch Telecom, Inc.'s financial resources are described in great detail in its 1999 SEC Form 10-K, a copy of which is attached hereto as Exhibit C.

2. In its data request, the TRA requested that Birch provide its 1999 audited financial statements (Income Statement, Balance Sheet and Statement of Cash Flow). However, as stated in its application, Birch is a newly-formed corporation, incorporated on February 8, 2000. As such, it does not have any financial statements for 1999. Birch has, however, attached hereto as Exhibit C the 1999 SEC Form 10-K of its parent corporation, Birch Telecom, Inc.

3. Birch has attached hereto as Exhibit B its projected financial statements for the next three years.

4. Birch's current financial statements and projections do not include any amounts related to reciprocal compensation for terminating ISP traffic.

5. Birch will comply with the requirements of T.C.A. §65-4-125, and is in the process of to procuring a corporate surety bond in the amount of twenty thousand dollars ($20,000) to secure the payment of any monetary sanction imposed in any enforcement proceeding brought under T.C.A. Title 65 or the Consumer Telemarketing Protection Act of 1990, by or on behalf of the TRA. Birch will, in accord with T.C.A. §65-4-125, forward the requisite corporate surety bond to the TRA immediately after it has been procured and prior to the September 1, 2000 statutory deadline.

IntraLATA Toll Dialing Parity Plan

In effort to prevent slamming from occurring, a Birch sales representative will meet with new customers to complete a sign-up form that requires the customer to state who their InterLATA and IntraLATA long distance PICs are and then sign the form as verification of their choice. New customers who do not meet directly with a sales representative will be sent the same form for completion. An order placed without this form properly completed and executed will be rejected. Each sales agent must attend training sessions and follow the protocol outlined above to ensure that new customers affirmatively select Birch to provide services.

Numbering Issues

1. Birch anticipates serving 75,000 customers in the State of Tennessee over the next five years. Due to number portability, Birch presumes that up to 95% of these customers will continue to use their current NXX. Given this, Birch's expected demand for NXXs per NPA during the first year after certification is quite small, with at most only one NXX likely to be required in the first year.

2. Birch anticipates that it may request up to three (3) NXXs from NANPA once the footprint is established. This number is subject to change, however, depending on whether or not problems appear with number portability, and depending on customer response.

3. Birch will establish its service footprint to cover all BellSouth territory in the State of Tennessee.

4. Birch will sequentially assign telephone numbers within NXXs.

5. Birch will attempt to conserve limited numbering resources by utilizing existing telephone numbers through number portability, and by reserving only those numbers that it determines necessary based upon its estimated customer base.

6. The percentage of fill in an existing NXX that Birch will use as an indication that new NXXs are needed for growth is yet to be determined, and will be based upon the rate of growth and use of existing and new telephone numbers.

<u>**Tennessee Specific Operational Issues**</u>

1. Birch will comply with all applicable rules and statutes, and, therefore, will comply with T.C.A. §65-21-114 by providing toll-free telephone service for all calls made between two points in the same county. In order to comply with the requirements of T.C.A. §65-21-114, Birch will charge a flat rate for all calls originating and terminating within the same county.

2. Birch is aware of the Tennessee County Wide Calling database maintained by BellSouth and will arrange with BellSouth to have Birch's telephone numbers entered on this database. Birch is in the process of contacting BellSouth in an effort to ascertain and understand the procedures for entering its numbers on the Tennessee County Wide Calling database.

3. Birch intends to provide metro area toll-free calling ("MAC") around Memphis, Nashville, Knoxville and Chattanooga, and is currently investigating the mechanisms available to enable Birch to provide MAC in these areas.

4. Birch is aware of the MAC database maintained by BellSouth, is in the process of contacting BellSouth in an effort to ascertain and understand the procedures for entering its numbers on the MAC database.

5. The employee at Birch who will be responsible for handling customer complaints is Charles Fuller, Vice President of Customer Service. Mr. Fuller can be reached at (800) 772-4724. The employee at Birch who will be responsible for working with the TRA on such complaints is Barbara Fillinger, Supervisor of Regulatory Complaints and Compliance. Ms. Fillinger can be reached at (816) 300-3290.

6. Birch intends to use direct marketing with a door-to-door sales force to market its services. Birch is aware of the telemarketing statutes and regulations, including the recently enacted Senate Bill 2904/House Bill 2610, which concerned the newly established do not call list. Birch will comply with these statutes and regulations.

<u>Miscellaneous</u>

1. Birch has attached hereto the sworn pre-filed testimony of Mr. Gregory C. Lawhon, Senior Vice President of Birch, which describes the services to be provided by Birch in the State of Tennessee, and Birch's technical, managerial, and financial abilities to provide such services.

2. Birch does not, as a matter of course, require either deposits or advance payments from customers or applicants for service. However, as stated in its tariff, Birch *may* require a customer or applicant for service to make an advance payment (1) if the applicant is unable to establish that he had a previous account with a telephone utility for a period of at least 12 months for which all undisputed charges were satisfactorily paid, or (2) if the applicant has had no previous telephone service or has had previous telephone service of less than 12 months. The customer or applicant for service's credit record will be accessed and evaluated by means of a mechanized retrieval system between Birch and nationally recognized credit bureaus.

   No security payment will be required of those applicants who meet Birch's criteria, as evaluated by the scoring model. The criteria used in assessing a score is as follows: collection judgments, written-off accounts, outstanding collection accounts, various degrees of delinquency history from 30-180 days and not paid in full or current at the time of scoring, bankruptcies, liens, other public records. The advance payment will not exceed an amount equal to all nonrecurring charges and two month's estimated recurring charges, as a condition of continued or new service. In addition, where special construction is involved, the advance payment may also include an amount equal to the estimated nonrecurring charges for the special construction and two month's estimated recurring charges. The advance payment will be credited to the customer's initial bill and, to the extent that a credit balance remains after the amount of the initial bill has been satisfied, then the credit balance will be applied to subsequent bills in the same manner until there is no balance remaining on the advance payment.

Birch reserves the right to examine the credit record of all service applicants as stated above and require a security deposit, not to exceed two month's estimated recurring charges, when determined to be necessary to assure future payment. The security deposit will be computed by Birch in accordance with Commission rules and regulations.

For residential customers, no deposit will be required, if it can be verified that the residential applicant has been a customer of any telephone company in Tennessee for the same kind of service within the last two (2) years, and is not delinquent in payment of any telephone service account and during the last 12 consecutive months of service did not have more than two occasions in which a bill for telephone service was paid after becoming delinquent, did not present a dishonored check, and never had service disconnected for nonpayment, or if the residential applicant furnishes in writing a satisfactory guarantee to secure payment of bills for the service required. Guaranty contracts shall be on a form provided by Birch which shall include Birch's right to transfer charges from a defaulted bill of the guaranteed account to the account or accounts of the guarantor. Guarantors must be present Birch customers and must be acceptable as guarantors to Birch.

For business customers, if the credit of an applicant for business service has not been established satisfactorily to Birch, the applicant may be required to make a deposit. Cash deposits will accrue interest at a rate that shall be equal to the current interest rate established by the Commission for consumer deposits. If the deposit is made within 30 days of receipt of deposit, no interest payment will be paid. If Birch retains the deposit more than 30 days, payment of interest shall be made retroactive to the date of deposit.

Payment of the interest to the customer shall be annually if requested by the customer, or at the time the deposit is returned or credited to the customer's account. The deposit shall cease to draw interest on the date it is returned or credited to the customer's account. The deposit shall cease to draw interest after the discontinuance of service.

If a customer pays all undisputed charges for 12 consecutive billing cycles, the deposit shall be promptly refunded along with accrued interest, or credited to future charges on subsequent bills.

A present customer may be required to post a new or additional deposit as a condition of continued service if undisputed charges have become delinquent in two out of the last 12 billing periods or if the customer has had service disconnected during the last 12 months, has presented a dishonored check or has had significant changes in toll or recurring charges. The amount of the deposit shall not exceed the estimated charges for two months tariffed services plus 30 percent of the monthly estimated charge for the customer.

If service is not connected, or after disconnection of service, Birch shall promptly and automatically refund the customer's deposit plus accrued interest on the balance, if any, in excess of the unpaid bills for service furnished. A transfer of service from one premises to another within the service area of Birch shall not be deemed a disconnection for application of deposits, and no additional deposit may be required unless otherwise permitted.

When the customer has paid bills for 12 consecutive months without having service disconnected for nonpayment and without having more than two occasions in which a bill was delinquent, and has not presented a dishonored check, and when the customer is not delinquent in the payment of the current bills, Birch shall promptly and automatically refund the deposit plus accrued interest in the form of a credit to the customer's bill, or void the guarantee. If the customer does not meet these refund criteria, the deposit and interest may be retained.

The deposit and interest may be retained pending the resolution of a dispute with respect to charges secured by the deposit.

Because Birch does not, as a matter of course, require either deposits or advance payments, and, may never in fact collect either from its Tennessee customers, Birch has not procured a bond for the amount of the deposits at this time.

3. Birch has attached hereto as <u>Exhibit D</u> a chart which identifies all complaints filed with state and federal regulatory agencies involving Birch or its affiliated entities, and describes the nature of the complaint, the governmental agency or office that received the complaint, and how was the complaint resolved.

We have included an extra copy of this filing, marked "Stamp and Return," as well as a self-addressed, pre-paid overnight airbill and delivery envelope. Please stamp and return the extra copy to confirm your receipt.

Please direct any inquiries regarding this filing to the undersigned.

Respectfully submitted,
BIRCH TELECOM OF THE SOUTH, INC.

By ______________________
Valerie M. Furman

VMF/clh
Enclosures

cc: Darrell Whitis (via facsimile)

1154458 v1; _QS@01!.DOC

EXHIBIT A

Organizational Chart of Birch's Corporate Structure

Birch Corporate Organization Chart

All Direct Wholly Owned Subsidiaries of Birch Telecom, Inc., Except for the Following Indirect Wholly Owned Subsidiaries:
Birch Telecom of Texas Ltd., L.L.P., American Local Telecommunications, L.L.C., G.B.S. Communications, Inc., and M.B.S. Leasing, Inc.

Name
State of Organization/Foreign Qualification
Function
Authorized/Issued Capital/Par Value

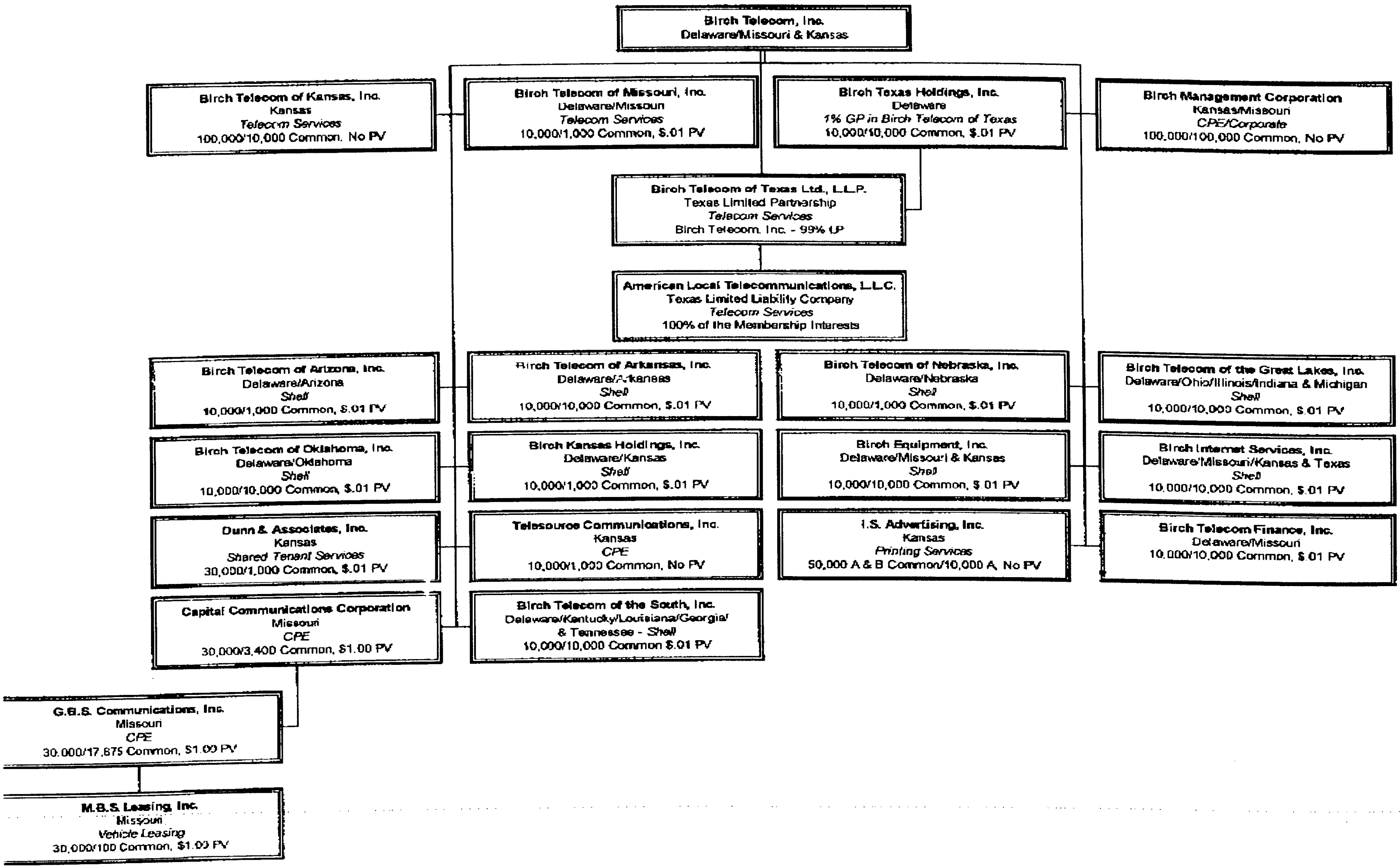

EXHIBIT B

Capital Costs and Projected Financial Statements

Income Statement

Budgeted (in millions)	2000	2001	2002	2003
Revenue	$-	$6.60	$25.50	$42.90
Cost of Sales	-	3.4	12.4	20.6
Gross Margin	-	3.2	13.1	22.3
General Expenses	1.1	6.6	7.9	9.5
Contribution	-1.1	-3.4	5.2	12.8

Balance Sheet

Budgeted (in millions)	2000	2001	2002	2003
Cash	$0	$0.00	$0.00	$0.00
Receivables	0	$2.00	$4.20	$6.30
Plant & Equipment (Capital Costs)	1.5	5.6	17.1	29.6
Total Assets	**1.5**	**7.6**	**21.3**	**35.9**
Accounts Payable	0.3	1.6	3.4	5
Investments	2.3	10.5	17.3	17.4
Contributions from Operations	-1.1	-4.5	0.7	13.5
Total Liabilities and Contributions	**1.5**	**7.6**	**5.2**	**12.8**

Statement of Cash Flows

Budgeted (in millions)	**2000**	**2001**	**2002**	**2003**
Cash flows from operations	-0.8	-4.1	$4.70	$12.40
Cash flows from investments	-1.5	-4.1	-11.5	-12.5
Cash flows from financing	2.3	8.2	6.8	0.1
Net change	**0**	**0**	**0**	**0**

EXHIBIT C

1999 SEC FORM 10-K REPORT OF BIRCH TELECOM, INC.

BIRCH TELECOM INC /MO

Filing Type: 10-K405
Description: Annual Report
Filing Date: Mar 30, 2000
Period End: Dec 31, 1999

Primary Exchange: N/A
Ticker: N/A

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EX-27.1

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

FORM 10-K

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1999

/ / TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER:
333-62797

BIRCH TELECOM, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	43-1766929 (I.R.S. EMPLOYER IDENTIFICATION NO.)
2020 BALTIMORE AVENUE KANSAS CITY, MISSOURI (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	64108 (ZIP CODE)

Registrant's telephone number, including area code:

(816) 300-3000

Securities registered pursuant to Section 12(b) of the Act:	Securities registered pursuant to Section12(g) of the Act:
14% senior notes due 2008 (Title of Class)	None (Title of Class)

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

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. There were 4,781,101 shares of common stock, $.001 par value, outstanding as of March 23, 2000.

PART I

THIS FORM 10-K CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF CERTAIN FACTORS, INCLUDING THOSE SET FORTH UNDER THE CAPTION "BUSINESS--RISK FACTORS" AND ELSEWHERE IN THIS FORM 10-K. UNLESS THE CONTEXT SUGGESTS OTHERWISE, REFERENCES IN THIS FORM 10-K TO "WE," THE "COMPANY" OR "BIRCH" MEAN BIRCH TELECOM, INC. AND ITS WHOLLY-OWNED SUBSIDIARIES.

ITEM 1. BUSINESS

OVERVIEW

We are a rapidly growing integrated communications provider. We seek to become the leading provider of telecommunications services for small and mid-sized businesses in each of the cities we serve. We offer state-of-the-art telecommunications services to our customers, who today are located throughout Missouri, Kansas and Texas. These voice and data service offerings include local and long distance telephone service, Internet access, web hosting, integrated voice and data transmission over broadband lines and customer premises equipment sales and services. We offer these services to our customers through a combination of leased and owned network facilities. We are currently deploying collocations and transmission equipment throughout our markets to deliver digital subscriber line service, which will support dedicated high-speed Internet access and eventually voice services. We expect to have over 130 collocations operational by the end of this year. Our revenue for the year ended December 31, 1999 was $60.5 million, a 132% increase over 1998.

BUSINESS STRATEGY

We believe that our business is poised for rapid expansion and that our experienced management team is well prepared to execute our focused business strategy. The key elements of our strategy include:

FOCUSING ON SMALL AND MID-SIZED BUSINESS CUSTOMERS

We focus on meeting the needs of small and mid-sized businesses in each of the cities we serve. Our tailored service offerings, direct sales model, and proactive customer service approach allow us to differentiate ourselves and achieve significant penetration into this very large, established customer base. We believe small and mid-sized businesses have not received a satisfying level of attention from the incumbent telephone companies, are unaware of their telecommunications network options and value our consultative, direct sales approach.

PROVIDING COMPLETE SERVICE PACKAGES THAT ARE TAILORED TO OUR CUSTOMERS

Our service offerings are specifically designed for the needs of our target customers. We provide simplified, feature-rich packages of services, superior value and a single source for all of our customers' networking requirements, all conveniently billed on a single invoice. Our service offerings include features offered in packages that we believe are not generally available from other providers. Our packages are priced to offer savings of 10% to 40% from comparable services provided by the incumbent telephone company. Our direct sales representatives consult with our customers in person and assist them in selecting service packages appropriate for their needs.

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CREATING A STRONG BRAND PRESENCE

We have quickly achieved a high level of brand awareness in our markets through an aggressive multi-media advertising campaign targeted at the incumbent telephone company. Our marketing efforts include billboard, radio and print advertising, as well as sponsorship of major local events, affiliations with local organizations and direct mailings. We believe we have been able to achieve a higher level of brand awareness in our markets than any other new market entrants. We plan to use our proven marketing and advertising strategy to help us achieve rapid and deep penetration in each new market we enter.

DEPLOYING A DIRECT SALES FORCE IN EACH OF OUR MARKETS

We deploy a large locally-based sales force focused on achieving a significant market share in each of our markets. We believe that our extensively marketed brand name, visible local presence, readily available services and emphasis on personal customer service have enabled our 170-person sales force to achieve high levels of productivity and quickly penetrate new markets.

INVESTING IN INDUSTRY-LEADING, SCALABLE BACK OFFICE SYSTEMS

We believe our state-of-the-art billing and operating systems are capable of supporting a significant number of lines. These systems, which include Saville Convergent Billing Platform-TM-, MetaSolv Telecom Business Solution-TM- and Harris Network Management-TM-, have already withstood the test of high volumes and rapid growth within our operation. Over the past year, we have expanded our provisioning capacity from 3,000 lines per month to nearly 15,000 lines per month and believe that our existing infrastructure can support continued capacity increases.

MAINTAINING MAXIMUM NETWORK FLEXIBILITY

- INTEGRATING DATA AND VOICE NETWORK SERVICES. By integrating both data and voice services, we believe we will be able to deliver a broadband digital subscriber line connection to a significant percentage of our customers. We believe this integration will yield bandwidth flexibility to our customers and the strategic advantage of an improved product with reduced monthly costs.

- CAPITALIZING ON OUR UNBUNDLED NETWORK ELEMENT PLATFORM. We provide service to a majority of our customers by leasing substantially all of the unbundled network elements from the incumbent telephone company and using our advanced back office systems to combine these elements into integrated Birch-branded voice services. This platform has allowed us to offer voice services to customers located virtually anywhere in our markets and achieve high gross margins and superior returns on incremental capital invested. The unbundled network element platform, or UNE-P, allows us to minimize current capital expenditures and maintain design flexibility for the next generation of telecommunications technology.

- POSITIONING FOR MASS DEPLOYMENT OF BROADBAND. Our network objective is to mass-deploy broadband facilities (primarily digital subscriber lines) that support both voice and data over a single line. We are implementing collocations at central offices of the incumbent telephone company throughout our markets and intend to deploy packet switches that can handle voice and data over a single line as soon as they become available.

EXPANDING OUR GEOGRAPHIC REACH

We currently serve 17 markets that have populations ranging in size from 95,000 to 4.5 million, and we intend to offer our services in 20 additional markets before the end of 2001. We expect to

expand our operations in Texas and into Oklahoma in the second quarter of this year and to commence service in the regions served by Ameritech and BellSouth in 2001. We have developed systems, network capabilities and an experienced sales force and customer service team that position us to rapidly penetrate these new markets and regions.

GROWING THROUGH ACQUISITIONS

We have completed six acquisitions since our inception in December 1996 for total consideration of $27.7 million. From time to time, we consider making additional acquisitions to further complement our service capabilities or expand our geographic scope. We believe we have been highly successful in integrating our acquisitions. With our diverse sources of capital and highly sophisticated stockholders and board members, we believe we are well positioned to continue to evaluate a variety of these opportunities and make selected acquisitions where appropriate.

TELECOMMUNICATIONS SERVICES

OFFERED SERVICES

We design our voice and data services to appeal to small and mid-sized businesses that value simple integrated communications service packages from a single provider. We believe that the key to attracting and retaining our target customers is to offer a comprehensive set of services. These services include voice offerings of local lines, features and long distance at flat per-minute rates, and data offerings including dedicated digital subscriber line and dial-up Internet access, web hosting and other data services.

We divide our service offerings generally into three broad categories: voice, Internet and web hosting. The chart below sets forth the different service packages and options provided within each of these categories.

SERVICE PACKAGES

VOICE

BIRCH BASIC
A standard line
BIRCH BELLS
Birch Basic with any three non-premium customer-selected features
BIRCH BELLS AND WHISTLES
Birch Basic with any seven customer-selected features
VOICE MAIL
Call answering, messaging and message waiting indicator
Optional features include fax mail, pager notification and extension mailboxes
LINEBACKER
Inside wire protection plan
MIGHTY MOUTH
A two-way dedicated connection to

us, a trunk level one digital transmission link, direct inward dialing and number identification for inbound calls

INTERNET

- - ------------------------------------

DIAL

Unlimited Internet access, two email boxes per account, remote access to email via the Web and five megabytes of storage space plus any customer-selected features

DIAL COMPLETE

Dial plus extended period of inactivity before disconnect

ISDN COMPLETE

A dedicated integrated services digital network, an on-premise integrated service digital network router, up to 25 email boxes, dedicated Internet protocol addresses for public applications, network address translation, custom domain services, plus any customer-selected features

DSL COMPLETE

A symmetric digital subscriber line service, an on-premise router, up to 100 email boxes, Internet protocol addresses for public applications, network address translation, custom domain services, plus any customer-selected features

T1 COMPLETE

A two-way dedicated connection to us, an on-premise router, up to 100 email boxes, Internet protocol addresses for public applications, network address translation, custom domain services, plus any customer-selected features

THE INTEGRATOR

A two-way dedicated connection to us, an on-premise integrated router for voice and data, customer selection of voice and data channels to a maximum of 48, selected voice features, up to 50 email boxes, Internet protocol addresses for public applications, network address translation, custom domain services, plus any customer-selected features

WEB HOSTING

- - ------------------------------------

SPACE GENIE

Space Genie web-building tool, 10 megabytes of storage, 1,000 megabytes of monthly traffic, online account status report, site submission to major search engines, custom domain services, 10 email addresses, autoresponders, autoforwarders and web-based management of email tools plus any customer-selected features

SPACE CADET

Space Genie plus 20 additional megabytes of storage, 1,000 additional megabytes of monthly traffic, common gateway interface binary access, and script library, web-based management of common gateway interface script auto-install and statistics plus any customer-selected features Additional optional features include encryption services support for real audio/video and support for Microsoft FrontPage extensions

SPACE HOG

Space Cadet plus an additional 45 megabytes of storage, 3,000 megabytes of monthly traffic, 10 email addresses, autoresponders and autoforwarders and support for real audio/video

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DELIVERY OF SERVICES

UNE-P

We lease all of the unbundled network elements necessary to provide service from the incumbent local exchange carriers. We believe that our UNE-P strategy allows us to enter into new markets more quickly than if we had initially deployed our own network facilities. This strategy also reduces initial capital requirements in each market, allowing us to focus our capital resources initially on the critical areas of sales, marketing and operations support systems. In addition, we believe UNE-P will allow us to avoid further deploying circuit switches and maintain design flexibility for the next generation of telecommunications technology.

BROADBAND

We intend to install digital subscriber line equipment at our collocation sites, at our switch sites and at our customers' locations. We believe this equipment will allow us to deliver multiple voice calls and data traffic over a single, standard telephone line and is expected to provide us with substantial cost savings. Using DSL technology, we believe we will increase the amount of information we carry on a standard telephone line, which we refer to as bandwidth, to up to 1.5 million bits per second. The bandwidth is the equivalent of 24 regular voice telephone lines. Our digital subscriber line equipment will be programmed to allocate the available bandwidth.

We believe this technology will reduce our costs since we will lease a reduced number of standard telephone lines per customer from the incumbent carrier. For example, if a customer today has eight voice lines, we must order from and provision through the incumbent carrier eight individual standard telephone lines. If the same customer were to buy our service which uses digital subscriber line technology, we would only order and provision one standard telephone line from the incumbent carrier. Also, we expect that future products and services designed to take advantage of the increased bandwidth provided by digital subscriber line technology will allow us to generate incremental revenue with attractive margins.

CUSTOMER PREMISES EQUIPMENT

We offer our customers equipment they need to run their internal phone systems, including data routers and wiring, telephone equipment and integrated access devices. We also sell and service standard key systems, private branch exchanges and voice-mail systems, and provide inside-wire services for commercial accounts, including wiring for data networking, in Kansas and Missouri. We are an authorized equipment distributor for Northern Telecom, Inc., Toshiba America Information Systems, Inc., NEC America, Inc., Executone Information Systems, Inc. and Tadiran Electronic Industries, Inc.

SALES AND MARKETING

SALES

As of March 23, 2000, we had a direct sales force of 170 representatives operating from 23 offices throughout Missouri, Kansas and Texas. Of these representatives, 28 were primarily selling customer premises equipment and the remaining 142 were selling local, long-distance, data and Internet services. The sales representatives are supported by sales managers. Over the next 12 months, we plan to increase our sales staff in existing markets and open additional sales offices in Texas and Oklahoma and in Ameritech's and BellSouth's regions. We supplement our sales efforts through brand awareness efforts including local and regional advertising, public relations and local sponsorships.

We seek to convert small to mid-sized business customers from the incumbent provider of telecommunications services in their market and to establish a solid, long-term relationship with them.

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Our sales representatives meet with prospective customers to gain a thorough understanding of their business and telecommunications requirements. Sales representatives then suggest alternatives for operation enhancements and cost savings based on our service packages.

We compensate our sales representatives with a competitive base salary, stock options and commissions based on sales results. We use a revenue-based commission structure that enables us to attract productive sales people experienced in disciplined, activity-based sales. This commission structure is based on incremental revenue and is not subject to a cap.

We do not actively market to residential customers. Nonetheless, we have found that our sales and promotional efforts attract residential customers, many of whom are owners or employees of businesses using our telecommunication services. Residential customers call our customer service center to receive forms to apply for service. We do not pay sales commissions for residential sales.

ADVERTISING AND PROMOTION

We conduct extensive marketing campaigns in our local markets. We make use of advertising and public relations to attract small to mid-sized business customers and contrast our service attributes with Southwestern Bell's. Our marketing campaign includes billboard, radio and print advertising, as well as sponsorship of major local events, affiliations with local organizations and direct mailings focusing on public relations. We also believe that our willingness to serve residential customers--unlike many other competitive local exchange carriers--creates greater interest in our development among the news media and general public. In the past, our market launches have attracted extensive local media coverage.

In keeping with our philosophy of being accessible to our customers, we establish local sales and customer service offices in most of the cities and towns that we serve. In many of these cities and towns, we are the only provider of local telephone service that maintains an office. Our offices are open to walk-in traffic and often are located in high-profile areas.

Because we are able to deliver a comprehensive set of products to our target customers, we believe we have strong customer loyalty. Our customer churn rates have generally been less than 1.5% per month.

PRICING

We do not intend to position ourselves as the cheapest provider of services, especially long distance services. We target customers who value the convenience of our service offerings and personalized customer service. Customers who have the highest price sensitivity are likely to move frequently among providers, driving up churn rates. However, we do set our pricing so that our local business customers can generally save from 10% to 40% on the incumbent provider's rates. Internet, long distance and customer premises equipment are generally priced at rates competitive with that of other service providers.

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OUR MARKETS

The following chart sets forth the markets in which we provide service or expect to provide service by May 2000.

MARKET	ESTIMATED POPULATION*	INITIAL SERVICE DATE	BIRCH LINES IN SERVICE AS OF FEBRUARY 29, 2000
St. Joseph, Missouri	97,111	March 1998	2,402
Topeka, Kansas	164,932	May 1998	9,720
Wichita, Kansas	530,508	May 1998	9,098
Kansas City, Missouri	1,709,273	May 1998	25,176
St. Louis, Missouri	2,557,806	May 1998	17,125
Beaumont, Texas	374,991	May 1999	3,824
Fort Worth, Texas	1,404,904	May 1999	8,202
Longview/Marshall, Texas	208,250	May 1999	742
Tyler, Texas	166,723	May 1999	2,017
Waco, Texas	202,983	May 1999	3,565
Houston, Texas	4,320,041	June 1999	7,985
Austin, Texas	1,071,023	July 1999	4,520
Corpus Christi, Texas	387,100	July 1999	2,888
Lubbock, Texas	230,672	August 1999	2,705
Dallas, Texas	3,278,109	February 2000	1,834
San Antonio, Texas	1,511,386	February 2000	341
Amarillo, Texas	208,165	March 2000	125
Midland/Odessa, Texas	243,389	April 2000	258
Wichita Falls, Texas	137,103	April 2000	19
Abilene, Texas	121,456	May 2000	54
El Paso, Texas	701,576	May 2000	31
Other	N/A	N/A	32,374

* Population data derived from the United States Bureau of the Census, State and Metropolitan Areas datebook 1997 to 1998.

BACK OFFICE SYSTEMS

Back office systems refer to the hardware and software systems that support the primary functions of our operations, including:

- order entry and provisioning;

- billing;

- data center;

- trouble management; and

- sales support.

Our goal is to have a back office that allows us to convert our customers' service from their current local providers to our networks easily and quickly. Over time, we strive to have "flow through" provisioning capabilities, allowing services to be implemented through a single systems interface that updates all ordering, inventory, billing and monitoring systems.

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We have implemented the primary elements of our back office, including order entry, provisioning, billing and network management. We believe we have selected the best application for each function. The following table describes our key back office systems that provide crucial operational functionality, their purpose and timeline for implementation.

SYSTEM	PURPOSE	IN-SERVICE DATE
Southwestern Bell Verigate	electronic direct ordering and provisioning for local telephone service	Q1 1998
Saville CBP(TM)	billing	Q1 1999
MetaSolv TBS(TM)	order management inventory provisioning trouble management customer service	Q2 1999
Harris HNM(TM)	network management	Q4 1998
DSET(TM)	electronic bonding gateway to incumbent telephone company	Q2 2000 (est.)
HNC ATACS(TM)	fraud management	Q2 2000 (est.)
TBD	enhanced call record mediation	Q3 2000 (est.)
TBD	application integration middleware	Q4 2000 (est.)
TBD	customer care sales force automation	Q4 2000 (est.)

ORDER ENTRY AND PROVISIONING

Order entry involves the initial loading of customer data into our information systems. Currently, our sales executives take orders and our customer care and provisioning representatives load the initial customer information into our Saville billing system and our MetaSolv provisioning system. We intend to increase the efficiency and data accuracy of these provisioning activities by implementing a sales force automation system to be combined with Saville CBP and MetaSolv TBS through application integration middleware. This system will facilitate entry of sales orders from the sales offices and transmit relevant account and order information to Saville CBP and MetaSolv TBS. Implementing this system will eliminate several manual steps in the provisioning process.

We use the MetaSolv TBS-TM- system to manage and track the timely completion of each step in the provisioning process. When MetaSolv is coupled with capabilities of the DSET electronic bonding system, we believe we will be able to submit orders to external business partners, including Southwestern Bell, electronically, thereby minimizing implementation time, coordination complexities and installation costs. Currently, we provision orders electronically through Southwestern Bell's electronic provisioning system, or Verigate.

In addition to the cost benefits associated with the electronic installation of access lines and inventory management system, the MetaSolv system improves our internal processes in various other ways, including:

- directing electronic customer orders to the appropriate employee, prompting them to complete required provisioning tasks, including network component assignments and management of outside vendor activities; and

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- tracking order progress and alerting operations personnel of steps required to fulfill orders within standard work intervals.

The MetaSolv TBS system enables a customer care coordinator to keep an installation on schedule and notify the customer of any potential delays. Once an order has been completed, we update our billing system to initiate billing of installed services.

BILLING

The Saville billing system provides our customers with a consolidated invoice for all of our services. Customer calls generate billing records that are transmitted from the call records to the Saville billing system. These records are then processed by the billing software, which calculates usage costs, integrates fixed monthly charges, calculates taxation and provides the data necessary to create a simple customer invoice. We provide invoice information to a third party printer, which prepares and distributes bills to our customers. Our customers pay us directly.

This Saville system allows us to add advanced features such as special discounts based on call volume, or number of services used, complex local taxation and discrete billing options by type of service ordered. We believe these features are exceptionally important given our sophisticated client base.

TROUBLE MANAGEMENT

We use MetaSolv TBS-TM-, a customer care and trouble management system, to provide high quality customer service. Our trouble management system is integrated into the operational support system. It enables our customer care personnel to track customer problems proactively, assign repair work to the appropriate technical teams and provide employees and management access to comprehensive reports on the status of service activity.

NETWORK MANAGEMENT

We use the Harris Network Management system to continuously monitor and operate our switch networks. The information provided by the Harris system allows our network operations staff to quickly repair problems in the networks, thereby eliminating or minimizing impacts to our customers.

SOUTHWESTERN BELL VERIGATE

Verigate is the Southwestern Bell end-user interface system that allows our customer service, trouble management and service provisioning representatives to access the Southwestern Bell operating systems. Verigate allows us to send local service requests to receive order commitments back from, reserve new telephone numbers with, view an order's status at, and test or report customer problems to Southwestern Bell.

DATA CENTER

During the second quarter 2000, we plan to occupy an 8,000 square foot data center in Kansas City, Missouri. We believe this center has sufficient space to support significant increases in our access lines, customers and employees.

NETWORK FACILITIES

LEASED FACILITIES

During 1999, we began to lease substantially all of the network elements from Southwestern Bell and combine these elements into integrated Birch-branded voice services without deploying a switch. By

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using UNE-P, we are able to offer our services to a broader geographical area than we can by using our own switches. Many of our competitors are limited to serving customers that are located near their facilities. UNE-P allows us to serve many customers in disparate geographic areas.

Where we have installed switches, we lease transmission facilities from Southwestern Bell to connect our switches to our collocated equipment in Southwestern Bell's central offices and to unbundled loops. Given the current capacity of existing local networks, we do not anticipate having to build local transmission facilities in the future. Similarly, we believe that the capacity of existing long-distance networks renders direct ownership of long distance transmission facilities unnecessary.

Leasing, rather than building, facilities supports our strategy of rapid local market development because our sales activity is not constrained by network expenditures. Moreover, by leasing transmission facilities, we can offer our services throughout a metropolitan area and we are not constrained by the limited number of locations in which we could build transmission facilities.

OWNED FACILITIES

We deploy data transmission packet switches in most of our markets. We use these packet switches to transmit data over our leased transmission lines and plan to use these packet switches to transmit our long distance voice traffic once our conversion plan is implemented.

We currently operate local/long distance circuit switches in Kansas City and St. Louis, Missouri and Wichita, Kansas. We do not intend to deploy more circuit switches because we believe voice-capable packet switches will be more economical to operate in the future. Additionally, we collocate our electronic equipment at Southwestern Bell's central offices to support future digital subscriber line services and existing circuit switches. Collocation allows us to connect to transmission lines we lease from Southwestern Bell.

At the customer's premises, we connect unbundled loops directly to customer-owned equipment. We may also deploy electronic equipment (intelligent channel banks or access servers) that concentrate data and voice traffic. This enables us to obtain higher capacity from the transmission line of the incumbent local exchange carrier.

OPERATIONS

EMPORIA AND KANSAS CITY SERVICE CENTERS

Our service centers in Emporia, Kansas and Kansas City, Missouri are critical to our ability to offer excellent service and to support growth. These service centers process orders, interface with Southwestern Bell's operational support systems and provide customer service, trouble resolution, billing and collection services for our customers. These service centers provide rapid, human assistance rather than the automated, cumbersome customer interface currently used by many telecommunications providers.

FIELD TECHNICAL OPERATIONS

Our field technicians service our facilities and customer-owned facilities. These technicians install, repair and maintain digital switches, transmission equipment, private branch exchanges, key systems, data equipment and inside wiring, including wiring for data networking. We believe field technicians are often the most respected source of telecommunications advice for small and mid-sized business customers. We believe that having a skilled, in-demand group of technicians supports our customer base, provides expertise for data deployment and strengthens customer loyalty.

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COMPETITION

The telecommunications industry is highly competitive. We believe we compete principally on the basis of customer service, accurate billing, variety of services and, to a lesser extent, pricing levels and less complex pricing structures. Our ability to compete effectively depends upon our continued ability to maintain high quality, market-driven services at prices generally equal to or below those charged by competitors. To maintain our competitive posture, we believe that we must be able to provide high quality integrated communications services and be positioned to reduce our prices in response to potential competition. Any of these reductions could adversely affect us. Many of our current and potential competitors have financial, technical, marketing, personnel and other resources, including brand name recognition, substantially greater than ours, as well as other competitive advantages over us.

INCUMBENT TELEPHONE COMPANIES

In our existing markets, we compete principally with Southwestern Bell. As a recent entrant in the telecommunications services industry, we may not achieve a significant market share for any of our services in our markets. In particular, Southwestern Bell and other local telephone companies have long-standing relationships with their customers, have financial, technical and marketing resources substantially greater than ours, have the potential to subsidize competitive services with revenue from a variety of businesses and currently benefit from existing regulations that favor these incumbent local exchange carriers over us in some respects. While recent regulatory initiatives, which allow competitive local exchange carriers such as us to interconnect with incumbent local exchange carrier facilities, provide increased business opportunities for us, these interconnection opportunities have been, and likely will continue to be, accompanied by increased pricing flexibility for and relaxation of regulatory oversight of the incumbent local exchange carriers. Future regulatory decisions could grant incumbent local exchange carriers increased pricing flexibility or other regulatory relief. These initiatives could also have a material adverse effect on us.

COMPETITIVE LOCAL EXCHANGE CARRIERS/INTEREXCHANGE CARRIERS/OTHER MARKET ENTRANTS

We also face competition from other current and potential market entrants. These market entrants include long distance carriers that compete with our long distance services and seek to enter, reenter or expand into the local exchange market. AT&T, GTE, MCI WorldCom and Sprint are among these carriers. Competitive local exchange carriers, resellers of local exchange services, competitive access providers, cable television companies, electric utilities, microwave carriers, wireless telephone system operators and private networks built by large end users also compete with us. In addition, consolidation and strategic alliances within the telecommunications industry, or the development of new technologies could put us at a competitive disadvantage. Not only does the Telecommunications Act impose regulatory requirements on all local telecomunications service providers, but it also grants the FCC expanded authority to reduce the level of regulation applicable to any telecommunications service provider, including any incumbent telecommunications service providers. The manner in which these provisions of the Telecommunications Act are implemented and enforced could have a material adverse effect on our ability to compete successfully against incumbent local exchange carriers and other telecommunications service providers.

The changes in the Telecommunications Act radically altered the market opportunity for new telecommunications service providers. Because the Telecommunications Act requires local exchange carriers to unbundle their networks, new telecommunications service providers are able to rapidly enter the market by installing switches and leasing trunk and loop capacity. Newer providers, like us and some competitors that we may encounter in some of our markets, will not have to replicate existing facilities until traffic volume justifies building them, and can be more opportunistic in designing and implementing networks.

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In addition to the new telecommunications service providers, interexchange carriers and other competitors listed above, we may face competition from other market entrants such as electric utilities, cable television companies and wireless companies. Electric utilities have existing assets and low cost access to capital which could allow them to enter a market rapidly and accelerate network development. Cable television companies are entering the telecommunications market by upgrading their networks with fiber optics and installing facilities to provide fully interactive transmission of broadband voice, video and data communications. Finally, wireless companies intend to develop wireless technology for deployment in the United States as a broadband substitute for traditional wireline local telephones. Some Internet companies are also developing applications to deliver switched voice communications over the Internet.

LONG DISTANCE SERVICES

The long distance telecommunications industry has numerous entities competing for the same customers and a high churn rate, as customers frequently change long distance providers in response to offerings of lower rates or promotional incentives. Prices in the long distance market have declined significantly in recent years and are expected to continue to decline. Our primary competitors are the major interexchange carriers and resellers of long distance services. We believe that pricing levels are a principal competitive factor in providing long distance service; however, we seek to avoid direct price competition by packaging long distance service, local service, customer premises equipment and Internet access service together with a simple pricing plan.

CUSTOMER PREMISES EQUIPMENT

We compete with numerous equipment vendors and installers and telecommunications management companies for the sale of customer premises equipment and related services. We generally offer our products at prices consistent with other providers and differentiate our service through our product packages.

DATA/INTERNET SERVICES

The Internet services market is highly competitive, and we expect that competition will continue to intensify. Internet service, meaning both Internet access and on-line content services, is provided by Internet service providers, satellite-based companies, long distance carriers and cable television companies. Many of these companies provide direct access to the Internet and a variety of supporting services to businesses and individuals. In addition, many of these companies, such as America Online, Inc., MSN, Prodigy Services Company and WebTV Networks, offer on-line content services consisting of access to closed, proprietary information networks. Long distance companies, among others, are aggressively entering the Internet access markets. Long distance carriers have substantial transmission capabilities, traditionally carry data to large numbers of customers and have an established billing system infrastructure that permits them to add new services. Satellite companies are offering broadband access to the Internet from desktop PCs. Cable companies are starting to provide Internet services using cable modems to customers in major markets. Many of these competitors have substantially greater financial, technological, marketing, personnel, name-brand recognition and other resources than those available to us.

EMPLOYEES

At December 31, 1999, we employed 935 persons. Additionally, we occasionally hire temporary employees. We are not party to any collective bargaining arrangements and believe that our relationship with our employees is good.

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REGULATION

REGULATORY OVERVIEW

We are subject to regulation by federal, state and local government agencies. Historically, the FCC had jurisdiction over interstate long distance services and international services, while state regulatory commissions had jurisdiction over local and intrastate long distance services.

In 1996, Congress passed the Telecommunications Act of 1996, opening the local market to competition and allowing the Bell operating companies to compete for the first time in the long distance market within their local service regions once specified conditions were met. The Telecommunications Act fundamentally changed the way telecommunications is regulated in this country. The FCC was given a major role in writing and enforcing the rules under which new competitors could compete in the local marketplace. Those rules, coupled with additional rules and decisions promulgated by the various state regulatory commissions, form the core of the regulatory framework under which we operate in providing local exchange service.

With a few limited exceptions, the FCC continues to retain exclusive jurisdiction over our provision of interstate and international long distance service, and the state regulatory commissions regulate our provision of intrastate local and long distance service. Additionally, municipalities and other local government agencies may regulate limited aspects of our business, such as use of government-owned rights-of-way, and may require permits such as zoning approvals and building permits.

In the aftermath of the Telecommunications Act, the regulation of the telecommunications industry has been in a state of flux. The FCC and state regulatory commissions have adopted many new rules to implement this legislation and encourage competition, but that implementation is ongoing. The following summary of regulatory developments does not purport to describe all current and proposed federal, state and local regulations and legislation affecting the telecommunications industry. Many of these are currently the subject of judicial proceedings, legislative hearings and administrative proposals, any of which could change, in varying degrees, the manner in which this industry operates. We cannot predict at this time the outcome of these proceedings or their impact upon the telecommunications industry or on us.

THE TELECOMMUNICATIONS ACT

THE TELECOMMUNICATIONS ACT'S LOCAL COMPETITION FRAMEWORK

One of the key goals of the Telecommunications Act is to encourage competition in local telephone service. To do this, the Telecommunications Act provides three means by which telecommunications service providers can enter the local phone service marketplace. The three modes of entry are as follows:

- RESALE. Incumbent telephone companies are required to permit new telecommunications service providers to purchase their services for resale to the public at a wholesale rate that is less than the rate charged by the incumbent telephone companies to their retail customers.

- ACCESS TO NETWORK ELEMENTS. Incumbent telephone companies are required to lease to new telecommunications service providers the various elements in their network that are used to provide local telephone service. The leased parts of the incumbent telephone companies' networks are known as unbundled network elements. The incumbent telephone companies must make unbundled network elements available at rates that are based on their forward-looking economic costs.

- CONSTRUCTION OF NEW FACILITIES. New telecommunications service providers may also enter the local phone service market by building entirely new facilities. The incumbent telephone companies are required to allow new telecommunications service providers to interconnect their

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facilities with the incumbent telephone company's, so each carrier's customers can reach the other's.

To facilitate new telecommunications service providers' entry into local telephone markets using one or more or some combination of these three methods, the Telecommunications Act imposes on incumbent telephone companies the obligation to open their networks and markets to competition. When requested by competitors, incumbent telephone companies are required to negotiate, in good faith, agreements that lay out terms governing the interconnection of their network, access to unbundled network elements and resale. Incumbent telephone companies must also allow competing carriers to "collocate," or place their own equipment in incumbents' central offices.

In addition, all local exchange carriers, including both incumbent and new telecommunications service providers, are subject to the following requirements:

- INTERCONNECTION. All local telecommunications service providers must permit their competitors to interconnect with their facilities either directly or indirectly. Incumbent telephone companies are additionally obligated to permit interconnection at any technically feasible point within their networks, on nondiscriminatory terms, at prices based on cost (which may include a reasonable profit);

- NUMBER PORTABILITY. All local telecommunications service providers must implement number portability technology that allows a customer to retain its existing phone number if it switches from one local exchange carrier to a competitor. This technology primarily benefits new telecommunications service providers, which can gather market share more easily if customers can switch to these carriers without changing telephone numbers;

- RECIPROCAL COMPENSATION. All local telecommunications service providers must complete local calls originated by other telecommunications service providers under reciprocal compensation arrangements. That is, the local provider terminating a local call is entitled to payment from the local provider originating a call. Charges assessed by the incumbent telephone company for terminating calls originated on a new telecommunications service provider's network must be based on a reasonable approximation of additional cost. The FCC recently determined that Internet service provider-bound traffic is interstate in nature, not local, and is therefore outside the scope of the Telecommunications Act's reciprocal compensation provisions. The FCC has initiated a proceeding to determine appropriate carrier-to-carrier compensation for Internet service provider-bound traffic. At the same time, the FCC has declined to overturn a multitude of state decisions requiring incumbent telephone companies to pay new telecommunications service providers compensation for delivering Internet traffic to Internet service providers that had selected a new telecommunications service provider as their local service provider. The FCC's decision is on appeal, and incumbent telephone companies are also expected to ask states or federal courts to reverse the existing state determinations;

- DIALING PARITY. Requires all local telecommunications service providers to provide nondiscriminatory access to telephone numbers, operator services, directory assistance and directory listing with no unreasonable dialing delays. Local dialing parity ensures that customers on one local exchange carrier do not have to dial extra digits to reach customers on a different local or toll carrier's network; and

- ACCESS TO RIGHTS-OF-WAY. Requires all local telecommunications service providers to permit competing providers access to poles, ducts, conduits and rights-of-way at reasonable and nondiscriminatory rates, terms and conditions. The FCC has opened a proceeding seeking to define in greater detail the scope of the incumbent telephone company's obligation to provide access to rights-of-way that it owns or controls, including those within its own central offices and other buildings, and buildings owned by private third parties.

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Executing an interconnection agreement does not guarantee a new telecommunications service provider unfettered access to the incumbent telephone company's market. Interconnection agreements between incumbent telephone companies and new telecommunications service providers may have short terms, requiring the new telecommunications service provider to renegotiate the agreements on a regular basis. Incumbent telephone companies may not provide timely provisioning or adequate service quality, thereby impairing a new telecommunications service provider's reputation with customers who can easily switch back to the incumbent telephone company. In addition, the prices set in the agreements or through state regulatory commission arbitration proceedings may be subject to changes mandated by state regulatory commissions as they develop permanent rules governing interconnection and may not in all instances be set at levels that allow new telecommunications service providers to compete effectively.

THE FCC'S RULES IMPLEMENTING THE TELECOMMUNICATIONS ACT'S LOCAL COMPETITION PROVISIONS

In August 1996, the FCC issued an order implementing the local competition provisions of the Telecommunications Act. The FCC established rules about how interconnection and collocation were to be provided, put forth a method that state commissions should use to establish prices for interconnection and unbundled network elements, and specified which parts of an incumbent's network must be made available as unbundled network elements to competing carriers. The FCC also held that incumbent telephone companies must provide new telecommunications service providers with "combinations" of unbundled network elements, making it possible for new telecommunications service providers, in many instances, to provide service to customers by leasing all of the component unbundled network elements from the incumbent telephone company. This method of providing service is known as the unbundled network element platform, or UNE-P. Specifically, among other rules, the FCC established a list of seven network elements, comprising most of the significant facilities, features, functionalities or capabilities of the network, that the incumbent telephone companies must unbundle. In addition, the FCC mandated a particular forward-looking pricing methodology for these network elements that produces relatively low element prices that are favorable to competitors.

After the FCC released its rules, numerous parties challenged the rules before the United States Court of Appeals for the Eighth Circuit. The Eighth Circuit overturned many of the FCC's rules on the grounds that the agency had exceeded its authority and misinterpreted the law.

On January 25, 1999, the United States Supreme Court largely reversed the Eighth Circuit's decision, holding that the FCC has general jurisdiction to implement the local competition provisions of the Telecommunications Act and reestablishing the validity of many of the FCC's interconnection rules. In so doing, the Supreme Court stated that the FCC has authority to set pricing guidelines for unbundled network elements, to prevent incumbent telephone companies from separating existing combinations of network elements, and to establish "pick and choose" rules regarding interconnection agreements. "Pick and choose" rules would permit a carrier seeking interconnection to pick and choose among the terms of service from other interconnection agreements between the incumbent and various new telecommunications service providers.

Although it upheld the FCC's jurisdiction to establish unbundled network element pricing guidelines, the Supreme Court did not evaluate the specific "forward-looking" pricing methodology adopted by the FCC, and the case has been remanded to the Eighth Circuit for further consideration of that specific pricing methodology. Some incumbent telephone companies have argued that this pricing methodology does not allow adequate compensation for the provision of unbundled network elements. The Eighth Circuit heard oral arguments on this pricing issue on September 16, 1999, but has not yet issued a ruling. We cannot predict the outcome of this proceeding. If the Eighth Circuit fails to uphold the FCC's forward-looking pricing methodology, it may materially adversely affect our business.

Additionally, the Supreme Court vacated the FCC rules defining what network elements must be unbundled and made available to the new telecommunications service providers by the incumbents. The Supreme Court held that the FCC must provide a stronger rationale to support the degree of unbundling ordered.

On November 5, 1999, in response to the Supreme Court's ruling, the FCC released new rules specifying which portions of the incumbent telephone companies' networks must be made available as unbundled network elements. The FCC reaffirmed that incumbent telephone companies must provide unbundled access to the following six network elements:

- loops, including loops used to provide high-capacity and advanced telecommunications services such as digital subscriber lines;

- network interface devices;

- local circuit switching;

- dedicated and shared transport;

- signaling and call-related databases; and

- operations support systems.

The FCC removed from the list of unbundled network elements operator service and directory assistance. The FCC concluded that the market has developed sufficiently that new telecommunications service providers can and do self-provide these services, or acquire them from alternative sources. The FCC also noted that incumbent telephone companies remain obligated under the non-discrimination requirements of the Communications Act of 1934 to comply with the reasonable request of a new telecommunications service provider that purchases these services from the incumbent telephone companies to rebrand or unbrand those services, and to provide directory assistance listings and updates in daily electronic batch files. In addition, the competitive checklist contained in section 271 of the Communications Act of 1934 requires Bell operating companies to provide nondiscriminatory access to these services.

The FCC also modified the local switching unbundled network element, concluding that incumbents need not provide access to unbundled local circuit switching for customers with four or more lines that are located in the densest parts of the top 50 metropolitan statistical areas so long as the incumbent makes available an alternative arrangement for reaching customers, known as the enhanced extended link. The enhanced extended link allows new telecommunications service providers to gain access to customers without collocating in every central office, because it combines the local loop with a multiplexer and transport to the new telecommunications service provider's local existing collocated facilities or switch. Notwithstanding the FCC's ruling, unrestricted access to unbundled switching is available in Texas, where state rulings require incumbent telephone companies to make switching available as an unbundled network element.

In addition to these changes, the FCC also:

- Limited the scope of the shared transport unbundled network element, holding that the incumbent must only offer shared transport as a unbundled network element where unbundled local circuit switching is provided.

- Held that incumbents are not required to offer packet switching as a unbundled network element in most cases.

- Held that both the loop and transport unbundled network elements include access to "dark fiber." Dark fiber is distinguished from "lit fiber" transmission capacity in that dark fiber is sold independently from the electronics necessary to "light" the fiber and transmit information. The

availability of dark fiber from incumbents as a unbundled network element could create an additional source of dark fiber in the market.

- Ordered "sub-loop unbundling," which will allow new telecommunications service providers to connect at any feasible point along the local loop, and not just at the central office. In some incumbent networks, subloop unbundling will make it easier for new telecommunications service providers to use portions of the unbundled network element loop to offer advanced services, such as digital subscriber lines. In a separate order, the FCC also ordered the unbundling of the "high-frequency" portion of the loop, which also makes it easier and less expensive for new telecommunications service providers to use unbundled network elements to offer advanced services, such as digital subscriber lines.

The FCC's decision regarding unbundled network elements is currently the subject of petitions for reconsideration filed at the FCC by various parties, including us. Some incumbent telephone companies have asked the FCC to expand the limitation on switching by, among other things, extending its geographic scope. We and other new telecommunications service providers have asked the FCC to either do away with the limitation or make it applicable to only larger customers. We cannot predict the outcome of this proceeding. If the FCC further restricts the availability of unbundled switching, it could adversely affect our ability to serve customers efficiently.

Another open question is whether incumbent telephone companies are required to combine network elements not currently combined in their networks for requesting new telecommunications service providers. The FCC's rules requiring the incumbent telephone companies to do so were vacated by the Eighth Circuit, but the FCC and the new telecommunications service provider industry have asked that court to reinstate the rules in the wake of the Supreme Court's decision. If the rules are reinstated, it will significantly expand the ability of new telecommunications service providers to provide service to customers using network elements purchased from the incumbent telephone companies. Also unsettled is the scope of the FCC's rule requiring incumbent telephone companies to provide requesting new telecommunications service providers with combinations of network elements that are "currently combined" in the incumbent telephone company's network. The new telecommunications service provider industry has taken a broad view of this requirement, interpreting it to mean that new telecommunications service providers are entitled to purchase network element combinations so long as they are combined anywhere in the incumbent telephone company's network. The incumbent telephone companies, by contrast, have taken a much narrower view, arguing that the rule requires the incumbent telephone companies only to provide combinations of network elements that are currently in service to a particular customer. The ultimate resolution of this question could expand or restrict our ability to provide service to our customers using network elements purchased from the incumbent telephone company.

The Eighth Circuit is expected to rule on the pricing issue in the next several months and may also rule on the incumbent telephone companies' obligation to provide new network element combinations in the same decision. It is not clear when the FCC or the courts will act to define the scope of "currently combined." The possible impact of the resolution of these open issues on existing interconnection agreements between incumbent telephone companies and new telecommunications service providers or on agreements that may be negotiated in the future cannot be determined at this time.

In addition to its rulings regarding interconnection and unbundled network elements, the FCC has issued a series of orders on the ability of new telecommunications service providers to provide digital subscriber lines and other high-bandwidth services to their customers for, among other things, Internet access. Those orders have made clear that new telecommunications service providers are entitled to collocate the equipment necessary to provide those services in incumbent telephone companies' central offices; that incumbent telephone companies must, where technically feasible, provide new

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telecommunications service providers with high-quality loops capable of supporting digital subscriber lines and that the incumbent telephone companies must provide new telecommunications service providers with information concerning the make-up of their networks to allow the new telecommunications service provider to determine if a particular customer can be served with digital subscriber line service. However, many of the details of the orders' implementation are unsettled and we cannot assure you that the rules are sufficient to ensure that the incumbent telephone companies meet their obligations.

THE STATES' ROLE IN IMPLEMENTING THE LOCAL COMPETITION PROVISIONS

Although the FCC establishes nationwide guidelines governing entry by new telecommunications service providers under the Telecommunications Act, state regulatory commissions also have major roles in implementing the local competition provisions of the act. Among other things, state regulatory commissions must approve or reject interconnection agreements, and they have chief responsibility for arbitrating and mediating these agreements if the negotiating carriers cannot reach an understanding on the agreement's terms. State regulatory commissions are also charged with developing and implementing cost-based prices for interconnection and unbundled network elements, in accordance with the Telecommunications Act and the forward-looking pricing guidelines set by the FCC. State regulatory commissions are also permitted to establish additional unbundled network elements consistent with federal law and policy.

BELL OPERATING COMPANIES ENTRY INTO LONG DISTANCE

The Telecommunications Act also seeks to encourage local competition by requiring the regional Bell operating companies to demonstrate on a state-by-state basis that they have adequately opened their network and market to competitors before they can provide long distance service to end users in their own local service areas. Specifically, the Telecommunications Act lays out a 14-point checklist which generally requires a regional Bell operating company to prove to the FCC that it has complied with the interconnection and network access obligations discussed above and that it faces effective competition in the state where it seeks to provide long distance service. While the FCC has ultimate responsibility for deciding whether the checklist conditions have been met, the FCC is required to first consult with the appropriate state regulatory commission.

Southwestern Bell is in the process of applying for authority to provide long distance service in Texas. The FCC is expected to rule on Southwestern Bell's application in April 2000. Southwestern Bell has also begun the process of applying for long distance authority in Kansas by making a preliminary filing with the Kansas state regulatory commission. If Southwestern Bell receives approval from the FCC as described above, Southwestern Bell will be able to provide in-region long distance services, which will enable it to provide customers with a full range of local and long distance telecommunications services. The ability of Southwestern Bell to provide long distance services is expected to be an additional source of competition for us.

OTHER FEDERAL REGULATION

The FCC regulates our interstate and international service offerings. Those services include our provision of interstate and international long distance service and our provision of interstate access service. The FCC has established different levels of regulation for dominant carriers and non-dominant carriers. Incumbent telephone companies, such as the Bell operating companies and GTE, are currently considered dominant carriers, and are subject to extensive rate and operational regulation, while new telecommunications service providers such as we are considered non-dominant carriers, and are subject to substantially less regulation.

INTERSTATE AND INTERNATIONAL LONG DISTANCE SERVICES

Interstate and international long distance services of non-dominant carriers are subject to relatively little regulation by the FCC. Our provision of international long distance services requires prior authorization by the FCC under Section 214 of the Telecommunications Act, which we have obtained. We are also required to file tariffs with the FCC for international long distance service on an ongoing basis.

Under the FCC's streamlined regulation of non-dominant carriers, we may install and operate facilities for the transmission of domestic interstate communications without prior FCC authorization.

In addition, in October 1996, the FCC adopted an order in which it eliminated the requirements that non-dominant interstate interexchange carriers maintain tariffs on file with the FCC for domestic interstate services. The order does not apply to the switched and special access services of the Bell operating companies or other local exchange carriers. The FCC order was issued under authority granted to the FCC in the 1996 Act to "forbear" from regulating any telecommunications services provider under some circumstances. After a nine-month transition period, relationships between interstate carriers and their customers would be set by contract. At that point, long distance companies would be prohibited from filing tariffs with the FCC for interstate, domestic, interexchange services. Several parties filed notices for reconsideration of the FCC order and other parties appealed the decision. On February 13, 1997, the United States Court of Appeals for the District of Columbia Circuit stayed the implementation of the FCC order pending its review of the order on its merits. Currently, that stay remains in effect and interstate long distance telephone companies are therefore still required to file tariffs.

The D.C. Circuit heard oral argument on the merits of the FCC's detariffing order on March 14, 2000, but has not yet issued an order. If the stay is lifted and the FCC order becomes effective, telecommunications carriers will no longer be able to rely on the filing of tariffs with the FCC as a means of providing notice to customers of prices, terms and conditions on which they offer their interstate services. The FCC has required that non-dominant interexchange carriers post their rates, terms and conditions for all their interstate, domestic services on their Internet web sites if they have one; this rule is effective once the FCC's mandatory detariffing order takes effect. This may result in significant administrative expenses for us. The obligation to provide non-discriminatory, just and reasonable prices remains unchanged under the Communications Act of 1934. Tariffs also allow a carrier to limit its liability to its customers, including in connection with service interruptions. If tariffs are eliminated, we may become liable for costs that we would have been able to limit through tariff filings, and we cannot assure you that the potential liabilities will not have a material adverse effect on our results of operations and financial condition.

ACCESS SERVICES

Unlike dominant carriers, which are subject to extensive rate regulation, we and other non-dominant carriers are subject to relatively little regulation of our interstate access services. The FCC has eliminated the requirement that non-dominant carriers must file tariffs for their access services. While no longer mandatory, carriers may continue to file access tariffs. We have chosen to continue to do so.

In August 1999, the FCC granted incumbent telephone companies subject to price cap rate regulation, including the regional Bell operating companies, substantial pricing flexibility with regard to some interstate access services. Among other things, the FCC's new rules permit incumbent telephone companies, upon a showing that the services in question are subject to sufficient levels of competition, to offer volume and term discounts and contract tariffs for particular access services. The new rules also allow incumbent telephone companies, upon meeting a higher competitive standard, to file tariffs for their access services free from many rate structure requirements. To the extent these regulatory

initiatives enable or require incumbent telephone companies to offer selectively reduced rates for some access services, the rates we may charge for these access services will likely be constrained. In addition, the FCC has recently initiated a proceeding to examine whether to regulate the rates that new telecommunications service providers charge for their access services. While the FCC has received considerable opposition from the new telecommunications service provider industry and others to doing so, we cannot assure you that the FCC will not adopt some form of regulation for new telecommunications service provider access charges. The timing of the FCC's decision is uncertain.

In addition to the pricing flexibility described above, the FCC is currently considering a joint proposal from AT&T, Bell Atlantic, BellSouth, GTE, SBC Communications and Sprint to lower significantly and deleverage interstate access charges for participating price cap local exchange carriers. The FCC could issue an order on this proposal in the first half of 2000. If adopted, these pricing reforms could increase competition among carriers offering local exchange and exchange access service in our operating area.

ADDITIONAL FEDERAL ISSUES

ACCESS TO POLES, DUCTS, CONDUITS AND RIGHTS-OF-WAY. An area of the law that remains in flux concerns the extent of a carrier's obligations to provide access to poles, ducts, conduits and rights-of-way. We are obligated under Section 224 of the Communications Act to permit other carriers reasonable access to our poles, ducts, conduits and rights-of-way and the FCC has adopted comprehensive rules governing how access is to be provided. The FCC is also currently considering additional rules, including whether access to rooftops and space inside buildings, including buildings owned by utilities, should be mandated under the Telecommunications Act.

EEO REPORT. The FCC requires us to file an annual employment report to comply with the FCC's equal employment opportunity policies.

TRUTH IN BILLING. The FCC has adopted new rules designed to make it easier for customers to understand the bills of telecommunications carriers. These new rules establish requirements regarding the formatting of bills and the information that must be included on bills. These rules have been appealed in federal court.

ANTI-SLAMMING RULES. The FCC implemented the so-called "anti-slamming" rules, which protect consumers whose pre-subscribed carriers have been switched without their consent. Under the rules, a carrier found to have slammed a customer is subject to substantial fines and must remove from the consumer's bill all charges incurred within 30 days of the slamming. While we do not engage in these practices, a slamming fine, if levied, could have a material impact on our business in the future.

CUSTOMER PROPRIETARY NETWORK INFORMATION. In February 1998, the FCC adopted rules implementing Section 222 of the Communications Act of 1934, which governs the use of customer proprietary network information by telecommunications carriers. Customer proprietary network information generally includes any information regarding a subscriber's use of a telecommunications service, where it is obtained by a carrier solely by virtue of the carrier-customer relationship. The FCC has clarified that customer proprietary network information does not include a subscriber's name, telephone number, and address, as this information is generally not derived from the carrier's provision of a telecommunications service to a customer. Under the FCC's rules, a carrier may only use a customer's proprietary network information to market services that are "necessary to, or used in," the provision of a service that the carrier already provides to the customer, unless it receives the customer's prior oral or written consent to use that information to market other services. In December 1999, the United States Court of Appeals for the Tenth Circuit vacated the FCC's original and modified customer proprietary network information rules on the grounds that they violate the First Amendment. However, Section 222 of the Communications Act remains the law and that section, in addition to the FCC's

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now-vacated rules, provides some guidance on the use of customer proprietary network information rules. Uncertainty regarding restrictions on the use of customer proprietary network information rules may impede our ability to market integrated packages of services effectively and to expand existing customers' use of our services.

UNIVERSAL SERVICE. On May 8, 1997, the FCC released an order establishing a significantly expanded federal universal service subsidy regime under the Telecommunications Act. The universal service program provides support to carriers serving low-income customers and customers who live in areas where the cost of providing telecommunications services is high. In addition, the FCC established new subsidies for telecommunications and some information services provided to qualifying schools and libraries and for services provided to rural health care providers. Providers of interstate telecommunications services, as well as other entities, such as private carriers offering excess capacity to end user customers, must pay for these programs. Our contribution to the federal support funds would be calculated based on a percentage of our gross end-user interstate and international telecommunications revenues. The assessment rate for the second quarter of 2000 is 5.7101% of interstate and international end-user telecommunications revenues. The contribution factor issued by the FCC varies quarterly. The amounts contributed may be billed to customers. Currently, the FCC is calculating assessments based on the prior year's revenues. Assuming that the FCC continues to calculate contributions based on the prior year's revenues, we believe that we will not be liable to contribute any material amount to these programs during 2000 because we had limited interstate and international end user revenues in 1999. The threshold before we are required to contribute is a $10,000 contribution, which translates into roughly $175,000 in interstate end user telecommunications revenues. With respect to subsequent years, however, we are currently unable to quantify the amount of any contributions that we will be required to make or the effect that these required contributions will have on our financial condition.

The FCC has recently adopted the cost model which it will use to determine the support needed in high-cost areas and the inputs for the model. The new high-cost support mechanism, which went into effect on January 1, 2000 for non-rural carriers, substantially increases the amount of high-cost support provided to non-rural carriers. The United States Court of Appeals for the Fifth Circuit recently issued an order upholding in part, and reversing in part, the May 8th FCC order implementing these funds. Numerous FCC orders revising these funds are subject to petitions for reconsideration and further petitions for appeal. The outcome of these proceedings or their effect cannot be predicted.

In addition to the universal service mechanisms described above, the FCC is currently considering a joint proposal from Bell Atlantic, BellSouth, GTE, SBC

Communications, AT&T, and Sprint to create a $650 million fund to provide universal service support for interstate access charges. If adopted, this proposal could significantly increase the contribution obligations of other telecommunications carriers.

COMMUNICATIONS ASSISTANCE FOR LAW ENFORCEMENT ACT. Under this act, telecommunications carriers are required to: (1) provide law enforcement officials with call content and call identifying information under a valid electronic surveillance warrant, and (2) reserve a sufficient number of circuits for use by law enforcement officials in executing court authorized electronic surveillance. If we provide facilities-based services, we may incur costs in meeting both of these requirements. In particular, regarding the requirements related to call content and identification, except in very limited circumstances the government is required to compensate carriers only for the costs of making equipment installed or deployed before January 1, 1995 compliant with this act. While the telecommunications industry is attempting to negotiate legislative and administrative changes to this reimbursement cut-off date, as it stands today, we will be financially responsible for ensuring that our post-1995 equipment is in compliance. Regarding the circuit capacity requirements, the government will finance any necessary increases in capacity for equipment that we have specifically identified as installed or deployed prior to September 8, 1998, and we are responsible for paying only for any necessary increases in capacity for equipment installed or deployed after that date.

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STATE AND LOCAL REGULATION

In general, state regulatory commissions have regulatory jurisdiction over us when our facilities and services are used to provide local and other intrastate services. Under the Telecommunications Act, state commissions continue to set the requirements for providers of local and intrastate services, including quality of services criteria. State regulatory commissions also can regulate the rates charged by new telecommunications service providers for intrastate and local services and can set prices for interconnection by new telecommunications service providers with the incumbent telephone company networks, in accordance with guidelines set by the FCC. In addition, state regulatory commissions in many instances have authority under state law to adopt additional regulations governing local competition, so long as the state's actions are not inconsistent with federal law or regulation.

Most state regulatory commissions require companies that wish to provide intrastate common carrier services to register or be certified to provide these services. These certifications generally require a showing that the carrier has adequate financial, managerial and technical resources to offer the proposed services in a manner consistent with the public interest. In most states, we are also required to file tariffs setting forth the terms, conditions and prices for services that are classified as intrastate, and to update or amend our tariffs as rates change or new products are added. We may also be subject to various reporting and record-keeping requirements.

We are currently certified by the Missouri Public Service Commission, the Kansas Corporation Commission, the Texas Public Utilities Commission and the Oklahoma Corporation Commission to provide both local and intrastate long distance service in those states. We have tariffs on file in each of these states.

If we choose to install our own transmission facilities, we may be required, in some cities, to obtain street opening and construction permits, permission to use rights-of-way, zoning variances and other approvals from municipal authorities. We also may be required to obtain a franchise to place facilities in public rights of way. In some areas, we may be required to pay license or franchise fees for these approvals. We cannot assure you that fees will remain at current levels, or that our competitors will face the same expenses, although the Telecommunications Act requires that any fees charged by municipalities be reasonable and non-discriminatory as among telecommunications carriers.

RISK FACTORS

RISKS RELATED TO OUR BUSINESS:

WE HAVE A HISTORY OF OPERATING LOSSES, AND WE MAY NOT BE PROFITABLE IN THE FUTURE.

We have incurred significant losses since we began operations as a competitive telecommunications provider and expect to continue to incur losses in the future as we build our network. For the year ended December 31, 1999, we had operating losses of $49.7 million and a net loss of $61.8 million. As of December 31, 1999, we had an accumulated deficit of $79.8 million. We expect to experience losses during our network and service deployment, which will continue for the foreseeable future. Prolonged effects of generating losses without additional funding may restrict our ability to pursue our business strategy.

If we cannot achieve profitability from operating activities, we may not be able to meet:

- our capital expenditure requirements;

- our debt service obligations; or

- our working capital needs.

OUR HIGHLY LEVERAGED CAPITAL STRUCTURE LIMITS OUR ABILITY TO OBTAIN ADDITIONAL FINANCING AND COULD ADVERSELY AFFECT OUR BUSINESS IN SEVERAL OTHER WAYS.

The level of our outstanding debt greatly exceeds the level of our revenue and stockholders' equity. As of December 31, 1999, we had $125.8 million of long-term indebtedness outstanding, including $10.0 million outstanding under our senior credit facility and $114.7 million of senior notes outstanding. This indebtedness represented 103.5% of our total capitalization at that date. We may, and are also permitted under the terms of our debt instruments to, incur substantial indebtedness in the future.

Our large amount of indebtedness could significantly impact our business for the following reasons:

- it limits our ability to obtain additional financing to complete our roll-out plan, to develop new services or to otherwise respond to unanticipated competitive pressures;

- it means that we will need to dedicate a substantial portion of our operating cash flow to fund interest expense on our senior credit facility and our senior notes, thereby reducing funds available for working capital, capital expenditures or other purposes;

- it makes us vulnerable to interest rate fluctuations because our senior credit facility loans bear interest at variable rates;

- it limits our ability to compete with companies who are not as highly leveraged, especially those who may be able to price their service offerings at levels below those we can or are willing to match; and

- it limits our ability to expand into new markets and to react to changing market conditions, changes in our industry and economic downturns.

OUR EXISTING DEBT INCLUDES RESTRICTIVE AND FINANCIAL COVENANTS THAT LIMIT OUR OPERATING FLEXIBILITY.

Our senior credit facility and the indenture relating to our senior notes contain covenants that, among other things, restrict our ability to take specific actions, even if we believe them to be in our best interest. These include restrictions on our ability to:

- incur additional debt;

- pay dividends or distributions on, or redeem or repurchase, capital stock;

- create liens or negative pledges with respect to our assets;

- make investments, loans or advances;

- issue, sell or allow distributions on capital stock of specified subsidiaries;

- enter into sale and leaseback transactions;

- prepay or defease specified indebtedness;

- enter into transactions with affiliates;

- enter into specified hedging arrangements;

- merge, consolidate or sell our assets; or

- engage in any business other than telecommunications.

The senior notes also require us to offer to purchase these notes from the holders at 101% if we undergo a change of control. In addition, the senior credit facility imposes financial covenants that require us to comply with specified financial ratios and tests, including minimum revenues, minimum EBITDA/maximum EBITDA losses, minimum access lines, senior secured debt to total capitalization, maximum capital expenditures, maximum leverage ratios, minimum interest coverage ratios and pro forma debt service coverage ratios. We cannot assure you that we will be able to meet these requirements or satisfy these covenants in the future. If we fail to do so, our debts could become immediately payable at a time when we are unable to pay them. This could adversely affect our ability to carry out our business plan and would have a negative effect on our financial condition.

WE EXPECT TO GROW AND CANNOT GUARANTEE THAT WE WILL BE ABLE TO EFFECTIVELY MANAGE OUR FUTURE GROWTH.

If we successfully implement our business plan, our operations will expand rapidly, and we will be providing packaged telecommunications services on a widespread basis. This could place a significant strain on our management, operational, financial and other resources and increase demands on our systems and controls. Failure to manage our future growth effectively could adversely affect the expansion of our customer base and service offerings. We cannot assure you that we will successfully implement and maintain efficient operational and financial systems, procedures and controls or successfully obtain, integrate and manage the employees and management, operational, financial and other resources necessary to manage a developing and expanding business in our evolving, highly regulated and increasingly competitive industry.

TO EXPAND AND DEVELOP OUR BUSINESS WE WILL NEED A SIGNIFICANT AMOUNT OF CASH, WHICH WE MAY BE UNABLE TO OBTAIN.

The expansion and development of our business and the deployment of our networks, services and systems will require significant capital expenditures, working capital and debt service and generate negative operating cash flows.

The actual amount and timing of our future capital requirements may differ materially from our estimates as a result of, among other things, the demand for our services and regulatory, technological and competitive developments, including additional market developments and new opportunities, in our industry. Our revenue and costs may also be dependent upon factors that are not within our control, including regulatory and legislative developments, the response of our competitors to their loss of customers to us and to changes in technology, the nature and penetration of services that we may offer and the number of subscribers and the services for which they subscribe. Due to the uncertainty of

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these factors, actual revenues and costs may vary from expected amounts, possibly to a material degree, and these variations are likely to affect our future capital requirements.

We also expect that we will require additional financing or may require financing sooner than anticipated to complete our roll-out plan or if our development plans change or prove to be inaccurate. We may also require additional financing in order to develop new services or to otherwise respond to changing business conditions or unanticipated competitive pressures. Sources of additional financing may include commercial bank borrowings, vendor financing, or the private or public sale of equity or debt securities. If we decide to raise additional funds through the incurrence of debt, our interest obligations will increase, and we may become subject to additional or more restrictive financial covenants, which could impair our ability to develop our business. We cannot assure you that we will be successful in raising sufficient additional capital on favorable terms or at all. Failure to raise sufficient funds may require us to modify, delay or abandon some of our future expansion or expenditure plans.

RESISTANCE BY POTENTIAL CUSTOMERS TO ACCEPT US AS A NEW PROVIDER OF TELECOMMUNICATIONS SERVICES MAY REDUCE OUR ABILITY TO INCREASE OUR REVENUE.

The success of our service offerings will depend upon, among other things, the willingness of additional customers to accept us as a new provider of integrated communications services. We cannot assure you that we will be successful in overcoming the resistance of potential customers to change their service provider, particularly those that purchase services from the traditional telephone companies, or that customers will buy our services. Any lack of customer acceptance would reduce our ability to increase our revenue.

IF WE ARE UNABLE TO DEVELOP OR INTEGRATE OUR SYSTEMS OR PROPERLY MAINTAIN AND UPGRADE THEM, WE MAY NOT BE ABLE TO BILL OUR CUSTOMERS EFFECTIVELY OR PROVIDE ADEQUATE CUSTOMER SERVICE.

Sophisticated back office information and processing systems are vital to our growth and our ability to monitor costs, bill customers, provision customer orders, achieve operating efficiencies and maintain our operating margins. Our plans for the development and implementation of these systems rely, for the most part, on choosing products and services offered by third party vendors and integrating these products and services in-house to produce efficient operational solutions. We cannot assure you that we will successfully implement these systems on a timely basis or that we will implement them at all. We also cannot assure you that, once implemented, these systems will perform as we expect. Risks to our business associated with our systems include:

- failure by these vendors to deliver their products and services in a timely and effective manner and at acceptable costs;

- failure by us to identify all of our information and processing needs adequately;

- failure of our related processing or information systems; or

- failure by us to effectively integrate new products or services.

Furthermore, as our suppliers revise and upgrade their hardware, software and equipment technology, we could encounter difficulties in integrating this new technology into our business or the new systems may not be appropriate for our business. In addition, our right to use these systems depends upon license agreements with third party vendors. Vendors may cancel or elect not to renew some of these agreements, which may adversely affect us.

WE MAY NEED TO RELY ON THE ESTABLISHED LOCAL TELEPHONE COMPANIES TO IMPLEMENT OUR SERVICES SUCCESSFULLY. THEIR FAILURE TO COOPERATE WITH US COULD ADVERSELY AFFECT THE SERVICES WE OFFER.

We are a recent entrant into the local telecommunications services industry. The local exchange services market in most states was only recently opened to competition. There are numerous operating complexities associated with providing these services. We will be required to develop new products, services and systems and will need to develop new marketing initiatives to sell these services. We cannot assure you that we will be able to develop these products and services.

We plan to deploy high capacity voice and data switches in most of the markets we serve. We initially intend to rely on the networks of established telephone companies or those of new market entrants for some aspects of transmission. Federal law requires most of the traditional local telephone companies to lease or "unbundle" elements of their networks and permit us to purchase the elements we need, thereby decreasing our operating expenses. We cannot assure you that this unbundling will continue to occur in a timely manner or that the prices for these elements will be favorable to us. Our current strategy depends in large part on our ability to provide service to our customers by leasing all of the network elements necessary to provide local telephone service from the incumbent telephone company rather than through the use of our own equipment and facilities. UNE-P allows us to minimize capital expenditures and permits us to enter new markets quickly, while allowing us to maintain significant gross margins. If the incumbent local telephone companies do not cooperate in making UNE-P available, our ability to provide service to customers could be materially adversely affected.

In addition, our ability to implement successfully our services will require the negotiation of interconnection and collocation agreements with established telephone companies and other new market entrants, which can take considerable time, effort and expense and is subject to federal, state and local regulation. Interconnection agreements are agreements between local telecommunications services providers that set forth the terms and conditions governing how those providers will interconnect their networks and/or purcnase or lease network facilities and services.

Our interconnection agreements with Southwestern Bell provide that our connection and maintenance orders will receive the same attention as Southwestern Bell's end-user customers and that Southwestern Bell will provide capacity at key telecommunications intersections to keep call blockage within industry standards. Accordingly, we depend and will continue to depend on Southwestern Bell and, as we expand our network, we will depend on other traditional telephone companies to assure uninterrupted service and competitive services. Blocked calls result in customer dissatisfaction and risk the loss of business. Interconnection agreements, such as our agreements with Southwestern Bell, typically have short terms, requiring us to renegotiate frequently. Some of our agreements with Southwestern Bell have one year or less remaining before we will have to renegotiate them. We cannot assure you that we will be able to renegotiate these interconnection agreements in our existing markets, or negotiate new interconnection agreements in new markets, on favorable terms. In addition, the prices set forth in our interconnection agreements may be subject to significant rate increases at the discretion of the regulatory authority in each state in which we operate. Our profitability partially depends on these state-regulated rate structures. We cannot assure you that the rates charged to us under the interconnection agreements will allow us to offer low enough usage rates to attract a sufficient number of customers and to operate our business profitably or at favorable gross margins.

Many new carriers have experienced difficulties in working with the established telephone companies with respect to ordering, interconnecting, leasing premises and implementing the systems used by these new carriers to order and receive unbundled network elements and wholesale services. We cannot assure you that established telephone companies will be accommodating to us. If we are unable to obtain the cooperation of an established telephone company in a region, our ability to offer local services in this region on a timely and cost-effective basis would be adversely affected. In addition,

both proposed and recently completed mergers involving regional Bell operating companies and other competitors could facilitate a combined entity's ability to provide many of the services we offer, thereby making it more difficult to compete against them.

DIGITAL SUBSCRIBER LINE TECHNOLOGY MAY NOT OPERATE AS EXPECTED ON INCUMBENT LOCAL CARRIER NETWORKS AND MAY INTERFERE WITH OR BE AFFECTED BY OTHER TRANSPORT TECHNOLOGIES.

Our ability to provide digital subscriber line services to potential customers depends on the quality, physical condition, availability and maintenance of telephone lines within the control of the incumbent carriers. If the telephone lines are not adequate, we may not be able to provide digital subscriber line services to many of our target customers, and this will diminish our expected revenue. We believe the current condition of telephone lines in many cases may be inadequate to permit us to fully implement these services. We also believe that the incumbent carriers may not maintain or improve the telephone lines in a condition that will allow us to implement our digital subscriber line services effectively. Further, the incumbent carriers may claim their lines are not of sufficient quality to allow us to fully implement or operate our digital subscriber line services. In addition, some customers use technologies other than copper lines to provide telephone services, and as a result, digital subscriber line services might not be available to these customers.

All transport technologies using copper telephone lines have the potential to interfere with, or to be interfered with by, other traffic on adjacent copper telephone lines. This interference could degrade the performance of our services or make us unable to provide service on selected lines. In addition, incumbent carriers may claim that the potential for interference by digital subscriber line technology permits them to restrict or delay our deployment of this technology. The telecommunications industry and regulatory agencies are still developing procedures to resolve interference issues between telecommunications providers, and these procedures may not be effective. We may be unable to successfully negotiate interference resolution procedures with incumbent carriers. Interference, or claims of interference, if widespread, would adversely affect our speed of deployment, reputation, brand image, service quality and customer retention and satisfaction.

IF WE ARE UNABLE TO ATTRACT AND RETAIN KEY MANAGEMENT AND PERSONNEL, WE MAY NOT BE ABLE TO IMPLEMENT OUR BUSINESS PLAN.

We believe that our future success will be due, in part, to our experienced management team, including Messrs. Scott, Goldman, Hollingsworth, Lawhon, Moline, Shackelford and Vranicar, each of whom is party to an employment agreement. Losing the services of one or more members of our management team could adversely affect our business and our expansion efforts and possibly prevent us from:

- further deploying and improving our operational, financial and information systems and controls;

- hiring and retaining qualified sales, marketing, administrative, operating and technical personnel; and

- training and managing new personnel.

In addition, competition for qualified employees has intensified in recent years and may become even more intense in the future. Our ability to implement our business plan depends on our ability to hire and retain a large number of new employees each year. Inability to hire sufficient qualified personnel could impair our ability to increase revenue, and customers could experience delays in installation of service or experience lower levels of customer care.

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WE MAY NOT HAVE THE ABILITY TO DEVELOP STRATEGIC ALLIANCES OR TO MAKE OR SUCCESSFULLY INTEGRATE ACQUISITIONS NEEDED TO COMPLEMENT OUR EXISTING BUSINESS.

As part of our growth strategy, we seek to develop strategic alliances and to make investments or acquire assets or other businesses. We regularly engage in discussions relating to potential acquisitions. We are unable to predict whether or when any prospective acquisitions or strategic alliances will occur or the likelihood of a material transaction being completed on favorable terms and conditions. Our ability to finance acquisitions and strategic alliances may be constrained by our degree of leverage at the time of the acquisition. In addition, our senior credit facility and senior notes may significantly limit our ability to make acquisitions or enter into strategic alliances and to incur indebtedness in connection with acquisitions and strategic alliances.

In addition, if we were to proceed with one or more significant strategic alliances, acquisitions or investments in which the consideration consists of cash, we could use a substantial portion of our available cash, to consummate the strategic alliances, acquisitions or investments. The financial impact of acquisitions, investments and strategic alliances could cause substantial fluctuations in our quarterly and yearly operating results.

The integration of any future acquisitions or strategic alliances would be accompanied by the risks commonly encountered in these transactions. These risks include, among others:

- the difficulty of assimilating the acquired operations and personnel;
- the potential disruption of our ongoing business and diversion of resources and management time;
- the inability of management to maximize our financial and strategic position by the successful incorporation of licensed or acquired technology and rights into our service offerings;
- the possible inability of management to maintain uniform standards, controls, procedures and policies;
- the risks of entering markets in which we have little or no direct prior experience; and
- the potential impairment of relationships with employees or customers as a result of changes in management or otherwise arising out of these transactions.

We cannot assure you that we will be able to integrate acquired businesses or assets successfully.

A SYSTEM FAILURE COULD CAUSE DELAYS OR INTERRUPTIONS OF SERVICE, WHICH COULD CAUSE US TO LOSE CUSTOMERS.

Our success will require that our networks provide competitive reliability, capacity and security. Some of the risks to our networks and infrastructure include:

- physical damage to access lines;
- power surges or outages;
- capacity limitations;

- software defects;

- lack of redundancy; and

- disruptions beyond our control.

These disruptions may cause interruptions in service or reduced capacity for customers, any of which could cause us to lose customers.

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ALL YEAR 2000 PROBLEMS MAY NOT HAVE BEEN ADDRESSED BY OUR SUPPLIERS, AND ANY SERVICE INTERRUPTION WE EXPERIENCE AS A RESULT OF THESE PROBLEMS MAY CAUSE US TO LOSE CUSTOMERS.

The Year 2000 issue generally describes the various problems that may result from the improper processing of dates and date-sensitive transactions by computers and other equipment as a result of computer hardware and software using two digits, rather than four digits, to identify the year in a date. Any computer programs or systems of our suppliers that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. While we have experienced no Year 2000 issues to date, and we are not aware of any material issues for our suppliers, we are continuing to evaluate and determine whether our significant suppliers are in compliance or have appropriate plans to remedy Year 2000 issues when their systems interact with our systems. We do not expect that this will have a material impact on our operations. However, we cannot assure you that the systems of other companies on which we rely are Year 2000 compliant, that another company's failure to successfully convert, or that another company's conversion to a system incompatible with our systems, would not have an impact on our operations. The failure of our principal suppliers to be Year 2000 compliant could result in delays in service deliveries from those suppliers and materially impact our ability to do business.

OUR OFFICERS AND DIRECTORS EXERT SUBSTANTIAL INFLUENCE OVER US.

Our executive officers, directors and entities affiliated with them together beneficially own a substantial percentage of our outstanding common stock. As a result, these stockholders are able to exercise substantial influence over all matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions. This concentration of ownership may also have the effect of delaying or preventing a change in our control.

RISKS RELATED TO OUR INDUSTRY:

WE MAY NOT BE ABLE TO COMPETE EFFECTIVELY AGAINST OTHER COMPANIES.

The telecommunications industry is highly competitive and is affected by the introduction of new services by, and the market activities of, major industry participants. Several of our competitors are substantially larger and have greater financial, technical and marketing resources than we do. We have not achieved, and do not expect to achieve, a significant market share for any of the broadband telecommunications services we offer in our target markets. In particular, larger competitors have advantages over us that could cause us to lose customers and impede our ability to attract new customers, including:

- long-standing relationships and brand recognition with customers;

- financial, technical, marketing, personnel and other resources substantially greater than ours;

- more funds to deploy telecommunications services;

- potential to lower prices of competitive telecommunications services; and

- fully-deployed networks.

We face competition from other current and potential market entrants, including:

- domestic and international long distance providers seeking to enter, re-enter or expand entry into the local telecommunications marketplace; and

- other domestic and international telecommunications providers, resellers, cable television companies, electric utilities and Internet companies.

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A continuing trend toward combinations and strategic alliances in the telecommunications industry could give rise to significant new competitors. This could cause us to lose customers and impede our ability to attract new customers.

FCC AND STATE REGULATIONS MAY LIMIT THE SERVICES WE CAN OFFER OR IMPACT OUR ABILITY TO CONDUCT OUR BUSINESS.

Our networks and the provision of telecommunications services are extensively regulated at the federal, state and local levels. Existing and future governmental regulations may greatly influence how we operate our business, our business strategy and ultimately, our viability. The costs of complying with federal, state and local regulations and the delays in receiving required regulatory approvals or the enactment of new adverse regulation or regulatory requirements may be greater than we anticipate and divert our resources from implementing our business plan. We cannot predict the future regulatory framework for our business.

Our provision of telecommunications services may be subject to the requirement that we obtain proper authorizations from the FCC or state commissions. We cannot assure you that the FCC or state commissions will grant the required authority or refrain from taking action against us if we are found to have provided services without obtaining the necessary authorizations. If we do not fully comply with the rules of the FCC or state regulatory agencies, third parties or regulators could challenge our authority to do business. These challenges could cause us to incur substantial legal and administrative expenses.

Federal law governing the telecommunications industry remains in a state of flux. The Telecommunications Act remains subject to judicial review and additional FCC rulemaking, and thus it is difficult to predict what effect the legislation or these FCC rules will have on us and our operations. There are currently many regulatory actions underway and being contemplated by federal and state authorities regarding interconnection pricing, universal service support, access charge reform, and other issues that could result in significant changes to the business conditions in the telecommunications industry.

Our current business strategy depends in large part on our ability to provide service to our customers through UNE-P. Our ability to provide service to customers through UNE-P depends in turn on FCC and state commission rulings requiring incumbent local telephone companies to lease us the necessary network elements. If those rules are changed by the FCC or state commissions, or are struck down by the courts, our ability to provide service to our customers through UNE-P could be materially adversely affected. For example, the FCC could remove one or more of the necessary elements from the list of elements that the incumbent telephone companies are required to provide to us. The FCC could also expand the scope of an existing exception in its rules that permits incumbent telephone companies to opt not to make UNE-P available in the highest density geographic areas within the largest 50 metropolitan statistical areas if they meet certain conditions. If the FCC acts to expand the scope of the geographic exception to include our target markets, our business could be materially adversely affected. Some states in our current operating region, including Texas and Missouri, have gone beyond the FCC's minimum requirements and independently ordered Southwestern Bell to make UNE-P available throughout those states under terms more favorable to new telecommunications service providers than those required by the FCC. We cannot assure you that those favorable state rulings will remain in place. If UNE-P does not continue to be available on the favorable terms ordered by the states, our business could be materially adversely affected.

The United States Court of Appeals for the Eighth Circuit is currently considering challenges to the pricing methodology established by the FCC for setting the rates paid by telecommunications service providers to incumbent telephone companies for access to network elements. If the court strikes down some or all of the FCCs's pricing methodology and that methodology is ultimately replaced with

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a methodology that imposes higher rates for network elements, we could be materially adversely affected.

Federal universal service support mechanisms could increase the costs of providing service to our customers. We derive revenue from the provision of interstate and international telecommunications services to end users that may be subject to the requirement that we contribute to the FCC's Universal Service Fund based on a percentage of this revenue. The assessment for the first quarter of 2000 is 5.8995%, and the assessment for the second quarter of 2000 is 5.7101% of interstate and international end user telecommunications revenue. The contribution factor varies quarterly at a rate set by the FCC. To the extent the contribution factor increases, our costs of providing service will increase.

Our Internet operations are not currently regulated directly by the FCC or any other governmental agency, other than regulations applicable to businesses generally. However, the FCC has recently indicated that the regulatory status of some services offered over the Internet may have to be re-examined. New laws or regulations relating to Internet services, or existing laws found to apply to them, may adversely affect our Internet operations.

WE MAY BE UNABLE TO ADAPT TO TECHNOLOGICAL CHANGE.

The telecommunications industry is subject to rapid and significant changes in technology, including continuing developments in digital subscriber line technology. This technology does not presently have widely accepted standards, and alternative technologies for providing high speed data transport and networking may develop. The absence of widely accepted standards may delay or increase the cost of our market entry due to changes in equipment specifications and customer needs and expectations. We may also rely on a third party for access to new technologies. In addition, if we acquire new technologies, we may not be able to implement them as effectively as other companies with more experience with those technologies and in their markets.

WE MAY FAIL TO ACHIEVE ACCEPTABLE PROFITS ON OUR LONG DISTANCE BUSINESS DUE TO DECLINING PRICES, LOW CUSTOMER RETENTION RATES AND OUR CONTRACTUAL OBLIGATIONS.

Prices in the long distance business have declined substantially in recent years and are expected to continue to decline. In addition, the long distance industry has a low customer retention rate, as customers frequently change long distance providers in response to the offering of lower rates or promotional incentives by competitors. We will rely on other carriers to provide us with a major portion of our long distance transmission network. Agreements with these carriers typically provide for the resale of long distance services on a per-minute basis and may contain minimum volume commitments. The negotiation of these agreements involves estimates of future supply and demand for transmission capacity, as well as estimates of the calling patterns and traffic levels of our future customers. In the event that we fail to meet these minimum volume commitments, we may have to pay underutilization charges, and, in the event we underestimate our need for transmission capacity, we may have to obtain capacity through more expensive means.

AS A NEW DATA TRANSMISSION ENTRANT IN A MARKET, WE MAY INITIALLY GENERATE LOW OR

NEGATIVE GROSS MARGINS.

As a new entrant in the data transmission business, we expect to generate low or negative gross margins and substantial start-up expenses as we begin to offer data transmission services. The success of our data transmission business will depend upon, among other things, the effectiveness of our sales personnel in the promotion and sale of our data transmission services, the acceptance of these services by potential customers, and our ability to hire and train qualified personnel and further enhance our services in response to future technological changes. We cannot assure you that we will be successful in these endeavors.

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THIS FORM 10-K CONTAINS FORWARD-LOOKING STATEMENTS THAT MAY NOT BE ACCURATE INDICATORS OF OUR FUTURE PERFORMANCE.

This Form 10-K contains forward-looking statements within the meaning of the federal securities laws. Discussions containing forward-looking statements may be found in the material set forth in this section and under "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as in the Form 10-K generally. The words "believe," "estimate," "expect," "intend," "anticipate," "plan," and similar expressions and variations of these expressions identify some of these forward-looking statements that speak only as of the dates on which they were made. We caution you that these forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors, including, without limitation, the risk factors set forth above and the matters set forth in this Form 10-K generally. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements included in this document. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 2. PROPERTIES

We lease 43,783 square feet in office space in Kansas City, Missouri for our corporate headquarters. This lease expires December 2006. Recently, we leased an additional 64,546 square feet of office space in Kansas City to expand our corporate headquarters. This lease expires February 2008. In Emporia, Kansas, we own two buildings totaling 58,500 square feet for our customer care center and provisioning divisions. In addition, we lease an aggregate of 21,175 square feet to house our four circuit switches in Kansas City and St. Louis, Missouri and Wichita, Kansas. These leases expire March 2003, November 2008, August 2005 and June 2008. We also lease space in 27 buildings, totaling approximately 110,823 square feet, in Missouri, Kansas, Texas and Oklahoma for our sales offices and customer premises equipment sites. These leases are generally leased on a month-to-month or annual basis.

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ITEM 3. LEGAL PROCEEDINGS

From time to time, we may be involved in claims or litigation that arise in the normal course of business. We are not a party to any legal proceedings which, if decided adversely, would have a material adverse effect on our business or financial condition or results of operations.

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

None.

PART II

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

MARKET INFORMATION

There is no established public trading market for our common stock. However, on March 23, 2000, we filed a registration statement on Form S-1 with the Securities and Exchange Commission, contemplating our initial public offering in the second quarter of 2000.

HOLDERS

As of March 23, 2000, there were 81 holders of record of our common stock.

DIVIDENDS

We have never paid or declared any cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future. We currently intend to retain all future earnings, if any, for use in the operation of our business and to fund future growth. The terms of our senior credit facility and senior notes indenture restrict our ability to declare and pay dividends on our common stock.

RECENT SALES OF UNREGISTERED SECURITIES

During 1999 we issued the following securities which were not registered under the Securities Act of 1933, as amended.

In February 1999, we acquired American Local, a competitive local exchange carrier based in the Dallas, Texas metropolitan area. The acquisition included substantially all assets of American Local. The total purchase price was approximately $1.6 million in cash and $211,000 in stock representing 70,334 shares. This issuance was exempt from registration pursuant to Section 4(2) of the Securities Act.

During July 1999 we completed a private placement to approximately 55 of our existing investors in our series B preferred stock of 2,222,222 shares of series D preferred stock at a purchase price of $4.50 per share for aggregate net proceeds of approximately $10 million. This issuance was exempt from registration pursuant to Section 4(2) of the Securities Act.

During August 1999, BTI Ventures, L.L.C., an affiliate of KKR, purchased 13,333,334 shares of our series F preferred stock at a purchase price of $4.50 per share for aggregate net proceeds of $60.0 million. On March 23, 2000, KKR exercised its options to purchase an additional 5,263,158 shares of series F preferred stock at $4.75 per share and 5,000,000 shares of series F preferred stock at $5.00 per share. In connection with the private placement of the series F preferred stock to BTI Ventures, L.L.C., which closed on August 5, 1999, and the related exercise of the KKR options, Lehman Brothers

Inc. earned compensation which included 646,300 shares of our series D preferred stock. These issuances were exempt from registration pursuant to Section 4(2) of the Securities Act.

During August 1999, in connection with the series F preferred stock offering, we repurchased 2,222,222 shares of our series C preferred stock for $10 million from a board member.

During August 1999, in connection with the series F preferred stock offering, we converted each outstanding share of series B preferred stock into one share of amended and restated series B preferred stock. The holders of series B preferred stock, approximately 70 accredited investors, surrendered their existing redemption and participating liquidation preference in exchange for 0.2222 shares of our series E preferred stock. These issuances were exempt from registration pursuant to Section 4(2) of the Securities Act. We redeemed the series E preferred stock for a total of $8.6 million.

In March 1999, Mr. Jalkut, a member of our board of directors, agreed to purchase 26,667 shares of our common stock for $200,000, and Mr. Ejabat, a member of our board of directors, agreed to purchase 66,667 shares of our common stock for $500,000.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial and operating data for the periods indicated. Our statement of operations data and other financial data for the years ended December 31, 1997, 1998 and 1999 and our balance sheet data as of December 31, 1998 and 1999, as well as the statement of operations data, other financial data and balance sheet data for the predecessor company as of and for the year ended December 31, 1997, have been derived from, and is qualified by reference to, consolidated financial statements included elsewhere in this Form 10-K.

EBITDA consists of earnings before interest, income taxes, depreciation and amortization. EBITDA is provided because it is a measure of financial performance commonly used in the telecommunications industry. EBITDA is used by management and some investors as an indicator of a company's historical ability to service debt. Management believes that an increase in EBITDA is an indicator of improved ability to service existing debt, to sustain potential future increases in debt and to satisfy capital requirements. We have presented EBITDA to enhance your understanding of our operating results. You should not construe it as an alternative to operating income, as an indicator of our operating performance nor as an alternative to cash flows from operating activities as a measure of liquidity determined in accordance with GAAP. We may calculate EBITDA differently from other companies. For further information, see our consolidated financial statements and the related notes elsewhere in this prospectus.

The predecessor company is Valu-Line, which merged with us in February 1998. Prior to February 1998, Birch had no revenues and was a development stage company.

We acquired Boulevard, Telesource and TFSnet in 1998 and American Local and Capital in 1999. The statement of operations data, other financial data and operating data in the table include the operations of these companies beginning on the dates they were acquired. These acquisitions affect the comparability of the financial data for the periods presented.

For purposes of calculating the ratio of earnings to fixed charges, earnings are defined as loss before income taxes plus fixed charges. Fixed charges consist of interest expense and a reasonable approximation of the interest factor included in rental payments on operating leases. Earnings were insufficient to cover fixed charges for the years ended December 31, 1997, 1998 and 1999. See Exhibit 12.1 for the computation of the ratio of earnings to fixed charges.

	YEAR ENDED DECEMBER 31,					
	THE PREDECESSOR			BIRCH		
	1995	1996	1997	1997	1998	1999
	(IN THOUSANDS, EXCEPT PER SHARE AND OPERATING DATA)					
STATEMENT OF OPERATIONS DATA:						
Revenue	$12,226	$13,217	$16,801	$ --	$ 26,087	$ 60,538
Cost of services	8,284	8,749	11,842	--	18,886	46,358
Gross margin	3,942	4,468	4,959	--	7,201	14,180
Selling, general and administrative	3,520	3,561	4,067	1,776	15,769	53,045
Depreciation and amortization	189	311	341	27	2,308	10,828
Income (loss) from operations	233	596	551	(1,803)	(10,876)	(49,693)
Interest income (expense), net	(58)	(102)	(97)	14	(5,332)	(12,111)
Income (loss) before income taxes	175	494	454	(1,789)	(16,208)	(61,804)
Provision for income taxes	81	205	186		--	--

Net income (loss)	$ 94	$ 289	$ 268	(1,789)	(16,208)	(61,804)
Preferred stock dividends				--	(1,696)	(3,550)
Amortization of preferred stock issuance costs				--	(29)	(292)
Loss applicable to common stock				$(1,789)	$(17,933)	$(65,646)
Weighted average shares outstanding--basic and diluted				1,235	3,809	4,956
Loss per common share--basic and diluted				$ (1.45)	$ (4.71)	$ (13.25)
OTHER FINANCIAL DATA:						
Cash flows from operating activities	$ (267)	$ 834	$ 488	$(1,551)	$(10,643)	$(53,225)
Cash flows from investing activities	(230)	(513)	(243)	(128)	(67,093)	(31,796)
Cash flows from financing activities	259	(257)	(145)	1,889	117,271	50,329
EBITDA	422	907	892	(1,776)	(8,568)	(38,865)
Capital expenditures	230	513	243	128	21,550	41,360
Ratio of earnings to fixed charges	3.5x	5.2x	4.9x	--	--	--
Deficiency of earnings to fixed charges	--	--	--	1,789	16,208	61,804
OPERATING DATA:						
Local Customers at end of period				--	14,735	38,487
Access Lines in service at end of period				--	39,323	112,518
Average lines per business customer				--	4.73	4.48
Average lines per residential customer				--	1.25	1.22
Circuit switches in service at end of period				1	1	4
Data switches in service at end of period				--	1	19
Employees at end of period				14	345	935

	DECEMBER 31,					
	THE PREDECESSOR			BIRCH		
	1995	1996	1997	1997	1998	1999
			(IN THOUSANDS)			
BALANCE SHEET DATA:						
Cash and cash equivalents	$ 96	$ 158	$ 258	$ 210	$ 39,745	$ 5,053
Pledged securities	--	--	--	--	37,785	23,420
Property and equipment	2,265	2,721	2,964	128	26,900	70,192
Total assets	3,971	3,868	4,802	534	134,149	146,971
Long-term debt and capital lease obligations	1,431	792	681	--	115,791	125,785
Redeemable preferred stock	--	--	--	--	14,063	63,550
Total stockholders' equity (deficit)	1,108	1,397	1,665	29	(7,099)	(67,757)

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

YOU SHOULD READ THE FOLLOWING DISCUSSION OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS TOGETHER WITH THE FINANCIAL STATEMENTS AND RELATED NOTES THAT ARE INCLUDED LATER IN THIS FORM 10-K. THIS DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF VARIOUS FACTORS, INCLUDING THOSE SET FORTH UNDER "RISK FACTORS" OR IN OTHER PARTS OF THIS FORM 10-K.

OVERVIEW

We were organized on December 23, 1996 to become a leading provider of telecommunications services for small and mid-sized businesses in our target markets. From that date until the February 1998 acquisition of Valu-Line, our predecessor, we were a development stage company with no revenue and principal activities consisting of procuring governmental authorizations, raising capital, hiring management and other key personnel, designing and developing our telephone networks, acquiring equipment and facilities, negotiating resale and interconnection agreements and pursuing acquisition opportunities. We had no assets, liabilities or financial activity prior to January 1, 1997.

The following is a summary of our major transactions and events.

DATE	EVENT

- - ----	---

February 1998	Merged with Valu-Line Companies, Inc., a provider of switched long distance, resold services and customer premises equipment sales and service in Kansas.
February/March 1998	Raised $13.0 million from the issuance of series B
preferred	
	stock and convertible notes used to pay the cash
portion of	
	the consideration in the Valu-Line merger, to repay
debt and	
	for general corporate purposes.
March 1998	Launched St. Joseph, Missouri market.
May 1998	Acquired Boulevard Phone Company, a provider of shared tenant service in the Kansas City, Missouri
metropolitan	
	area.
May 1998	Acquired Telesource Communications, Inc., a customer equipment sales and service provider in the Kansas
City,	
	Missouri metropolitan area.
May 1998	Launched St. Louis and Kansas City, Missouri and
Wichita and	
	Topeka, Kansas markets.
June 1998	Completed a $115.0 million private offering of 14%
senior	
	notes due June 2008 and 115,000 warrants to purchase 1,409,734 shares of common stock.
September 1998	Acquired TFSnet, Inc., a provider of Internet service
in the	
	Kansas City, Missouri metropolitan area.
February 1999	Acquired American Local, a communications provider
based in	
	the Dallas, Texas metropolitan area.
March 1999	Acquired Capital Communications Corporation, a customer equipment sales and service provider based in the St.
Louis,	
	Missouri metropolitan area.
May 1999-August 1999	Launched 11 Texas markets.
July 1999/August 1999	Sold $60.0 million of series F preferred stock to an affiliate of KKR, granted options to purchase an
additional	
	$50.0 million of series F preferred stock, sold $10.0 million of series D preferred stock and redeemed $10.0 million of series C preferred stock and $8.6 million of series E preferred stock.
December 1999/February 2000	Obtained a $75.0 million debt facility for general
corporate	
	purposes of our subsidiaries and to finance telecommunications equipment, inventory, network assets
and	
	back office systems. The facility was increased to
$125.0	
	million during syndication in February 2000.

March 2000	KKR exercised its options to purchase an additional $50.0 million series F preferred stock.
March 2000 for	Filed a registration statement on Form S-1 with the SEC
stock.	an underwritten initial public offering of common

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FACTORS AFFECTING OPERATIONS

REVENUE. We generate most of our revenue from the sale of our voice and data products, including local and long distance telephone service, Internet access and customer premises equipment to small and mid-sized business customers in various markets in Missouri, Kansas and Texas. Revenue from local services consists of charges for basic local service and custom calling features. We offer local telephone service at a discount to the competing incumbent provider of telecommunications services and offer long distance service at flat per-minute rates. We offer customer premises equipment and related services at negotiated rates generally consistent with other competitors. We also offer data services in select markets primarily at flat monthly rates. We expect that over the near term these services will continue to be the principal components of our revenue.

Our revenue consists of monthly recurring charges and usage charges. Monthly recurring charges include the fees paid by our customers for lines in service, additional features on those lines and collocation space. Usage charges consist of fees paid for each call made generally measured by the minute but also measured by the call. Additionally, revenue from customer premises equipment sales is recognized upon project completion.

OPERATING EXPENSES. Our primary operating expenses are cost of services and selling, general and administrative expenses.

COST OF SERVICES. Our cost of services includes the cost of leasing unbundled network elements from the incumbent telephone company for combination into Birch-branded voice services and purchasing the complete "bundle" of traditional incumbent telephone company services for resale to our local service subscribers. We lease local telephone network components to provide service for our customers under an interconnection agreement with the incumbent telephone company in our target markets. In markets where we have a local circuit switch, we can avoid leasing the switch and related features from the incumbent telephone company, which improves our gross margins.

Incumbent telephone companies typically charge both a start-up fee as well as a monthly recurring fee for use of their central offices for collocation of transmission equipment. Physically collocating our transmission equipment in or near existing incumbent telephone company switching offices allows us to combine leased digital subscriber lines with our data transmission switches to provide high speed data services and, eventually, voice and data services over a single digital subscriber line. We also invest in transmission and distribution electronics equipment associated with our switches. All of these costs are reflected in our cost of services.

Our primary long distance expenses are expenses associated with network access and our leased long distance network. We purchase long distance capacity from third party providers for all calls terminating outside of our network.

Our primary expense associated with providing data services to our customers is the cost of leasing transmission facilities. Our primary expense associated with customer premises equipment is the cost of purchasing equipment from manufacturers and labor for service and equipment installation.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Our selling, general and administrative expenses include selling and marketing costs and customer service, billing, corporate administration, personnel and network maintenance expenses.

We employ a direct sales force in each of our target markets. To attract and retain a highly qualified sales force, we offer our sales personnel a compensation package that emphasizes commissions. We expect to incur significant selling and marketing costs as we expand our operations.

We have implemented and continue to refine tailored systems for operations support systems and other back office systems that provision and track customer orders from point of sale to the installation

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and testing of service. Along with the development costs of these systems, we also incur ongoing expenses for customer service and billing systems. As our strategy stresses the importance of personalized customer service, we expect that our customer service department will become a larger part of our ongoing administrative expenses. We also expect billing costs to increase as the number of our customers and the call volume increase. We incur other costs and expenses, including the costs associated with maintenance of our network, administrative overhead, office leases and bad debt. We expect that these costs will grow significantly as we expand our operations and that administrative overhead will be a large portion of these expenses during the expansion phase of our business. However, we expect these expenses to become a smaller percentage of our revenue as we build our customer base.

We have experienced operating losses since inception as a result of efforts to build our customer base, develop and construct network infrastructure, build internal staffing, develop systems and expand into new markets. We expect to continue to focus on increasing our customer base and geographic coverage. Accordingly, we expect that cost of services, selling, general and administrative expenses, and capital expenditures will continue to increase significantly, all of which may have a negative impact on operating results. The projected increases in capital expenditures will continue to generate negative cash flows for at least the next several years as we develop and construct our voice and data networks. We may also be forced to change our pricing policies to respond to a changing competitive environment, and we cannot assure you that we will be able to maintain our gross and operating margins. We cannot assure you that growth in our revenue or customer base will continue or that we will be able to achieve or sustain profitability or positive cash flows.

RESULTS OF OPERATIONS

BIRCH TELECOM, INC.

YEAR ENDED DECEMBER 31, 1999 COMPARED TO YEAR ENDED DECEMBER 31, 1998

REVENUE. Revenue increased 132.1% to $60.5 million for 1999 compared to $26.1 million for 1998. The increase in revenue was principally a result of new customer sales in new and existing markets and the acquisitions of Capital in March 1999 and American Local in February 1999. As a percentage of total revenue, communications services were 87.5% for 1999 and 83.5% for 1998, and equipment sales were 12.5% for 1999 and 16.5% for 1998.

COST OF SERVICES. Cost of services increased 145.5% to $46.4 million for 1999 compared to $18.9 million for 1998. The increase in cost of services was primarily the result of associated revenue increases. Gross margins increased 96.9% to $14.2 million (23.4% of revenue) for 1999 compared to $7.2 million (27.6% of revenue) for 1998. The decline in gross margin as a percentage of revenue was principally the result of a greater percentage of revenue being derived from resold local service during 1999 compared to 1998. Additionally, long distance margins declined as a result of competitive pricing pressures.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased 236.4% to $53.0 million for 1999 compared to

$15.8 million for 1998. The increase in expense was primarily a result of supporting and attracting customers in new and existing markets, market launches in Texas and the acquisitions of Capital and American Local each of which affected wages, rent and advertising expense. Additionally, we had 935 employees at December 31, 1999 compared to 345 employees at December 31, 1998. EBITDA, a commonly used measure by securities analysts of earnings before deducting interest, taxes, depreciation and amortization, decreased 353.6% to a loss of $38.9 million for 1999 compared to a loss of $8.6 million for 1998.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 369.2% to $10.8 million for 1999 compared to $2.3 million for 1998. The increase in depreciation and amortization was

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primarily attributable to the depreciation of network assets added in our markets and the amortization of intangible assets related to acquisitions.

INTEREST. Interest expense increased 82.2% to $15.0 million for 1999 compared to $8.3 million for 1998. The increase in interest expense was primarily a result of a full year of interest charges on our senior notes sold in June 1998. Interest income remained virtually unchanged at $2.9 million in 1999 and 1998. Interest income is primarily derived from pledged securities purchased in connection with our senior notes.

NET LOSS. Net loss increased 281.3% to $61.8 million for 1999 compared to $16.2 million for 1998.

YEAR ENDED DECEMBER 31, 1998 COMPARED TO YEAR ENDED DECEMBER 31, 1997

REVENUE. Revenue was $26.1 million for 1998, resulting from the acquisitions of Valu-Line, Boulevard, Telesource and TFSnet and new customer sales from new markets. There was no revenue for 1997 because we were in the developmental stage. In addition to revenue generated as a result of acquisitions in 1998, revenue was generated from the sale of local telephone services to new customers.

COST OF SERVICES. Cost of services and gross margin totaled $18.9 million and $7.2 million, respectively, for 1998 as a result of the associated revenue increases.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased $14.0 million to $15.8 million for 1998 compared to $1.8 million for 1997. The increase in expense was primarily a result of the Valu-Line, Boulevard, Telesource and TFSnet acquisitions and opening five new markets in 1998. Additionally, we expanded our engineering and operations staff in preparation for switch deployment. EBITDA decreased 382.4% to a loss of $8.6 million for 1998 compared to a loss of $1.8 million for 1997.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased to $2.3 million for 1998 compared to $27,000 for 1997, most of which was attributable to the fixed and intangible assets acquired in the Valu-Line, Boulevard, Telesource and TFSnet acquisitions.

INTEREST. Interest expense was $8.2 million for 1998 primarily from interest charges on the senior notes. There was no interest expense in 1997. Interest income was $2.9 million in 1998 compared to $14,000 for 1997 primarily as a result of invested funds received from the senior notes.

NET LOSS. Net loss was $16.2 million for 1998 compared to $1.8 million for 1997.

VALU-LINE COMPANIES, INC. (PREDECESSOR COMPANY)

YEAR ENDED DECEMBER 31, 1997 COMPARED TO YEAR ENDED DECEMBER 31, 1996

REVENUE. Revenue increased 27.1% to $16.8 million for 1997 compared to

$13.2 million for 1996. The increase was primarily a result of entering the local service market in March 1997 and long distance volumes increasing faster than the decline in long distance pricing. Customer premises equipment sales were 18% of revenue, or $3.0 million, for 1997 compared to 19.1% of revenue, or $2.5 million, for 1996.

COST OF SERVICES. Cost of services increased 35.4% to $11.8 million for 1997 compared to $8.7 million for 1996. The increase was primarily a result of associated revenue increases. Gross margin increased 11.0% to $5.0 million, or 29.5% of revenue, for 1997 compared to $4.5 million, or 33.8% of revenue, for 1996. The decrease in gross margin as a percentage of revenue was primarily a result of low margins on resold local service, which started in March 1997.

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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased 14.2% to $4.1 million for 1997 compared to $3.6 million for 1996. The increase in expense was primarily a result of sales commissions related to increased business volumes and increased customer service expenditures associated with the commencement of local service. EBITDA decreased 1.7% to $892,000 for 1997 compared to $907,000 for 1996. The decrease in EBITDA was primarily a result of the start-up costs associated with offering local service.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 9.6% to $341,000 for 1997 compared to $311,000 for 1996.

INTEREST EXPENSE. Interest expense was $97,000 for 1997 compared to $102,000 for 1996.

INCOME TAXES. Income taxes decreased 9.3% to $186,000 for 1997 compared to $205,000 for 1996.

NET INCOME. Net income was $268,000 for 1997 compared to $289,000 for 1996.

LIQUIDITY AND CAPITAL RESOURCES

Our total assets increased to $147.0 million at December 31, 1999 from $134.1 million at December 31, 1998. This increase was primarily the result of capital outlays for expansion of our local and data networks and development of operations support systems and automated back office systems, partially offset by the use of cash to fund operations. At December 31, 1999, our current assets of $38.8 million exceeded current liabilities of $25.4 million, resulting in working capital of $13.4 million, representing a decrease of $36.3 million compared to working capital of $49.7 million at December 31, 1998. At December 31, 1998, our current assets of $61.1 million exceeded current liabilities of $11.4 million. The decrease in working capital was primarily attributable to the use of cash to fund operations and capital outlays for expansion of our network, support systems and back office systems. Pledged securities to satisfy interest payments on our senior notes amounted to $23.4 million at December 31, 1999 and $37.8 million at December 31, 1998.

OPERATING ACTIVITIES. Net cash used in operating activities was $53.2 million for the year ended December 31, 1999 compared to $10.6 million for the year ended December 31, 1998. Net cash used in operating activities was primarily used to fund our net losses of $61.8 million in 1999 and $16.2 million in 1998.

INVESTING ACTIVITIES. Net cash used in investing activities was $31.8 million for the year ended December 31, 1999 compared to $67.1 million for the year ended December 31, 1998. In 1999, net cash used in investing activities was primarily used for the purchase of property and equipment related to the expansion of our networks, support systems and back office systems of $41.4 million and acquisitions of $4.8 million, partially offset by net proceeds from the sale of pledged securities of $16.1 million for the semi-annual interest payments on the senior notes. In 1998, net cash used in investing activities was primarily used for the purchase of pledged securities related to our senior notes of $44.2 million, acquisitions of $7.8 million and purchases of property and equipment related to the expansion of the network, support systems and back office systems of $21.6 million, partially offset by net proceeds from the sale of pledged securities of $7.7 million.

FINANCING ACTIVITIES. Net cash provided by financing activities was $50.3 million for the year ended December 31, 1999 compared to $117.3 million for the year ended December 31, 1998. In 1999, net cash provided by financing activities was primarily a result of $70.0 million in proceeds from the sale of series D and series F preferred stock and borrowings of $10.0 million under our senior credit facility, partially offset by the redemption of series C and series E preferred stock of $18.6 million and the payment of financing costs related to the series D and series F preferred stock and on our senior credit facility of $8.8 million.

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In 1998, net cash provided by financing activities was primarily a result of proceeds of $114.7 million from the private offering of our senior notes. These senior notes bear interest at a fixed rate of 14% per annum and are due in June 2008. Subject to limitations, we may redeem a portion of these senior notes prior to their maturity date if we pay a designated premium. The indenture with respect to the senior notes contains a number of restrictive financial and operational covenants with which we must comply.

In February 2000, we increased the capacity of our $75.0 million senior credit facility to $125.0 million. This credit facility provides for a $25.0 million reducing revolver and $100.0 million in multi-draw term loans. The revolver is available for general corporate purposes of our subsidiaries and the term loans are to be used to finance telecommunications equipment, inventory, network assets and back office systems. The senior credit facility is secured by a perfected first priority security interest in substantially all of our assets and capital stock of our subsidiaries and contains a number of financial and operational covenants with which we must comply. Among other things, the covenants require us to maintain specified levels of revenue, EBITDA, ratio levels and access lines and restrict our ability to incur additional indebtedness, pay dividends, enter into related party transactions or sell our assets.

In March 2000, KKR exercised its options to purchase an additional $50.0 million of our series F preferred stock.

The development and expansion of our business will continue to require significant capital to fund capital expenditures, working capital and debt service and will generate negative operating cash flows.

Our principal capital expenditure requirements will include:

- the purchase, installation, and expansion of switches and transmission equipment for our local and data networks; and

- the further development of operations support systems and automated back office systems.

We do not believe that the growth of our long distance and customer premises equipment business will require significant capital expenditures.

Our business plan calls for us to offer our services in an additional 20 markets before the end of 2001. We expect to expand our operations in Texas and into Oklahoma in the second quarter of this year and to commence service in the regions served by Ameritech and BellSouth in 2001. We currently estimate that the cash required to fund these capital expenditures will be approximately $225.0 million over the next two years. We will need additional cash to fund our working capital needs, debt service requirements and operating losses. Until we begin to generate positive cash flow from operations, these liquidity requirements will need to be financed with additional debt and equity capital. In addition, depending on prevailing capital market conditions, we may choose to repurchase all or a portion of our senior notes. We believe that our current resources, including availability under our senior credit facility, together with the net proceeds from our proposed initial public offering, planned for the second quarter of 2000, will be sufficient to satisfy our liquidity needs for at least the next 12 months.

Thereafter, we will need substantial additional capital to finance our business plan. If our plans or assumptions change, if our assumptions prove to be inaccurate, or if we experience unexpected costs or competitive pricing pressures, we will be required to seek additional capital sooner than we currently expect. In particular, if we elect to pursue acquisition opportunities or open additional markets, our cash needs may increase substantially. We cannot assure you that our current projection of cash flow and losses from operations, which will depend upon numerous future factors and conditions, many of which are outside of our control, will be accurate. Actual results will almost certainly vary materially from our current projections. The cost of expanding our network services and sales efforts, funding

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other strategic initiatives and operating our business will depend on a variety of factors, including, among other things:

- the number of subscribers and the services for which they subscribe;

- the nature and penetration of services that we may offer;

- regulatory and legislative developments; and

- the response of our competitors to their loss of customers to us and to changes in technology.

We intend to seek additional debt and equity financing to fund our future liquidity needs. We cannot assure you that we will be able to raise additional capital on satisfactory terms or at all. If we decide to raise additional funds through the incurrence of debt, our interest obligations will increase and we may become subject to additional or more restrictive financial covenants. In addition, the terms of our senior credit facility and our senior notes each restrict our ability to obtain additional debt financing. If we decide to raise additional funds through the issuance of equity, the ownership interests represented by the common stock will be diluted. In the event that we are unable to obtain additional capital or to obtain it on acceptable terms or in sufficient amounts, we may be required to delay the development of our network and business plans or take other actions that could materially and adversely affect our business, operating results and financial condition.

IMPACT OF THE YEAR 2000 ISSUE

The Year 2000 issue results from computer programs being written using two digits rather than four to define the year. Any of our computer programs or systems, or those of our suppliers, that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculation causing the disruption of operations, including among other things:

- a temporary inability to process transactions;

- a temporary inability to send invoices;

- a temporary inability to engage in normal business activities; and

- interruptions of customer care.

We did not experience any problems on January 1, 2000 and to date, we have not experienced, nor are we aware of, any material Year 2000 issues with any of our internal systems or our services, and we do not anticipate experiencing any issues in the future. Further, we are unaware of any issues with our vendors, suppliers or customers that will materially affect us.

We believe that we have identified all major computers, software applications and related equipment used in connection with our internal operations that will need to be modified, upgraded or replaced to minimize the possibility of a material disruption to our business. We have completed assessing the potential impact of Year 2000 issues on these computers, equipment and applications and have modified, upgraded and replaced major systems that we believe have Year 2000 issues.

In addition to computers and related information, operation, and network systems, the operation of office systems, facilities and equipment, such as fax machines, security systems and other common office devices, may have Year 2000 issues that have not yet surfaced. We will continue to monitor the performance of these office systems, equipment and facilities.

We expect that we will be able to resolve any significant Year 2000 issues we have identified with third party suppliers of components of telecommunications services and our key subcontractors. However, because we have no control over the actions of these parties, they may not remediate any or all of the Year 2000 issues identified. Any failure of any of these third parties to timely resolve Year

2000 issues with either their products sold to us, or their systems could have a material adverse effect on our business, operating results and financial condition. In addition, the delivery of our services also depends on the operation of the networks of many local exchange carriers and long distance carriers with whom we must interact as part of our normal business operations, but with whom we do not have formal contractual arrangements. Consequently, failure of these carriers' networks to fully operate as a result of Year 2000 issues could also affect our operations. To our knowledge, none of these networks experienced any problems on or since January 1, 2000.

Our total cost to date to proactively address our Year 2000 issues has not been material. The cost of addressing Year 2000 issues is reported as a general and administrative expense.

We believe we identified and resolved all Year 2000 issues that could materially and adversely affect our business operations. However, for the reasons discussed above, we believe that it is not possible to determine with complete certainty that all Year 2000 issues affecting us have been identified or corrected and we may not know that this is true for several months. As a result, we believe that the following consequences are possible:

- operational inconveniences and inefficiencies for us that will divert our management's time and attention and our financial and human resources from ordinary business activities;

- business disputes and claims for pricing adjustments or penalties by our customers due to Year 2000 issues, which we believe will be resolved in the ordinary course of business; and

- business disputes alleging that we failed to comply with the terms and conditions of contracts or industry standards of performance that result in litigation or contract termination.

We developed contingency plans to be implemented if our efforts to identify and correct Year 2000 issues affecting our internal systems were ineffective. We have adopted the Year 2000 contingency plans as our standard operational contingency plans. Our contingency plans are designed to minimize the disruptions or other adverse effects. Our plans include:

- accelerated replacement of affected equipment or software;

- short to medium-term use of backup equipment and software;

- increased work hours for our personnel; and
- use of contract personnel to correct on an accelerated schedule any Year 2000 issues that arise or to provide manual workarounds for information systems.

Our implementation of any of these contingency plans could require us to expend additional funds and could have a material adverse effect on our business, operating results and financial condition. Our efforts in this regard, if necessary, will be to minimize expense associated with the implementation and use of any contingency planning with our objective to employ the least costly plan necessary to address the relevant operational issues.

IMPACT OF INFLATION

We do not believe that inflation has had a significant impact on our consolidated operations.

SEASONALITY

Our business is not considered to be seasonal.

RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which supersedes SFAS No. 80, "Accounting for Futures Contracts," SFAS No. 105,

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"Disclosure of Information About Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentration of Credit Risk," and SFAS No. 119, "Disclosures about Derivative Financial Instruments and Fair Value of Financial Instruments," and also amends some aspects of other SFAS's previously issued. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. SFAS No. 133 is effective for our consolidated financial statements for the year ending December 31, 2001. We do not expect the impact of SFAS No. 133 to be material in relation to our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not have operations subject to risks of foreign currency fluctuations, nor do we use derivative financial instruments in our operations or investment portfolio. Our earnings are affected by changes in interest rates as our long-term debt under our senior credit facility has variable interest rates based on either the prime rate or LIBOR. Our exposure to variable interest rate risk during 1999 was insignificant due to our level of floating rate borrowings. However, if interest rates for our long-term debt under our senior credit facility had averaged 10% more and the full amount available under our senior credit facility had been outstanding for the entire year, our interest expense would have increased, and loss before taxes would have increased by $12.5 million for the year ended December 31, 1999. These amounts are determined by considering the impact of the hypothetical interest rates on our borrowing cost and outstanding debt balances. These analyses do not consider the effects of the reduced level of overall economic activity that could existing in this environment. Further, in the event of a change of this magnitude, management would likely take actions to further mitigate our exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no changes in our financial structure. We had $114.7 million of senior notes outstanding as of December 31, 1999. These notes bear interest at a fixed rate of 14% and are not subject to risk from interest rate fluctuations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

For information required by Item 8, refer to the consolidated financial statements included in the Financial Statements and Financial Statement Schedule section filed as part of this document.

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

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

DIRECTORS, EXECUTIVE OFFICERS AND OTHER KEY EMPLOYEES

The following table sets forth information concerning our directors, executive officers and other key personnel, including their ages as of March 23, 2000:

NAME	AGE	POSITION
Richard A. Jalkut	56	Chairman of the Board
David E. Scott	40	President, Chief Executive Officer and Director
Donald H. Goldman	40	Executive Vice President and Chief Operating Officer
David M. Hollingsworth	35	Senior Vice President of Financial Operations
Gregory C. Lawhon	40	Senior Vice President of Public Policy and General Counsel
Bradley A. Moline	33	Senior Vice President of Finance and Chief Financial Officer
Jeffrey D. Shackelford	39	Senior Vice President of Sales
David W. Vranicar	41	Senior Vice President and Chief Information Officer
Henry H. Bradley	54	Director
Adam H. Clammer	29	Director
Mory Ejabat	49	Director
James H. Greene, Jr	49	Director
Henry R. Kravis	55	Director
Alexander Navab, Jr	33	Director
Thomas R. Palmer	33	Director
George R. Roberts	56	Director

RICHARD A. JALKUT is our chairman of the board and has been a director since March 2000. Since 1997, he has been president and chief executive officer of Pathnet, a privately held telecom company. From 1994 to 1997, Mr. Jalkut was the president, chief executive officer and chairman of the board of Nynex Telecommunications Group. From 1991 to 1994, he was the president, chief executive officer and chairman of the board of New York Telephone Company, and from 1990 to 1991, he was the executive vice president and chief operating officer.

DAVID E. SCOTT, a co-founder and director, is also our president and chief executive officer. Mr. Scott has 17 years of managerial experience in the telecommunications industry. Prior to joining us, Mr. Scott was president and general manager of Kansas City FiberNet, a competitive local exchange carrier owned jointly by the country's two largest cable operators, TCI and Time Warner. Prior to his tenure at Kansas City FiberNet, Mr. Scott was vice president of strategic development for Sprint, responsible for developing investment plans in the competitive local exchange, wireless (PCS) and international marketplaces. Mr. Scott also served as director of strategic planning for Sprint from 1988 to 1991. Mr. Scott also serves as a director of BizSpace, Inc., an Internet publishing and E-commerce company he co-founded with Donald H. Goldman. BizSpace, Inc. produces web sites that serve as on-line trade publications. Their first website, www.clec.com, serves the competitive local exchange carrier industry. Mr. Scott holds a Bachelor of Science degree in electrical engineering, SUMMA CUM LAUDE, from the University of Missouri and a Master of Business Administration degree from the University of Chicago.

DONALD H. GOLDMAN joined us in March 1998 as senior vice president of Internet services and is currently our executive vice president and chief operating officer. Mr. Goldman has over 15 years of managerial experience in the telecommunications industry. Prior to joining us, Mr. Goldman served as

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vice president, corporate development at Sprint where he developed strategy and managed the acquisition of companies in the areas of systems integration, Internet telephony, and wireless (PCS) services among others. While at Sprint, Mr. Goldman led the team that founded Sprint PCS. Mr. Goldman also serves as chairman of the board of BizSpace, Inc. Mr. Goldman holds a Bachelor of Arts degree, with honors, from Johns Hopkins University and a Master of Business Administration degree from the University of Chicago.

DAVID M. HOLLINGSWORTH joined us in February 2000 as senior vice president of financial operations. Prior to joining us, from 1998 to February 2000, Mr. Hollingsworth was the vice president of finance and corporate development for GST Telecommunications. From 1997 to 1998, Mr. Hollingsworth was a telecommunications analyst at George K. Baum and Company. From 1993 through 1996, Mr. Hollingsworth served as director of finance and administration for Kansas City FiberNet. Before FiberNet, Mr. Hollingworth was a mergers and acquisitions manager for Sprint Corporation. Mr. Hollingsworth holds a Bachelor of Arts in Business Administration, CUM LAUDE, from Washington State University.

GREGORY C. LAWHON joined us in January 1997 as senior vice president of public policy and general counsel. Prior to joining us, Mr. Lawhon practiced law for twelve years with the 90-lawyer Kansas City firm of Spencer Fane Britt & Browne. A partner in the firm since 1990, he was head of the firm's communications and media group and a member of its business group. Mr. Lawhon's areas of practice were mergers and acquisitions, with an emphasis on communications industry acquisitions, cable television franchising, and commercial and regulatory issues with respect to the telecommunications industry. Mr. Lawhon holds a Bachelor of Arts degree in Economics, MAGNA CUM LAUDE, from Vanderbilt University, and a law degree from Columbia University, where he was a Harlan Fiske Stone Scholar.

BRADLEY A. MOLINE joined us in July 1997 as senior vice president of finance and chief financial officer. From 1994 to 1997, Mr. Moline was the treasurer and chief financial officer of Covenant Transport, Inc., a transportation company in Chattanooga, Tennessee that became publicly traded during his tenure. Prior to joining Covenant Transport, Mr. Moline worked for Ernst & Young LLP in Kansas City, Missouri and Grant Thornton in Lincoln, Nebraska, providing customer services in the auditing and consulting areas. Mr. Moline holds a Bachelor of Administration degree in Business Administration, with distinction, from the University of Nebraska and is a certified public accountant.

JEFFREY D. SHACKELFORD, a co-founder, is senior vice president of sales. Mr. Shackelford has 13 years of experience in the telecommunications industry. Prior to joining us, Mr. Shackelford served as director of sales and marketing for Kansas City FiberNet. Prior to joining Kansas City FiberNet, Mr. Shackelford was the Branch Manager for Sprint's commercial sales office in Kansas City and was responsible for sales and service of small to large business customers. During his tenure at Sprint, which began in 1988, Mr. Shackelford also developed the long distance industry's first PC-based call management system, FONVIEW. Mr. Shackelford holds a Bachelor of Science degree in Computer Science from the University of Kansas.

DAVID W. VRANICAR joined us in March 1997 and serves as senior vice president and chief information officer. Prior to joining us, Mr. Vranicar was vice president, international business development, at Sprint. Before joining Sprint in 1992, Mr. Vranicar was vice president, Asia/Pacific operations, at MPSI Systems Private Ltd., based in Singapore. MPSI is a software and information services company that develops and markets decisions-support software and databases to major retail companies. Mr. Vranicar was the company's senior executive in the Asia/Pacific division, directing a staff of approximately 80 engaged in software development, computer graphics, and customer technical support. Mr. Vranicar holds a Bachelor of Business degree in Marketing, with honors, from the University of Texas at Austin, and a Master of Business Administration degree, with distinction, from the University of Michigan at Ann Arbor.

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HENRY H. BRADLEY has been a director since January 1997. He is the chairman of the board of News-Press & Gazette Company, or NPG, one of our co-founders. NPG is a family-owned company that owns and operates a daily newspaper, cable television systems, network affiliate broadcast television stations and FM and AM radio stations. Mr. Bradley has held a number of other positions with NPG since joining NPG in 1971, including terms as the editor and publisher of the St. Joseph News-Press. Mr. Bradley holds a Bachelor's degree from the University of Missouri.

ADAM H. CLAMMER has been a director since August 1999. Prior to joining KKR in 1995, he was with Morgan Stanley & Co. in its mergers and acquisitions department. At KKR, Mr. Clammer has been involved in investments in Intermedia Communications, Inc., CAIS Internet, Inc., Zhone Technologies, RELTEC and Borden. He is also a director of AEP Industries, Inc. and a number of private companies.

MORY EJABAT has been a director since March 2000. Since September 1999, Mr. Ejabat has been the chairman and chief executive officer of Zhone Technologies, Inc. Prior to joining Zhone, Mr. Ejabat served as the president and chief executive officer of Ascend Communications, Inc. from June 1995 to June 1999. Before becoming the president and chief executive officer of Ascend in 1995, Mr. Ejabat had served as vice president, operations from 1990 to 1992 and as executive vice president from 1992 to 1995.

JAMES H. GREENE, JR. has been a director since August 1999 and is a member of the limited liability company which serves as the general partner of KKR and a general partner of KKR Associates. He is also a director of Accuride Corporation, Owens-Illinois, Inc., Safeway Inc., Shoppers Drug Mart, Inc., Intermedia Communications, Inc., CAIS Internet, Inc., Tenovis, formerly a division of Bosch Telecom, and Zhone Technologies.

HENRY R. KRAVIS has been a director since March 2000. He is a founding partner of KKR and since January 1996 a managing member of the executive committee of the limited liability company that serves as the general partner of Kohlberg Kravis Roberts & Co., L.P. He is also a director of Accuride Corporation, Borden, Inc., The Boyds Collection, Ltd., Evenflo Company Inc., The Gillette Company, IDEX Corporation, KinderCare Learning Centers, Inc., KSL Recreation Group, Inc., Owens-Illinois, Inc., PRIMEDIA Inc., Regal Cinemas, Inc., Safeway, Inc., Sotheby's Holdings, Inc., Spalding Holdings Corporation, and TI Group plc. Messrs. Kravis and Roberts are first cousins.

ALEXANDER NAVAB, JR. has been a director since August 1999. He has been an executive of KKR and a limited partner of KKR Associates since 1993. From 1991 to 1993, Mr. Navab was an associate at James D. Wolfensohn, Inc. He is also a director of Borden, Inc., KSL Recreation Group, Inc., Intermedia Communications, Inc., CAIS Internet, Inc., Tenovis, formerly a division of Bosch Telecom, and Zhone Technologies.

THOMAS R. PALMER has been a director since April 1999. Since June 1997, Mr. Palmer has been a general partner at Kansas City Equity Partners, and focuses on investments in the telecommunications and information technology sector. He joined the firm in August 1995. Prior to joining Kansas City Equity Partners, he held positions at Ameritech and Trans National Group. Mr. Palmer also serves on the boards of Net Sales, Vroom and several other private companies. Mr. Palmer is a graduate of Dartmouth College and the Kellogg School of Management at Northwestern University.

GEORGE R. ROBERTS has been a director since March 2000. He is a founding partner of KKR and since January 1996 a managing member of the executive committee of the limited liability company that serves as the general partner of Kohlberg Kravis Roberts & Co., L.P. He is also a director of Accuride Corporation, Borden, Inc., The Boyds Collection, Ltd., Evenflo Company Inc., IDEX Corporation, KinderCare Learning Center, Inc., KSL Recreation Group, Inc., Owens-Illinois, Inc., PRIMEDIA Inc., Regal Cinemas, Inc., Safeway, Inc. and Spalding Holdings Corporation. Messrs. Kravis and Roberts are first cousins.

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SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

During the year ended December 31, 1999, we did not have equity securities registered pursuant to Section 12 of the Exchange Act and this item is, therefore, non-applicable.

ITEM 11. EXECUTIVE COMPENSATION

DIRECTOR COMPENSATION

Directors who are also our executive officers do not receive any additional compensation for serving as members of the board of directors or any of its committees. Beginning in 2000, non-employee directors are expected to receive a cash stipend of $5,000 payable annually and reimbursement of expenses for serving on the board of directors and any committees of the board, as well as an annual option to purchase 5,000 shares of common stock. Each non-employee director currently on the board will receive an option to purchase 10,000 shares of common stock upon completion of our initial public offering at the offering price. These options will vest in equal annual installments over the next four years. In addition, Messrs. Ejabat and Jalkut each received on March 22, 2000 an additional option to purchase 30,000 shares of common stock at an exercise price of $7.50 per share. These options will vest in equal annual installments over the next two years.

COMPENSATION OF EXECUTIVE OFFICERS

The following table sets forth the cash and non-cash compensation paid or incurred on our behalf to our chief executive officer and each of the four other most highly compensated executive officers that earned more than $100,000 during 1999:

SUMMARY COMPENSATION TABLE

		ANNUAL COMPENSATION			LONG-TERM COMPENSATION AWARDS	
NAME AND PRINCIPAL POSITION	YEAR	SALARY($)	BONUS($)	OTHER ANNUAL COMPENSATION($)	SECURITIES UNDERLYING OPTIONS (#)(1)	ALL OTHER COMPENSATION ($)(2)
David E. Scott................	1999	203,846	--	--	200,000	8,153
President and Chief	1998	175,000	--	--	1,052,362	7,000
Executive Officer(3)	1997	164,904	--	--	--	--
Donald H. Goldman.............	1999	192,892	--	--	150,000	7,716
Executive Vice President	1998	101,346	--	--	263,750	--
and Chief	1997	--	--	--	--	--
Operating Officer(4)						
Gregory C. Lawhon.............	1999	184,615	--	--	75,000	7,385
Senior Vice President of	1998	175,000	--	--	328,863	5,386
Public Policy and General	1997	164,904	--	--	--	--
Counsel(3)						
David W. Vranicar.............	1999	177,331	--	--	75,000	7,093
Senior Vice President	1998	150,000	--	--	274,052	6,000
and Chief Information	1997	118,269	--	--	--	--
Officer(5)						
Stephen L. Sauder.............	1999	216,561	--	--	--	8,663
Vice President(6)	1998	226,471	--	--	--	--
	1997	134,577	128,667	--	--	--

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(1) Includes options to purchase shares of our common stock, which were issued under our 1998 employee stock option plan. Prior to the private placement of our series B preferred stock, we were a party to various stock option agreements with our employees, all of which were governed by our 1997 stock option plan. In connection with the 1998 private placement of series B preferred stock, the 1997 stock option plan was replaced with the 1998 stock option plan, and all stock option agreements governed by the 1997 stock option plan were terminated. Options issued to the members of management during 1998 were granted under our 1998 employee stock option plan and were exercisable immediately on grant at an exercise price of $0.001 per share. The shares issued under these options vest over a four-year period, at a rate of 6.25% per quarter. Options issued during 1999 were also granted under our 1998 stock option plan and vest 25% at the first anniversary of the grant, then 6.25% per quarter thereafter. All stock options have been adjusted to reflect a stock dividend made on June 23, 1998. Holders of exercised options have voting power with respect to all shares of common stock underlying the options. Upon termination of employment, we have the right to repurchase all options which have not vested as of that date, subject to some exceptions.

(2) Reflects matching contributions made by us under our 401(k) plan.

(3) Reflects compensation paid to Messrs. Scott and Lawhon commencing in January 1997.

(4) Mr. Goldman joined us in March 1998 as senior vice president of Internet services. In August 1999 Mr. Goldman was named senior vice president of operations and chief operating officer.

(5) Reflects compensation paid to Mr. Vranicar commencing in March 1997.

(6) Mr. Sauder joined us after the Valu-Line acquisition and currently serves as vice president. Compensation listed was paid by Valu-Line from January 1997 to February 1998.

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OPTIONS GRANTS

The following table sets forth summary information regarding option grants made during 1999 to our chief executive officer and each of our four other highly paid executive officers. The exercise price per share is equal to the fair market value of our common stock on the date of grant as determined by our board of directors:

	INDIVIDUAL GRANTS				POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM(3)	
NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED(#)(1)	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR(2)	EXERCISE OR BASE PRICE ($/SHARE)	EXPIRATION DATE	5%($)	10%($)
David E. Scott	200,000	11.5%	4.50	10/7/09	566,005	1,434,368
Donald H. Goldman	50,000	2.8%	3.00	1/15/09	94,334	239,061
	150,000	8.4%	4.50	10/7/09	424,504	1,075,776
Gregory C. Lawhon	75,000	4.3%	4.50	10/7/09	212,252	537,888
David W. Vranicar	75,000	4.3%	4.50	10/7/09	212,252	537,888
Stephen L. Sauder	--	--	--	--	--	--

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(1) Options granted to purchase shares of our common stock were made under our

1998 employee stock option plan. In the event that a purchaser ceases to provide service to us and our affiliates, we have the right to repurchase any of that person's unvested shares of common stock at the original option exercise price. Generally, these options vest 25% on the first anniversary of the grant date and quarterly thereafter at a rate of 6.25%.

(2) The percentage of total options was calculated based on options to purchase an aggregate of 1,794,800 shares of common stock granted to employees under the 1998 stock option plan in 1999.

(3) The potential realizable value was calculated based on the ten-year term of the options and assumed rates of stock appreciation of 5% and 10%, compounded annually from the date the options were granted to their expiration date based on the fair market value of the common stock on the date of grant.

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1998 EMPLOYEE STOCK OPTION PLAN

Under our 1998 employee stock option plan, as amended, options to purchase shares of our common stock in the form of both incentive stock options and nonqualified stock options were granted to our employees or employees of certain of our subsidiaries. A total of 7,720,845 shares of our common stock were reserved for issuance under this option plan. As of December 31, 1999, options to acquire 2,030,850 shares were issued and outstanding with a weighted average exercise price of $3.57 per share. These options generally vest 25% per year over four years from the date of grant. Under a resolution of our board of directors, no new options may be granted under this option plan.

401(K) PLAN

We have adopted a tax-qualified employee savings and retirement plan, or 401(k) plan, covering all of our full-time employees. Under the 401(k) plan, employees may elect to reduce their current compensation up to the statutorily prescribed annual limit and have the amount of the reduction contributed to the 401(k) plan. The 401(k) plan is intended to qualify under Section 401 of the Code so that contributions by employees to the 401(k) plan and income earned on plan contributions are not taxable to employees until withdrawn from the 401(k) plan. The trustees under the 401(k) plan, at the direction of each participant, invest the participant's assets in the 401(k) plan in selected investment options.

1999 OPTION VALUES

The following table shows for the fiscal year ended December 31, 1999, information regarding options granted to, exercised by, and held at year end by, our chief executive officer and each of our four other most highly paid executive officers during 1999:

			NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS(#)		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS($)	
NAME	SHARES ACQUIRED ON EXERCISE(#)(1)	VALUE REALIZED ($)(2)	EXERCISABLE	UNEXERCISABLE(3)	EXERCISABLE	UNEXERCISABLE (2)(3)
David E. Scott	263,091	1,972,916	--	791,953	--	5,039,060
Donald H. Goldman	65,938	494,465	12,500	335,859	168,750	1,562,547
Gregory C. Lawhon	82,216	616,536	--	259,985	--	1,612,206
David W. Vranicar	68,513	513,779	--	229,154	--	1,381,003
Stephen L. Sauder	--	--	--	--	--	--

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(1) For purposes of this table alone, "exercise" means an employee's acquisition of shares of common stock which have already vested, "exercisable" means options to purchase shares of common stock which are subject to exercise and "unexercisable" means all other options to purchase shares of common stock.

(2) Amounts shown under the "Value Realized" and "Value of Unexercised In-the-Money Options" are based upon the estimated December 31, 1999 estimated fair market value of our common stock of $7.50 per share minus the per share exercise price multiplied by the number of shares underlying the option.

(3) Includes options to purchase shares of common stock, which were issued under the 1998 employee stock option plan. Options issued during 1998 under the 1998 employee stock option plan were granted at an exercise price of $0.001 per share. Options issued during 1999 under the 1998 stock

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option plan were granted at an exercise price of $4.50 per share. All options vest 25% on the first anniversary of the grant date and quarterly thereafter at a rate of 6.25%.

EMPLOYMENT AGREEMENTS

Each of Messrs. Scott, Goldman, Lawhon, Moline, Shackelford and Vranicar entered into an amended and restated employment agreement with us in October 1999. In addition, Mr. Sauder entered into an employment agreement with us in February 1998, and Mr. Hollingsworth entered into an employment agreement with us in February 2000.

The base salary under each of these agreements is $200,000 per year, except that Mr. Scott's base salary is $250,000 per year, Mr. Goldman's is $225,000 per year and Mr. Sauder's is $213,000 per year. Each of the executives is eligible for a bonus based on achievement of performance criteria established by the board for that executive.

Each of the employment agreements provides that upon termination of employment by us, other than for cause, disability or death, or termination of the employment by the executive for good reason, we will pay the executive the following severance. We will pay the executive's salary for the remainder, if any, of the calendar month in which the termination is effective and, in the case of each of Messrs. Scott, Vranicar, Shackelford and Goldman, 24 calendar months thereafter and, in the case of each of Messrs. Lawhon, Sauder, Hollingsworth and Moline, 12 calendar months thereafter. In addition, we will pay each executive his prorated targeted incentive compensation for the year during which the termination is effective plus, in the case of each of Messrs. Scott, Vranicar, Shackelford and Goldman, two times the executive's targeted incentive compensation for that year, and, in the case of each of Messrs. Lawhon, Hollingsworth and Moline, the full amount of the executive's targeted incentive compensation for that year. Upon termination of employment for disability, we will pay the employee's salary through the remainder of the calendar month during which the termination is effective and for the lesser of (1) six calendar months thereafter or (2) the period until disability insurance benefits commence. Upon termination of employment from death, we will pay the employee's salary through the end of the calendar month in which his death occurs. Each agreement provides for noncompetition, nonsolicitation and nondisclosure covenants.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

None of the members of the compensation committee of the board of directors is currently or has been, at any time since our formation, our officer or employee.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS

The following is a report of the Compensation Committee of our Board of Directors (Committee), describing the compensation policies applicable to our executive officers during the fiscal year ended December 31, 1999.

GENERAL POLICIES

The Committee is responsible for assisting the Chief Executive Officer (CEO) in devising general compensation policies and compensation plans, as well as the specific compensation levels for individual executive officers. The Committee also administers the stock option, employee stock purchase and 401(k) plans and determines the terms and conditions of grants thereunder. The Committee consists of Messrs. Bradley, Greene, Navab and Mr. Scott, Birch's CEO. Prior to his departure from the board in August 1999, Ian Bund was a member of the Committee. Mr. Scott does not participate in Committee deliberations or decisions involving his own compensation.

The goals of the Committee are to:

- align compensation with business objectives and performance;

- adopt policies that enable us to attract, retain and reward executive officers and other key employees who contribute to Birch's long-term success; and

- motivate executives and employees as we seek to enhance long-term stockholder value..

In order to meet these goals, the Committee has adopted the following policies:

- Offer pay that is competitive with the practices of the leading telecommunications companies with which compete for talent. To ensure that pay is competitive, the Committee regularly compares its pay practices with these companies and sets it pay parameters based on this review.

- Maintain annual incentive opportunities sufficient to provide motivation to achieve specific operating goals and to generate rewards that bring total compensation to competitive levels.

- Provide significant equity-based incentives for executives and other key employees to ensure that they are motivated over the long-term. The Committee wants Birch's executives and employees to respond to business challenges and opportunities as owners and not just as employees.

The compensation mix offered to employees reflects a balance of annual cash payments, consisting of base salary and incentive bonus payments and long-term stock-based incentives in the form of stock options.

BASE SALARIES

The salary component of executive compensation is based on the executive's level of responsibility for meeting targeted objectives and their overall performance. Base salaries for executives are reviewed and adjusted at least annually based on information regarding competitive salaries, the results of industry compensation surveys, individual experience and performance.

CASH BONUSES

Our incentive program for executive officers provides direct financial incentives in the form of cash bonuses based on previous year performance.

STOCK OPTIONS

The Committee's long-term incentive program is centered around the granting of stock options under the 1998 Stock Option Plan. These stock options, which typically have vesting periods of four years, encourage key employees to continue their service with Birch and motivate their performance. Executive officers receive significant equity incentives to build long-term stockholder value. Grants are made at 100% of fair market value on the date of grant. Employees receive value from these grants only if Birch's common stock appreciates over the long-term. The size of option grants is determined based on competitive practices at leading companies in the telecommunications industry and our philosophy of linking executive compensation with stockholder interests. The Committee believes this approach creates an appropriate focus on longer term objectives and promotes executive retention.

COMPENSATION OF THE CHIEF EXECUTIVE OFFICER

Mr. Scott has served as Birch's President and CEO since inception. In February 1998, Mr. Scott entered into an employment agreement, the terms of which are described in more detail in "Employment Agreements."

During fiscal 1999, Mr. Scott received aggregate salary of $203,846, which reflects the August 1999 increase in Mr. Scott's base salary from $175,000 to $250,000. In addition, Mr. Scott was granted options to purchase an aggregate of 200,000 shares of our common stock in 1999. This compensation reflects the August 1999 increase in Mr. Scott's base salary from $175,000 to $250,000. Mr. Scott did not receive a cash bonus in 1999. In reviewing the compensation paid to Mr. Scott in 1999, the Committee considered a number of factors, including competitive market compensation packages, Mr. Scott's past performance and the responsibilities he has assumed as CEO. Based on its internal review and informal information reviewed by the Committee, the Committee believes that the base salary level for Mr. Scott is commensurate with salaries paid to chief executive officers of comparable companies in similar industries.

Overall, the Committee believes that Mr. Scott is being appropriately compensated in a manner that is consistent with the long-term interests of stockholders.

CONCLUSION

A significant portion of the Committee's compensation program, including Mr. Scott's compensation, are contingent on individual performance, and the realization of benefits is closely linked to increases in long-term stockholder value. The Committee remains committed to this philosophy of pay for performance, recognizing that the competitive market for talented executives and the volatility of the Company's business may result in highly variable compensation for a particular time period.

The members of the Committee submit the foregoing report.

COMPENSATION COMMITTEE:

Henry H. Bradley
James H. Greene, Jr.
Alexander Navab, Jr.
David E. Scott

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table provides summary information regarding the beneficial ownership of our outstanding capital stock as of March 23, 2000 for:

- each person or group who beneficially owns more than 5% of our capital stock on a fully diluted basis;

- each of the executive officers and the former executive officer named in the Summary Compensation Table;

- each of our directors; and

- all of our directors and executive officers as a group.

Beneficial ownership of shares is determined under the rules of the Securities and Exchange Commission and generally includes any shares over which a person exercises sole or shared voting or investment power. Except as indicated by footnote, and subject to applicable community property laws, each person identified in the table possesses sole voting and investment power with respect to all shares of common stock held by them. Shares of common stock subject to options currently exercisable or exercisable within 60 days of March 23, 2000 and not subject to repurchase as of that date are deemed outstanding for calculating the percentage of outstanding shares of the person holding these options, but are not deemed outstanding for calculating the percentage of any other person. Unless otherwise

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noted, the address for each director and executive officer is c/o Birch Telecom, Inc., 2020 Baltimore Avenue, Kansas City, Missouri 64108.

NAME AND ADDRESS OF BENEFICIAL OWNER (A)	NUMBER OF SHARES BENEFICIALLY OWNED				
		PREFERRED STOCK SERIES			
	COMMON STOCK (B)	B	C	D	F
DIRECTORS AND EXECUTIVE OFFICERS:					
Richard A. Jalkat(c).............	26,667	--	--	--	--
David E. Scott...................	1,190,768	--	189,900	--	--
Donald H. Goldman................	263,750	--	--	--	5.5
Gregory C. Lawhon................	380,137	49,453	--	--	--
Bradley A. Moline(d).............	297,932	74,509	--	--	--
Jeffrey D. Shackelford...........	794,162	--	126,600	--	--
David W. Vranicar................	316,780	36,266	--	--	--
Henry H. Bradley(e)..............	--	1,978,128	1,582,500	333,333	--
Adam H. Clammer(f)(1)............	--	--	--	--	23,596,492
Mory Ejabat(c)	66,667	--	--	--	--
James H. Greene, Jr.(f)(1).......	--	--	--	--	23,596,492
Henry R. Kravis(f)(1)............	--	--	--	--	23,596,492
Alexander Navab, Jr.(f)(1).......	--	--	--	--	23,596,492
Thomas R. Palmer(g)(m)...........	--	945,108	--	666,667	--
George R. Roberts(f)(1)..........	--	--	--	--	23,596,492
Stephen L. Sauder(h).............	--	85,719	4,089,575	--	--
All directors and executive officers as a group (16 persons).......................	3,336,862	3,169,183	5,988,575	1,000,000	23,596,492
5% OWNERS:					
News-Press & Gazette Company(i)..	--	1,648,438	1,582,500	222,222	--
Advantage Capital Missouri Partners I, L.P.(j)............	--	1,318,750	--	145,550	--
Advantage Capital Missouri Partners II, L.P.(j)...........	--	--	--	417,450	--
Pacific Capital, L.P.(k).........	--	1,219,925	--	--	--
BTI Ventures L.L.C.(f)(1)........	--	--	--	--	23,596,492
Kansas City Equity Partners I, L.P.(g)(m).....................	--	945,108	--	111,111	--
Kansas City Equity Partners Ventures II, L.P. (g)(m).......	--	--	--	555,556	--
White Pines Limited Partnership I(n)...............	--	989,128	--	--	--
LBI Group, Inc. (o)..............	--	--	--	586,617	--

NAME AND ADDRESS OF BENEFICIAL OWNER (A)	PERCENTAGE OF CLASS OWNED	
		PREFERRED STOCK SERIES
	COMMON	

	STOCK (B)	B	C	D	F
DIRECTORS AND EXECUTIVE OFFICERS:					
Richard A. Jalkat(c)	*	--%	--%	--%	--%
David E. Scott	24.9	--	3.0	--	--
Donald H. Goldman	5.68	--	--	--	--
Gregory C. Lawhon	8.0	*	--	--	--
Bradley A. Moline(d)	6.2	--	--	--	
Jeffrey D. Shackelford	16.6	--	2.0	--	--
David W. Vranicar	6.6	*	--	--	--
Henry H. Bradley(e)	--%	23.1	25.2	11.6	--
Adam H. Clammer(f)(l)	--	--	--	--	100.0
Mory Ejabat(c)	1.4	--	--	--	--
James H. Greene, Jr.(f)(l)	--	--	--	--	100.0
Henry R. Kravis(f)(l)	--	--	--	--	--
Alexander Navab, Jr.(f)(l)	--	--	--	--	100.0
Thomas R. Palmer(g)(m)	--	11.0	--	23.2	--
George R. Roberts(f)(l)	--	--	--	--	--
Stephen L. Sauder(h)	--	1.0	65.2	--	--
All directors and executive officers as a group (16 persons)	69.8	37.0	95.5	34.9	100.0
5% OWNERS:					
News-Press & Gazette Company(i)	--	19.2	25.2	7.8	--
Advantage Capital Missouri Partners I, L.P.(j)	--	15.4	--	5.1	--
Advantage Capital Missouri Partners II, L.P.(j)	--	--	--	14.6	--
Pacific Capital, L.P.(k)	--	14.2	--	--	--
BTI Ventures L.L.C.(f)(l)	--	--	--	--	100.0
Kansas City Equity Partners I, L.P.(g)(m)	--	11.0	--	3.9	--
Kansas City Equity Partners Ventures II, L.P. (g)(m)	--	--	--	19.4	--
White Pines Limited Partnership I(n)	--	11.5	--	--	--
LBI Group, Inc. (o)	--	--	--	20.5	--

NAME AND ADDRESS OF BENEFICIAL OWNER(A)	PERCENTAGE OF TOTAL VOTING POWER OF FULLY DILUTED COMMON STOCK
DIRECTORS AND EXECUTIVE OFFICERS:	
Richard A. Jalkat	*%
David E. Scott	3.0
Donald H. Goldman	
Gregory C. Lawhon	*
Bradley A. Moline(d)	*
Jeffrey D. Shackelford	2.0
David W. Vranicar	*
Henry H. Bradley(e)	8.5
Adam H. Clammer(f)(l)	51.2
Mory Ejabat	*
James H. Greene, Jr.(f)(l)	51.2
Henry R. Kravis	51.2
Alexander Navab, Jr.(f)(l)	51.2
Thomas R. Palmer(g)(m)	3.5
George R. Roberts	51.2
Stephen L. Sauder(h)	9.1
All directors and executive officers as a group (16 persons)	80.5
5% OWNERS:	
News-Press & Gazette Company(i)	7.5
Advantage Capital Missouri Partners I, L.P.(j)	3.2
Advantage Capital Missouri Partners II, L.P.(j)	*
Pacific Capital, L.P.(k)	2.7
BTI Ventures L.L.C.(f)(l)	51.2
Kansas City Equity Partners I, L.P. (KCEP)(g)(m)	2.3
Kansas City Equity Partners Ventures II, L.P.	

(KCEP) (g) (m)	1.2
White Pines Limited Partnership I(n)	2.2
LBI Group, Inc. (o)	1.3

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* Less than one percent

(a) Beneficial ownership is determined in accordance with the SEC's rules and includes voting and investment power with respect to the shares.

(b) Includes options to purchase shares of the common stock, which were issued pursuant to our 1998 Stock Option Plan. Certain options are exercisable immediately on grant at an exercise price of $.001 per share, and vest over a four-year period, at a rate of 6.25% per quarter. All other options are exercisable at a price of $4.50 per share subject to a four-year vesting period, at a rate of 6.25% per quarter. Holders of exercised options have voting power with respect to all shares of common stock underlying the options. Upon termination of employment with us, we have the right to purchase all options which have not vested as of that date, subject to certain exceptions.

(c) In March 1999, Mr. Jalkat, chairman of our board of directors, agreed to purchase 26,667 shares of our common stock for $200,000 and Mr. Ejabat, a member of our board of directors, agreed to purchase 66,667 shares of our common stock for $500,000.

(d) Includes 19,275 shares of Series B Preferred Stock held by Mr. Moline's immediate family subject to options exercisable within 60 days of February 29, 2000

(e) Includes 1,648,438 shares of Series B Preferred Stock, 1,582,500 shares of Series C Preferred Stock and 222,222 shares of Series D Preferred Stock held by News-Press & Gazette Company.

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Mr. Bradley and his brother hold voting power of News-Press & Gazette Company. Also includes 329,690 shares of Series B Preferred Stock and 111,111 shares of Series D Preferred Stock held by various trusts and relatives of the Bradley family.

(f) All of the shares indicated are owned of record by BTI Ventures L.L.C. and are included because of Messrs. Clammer's, Greene's, Kravis', Navab's and Roberts' affiliation with BTI Ventures L.L.C. These individuals disclaim beneficial ownership of the shares within the meaning of Rule 13d-3 under the Exchange Act.

(g) Includes 945,108 shares of Series B Preferred Stock and 111,111 shares of Series D Preferred Stock held by Kansas City Equity Partners Ventures I and 555,556 shares of Series D Preferred Stock held by Kansas City Equity Partners Ventures II. Mr. Palmer holds voting power of Kansas City Equity Partners Ventures.

(h) Includes 65,937 shares of Series B Preferred Stock held by Mr. Sauder's father, 1,544,787 shares of Series C Preferred Stock held in trust by his wife and 1,000,000 shares of Series C Preferred Stock held in trust by S.L. Sauder LTP. L.L.P.

(i) The principal business address of News-Press & Gazette Company is 825 Edmond Street, St. Joseph, MO 64501.

(j) The principal business address of Advantage Capital Missouri Partners L.P. is 7733 Forsyth Boulevard, Suite 1850, St. Louis, MO 63105.

(k) The principal business address of Pacific Capital, L.P. is 2401 Plymouth Road, Suite B, Ann Arbor, MI 48105.

(l) The principal business address of BTI Ventures L.L.C. is 9 W. 57(th) Street, Suite 4200, New York, NY 10019.

(m) The principal business address of Kansas City Equity Partners is 233 West 47(th) Street, Kansas City, MO 64112.

(n) The principal business address of White Pines Limited Partnership I is 2401 Plymouth Road, Suite B, Ann Arbor, MI 48105.

(o) The principal business address of LBI Group, Inc. is 3 World Financial Center, 200 Vesey Street, New York, NY 10285.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

SERIES D PREFERRED STOCK OFFERING

In July 1999, we completed a private placement of 2,222,222 shares of series D preferred stock at a purchase price of $4.50 per share for aggregate proceeds of approximately $10.0 million. The transaction was consummated pursuant to the purchasers rights agreement described below and the series D preferred stock purchase agreement. Under the series D preferred stock purchase agreement, NPG, a stockholder that owned in excess of 5% of our voting securities at the time of the series D preferred stock offering, purchased $1.0 million of series D preferred stock, and parties affiliated with NPG, including Henry H. Bradley, chairman of our board of directors at that time and of NPG, purchased $500,000 of series D preferred stock. Advantage Capital Missouri Partners I, L.P., a stockholder that owned in excess of 5% of our voting securities at the time of the series D preferred stock offering, purchased $655,000 of the series D preferred stock. In addition, Ian R. N. Bund, one of our directors at the time of the series D preferred stock offering, purchased $82,000 of the series D preferred stock. Affiliates of KCEP I and KCEP II also purchased $3.0 million of our series D preferred stock. Mr. Palmer, one of our directors at the time of the series D preferred stock offering, holds voting power of KCEP I and KCEP II.

SERIES F PREFERRED STOCK OFFERING

In August 1999, we issued and sold 13,333,334 shares of our series F preferred stock at a purchase price of $4.50 per share to BTI Ventures, L.L.C., an affiliate of KKR, for aggregate proceeds of $60.0 million. KKR received three seats on our then seven-seat board of directors. Additionally, on March 23, 2000, KKR exercised its options to purchase 5,263,158 shares of series F preferred stock at $4.75 per share and 5,000,000 shares of series F preferred stock at $5.00 per share. Giving effect to this exercise KKR's investment would have represented a 51.2% equity interest as of March 23, 2000. In connection with their exercise of these options, KKR received two additional seats on our eleven-seat board of directors.

In connection with the series F preferred stock offering, we repurchased 2,222,222 shares of our series C preferred stock from Stephen L. Sauder, a stockholder who owned more than 5% of our voting securities at the time of the series F preferred stock offering, for $10.0 million.

Also, in connection with the series F preferred stock offering, we converted each outstanding share of our series B preferred stock into one share of amended and restated series B preferred stock. In addition, the holders of series B preferred stock surrendered their existing redemption and participating liquidation preference in exchange for 0.2222 shares of our series E preferred stock. We redeemed the series E preferred stock issued to the series B preferred stock holders for a total of $8.6 million. The rights and preferences of the series B preferred stock were amended and restated to remove mandatory redemption rights and change the liquidation rights.

In connection with the series F preferred stock offering, NPG, a stockholder that owned in excess of 5% of our voting securities at the time of the series F preferred stock offering, received 366,320 shares of series E preferred stock, which were redeemed for an aggregate total of $1.6 million, and parties affiliated with NPG, including Henry H. Bradley, chairman of our board of directors and of NPG, received 73,264 shares of series E preferred stock, which were redeemed for an aggregate total of $329,690. Advantage Capital Missouri Partners I, L.P., a stockholder which owned in excess of 5% of our voting securities at the time of the series F preferred stock offering, received 293,056 shares of the of the series E preferred stock, which were redeemed for an aggregate total of $1.3 million. Bradley A. Moline, our senior vice president of finance and chief financial officer, received 15,385 shares of series E preferred stock, which were redeemed for an aggregate total of $69,234. Pacific Capital, L.P., a stockholder which owned in excess of 5% of our voting securities at the time of the series F preferred stock offering, received 271,095 shares of the of the series E preferred stock, which were redeemed for

an aggregate total of $1.2 million. Steven L. Sauder, our vice president, together with his father, Earl W. Sauder, received an aggregate of 19,048 shares of series E preferred stock, which were redeemed for an aggregate total of $85,718. KCEP I and KCEP II together received an aggregate of 210,022 shares of series E preferred stock, which were redeemed for an aggregate total of $945,099.

PURCHASERS RIGHTS AGREEMENT

Our current stockholders are parties to the purchasers rights agreement, which provides that they vote their respective shares in a manner as to elect persons specified in the agreement to serve as directors. The holders of series F preferred stock have agreed to vote their shares to elect Messrs. Greene, Navab and Clammer. The two additional designees of the holders of series F preferred stock are Messrs. Kravis and Roberts. In addition, the holders of series B preferred stock, series C preferred stock and series D preferred stock have agreed to vote their shares to elect Henry H. Bradley and Thomas R. Palmer. The holders of common stock have agreed to vote their shares for the election of David E. Scott. So long as the purchasers rights agreement is in effect, these investors will effectively control the election of our board of directors.

REGISTRATION RIGHTS

The parties to the purchasers rights agreement, subject to some conditions, have registration rights with respect to shares of common stock, including shares of common stock issuable upon conversion or redemption of shares of series F preferred stock or upon conversion of shares of series B preferred stock, series C preferred stock, or series D preferred stock. These purchasers have, subject to some conditions, demand and "piggy-back" registration rights. The purchasers rights agreement provides that each purchaser of stock is subject to lock-up restrictions in the event of a public offering of our securities.

RESTRICTIONS ON TRANSFER

Our outstanding common stock (including shares issued pursuant to options) and each series of preferred stock are subject to restrictions on transfer. Holders of common stock and each series of preferred stock that are parties to the purchasers rights agreement, subject to some exceptions, may not transfer their shares without first giving us the opportunity to purchase the shares. In addition, subject to some exceptions, the holders of common stock or any series of preferred stock that are parties to the purchasers rights agreement may not transfer their shares without first giving the other purchasers under the purchasers rights agreement the opportunity to participate in the transfer.

PRE-EMPTIVE RIGHTS

Holders of our common stock and each series of preferred stock that are parties to the purchasers rights agreement have the right to purchase a pro rata portion of any common stock or preferred stock that we propose to sell and issue, subject to some exceptions.

SIZE OF THE BOARD OF DIRECTORS

The purchasers rights agreement provides that so long as at least 6,666,667 shares of series F preferred stock remain outstanding, the holders of series F preferred stock are entitled to elect and remove directors in accordance with our restated certificate. In the event that less than 6,666,667 shares of series F preferred stock remain outstanding, but BTI Ventures L.L.C. and its affiliates, which include KKR, beneficially own at least 10% of our outstanding common stock, BTI has the right to designate the number of persons to serve as members of the board determined in accordance with a formula set forth in the purchasers rights agreement. Currently there are five BTI nominees sitting on our eleven seat board of directors.

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For so long as at least 8,532,394 shares of series B preferred stock, series C preferred stock and series D preferred stock remain outstanding, the holders of this stock, voting together as a class, are entitled to elect and remove directors pursuant to our restated certificate.

BTI DRAG-ALONG RIGHTS

Holders of common stock and each series of preferred stock that are parties to the purchasers rights agreement are required to sell their shares in the event that BTI Ventures L.L.C. or its affiliates agree to sell or transfer their shares, or to sell all or substantially all of our assets, to a third party.

BTI VETO RIGHTS

The purchasers rights agreement provides that for so long as BTI or any of its affiliates beneficially owns at least 6,666,667 shares of our common stock or series F preferred stock, the approval of at least one BTI nominee on our board will be required for our board of directors to approve and authorize any of the following: any changes in our capital structure, such as increases or decreases in the total authorized shares of our common stock and issuances of our capital stock; any payment of dividends or distributions on our capital stock; subject to limited exceptions, any reclassification, combination, split, redemption or other acquisition of any shares of our capital stock; any incurrence of indebtedness exceeding $5.0 million; any change in the size or composition of our board or any board committee or creation of any board committee; subject to limited exceptions, any affiliate transaction; any hiring or termination of a chief executive officer or other key officer; any adoption or modification of our annual budget and business plan; any amendment or modification of any material provision of our senior notes indenture, senior credit facility or any other material contract; any adoption, renewal or material modification of any material compensation or benefit plan or arrangement; any authorization of entering into a new line of business or the expansion outside of Missouri, Kansas and Texas; any consolidation, reorganization, recapitalization, merger or similar transaction; any transfer of our assets, including by pledge, in excess of $5.0 million; subject to limited exceptions, any acquisition of assets or securities for more than $5.0 million; any amendment to our certificate of incorporation or bylaws; any voting or similar arrangement regarding our capital stock; any payment, discharge or satisfaction of any material claim or liability or the commencement of a material suit; any joint venture involving material assets or the payment or receipt of more than $5.0 million; any material license, contract or agreement; or any liquidation, dissolution or winding up of our company.

OTHER TRANSACTIONS WITH AFFILIATES

VALU-LINE LOANS

As of December 31, 1997, Valu-Line of Kansas, Inc., which merged into us on February 10, 1998, had notes payable of $240,000 in the aggregate from Stephen L. Sauder and Mr. Sauder's father. Mr. Sauder was the president and principal stockholder of Valu-Line at the time the loan was made and currently owns more than 5% of our voting securities. The loans were due on demand. As of December 31, 1998, the amounts outstanding under these loans were fully repaid.

DEALINGS WITH VALU-BROADCASTING, INC.

In 1999, 1998, and 1997 we, and our predecessor, Valu-Line, provided services principally related to rent and operating costs to Valu-Broadcasting, Inc., an affiliate of Valu-Line, which is owned by Stephen L. Sauder, one of our stockholders who owned more than 5% of our voting securities at the time of the transactions, in the amounts of $29,187, $30,000 and $81,000, respectively. Valu-Line also received services principally related to advertising from Valu-Broadcasting in the amounts of $30,360, $40,000 and $41,000 in 1999, 1998 and 1997, respectively.

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SHARES ISSUANCES TO DIRECTORS

In March 2000, Mr. Jalkut, chairman of our board of directors, agreed to purchase 26,667 shares of our common stock for $200,000, and Mr. Ejabat, a member of our board of directors, agreed to purchase 66,667 shares of our common stock for $500,000.

PART IV.

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

(a) Documents filed as part of this report

(1) Financial Statements

See "Item 8. Financial Statements and Supplementary Data" for financial statements included with this Annual Report on Form 10-K.

(2) Financial Statement Schedules

Schedule II--Consolidated Valuation and Qualifying Accounts

BIRCH TELECOM, INC.
SCHEDULE II--CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999

		ADDITIONS			
	BALANCE BEGINNING OF YEAR	CHARGED TO INCOME	CHARGED TO OTHER ACCOUNTS	OTHER DEDUCTIONS	BALANCE END OF YEAR
			(IN THOUSANDS)		
1997					
Valuation allowance--deferred income tax assets	$ 0	$ 681	$ 0	$ 0	$ 681
1998					
Allowance for doubtful accounts	$ 0	$ 140	$133	$ (39)(1)	$ 234
Valuation allowance--deferred income tax assets	$ 681	$ 5,118	$ 0	$ 0	$ 5,799
1999					
Allowance for doubtful accounts	$ 234	$ 561	$125	$(464)(1)	$ 456
Valuation allowance--deferred income tax assets	$5,799	$22,942	$ 0	$ 0	$28,741

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(1) Accounts written off, net of recoveries.

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(3) Exhibits

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
2.1	Agreement and plan of merger among Birch Telecom, Inc., Valu-Line Companies, Inc., Stephen L. Sauder, Paula K. Sauder, Richard L. Tidwell, Sarah J. Tidwell, Stormy Supiran and Carla S. Supiran. (incorporated by reference to Exhibit 2.1 to Birch Telecom, Inc.'s registration statement on Form S-4, as amended (SEC File No. 333-62797), originally filed September 3, 1998 (Form S-4)).
3.1	Restated certificate of incorporation of Birch Telecom, Inc. (incorporated by reference to Exhibit 3.1 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
3.2	Restated bylaws of Birch Telecom, Inc. (incorporated by reference to Exhibit 3.2 to the Form S-4).
10.1	Birch Telecom, Inc. securities purchase agreement (incorporated by reference to Exhibit 10.1 to the Form S-4).
10.2	Birch Telecom, Inc. amended and restated purchasers rights agreement, dated August 5, 1999 (incorporated by reference to Exhibit 10.2 to the Form 10-Q).
10.3	Amended employment agreement dated as of October 7, 1999 between Birch Telecom, Inc. and David E. Scott. (incorporated by reference to Exhibit 10.3 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.4	Amended employment agreement dated as of October 7, 1999 between Birch Telecom, Inc. and Gregory C. Lawhon. (incorporated by reference to Exhibit 10.4 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.5	Amended employment agreement dated as of October 7, 1999 between Birch Telecom, Inc. and Donald H. Goldman. (incorporated by reference to Exhibit 10.5 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.6	Amended employment agreement dated as of October 7, 1999 between Birch Telecom, Inc. and David W. Vranicar. (incorporated by reference to Exhibit 10.6 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.7	Employment agreement dated as of February 10, 1998 between Birch Telecom, Inc. and Stephen L. Sauder (incorporated by reference to Exhibit 10.7 to the Form S-4).
10.8	General agreement between Birch Telecom, Inc. and Lucent

	Technologies Inc. (incorporated by reference to Exhibit 10.12 to the Form S-4).
10.9	Interconnection agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Southwestern Bell Telephone Company and Birch Telecom of Missouri, Inc. (Missouri Interconnection Agreement) (incorporated by reference to Exhibit 10.13 to the Form S-4).
10.10	Amendment No. 1 dated May 27, 1998 to Missouri interconnection agreement (incorporated by reference to Exhibit 10.10 to Birch Telecom, Inc.'s annual report on form 10-K for the fiscal year ended December 31, 1998, originally filed on March 31, 1999 (Form 10-K)).
10.11+	Software license agreement between Birch Telecom, Inc. and Saville Systems Inc. (incorporated by reference to Exhibit 10.14 to the Form S-4).
10.12	Interconnection agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Southwestern Bell Telephone Company and Birch Telecom of Kansas, Inc. (incorporated by reference to Exhibit 10.12 to the Form 10-K).

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EXHIBIT NO.	DESCRIPTION OF EXHIBIT
10.13	Interconnection agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Southwestern Bell Telephone Company and Birch Telecom of Texas Ltd., LLP. (incorporated by reference to the Exhibit 10.13 to the Form 10-K).
10.14	1998 stock option plan (incorporated by reference to Exhibit 10.14 to Birch Telecom Inc.'s annual report on Form 10-K for the fiscal year ended December 31, 1998, as amended, filed on May 7, 1999 (Form 10-K/A)).
10.15	Form of incentive stock option agreement under 1998 stock option plan (incorporated by reference to Exhibit 10.15 to the Form 10-K/A).
10.16	Form of nonstatutory stock option agreement under 1998 stock option plan (incorporated by reference to Exhibit 10.16 to the Form 10-K/A).
10.17	Lease agreement between Francor, L.L.C. and Birch Telecom, Inc. dated July 20, 1998 (incorporated by reference to Exhibit 10.17 to the Form 10-K/A).
10.18	Series D preferred stock purchase agreement, dated July 2, 1999 (incorporated by reference to Exhibit 10.18 to Birch Telecom Inc.'s quarterly report or Form 10-Q for the period ended September 30, 1999, filed November 15, 1999 (Form 10-Q)).
10.19	Series F preferred stock purchase agreement, dated July 13, 1999 (incorporated by reference to Exhibit 10.19 to the Form 10-Q).
10.20	Amended and restated credit agreement among Birch Telecom Finance, Inc., Birch Telecom, Inc., Lehman Brothers Inc.,

	Lehman Commercial Paper Inc., Bankers Trust Company and Bank of America, Inc., as agents and lenders, and the other lenders party thereto dated February 2, 2000. (incorporated by reference to Exhibit 10.20 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.21	Amended and restated guarantee and collateral agreement, dated as of February 2, 2000, among Birch Telecom Finance, Inc., Birch Telecom, Inc. and Lehman Commercial Paper, Inc., as collateral agent. (incorporated by reference to Exhibit 10.21 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.22	Amended employment agreement dated as of October 7, 1999 between Birch Telecom, Inc. and Bradley A. Moline. (incorporated by reference to Exhibit 10.22 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.23	Amended employment agreement dated as of October 7, 1999 between Birch Telecom, Inc. and Jeffrey D. Shackelford. (incorporated by reference to Exhibit 10.23 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.24	Employment agreement dated as of February 2000 between Birch Telecom, Inc. and David M. Hollingsworth. (incorporated by reference to Exhibit 10.24 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.25	Indenture, dated as of June 23, 1998, between Birch Telecom, Inc. and Norwest Bank Minnesota, National Association, as trustee, relating to $115,000,000 aggregate principal amount of 14% senior notes due 2008 (incorporated by reference to Exhibit 4.1 to the Form S-4).
10.26	Specimen certificate of 14% senior notes due 2008 (Exchange Notes) (included in Exhibit 4.1, which is incorporated by reference to Exhibit 4.1 to the Form S-4).
10.27	Collateral pledge and security agreement, dated as of June 23, 1998 from Birch Telecom, Inc., Pledgor, to Norwest Bank Minnesota, National Association, Trustee (incorporated by reference to Exhibit 4.5 to the Form S-4).
10.28	Letter agreement dated as of March 22, 2000 between Birch Telecom, Inc. and Mory

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
	Ejabat. (incorporated by reference to Exhibit 10.28 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.29	Letter agreement dated as of March 22, 2000 between Birch Telecom, Inc. and Richard A. Jalkut. (incorporated by reference to Exhibit 10.29 to Birch Telecom Inc.'s registration statement on Form S-1 filed March 23, 2000.)
10.30	Amendment number one dated as of March 23, 2000 to the amended and restated purchasers rights agreement. (incorporated by reference to Exhibit 10.30 to Birch Telecom

	Inc.'s registration statement on Form S-1 filed March 23, 2000.)
12.1*	Computation of Ratio of Earnings to Fixed Charges.
21.1	Subsidiaries of Birch Telecom, Inc. (incorporated by reference to Exhibit 21.1 to the Form S-4).
24.1*	Power of attorney (included on the signature page).
27.1*	Financial data schedule.

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* Filed herewith.

\+ Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Such portions have been filed separately with the Commission.

(b) Reports on Form 8-K.

On March 23, 2000 we filed Form 8-K with respect to a registration statement filing with the SEC as part of a proposed initial public offering of common stock. We attached a copy of our press release issued that same day.

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SIGNATURES

PURSUANT TO THE REQUIREMENTS OF THE SECTION 13 OR 15(D) OF THE SECURITIES AND EXCHANGE ACT OF 1934, AS AMENDED, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED, IN THE CITY OF KANSAS CITY, STATE OF MISSOURI.

BIRCH TELECOM, INC.

By: /s/ DAVID E.

SCOTT

David E.

Scott

PRESIDENT AND CHIEF

EXECUTIVE OFFICER

Date: March , 2000

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David E. Scott and Bradley A. Moline, and each of them, his attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place, and stead, in any and all capacities, to sign any and all amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission granting unto such attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming that all such attorneys-in-fact and agents, or any of them or their or his substitute or substituted, may lawfully do or cause to be done by virtue hereof.

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES AND EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BELOW BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT IN THE CAPACITIES AND AS OF THE DATES INDICATED.

SIGNATURE DATE - - --------- ----	TITLE -----
- - --- March 30, 2000 DAVID E. SCOTT	President, Chief Executive Officer and Director (Principal Executive Officer)
- - --- Financial March 30, 2000 BRADLEY A. MOLINE	Senior Vice President of Finance and Chief Financial Officer (Principal and Accounting Officer)
- - --- March 30, 2000 HENRY H. BRADLEY	Director
- - --- March 30, 2000 ADAM H. CLAMMER	Director
- - --- March 30, 2000 JAMES H. GREENE, JR.	Director
- - --- March 30, 2000 ALEXANDER NAVAB, JR.	Director
- - --- March 30, 2000 THOMAS R. PALMER	Director

INDEX TO FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

REPORT OF INDEPENDENT AUDITORS

THE BOARD OF DIRECTORS AND STOCKHOLDERS
BIRCH TELECOM, INC.

We have audited the accompanying consolidated balance sheets of Birch Telecom, Inc. (Birch) as of December 31, 1998 and 1999, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 1999. Our audit also included the financial statement schedule listed in the Index to Financial Statements and Financial Statement Schedule. These financial statements and schedule are the responsibility of Birch's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 Birch Telecom, Inc. at December 31, 1998 and 1999, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material aspects the information set forth therein.

Ernst & Young LLP

Kansas City, Missouri
February 17, 2000, except for note 19, as to which the date is March 23, 2000

BIRCH TELECOM, INC.

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 1998 AND 1999

(IN THOUSANDS, EXCEPT SHARE DATA)

	1998	1999
ASSETS		
Current assets:		

Cash and cash equivalents	$ 39,745	$ 5,053
Pledged securities	15,888	15,936
Accounts receivable, net	4,039	11,612
Inventory	916	3,735
Prepaid expenses and other	526	2,443
Total current assets	61,114	38,779
Property and equipment	26,900	70,192
Less: accumulated depreciation	747	8,080
Property and equipment, net	26,153	62,112
Pledged securities--noncurrent	21,897	7,484
Goodwill, net	16,863	19,316
Other intangibles, net	7,620	16,911
Other assets	502	2,369
Total assets	$134,149	$146,971
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 335	$ 1,300
Accounts payable	8,503	13,300
Accrued expenses	2,556	10,793
Total current liabilities	11,394	25,393
Senior credit facility	--	10,000
14% senior notes	114,681	114,715
Capital lease obligations, net of current maturities	778	836
Other long-term debt, net of current maturities	332	234
Series B redeemable preferred stock, 8,572,039 shares issued and outstanding in 1998 (stated at redemption and aggregate liquidation value)	14,063	--
Series F redeemable preferred stock, 13,333,334 shares issued and outstanding in 1999 (stated at redemption and aggregate liquidation value)	--	63,550
Stockholders' deficit:		
Series B preferred stock, 8,572,039 shares issued and outstanding in 1999	--	8
Series C preferred stock, 8,492,749 and 6,270,527 shares issued and outstanding	8	6
Series D preferred stock, 2,222,222 shares issued and outstanding in 1999	--	2
Common stock, $.001 par value, 80,000,000 shares authorized, 5,016,889 and 4,687,767 shares issued and outstanding	5	5
Warrants	337	337
Additional paid-in capital	10,548	11,686
Accumulated deficit	(17,997)	(79,801)
Total stockholders' deficit	(7,099)	(67,757)
Total liabilities and stockholders' deficit	$134,149	$146,971

See accompanying notes.

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BIRCH TELECOM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	1997	1998	1999
Revenue:			
Communications services	$ --	$ 21,783	$ 52,980
Equipment sales	--	4,304	7,558
Total revenue	--	26,087	60,538
Cost of services:			
Cost of communications services	--	16,339	41,870
Cost of equipment sales	--	2,547	4,488
Total cost of services	--	18,886	46,358
Gross margin	--	7,201	14,180
Selling, general and administrative expenses	1,776	15,769	53,045
Depreciation and amortization expense	27	2,308	10,828
Loss from operations	(1,803)	(10,876)	(49,693)
Interest expense	--	(8,254)	(15,036)
Interest income	14	2,922	2,925
Net loss	(1,789)	(16,208)	(61,804)
Preferred stock dividends	--	(1,696)	(3,550)
Amortization of preferred stock issuance costs	--	(29)	(292)
Loss applicable to common stock	$(1,789)	$(17,933)	$(65,646)
Loss per common share--basic and diluted	$ (1.45)	$ (4.71)	$ (13.25)
Weighted average number of common shares outstanding	1,235	3,809	4,956

See accompanying notes.

BIRCH TELECOM, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999
(IN THOUSANDS)

	SERIES A PREFERRED STOCK	SERIES B PREFERRED STOCK	SERIES C PREFERRED STOCK	SERIES D PREFERRED STOCK	SERIES E PREFERRED STOCK	COMMON STOCK $.01 PAR	WARRANTS $.01 PAR	COMMON STOCK $.001 PAR
Balance at December 23, 1996 (date of inception) and December 31, 1996	$ --	$ --	$ --	$ --	$ --	$ --	$ --	$ --
Issuance of common stock and warrants	--	--	--	--	--	18	18	--
Net loss and comprehensive loss	--	--	--	--	--	--	--	--
Balance at December 31, 1997	--	--	--	--	--	18	18	--
Recapitalization	--	--	2	--	--	(18)	(18)	--
Merger with Valu-Line	3	--	6	--	--	--	--	--
Issuance of warrants in connection with 14% senior notes	--	--	--	--	--	--	--	--
Redemption of series A preferred stock	(3)	--	--	--	--	--	--	--
Stock dividend	--	--	--	--	--	--	--	1
Option exercise	--	--	--	--	--	--	--	4
Restatement of series B preferred stock dividends	--	--	--	--	--	--	--	--
Amortization of series B preferred stock issuance costs	--	--	--	--	--	--	--	--
Series A preferred stock dividends	--	--	--	--	--	--	--	--
Accretion of series B preferred stock dividends	--	--	--	--	--	--	--	--
Net loss and comprehensive loss	--	--	--	--	--	--	--	--
Balance at December 31, 1998	--	--	8	--	--	--	--	5

	WARRANTS $.001 PAR	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	TOTAL
Balance at December 23, 1996 (date of inception) and December 31, 1996	$--	$ --	$ --	$ --
Issuance of common stock and warrants	--	1,782	--	1,818
Net loss and comprehensive loss	--	--	(1,789)	(1,789)
Balance at December 31, 1997	--	1,782	(1,789)	29
Recapitalization	--	34	--	--
Merger with Valu-Line	--	14,741	--	14,750
Issuance of warrants in connection with 14% senior notes	337	--	--	337
Redemption of series A preferred stock	--	(4,747)	--	(4,750)
Stock dividend	--	(1)	--	--
Option exercise	--	--	--	4
Restatement of series B preferred stock dividends	--	464	--	464
Amortization of series B preferred stock issuance costs	--	(29)	--	(29)
Series A preferred stock dividends	--	(168)	--	(168)
Accretion of series B preferred stock dividends	--	(1,528)	--	(1,528)
Net loss and comprehensive loss	--	--	(16,208)	(16,208)
Balance at December 31, 1998	337	10,548	(17,997)	(7,099)

BIRCH TELECOM, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) (CONTINUED)
YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999
(IN THOUSANDS)

	SERIES A PREFERRED STOCK	SERIES B PREFERRED STOCK	SERIES C PREFERRED STOCK	SERIES D PREFERRED STOCK	SERIES E PREFERRED STOCK	COMMON STOCK $.01 PAR	WARRANTS $.01 PAR	COMMON STOCK $.001 PAR
Balance at December 31, 1998	$ --	$--	$ 8	$--	$--	$ --	$ --	$ 5
Issuance of series D preferred stock	--	--	--	2	--	--	--	--
Issuance of series E preferred stock	--	--	--	--	2	--	--	--
Issuance of common stock	--	--	--	--	--	--	--	--
Restatement of series B preferred stock	--	8	--	--	--	--	--	--
Redemption of series C preferred stock	--	--	(2)	--	--	--	--	--
Redemption of series E preferred stock	--	--	--	--	(2)	--	--	--
Retirement of common stock	--	--	--	--	--	--	--	--
Amortization of series F preferred stock issuance costs	--	--	--	--	--	--	--	--
Accretion of series F preferred stock dividends	--	--	--	--	--	--	--	--
Net loss and comprehensive loss	--	--	--	--	--	--	--	--
Balance at December 31, 1999	$ --	$ 8	$ 6	$ 2	$--	$ --	$ --	$ 5

	WARRANTS $.001 PAR	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	TOTAL
Balance at December 31, 1998	$337	$ 10,548	$(17,997)	$ (7,099)
Issuance of series D preferred stock	--	9,998	--	10,000
Issuance of series E preferred stock	--	(2)	--	--
Issuance of common stock	--	211	--	211
Restatement of series B preferred stock	--	13,760	--	13,768
Redemption of series C preferred stock	--	(9,998)	--	(10,000)
Redemption of series E				

preferred stock	--	(8,570)	--	(8,572)
Retirement of common stock	--	(449)	--	(449)
Amortization of series F preferred stock issuance costs	--	(262)	--	(262)
Accretion of series F preferred stock dividends	--	(3,550)	--	(3,550)
Net loss and comprehensive loss	--	--	(61,804)	(61,804)
Balance at December 31, 1999	$337	$ 11,686	$(79,801)	$(67,757)

See accompanying notes.

BIRCH TELECOM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999

(IN THOUSANDS)

	1997	1998	1999
OPERATING ACTIVITIES			
Net loss	$(1,789)	$(16,208)	$(61,804)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	27	720	7,948
Amortization	--	1,588	2,880
Provision for losses on accounts receivable	--	140	561
Other	50	16	34
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	--	(1,905)	(7,633)
Inventory	--	(300)	(989)
Prepaid expenses	(7)	(370)	(1,907)
Other intangibles	--	--	(2,065)
Other assets	(87)	(198)	(2,357)
Accounts payable	255	3,888	4,592
Accrued expenses	--	1,986	7,515
Net cash used in operating activities	(1,551)	(10,643)	(53,225)
INVESTING ACTIVITIES			
Purchase of property and equipment	(128)	(21,550)	(41,360)
Business acquisitions, net of cash acquired	--	(7,757)	(4,801)
Amortization of discount on pledged securities	--	(1,231)	(1,725)
Maturity of pledged securities	--	7,692	16,100
Purchase of pledged securities	--	(44,247)	(10)
Net cash used in investing activities	(128)	(67,093)	(31,796)
FINANCING ACTIVITIES			
Proceeds from long-term debt	--	123	10,000
Proceeds from 14% senior notes	--	114,663	--
Proceeds from convertible notes	--	3,500	--
Proceeds from issuance of preferred stock	--	9,500	70,000
Proceeds from issuance of common stock and warrants	1,768	342	--
Payment of financing costs	(129)	(4,922)	(8,804)
Repayment of long-term debt	--	(321)	(773)
Repayment of capital lease obligations	--	(172)	(1,073)
Payment of series A preferred stock dividends	--	(168)	--
Borrowing (repayment) of notes payable to stockholders	250	(524)	--
Redemption of preferred stock	--	(4,750)	(18,572)
Redemption of common stock	--	--	(449)
Net cash provided by financing activities	1,889	117,271	50,329
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	210	39,535	(34,692)

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	--	210	39,745
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 210	$ 39,745	$ 5,053
Supplementary schedule of non-cash investing and financing activities:			
Amounts recorded in connection with acquisitions:			
Fair value of net assets acquired, net of cash acquired	$ --	$ 5,064	$ 2,693
Fair value of intangible assets	--	20,900	4,130
Assumption of liabilities	--	(2,430)	(939)
Assumption of long-term debt and capital lease obligations	--	(1,027)	(872)
Issuance of series A preferred stock	--	(4,750)	--
Issuance of series C preferred stock	--	(10,000)	--
Issuance of common stock	--	--	(211)
Common stock issued in exchange for other assets	50	--	--
Property and equipment additions acquired through capital lease	--	728	2,099
Property and equipment additions included in accounts payable	--	2,157	5,873
Supplemental disclosure of cash flow information:			
Cash payment for interest, net of interest capitalized of $436 in 1998 and $1,324 in 1999	--	7,725	13,690

See accompanying notes.

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BIRCH TELECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE COMPANY

Birch Telecom, Inc. was incorporated on December 23, 1996, as a Delaware corporation for the purpose of providing local, long distance, Internet access, and other communications services to business and residential customers. The consolidated financial statements of Birch Telecom, Inc. include the accounts of Birch Telecom, Inc. and the accounts of its wholly-owned subsidiaries (collectively, Birch). Birch currently serves certain markets in Missouri, Kansas and Texas. Birch's business is highly competitive and is subject to various federal, state and local regulations.

Birch was in the development stage for the period from December 23, 1996 (date of inception) to February 10, 1998. Accordingly, Birch had no operating revenue and incurred operating losses and operating cash flow deficits during that period.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CASH AND CASH EQUIVALENTS

For purposes of reporting cash flows, Birch includes as cash and cash equivalents highly liquid investments with original maturities of three months or less.

REVENUE RECOGNITION

Revenue for communications services is recognized when customers use the associated services. Equipment revenue is recognized when systems or services are substantially complete. Revenue on billings to customers in advance of providing services is deferred and recognized when earned. Customers are not charged fees to activate initial service.

COST OF SERVICES

Cost of services includes local and long-distance services purchased from incumbent local exchange carriers, interexchange carriers and certain providers of fiber optic telephone networks. Cost of services also includes costs associated with the sale and installation of telephone systems.

INVENTORY

Inventory is carried at the lower of average cost or market determined on a first-in, first-out basis and consists primarily of parts and equipment used in the maintenance and installation of telephone systems.

ADVERTISING COSTS

Advertising costs are expensed as incurred and totaled $895,000 in 1998 and $3.0 million in 1999. There were no advertising costs in 1997.

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BIRCH TELECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROPERTY AND EQUIPMENT

Property and equipment is stated at cost and depreciated using the straight-line method over the following estimated useful lives of the assets:

	YEARS
Communications network	2-10
Buildings, furniture, fixtures and equipment	2-40

GOODWILL AND OTHER INTANGIBLES

Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired in Birch's acquisitions. Goodwill is being amortized over 25 years using the straight-line method. Accumulated amortization on goodwill totaled $599,000 at December 31, 1998 and $1.4 million at December 31, 1999.

Other intangibles consist primarily of customer lists related to Birch's acquisitions, deferred financing costs and deferred line installation costs. Customer lists are amortized over 5 years using the straight-line method. The deferred financing costs are amortized over 5 to 10 years, the term of the associated financing, using the straight-line method. Deferred line installation costs are being amortized over 2 years, the approximate average life of customer contracts, using the straight-line method (see Note 6).

Birch reviews its long-lived assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-lived Assets and Long-lived Assets to be Disposed of," for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such events or changes in circumstances are present, a loss is recognized if the carrying value of the asset is in excess of the sum of the undiscounted cash flows expected to result from the use of the asset and its eventual disposition. An impairment loss is measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset.

INCOME TAXES

Birch accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. Birch recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences 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. Net deferred tax assets are reduced by a valuation allowance when appropriate (see Note 14). Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

STOCK OPTIONS

Birch has adopted the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation, which establishes a fair value based method for the financial reporting of its stock-based employee compensation plans. However, as allowed by SFAS No. 123, Birch has elected to continue to measure compensation using the intrinsic value based method as prescribed by Accounting Principles

Board Opinion No. 25, Accounting for Stock Issued to Employees. Under this method, compensation is measured as the difference between the market value of the stock on the grant date, less the amount required to be paid for the stock. The difference, if any, is charged to expense over the vesting period of the options. The estimated market value used for the stock options granted was determined on a periodic basis by Birch's board of directors. In accordance with APB No. 25, Birch has recorded no compensation expense related to options granted because the exercise price is equal to the estimated market value of the stock on the date of grant (see Note 15).

FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of the instruments. The fair value of Birch's pledged securities was $38 million at December 31, 1998 and $23.3 million at December 31, 1999. The fair value of Birch's senior notes is estimated to be $106 million at December 31, 1998 and $115 million at December 31, 1999 based on the quoted market rates for the debt. The fair value of other long-term debt, accounts receivable, accounts payable and accrued expenses approximates the recorded value.

USE OF ESTIMATES IN FINANCIAL STATEMENTS

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

LOSS PER SHARE

The net loss per share amount reflected on the consolidated statement of operations is based on the weighted-average number of common shares outstanding. Stock options and convertible preferred stock are anti-dilutive, and therefore excluded from the computation of earnings per share. In the future, these stock equivalents may become dilutive.

RECLASSIFICATIONS

Certain items in the 1997 and 1998 consolidated financial statements have been reclassified to be consistent with the classification in the 1999 consolidated financial statements.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which supersedes SFAS No. 80, Accounting for Futures Contracts, SFAS No. 105, Disclosure of Information About Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentration of Credit Risk, and SFAS No. 119, Disclosures about Derivative Financial Instruments and Fair Value of Financial Instruments, and also amends certain aspects of other SFAS's previously issued. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. SFAS No. 133 is effective for our consolidated financial statements for the

year ending December 31, 2001. We do not expect the impact of SFAS No. 133 to be material in relation to its consolidated financial statements.

3. ACQUISITIONS

In February 1998, Birch merged with Valu-Line Companies, Inc. (Valu-Line) in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of series A preferred stock having an aggregate liquidation preference of $4.75 million and 6,250,000 shares of series C preferred stock having an aggregate liquidation preference of $10.0 million. Since 1982, Valu-Line has been primarily providing switched long distance services, customer premises equipment (CPE) sales and services and, since March 1997, local service.

In May 1998, Birch acquired Boulevard Phone Company (Boulevard), a shared tenant service provider in the Kansas City metropolitan area, for $300,000 in cash and Telesource Communications, Inc. (Telesource), a CPE provider in the Kansas City metropolitan area, for $325,000 in cash.

In September 1998, Birch acquired TFSnet, Inc. (TFSnet), an Internet service provider based in the Kansas City metropolitan area, for $2.65 million.

In February 1999, Birch acquired American Local Telecommunications, LLC (ALT), a competitive local exchange carrier based in the Dallas, Texas metropolitan area. The acquisition included substantially all assets of ALT. The total purchase price was approximately $1.6 million in cash and $211,000 in common stock.

In March 1999, Birch acquired the stock of Capital Communications Corporation (Capital), a telecommunications equipment provider based in the St. Louis, Missouri metropolitan area. The total purchase price was approximately $3.0 million plus additional cash consideration, recorded as additional purchase price, based on local service lines converted to Birch's service from Capital's existing customer base, which totaled approximately $161,000 through December 31, 1999.

All of the acquisitions referenced above were recorded using the purchase method of accounting. Accordingly, the operations of each are included in the consolidated statements of operations and cash flows from the date of acquisition.

The following is unaudited pro forma information reflecting the effect of the 1998 acquisitions on the results as though they had been completed effective January 1, 1997 and 1998:

	YEARS ENDED DECEMBER 31,	
	1997	1998
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Revenue	$18,847	$29,193
Net loss	19,325	28,921
Loss per common share	15.65	8.05

The impact of the 1999 acquisitions was not material to our results of operations.

BIRCH TELECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. ACCOUNTS RECEIVABLE

The composition of accounts receivable, net as of December 31, 1998 and 1999 is as follows:

	1998	1999
	(IN THOUSANDS)	
Billed	$3,144	$ 9,312
Unbilled	1,129	2,756
	4,273	12,068
Less allowance for doubtful accounts	234	456
	$4,039	$11,612

5. PROPERTY AND EQUIPMENT

The composition of property and equipment as of December 31, 1998 and 1999 is as follows:

	1998	1999
	(IN THOUSANDS)	
Communications network	$ 5,966	$28,525
Buildings, furniture, fixtures and equipment	6,529	38,662
Construction in progress	14,405	3,005
	26,900	70,192
Less accumulated depreciation and amortization	747	8,080
Property and equipment, net	$26,153	$62,112

6. OTHER INTANGIBLES

The composition of other intangible assets, net as of December 31, 1998 and 1999 is as follows:

	1998	1999
	(IN THOUSANDS)	
Customer lists	$3,525	$ 4,225
Preferred stock issuance costs	325	6,989
Deferred financing costs	4,630	6,412
Deferred installation costs	--	2,363
Other	153	330
	8,633	20,319
Less accumulated amortization	1,013	3,408
Other intangibles, net	$7,620	$16,911

7. DEBT, PLEDGED SECURITIES AND WARRANTS

During December 1999, Birch completed a $75 million senior credit facility which increased to $125 million during syndication in February 2000. The financing provides for a $25 million reducing revolver and $100 million in multi-draw term loans. The revolver is available for general corporate

7. DEBT, PLEDGED SECURITIES AND WARRANTS (CONTINUED)

purposes of Birch's subsidiaries and the term loans are to be used to finance the development, design, installation and acquisition of telecommunications equipment, inventory network assets and back office systems. At Birch's election, the borrowings bear interest at either the Prime Rate plus a margin ranging from 1.50% to 2.50% or the London Interbank Offered Rate (LIBOR) plus a margin ranging from 2.75% to 3.75%. The applicable margins are based upon Birch's debt to EBITDA ratio, as defined by the senior credit facility. Interest is paid quarterly in arrears for loans bearing interest based upon Prime and/or on the last day of each relevant interest period, for periods not in excess of three months, for LIBOR loans. For LIBOR loans with interest periods of longer than three months, interest is paid each day which is three months after the first day of such interest period and the last day of such interest period. Commitment fees are paid quarterly in arrears on the average unused committed portion of the Facility, ranging from 0.75% to 1.25%. The applicable percentages are based upon Birch's average borrowings in relation to the average borrowing availability, as defined by the senior credit facility. For the year ended December 31, 1999 commitment fees totaled $25,174. Principal payments begin March 2003 and the credit facility matures December 30, 2006. The senior credit facility is secured by a perfected first priority security interest in substantially all of Birch's assets and capital stock. Deferred financing costs incurred amounting to $1.5 million at December 31, 1999 are being amortized over the life of the credit facility using the straight-line method. Amortization for the year ended December 31, 1999 was not significant.

During June 1998, Birch completed a $115 million private offering of 14% senior notes due June 2008 and 115,000 warrants to purchase 1,409,734 shares of common stock. Interest on the senior notes is payable semi-annually in arrears on June 15 and December 15 of each year. Warrants are exercisable at $0.01 per share and expire June 2008. Birch received net proceeds from the senior notes of $110.2 million and concurrently purchased pledged securities of $44.2 million. The pledged securities are restricted for interest payments on the senior notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. Birch classifies its pledged securities, consisting of $37.8 million at December 31, 1998 and $23.4 million at December 31, 1999 of U.S. Treasury securities, as held to maturity recorded at amortized cost and maturing between six and eighteen months. A portion of the proceeds from the senior notes, $337,000, was allocated to the warrants, and the resulting debt discount is being amortized over the life of the debt on the straight-line method, which does not differ materially from the effective interest method. Unamortized discount was $319,000 at December 31, 1998 and $285,000 at December 31, 1999. The amount allocated to the warrants represents the estimated fair value of the warrants at the date of issuance. Deferred financing costs incurred amounting to $4.9 million at December 31, 1999 are being amortized over the life of the senior notes using the straight-line method. Accumulated amortization on the financing costs totaled $1.5 million at December 31, 1999. The senior notes rank pari pasu in right of payment to all existing and future senior indebtedness of Birch and rank senior in the right of payment to all existing and future subordinated indebtedness of Birch.

A Registration Statement on Form S-4, registering Birch's 14% senior notes and exchanging the outstanding senior notes for exchange notes, was declared effective by the Securities and Exchange Commission (SEC) in March 1999. The terms and conditions of the exchange notes are identical to those of the senior notes in all material respects.

The senior credit facility and the senior notes indenture contain certain covenants which, among other things, restrict the ability of Birch to incur additional indebtedness, pay dividends or make

distributions of Birch's or its subsidiaries' stock, enter into sale and leaseback transactions, create liens, enter into transactions with affiliates or related persons, consolidate, merge or sell all of its assets. Birch was in compliance with these covenants at December 31, 1999.

Birch's debt consisted of the following at December 31, 1998 and 1999:

	1998	1999
	(IN THOUSANDS)	
14% senior notes	$114,681	$114,715
Senior credit facility:		
Equipment term loans	$ --	$ 10,000
Total senior credit facility	$ --	$ 10,000
Other long-term debt, interest accruing between 8.6% and 9.8%, maturing through 2013, secured by buildings	$ 345	$ 244
Less current maturities	13	10
	$ 332	$ 234

Assets securing the other long-term debt totaled $814,000 at December 31, 1998 and $766,237 at December 31, 1999, net of accumulated depreciation of $19,000 at December 31, 1998 and $35,037 at December 31, 1999.

Principal payments required on the outstanding debt during each of the next five years are as follows (IN THOUSANDS):

2000	$ 10
2001	10
2002	11
2003	5,012
2004	5,014
Thereafter	114,902
	$ 124,959

8. CAPITAL LEASE OBLIGATIONS

Birch leases telecommunications equipment, computer equipment and automobiles under capital leases with imputed interest between 8.0% and 12.0%. Assets under capital leases totaled $1.5 million at December 31, 1998 and $3.6 million at December 31, 1999, net of accumulated amortization of $210,000 at December 31, 1998 and $1.1 million at December 31, 1999. The future minimum lease

8. CAPITAL LEASE OBLIGATIONS (CONTINUED)

payments under the capital leases and the present value of the net minimum lease payments as of December 31, 1999 are as follows (IN THOUSANDS):

2000	$1,528
2001	545
2002	92
2003	57
2004	--
Total minimum lease payments	2,222
Less amount representing interest	96
Present value of net minimum lease payments	2,126
Less current maturities	1,290
	$ 836

Amortization expense for assets under capital leases was $157,000 for 1998 and $974,165 for 1999.

9. CAPITAL STRUCTURE

During 1997, $1.8 million of common stock and $18,000 of warrants were sold to management and equity investors for $1.00 and $0.01 per share, respectively.

The warrants entitled the holders to purchase an additional 1.8 million shares of common stock at $1.00 per share.

During February and March 1998, Birch issued $9.5 million of series B preferred stock at $4.50 per share and $3.5 million of convertible notes generating net proceeds of $12.4 million, converted all existing common stock to series C preferred stock, terminated common stock warrants, canceled the 1997 stock option plan, created the 1998 stock option plan and issued 474,750 shares of common stock to employees of Birch. Also during February 1998, Birch issued $4.75 million of series A preferred stock and $10.0 million of series C preferred stock in connection with the Valu-Line merger. Birch redeemed the series A preferred stock in June 1998. Also in June 1998, the convertible notes were converted into series B preferred stock.

During July and August 1999, Birch issued $10 million of series D preferred stock and $60 million of series F preferred stock at $4.50 per share. Options were granted to purchase $25 million of series F preferred stock at $4.75 per share and $25 million of series F preferred stock at $5.00 per share which expire on April 13, 2000. Additionally, Birch repurchased $10 million of series C preferred stock at $4.50 and recapitalized the series B preferred stock converting it into a new series B preferred stock and a new series E preferred stock. The series E preferred stock was then redeemed for $8.6 million. Net proceeds generated from these transactions totaled $44.4 million.

AUTHORIZED SHARES

At December 31, 1999, Birch had shares authorized totaling 80 million shares of common stock and 55 million shares of preferred stock. The preferred stock has designations of 8.75 million shares of series B, 8.5 million shares of series C, 2.2 million shares of series D, 1.9 million shares of series E and 30 million shares of series F.

9. CAPITAL STRUCTURE (CONTINUED)

RIGHTS

All classes of preferred stock are convertible and contain certain voting rights. The common stock also has voting rights similar to the series C preferred stock. The series B, series D and series F preferred stock have additional voting rights in certain circumstances. Additionally, the series F preferred stock contains mandatory redemption rights based on certain senior management retention. In the event of mandatory redemption, the shares are redeemable for amounts similar to the liquidation preference discussed below.

LIQUIDATION RIGHTS

Birch's series D and series F preferred stock have a liquidation preference over the series B and series C preferred stock and common stock at the greater of (i) the purchase price plus accrued but unpaid dividends or (ii) the amount the holders would have received upon liquidation if such shares of series D and series F preferred stock had been converted to common stock immediately prior to liquidation. Birch's series B preferred stock has a liquidation preference only over series C preferred stock and common stock at an amount equal to the sum of the purchase price plus accrued but unpaid dividends. Series C preferred stock has preference only over common stock at an amount equal to the sum of the purchase price plus accrued but unpaid dividends.

DIVIDENDS

The series B preferred stock accrued cumulative compounding dividends at 15% per annum until the series B was converted and restated into new series B. At that time, the rights and preferences were amended and restated to remove the mandatory dividend rights and now the series B cumulates cash dividends at 15% per annum, amounting to $814,000 at December 31, 1999. The series C preferred stock has a 10% non-cumulative cash dividend and the series D preferred stock cumulates cash dividends at a rate of 15% per annum, totaling $750,000 at December 31, 1999. Only the series F preferred stock contains mandatory dividend rights. Accrued cash dividends on series F preferred stock totaled $3.6 million at December 31, 1999, as reflected in stockholders' equity. Common stock dividends, if any, will be declared at the discretion of Birch's board of directors. Birch has not paid any cash dividends on common stock since inception and does not intend to pay any in the foreseeable future. Restrictions contained in the senior credit facility agreement and the senior notes indenture prohibit Birch from paying certain dividends on its capital stock.

On June 23, 1998, Birch paid a stock dividend, in the amount of 0.055 shares per share, to the holders of Birch's series B preferred stock, series C preferred stock and common stock as of June 15, 1998. Dividends paid on series A preferred stock in 1998 totaled $168,000.

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BIRCH TELECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. RELATED-PARTY TRANSACTIONS

During December 1997, Birch borrowed $250,000 from Birch's principal stockholder under a note payable. The note payable was fully repaid in February 1998.

Birch acquired notes payable to Valu-Line shareholders totaling $274,000 in the Valu-Line merger. These notes were fully repaid during 1998.

A broadcasting company owned by one of the Birch's shareholders rented office space from Birch for $30,000 during 1998 and $29,187 during 1999. Birch purchased advertising from the broadcasting company totaling $40,000 in 1998 and $30,360 in 1999.

A real estate company owned by the President of Birch's equipment division was paid $3,588 for building maintenance in 1998 and $12,587 in 1999.

11. COMMITMENTS AND CONTINGENCIES

Future minimum rental commitments at December 31, 1999 for all noncancelable operating leases, consisting mainly of leases for office space and equipment, are as follows (IN THOUSANDS):

2000	$ 2,766,794
2001	3,042,829
2002	2,925,940
2003	2,567,295
2004	2,443,322
Thereafter	7,769,655
Total	$21,515,835

Total rent expense was $81,000 in 1997, $485,000 in 1998 and $1.5 million in 1999. Birch may renew leases on its corporate offices in terms ranging from three to ten years at rates approximating the prevailing market. Renewal rentals are excluded from the table.

Various suits arising in the ordinary course of business are pending against

Birch. Management cannot predict the final outcome of the actions, but believes they will not be material to Birch's financial statements.

12. EMPLOYEE BENEFIT PLAN

Birch sponsors a 401(k) profit-sharing plan covering substantially all employees under which employees can contribute up to 15% of their annual salary subject to annual maximum limitations. Employees can participate after meeting the plan's eligibility requirements. Birch may also make discretionary contributions. Birch contributions to the plan were $148,000 in 1998 and $594,925 in 1999.

13. EMPLOYMENT AGREEMENTS

Birch has entered into employment agreements with certain executive employees which provide for payments to be made in connection with certain termination of employment or change of control. The benefits include cash compensation, immediate vesting of outstanding stock options and coverage under Birch's group health plan.

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BIRCH TELECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

14. INCOME TAXES

Net deferred taxes consist of the following as of December 31, 1998 and 1999:

	1998	1999
	(IN THOUSANDS)	
Deferred tax assets:		
Net operating loss carryforwards	$ 5,528	$ 28,770
Accruals and reserves not currently deductible	91	182
Other	668	614
	6,287	29,566
Valuation allowance	(5,799)	(28,741)
	488	825
Deferred tax liabilities:		
Property and equipment	488	825
	$ --	$ --

Net income tax benefits of approximately $5.1 million in 1998 and $22.9 in 1999 have been offset by increases in the valuation allowance. At December 31, 1999, Birch had operating loss carryforwards for federal income tax purposes of approximately $71.9 million, expiring in 2013 and 2014.

The primary difference that caused the effective tax rate to vary from the statutory federal income tax rate of 35% was the valuation allowance.

15. STOCK OPTION PLAN

At December 31, 1997, Birch had granted options to purchase common stock under the 1997 stock option plan. The options granted had a term of 10 years and vested over a four-year period. This plan was terminated and superseded in 1998 by the 1998 employee stock option plan. No options were or ever will be exercised and no shares were or will ever be issued under the terminated and superseded 1997 stock option plan.

Stock option activity under the 1997 stock option plan was as follows:

	SHARES	WEIGHTED-AVERAGE PER SHARE EXERCISE PRICE
Granted	2,783,000	$ 1.00
Exercised	--	--
Forfeited	--	--
Outstanding at December 31, 1997	2,783,000	1.00
Terminated	(2,783,000)	1.00
Outstanding at December 31, 1998	--	--

BIRCH TELECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

15. STOCK OPTION PLAN (CONTINUED)

Stock option activity under the 1998 employee stock option plan was as follows:

	SHARES	WEIGHTED-AVERAGE PER SHARE EXERCISE PRICE
Granted	5,093,064	$0.242
Exercised	4,566,889	0.001
Forfeited	14,250	2.500
Outstanding at December 31, 1998	511,925	2.334
Granted	1,794,800	3.845
Exercised	--	--
Forfeited	275,875	3.038
Outstanding at December 31, 1999	2,030,850	3.574

At December 31, 1998, 5,363 options were exercisable with a weighted average exercise price of $0.001. At December 31, 1999, 107,468 options were exercisable with a weighted average exercise price of $2.175.

The 1998 employee stock option plan authorized the grant of options for up to 6,195,845 shares of Birch's common stock. The options have a term of 10 years and vest over a four-year period. All options exercised during 1998 were for options granted with an early exercise provision. The shares from exercised options continue to be subject to the four-year vesting period. No options expired during 1998 or 1999.

Options granted in 1998 and 1999 had exercise prices approximating the market value of the common stock. Exercise prices for options outstanding at December 31, 1999 ranged from $0.001 to $4.50. The weighted-average remaining contractual life of those options is 9.4 years. The weighted-average fair values of options granted during the years ended December 31, 1998 and 1999 equaled $0.05 and $0.73, respectively. At December 31, 1999, Birch has reserved 1,628,956 shares of common stock for issuance under the 1998 stock option plan.

Birch estimated the fair value of each option grant using the minimum value method permitted by SFAS No. 123 for entities not publicly traded. Birch used the following assumptions in the calculation: risk-free interest rate of 5.25%, expected life of four years and no dividends being paid over the life of the options. Under the minimum value method, the volatility factor is excluded. Had compensation cost for the stock based compensation plan been determined as prescribed by SFAS No. 123, the net loss and loss per common share would have been as follows for the years ended December 31, 1997, 1998 and 1999:

	1997	1998	1999
	(IN THOUSANDS, EXCEPT PER SHARE DATA)		
Net loss--as reported	$(1,789)	$(16,208)	$(61,804)
Net loss--pro forma	(1,921)	(16,384)	(62,411)
Loss per share--Basic and Diluted--Pro Forma	(1.56)	(4.75)	(13.36)

16. SIGNIFICANT SUPPLIERS

Birch purchased telephone services from Southwestern Bell Telephone amounting to 35% of cost of services in 1998 and 65% in 1999. Birch is dependent upon incumbent telephone companies, such as Southwestern Bell, for the supply of fiber optic networks that we use. Birch purchased switches and other network equipment and software from Lucent Technologies amounting to $12.9 million in 1998 and $9.9 million in 1999.

17. YEAR 2000 ISSUE--UNAUDITED

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of Birch's computer programs that have date-sensitive software may recognize the date using "00" as the year 1900 rather than the year 2000. Birch completed all Year 2000 readiness work and experienced no significant problems as a result of the new year. Birch does not believe it has continued exposure to the Year 2000 problem and does not expect further costs incurred in relation to the Year 2000 issue to be substantial.

18. QUARTERLY DATA--UNAUDITED

The following table includes summarized quarterly financial data for the years ended December 31:

QUARTERS

	FIRST	SECOND	THIRD	FOURTH
	(IN THOUSANDS, EXCEPT PER SHARE DATA)			
1998:				
Revenue	$ 3,705	$ 6,060	$ 7,478	$ 8,844
Gross margin	1,063	1,628	2,305	2,205
Loss from operations	(567)	(1,486)	(2,996)	(5,827)
Net loss	(623)	(1,766)	(5,468)	(8,351)
Loss per common share--basic and diluted	(0.79)	(0.55)	(1.19)	(1.76)
1999:				
Revenue	$10,636	$ 13,975	$ 17,022	$ 18,905
Gross margin	2,711	3,574	3,753	4,142
Loss from operations	(7,128)	(9,525)	(13,710)	(19,330)
Net loss	(9,936)	(12,639)	(16,690)	(22,539)
Loss per common share--basic and diluted	(2.06)	(2.59)	(3.43)	(5.30)

19. SUBSEQUENT EVENTS

Since December 31, 1999, Birch has borrowed an additional $40 million through March 23, 2000 under the term loan portion of the senior credit facility.

On March 23, 2000 an affiliate of Kohlberg Kravis Roberts & Co. exercised its options to purchase an additional $50.0 million of Birch's series F preferred stock (see note 9).

Also on March 23, 2000, Birch filed a registration statement on Form S-1 relating to a proposed initial public offering of its common stock. All outstanding shares of Birch's preferred stock will automatically convert into shares of common stock upon completion of the proposed offering. In addition Birch expects to declare a 1.795 for 1 split of its common stock prior to completion of the offering. The conversion ratio for the preferred stock will be adjusted accordingly.

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Valu-Line Companies, Inc.

We have audited the accompanying consolidated balance sheet of the Valu-Line Companies, Inc. (the Company) as of December 31, 1997, and the related consolidated statements of income and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 audit provides 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 Valu-Line Companies, Inc. at December 31, 1997 and the consolidated results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Kansas City, Missouri

May 15, 1998

VALU-LINE COMPANIES, INC.

CONSOLIDATED BALANCE SHEET

DECEMBER 31, 1997

(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS	
Current assets:	
Cash and cash equivalents	$ 258
Accounts receivable, net of allowance of $70	1,790
Other receivables--related parties	97
Inventories	530
Prepaid expenses	37
Income taxes receivable	30
Other assets	60
Deferred income taxes	71
Total current assets	2,873
Property and equipment, net	1,612
Other assets	317
Total assets	$4,802
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Current maturities of long-term debt and capital lease obligation	$ 110
Notes payable--related parties	240
Accounts payable	1,262
Accrued expenses	225
Customer deposits	39
Accrued salaries and commissions	266
Deferred revenue	287
Total current liabilities	2,429
Long-term debt, net of current maturities	345
Capital lease obligation, net of current maturities	336
Deferred income taxes	27
STOCKHOLDERS' EQUITY	
Common stock, no par value, 100,000 shares authorized; 10,360 issued and outstanding	181
Retained earnings	1,484
Total stockholders' equity	1,665
Total liabilities and stockholders' equity	$4,802

See accompanying notes.

VALU-LINE COMPANIES, INC.

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

YEAR ENDED DECEMBER 31, 1997

(IN THOUSANDS EXCEPT SHARES AND PER SHARE DATA)

Revenue:	
Communications services, net	$13,785
Equipment sales, net	3,016
Total revenue	16,801
Cost of services:	
Cost of communications services	9,859
Cost of equipment sales	1,983
Total cost of services	11,842
Gross margin	4,959
Selling, general and administrative	4,067
Depreciation and amortization	341
Income from operations	551
Interest expense	97
Income before income taxes	454
Income tax expense	186
Net income	268
Retained earnings, beginning of year	1,216
Retained earnings, end of year	$ 1,484
Earnings per share--basic and diluted	$ 25.87
Common shares outstanding--basic and diluted	10,360

See accompanying notes.

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VALU-LINE COMPANIES, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 1997

(IN THOUSANDS)

OPERATING ACTIVITIES	
Net income	$268
Adjustments to reconcile net income to net cash from operating activities:	
Depreciation and amortization	341
Deferred income taxes	(14)
Income tax expense	73
Changes in operating assets and liabilities:	
Accounts receivable	(660)
Other receivables--related parties	(52)
Inventory	(94)
Income taxes receivable/payable	(56)

Accounts payable	520
Accrued expenses and other current liabilities	304
Other	(142)
Net cash provided by operating activities	488
INVESTING ACTIVITIES	
Purchase of property and equipment	(243)
Net cash used in investing activities	(243)
FINANCING ACTIVITIES	
Payment of notes payable	(11)
Payment of notes payable--related parties	(44)
Payment of capital lease obligation	(90)
Net cash used in financing activities	(145)
Net increase in cash and cash equivalents	100
Cash and cash equivalents, beginning of year	158
Cash and cash equivalents, end of year	$258

See accompanying notes.

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VALU-LINE COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 1997

1. THE COMPANY

These consolidated financial statements include the accounts of Valu-Line Companies, Inc., a Kansas Corporation, and its wholly-owned subsidiaries (collectively, the "Company"), Valu-Line of Kansas, Inc. and IS Advertising. The Company was acquired by Birch Telecom, Inc. in February 1998 (see NOTE 10). The accounts of Valu Broadcasting, Inc. and Steve Sauder Real Estate, respectively, a wholly-owned subsidiary of and a division of Valu-Line Companies, Inc., both of which were spun off in December 1997, have been excluded for all periods from these consolidated financial statements in order to reflect financial position and operating results on a basis consistent with the businesses acquired by Birch Telecom, Inc. All intercompany balances and transactions have been eliminated in consolidation.

The Company provides local, long distance, Internet, customer premises equipment and other communications services to business and residential customers in the state of Kansas.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CASH AND CASH EQUIVALENTS

For purposes of reporting cash flows, the Company includes as cash and cash equivalents, cash and marketable securities with original maturities of three months or less.

REVENUE RECOGNITION

Revenue from communications services is recognized when the services are provided. Revenue on billings to customers in advance of providing services is deferred and recognized when earned.

CONCENTRATION OF CREDIT RISK

The Company is exposed to concentrations of credit risk principally from customer accounts receivable. At December 31, 1997, the Company's customers are located in the state of Kansas. The Company performs ongoing credit evaluations of its customers as a means to reduce credit risk.

FAIR VALUES OF FINANCIAL INSTRUMENTS

As of December 31, 1997, the fair values of the Company's financial instruments, including cash equivalents and notes payable--related parties, approximate their carrying value.

INVENTORIES

Inventories, which consist of customer premises communications equipment held for sale and supplies, are valued at lower of average cost or market.

PROPERTY AND EQUIPMENT

Property and equipment, including assets held under capital leases, are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets or lease term.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)
USE OF ESTIMATES IN FINANCIAL STATEMENTS

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

3. PROPERTY AND EQUIPMENT

The components of property and equipment at December 31, 1997 are as follows:

	ESTIMATED USEFUL LIVES	1997
		(IN THOUSANDS)
Telecommunications and other equipment	5 years	$ 1,103
Office equipment, furniture and other	3-7 years	1,178
Buildings and improvements	40 years	683
		2,964
Accumulated depreciation and amortization		(1,352)
		$ 1,612

Telecommunication equipment under capital lease was $607,000 at December 31, 1997. Accumulated amortization totaled $194,000 as of December 31, 1997. Amortization of assets under capital lease is included in depreciation and amortization expense. Interest expense associated with the obligations under these leases amounted to $47,000 in 1997.

4. CAPITAL LEASE OBLIGATION

The Company leases telecommunications equipment under a capital lease. The future minimum lease payments under the capitalized lease and the present value of the net minimum lease payments as of December 31, 1997 are as follows (IN THOUSANDS):

1998	$137
1999	137
2000	137
2001	57
2002	57
2003	57

Total minimum lease payments	582
Less amount representing interest	(147)

Present value of net minimum lease payments with interest at 10.0%	435
Less current maturities	(99)

	$336
	====

VALU-LINE COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 1997

5. LONG TERM DEBT AND NOTES PAYABLE

The Company entered into a note payable with a financial institution in the amount of $300,000 in 1992 to finance the remodeling of a building. The note is payable in monthly installments through 2007. Interest is payable at prime plus 1 1/2% (10.0% at December 31, 1997). The note is secured by the building and the deposit accounts of the Company with the financial institution. The outstanding principal balance on the note was $262,000 at December 31, 1997.

In 1996, the Company issued a note payable of $100,000 to finance the purchase of an office building. The note is payable in monthly installments through 2011. Interest is payable at a variable rate (8.90% at December, 31, 1997). The note is secured by the building. The outstanding principal balance on the note was $94,000 at December 31, 1997.

Maturities on the aforementioned notes payable are as follows (IN THOUSANDS):

1998	$ 11
1999	13
2000	14
2001	15
2002	17
Thereafter	286

Total	$356

====

The Company also has notes payable to officers of the Company and members of their families. The notes are unsecured and payable on demand. Interest is payable at the treasury rate (5.85% at December 31, 1997). The outstanding principal balance on these notes was $240,000 at December 31, 1997. Principal and interest payments were $128,000 in 1997.

Total interest paid in 1997 was $97,000.

6. EMPLOYEE BENEFIT PLAN

The Company sponsors a 401(k) profit-sharing plan covering substantially all employees under which employees can contribute up to 15% of their annual salary subject to annual Internal Revenue Code maximum limitations. Employees can participate after meeting the plan's eligibility requirements. The Company may make a discretionary contribution. Company contributions to the plan were $81,000 in 1997.

VALU-LINE COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 1997

7. INCOME TAXES

The income tax expense (benefit) consisted of the following:

	YEAR ENDED DECEMBER 31, 1997 (IN THOUSANDS)
Current:	
Federal	$175
State	25
Total Current	200
Deferred:	
Federal	(12)
State	(2)
Total deferred	(14)
Income tax expense	$186

The differences between the amount computed by applying the statutory federal income tax rate to income before income taxes and the provision for income taxes are as follows:

	YEAR ENDED DECEMBER 31, 1997 (IN THOUSANDS)

Tax computed at statutory rate	$159
State taxes, net of federal effect	22
Other, net	5
Income tax expense	$186

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for federal and state income tax purposes. Significant components of the Company's deferred tax assets and liabilities at December 31, 1997 are as follows (IN THOUSANDS):

Deferred tax assets (current):	
Accrued liabilities	$32
Allowance for doubtful accounts	28
Inventory capitalization	11
	71
Deferred tax liability (noncurrent):	
Depreciation	27
Net deferred tax assets	$44

Net cash paid for income taxes for the year ended December 31, 1997 was $225,000.

VALU-LINE COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 1997

8. ADDITIONAL FINANCIAL INFORMATION

RELATED PARTIES

In 1997 Valu-Line provided services principally related to rent and operating costs to Valu-Broadcasting, Inc., an affiliate of Valu-Line at the time of the transactions, in the amount of $81,000. Valu-Line also received services principally related to advertising from Valu-Broadcasting, Inc. in the amount of $41,000 in 1997. In February 1998, Valu-Line merged with and into the Company pursuant to the Merger.

MAJOR SUPPLIER INFORMATION

Cost of communications services provided by Southwestern Bell approximated 40% of the total cost of communication services for the year ended December 31, 1997. Equipment purchases from Toshiba approximated 59% of cost of equipment sales for the year ended December 31, 1997.

9. COMMITMENTS AND CONTINGENCIES

Minimum rental commitments at year-end 1997 for all noncancelable operating leases, consisting mainly of leases for office space and vehicles, are as follows (IN THOUSANDS):

1998	$30
1999	19
2000	9

Thereafter	$58
	===

Total rent expense for 1997 was $56,000.

10. SUBSEQUENT EVENT

In February 1998, the Company was acquired by Birch Telecom, Inc. for $19,500,000. Shareholders of the Company received $4,750,000 of cash and $14,750,000 of preferred stock in Birch Telecom, Inc.

11. YEAR 2000 COMPLIANCE--UNAUDITED

Year 2000 issues arise from computer programs written using two digits rather than four to define the applicable year. Any of the Company's computer programs that have time-sensitive software may recognize a date using 00 as the year 1900 rather than the year 2000. This could result in a system failure or miscalculation causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices or engage in similar normal business activities.

Based on ongoing assessments, the Company determined that it will be required to modify or replace portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. The Company presently believes that with modifications to existing software and conversions to new software, the year 2000 issue will not pose significant operational problems for its computer systems. The Company estimates it will incur minimal expenses to modify and convert its systems and anticipates completing the year 2000 project by the year ending December 31, 1998.

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VALU-LINE COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED DECEMBER 31, 1997

11. YEAR 2000 COMPLIANCE--UNAUDITED (CONTINUED)

While the Company believes that its systems will be year 2000 compliant, there can be no assurance until the year 2000 occurs that all systems will function adequately. In addition, the Company interconnects and uses various local exchange companies' facilities to service its customers, and such facilities currently utilize numerous, date-sensitive computer applications. If these facilities are not year 2000 compliant, or if the systems of other local exchange companies, long distance carriers and others upon which the Company relies are not year 2000 compliant, it could have a material effect on the Company's business, operating results and financial condition.

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BIRCH TELECOM, INC.
SCHEDULE II--CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999

		ADDITIONS			
	BALANCE BEGINNING	CHARGED TO	CHARGED TO OTHER	OTHER	BALANCE END OF

	OF YEAR	INCOME	ACCOUNTS	DEDUCTIONS	YEAR
			(IN THOUSANDS)		
1997					
Valuation allowance--deferred income tax assets	$ 0	$ 681	$ 0	$ 0	$ 681
1998					
Allowance for doubtful accounts	$ 0	$ 140	$133	$ (39)(1)	$ 234
Valuation allowance--deferred income tax assets	$ 681	$ 5,118	$ 0	$ 0	$ 5,799
1999					
Allowance for doubtful accounts	$ 234	$ 561	$125	$(464)(1)	$ 456
Valuation allowance--deferred income tax assets	$5,799	$22,942	$ 0	$ 0	$28,741

- - -----------------------

(1) Accounts written off, net of recoveries.

EX-12.1
2
EXHIBIT 12.1

EXHIBIT 12.1

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

	YEARS ENDED DECEMBER 31,					
	THE PREDECESSOR(1)			BIRCH		
	1995	1996	1997	1997	1998	1999
	(IN THOUSANDS, EXCEPT RATIOS)					
Earnings						
Total earnings (loss)	$ 94	$289	$268	$(1,789)	$(16,208)	$(61,804)
Income tax	--	--	--	--	--	--
Subtotal	175	494	454	(1,789)	(16,208)	(61,804)
Fixed charges						
Interest charges	58	102	97	--	--	--
Interest factor of operating rents	13	16	19	--	--	--
Total fixed charges	71	118	116	--	--	--
Earnings, as adjusted	$246	$612	$570	$(1,789)	$(16,208)	$(61,804)
Ratio of earnings to fixed charges	3.46x	5.19x	4.91x	--	--	--
Deficiency of earnings to fixed charges	--	--	--	$(1,789)	$(16,208)	$(61,804)

Note: For purposes of calculating the ratio of earnings to fixed charges, earnings are defined as loss before income taxes plus fixed charges. Fixed charges consist of interest expense and a reasonable approximation of the interest factor included in rental payments on operating leases.

- - -----------------------

(1) The Predecessor company is Valu-Line Companies which was merged with us during February 1998. Prior to February 1998, we had no revenues and were in the developmental stage.

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-----END PRIVACY-ENHANCED MESSAGE-----

EXHIBIT D

Complaints Filed With State and Federal Regulatory Agencies Involving Birch or Its Affiliated Entities

Consumer complaints against Birch with Regulatory Bodies

Regulatory Body	Contact Person	Date Contacted	Who filed the Complaint	Basis of Complaint	Action Taken	Date Resolved	Comments
MO BBB	Julie M.	2/8/99	Jason Fruge	Internet: (no info on original complaint)	Gave $20 credit and cancelled his service	2/9/99	
KCC	Steve	3/15/99	Prima Land, Incorporated 316-276-6897	900# Service: Access to his 900# was blocked and wanted to know why	Rick Tidwell contacted the customer on this one and settled the matter	7/1/99	
MO PSC	Evelyn H.	4/14/99	Jack Burns Acct. #88716	Credit Check: Did not provide SS# so we denied service b/c no credit check	Set up new credit check policy. Mr. Burns sent credit rating from SWB & we provided him service	5/10/99	No Violation
FCC		5/3/99	John Queen 316-273-6171	Billing: Signed contract for business line. Worked from home so not business line	Credited him for calls and terminated contract with no penalty to Mr. Queen	6/3/99	
MO PSC	Evelyn H.	5/11/99	William Leberman 314-773-6018	Credit Check: Did not provide SS# so we denied service b/c no credit check	PUC said not their area. Talked to Mr. Lieberman and provided him service	6/1/99	No Violation
KCC	Rose M.	5/25/99	Nancy Dean 785-234-4388	Slamming: both local and LD was converted to Birch without her consent	We "fat fingered" the number and converted in error. Offered to pay any conversion charges	6/1/99	Violation
MO BBB	Julie M.	6/2/99	Joseph P. Blount	Internet: too much down time, lost e-mails, and incorrect invoices	Offering two free months of Internet access. 7/15/99 still talking with Mr. Blount		
KCC	Don	6/4/99	Jearl D. Pierce 316-256-6874	Internet: being charge LD for what should be a local call.	Customer admited that he had been dialing as LD	6/17/99	No Violation
KCC	Steve	6/14/99	LD Carrier and Brett Ulrich 785-256-2316 & 785-228-1959	PIC Changes: felt it took too long to convert to a new LD carrier	We need written approval to change PICs. KCC said we need to follow new FCC rules & not hold up changes	6/23/99	
KCC	Richard	7/1/99	Thelma Allan 785-733-2468	International calls on bill that she didn't make	Reviewed switch records to verify calls made from her line	7/22/99	No Violation
KCC	Steve	7/9/99	Gayle Seibel 316-654-3840	Billing: has not received a bill since April	Awaiting records from MCI. Bills to be sent out the week of July 19. Equal number of months to pay	7/14/99	No Violation
AG Office	Teresa S.	7/15/99	Robert J. Jensen 785-227-2014	Slamming: both local and LD was converted to Birch without his consent	We "fat fingered" the number and converted in error. Offered to pay any conversion charges.	7/22/99	Violation
KCC	Don	7/16/99	John Nagel 785-456-8547	Billing: has not received a bill since April. Not receiving bill consistently	Awaiting records from MCI. Bills to be sent out the week of July 19. Equal number of months to pay	7/22/99	No Violation
KCC	Steve		Reynolds & Sarrault 785-823-1333, 1394, 2054 & 9253, and 785-825-8779	Disconnect Notice: said we did not apply check they sent to us in January	Check was applied to equipment bill, therefore still owe on local and LD. Sent printout for their review, awaiting response. KCC says to give them until 7/27/99	8/17/99	
Consumer Group	Richard Mindy	7/20/99	Debra Manley 816-587-7533 & 587-7536	LD Restriction: Customer has one phone line and two numbers. Wants LD Block removed from second number.	Got LD restriction removed and line straightened out.	Late 7/99	

Regulatory Body	Contact Person	Date Contacted	Who filed the Complaint	Basis of Complaint	Action Taken	Date Resolved	Comments
KCC	Steve	7/26/99	Murray Pirckard 785-565-0787, 785-532-2877, 785-340-0272 & 785-340-0273	No Digiline/ISDN: customer had requested a digiline and SWBT told them no and we said yes but haven't set it up yet.	We resale in Manhattan, KS and SWBT does not have any more digilines available. Awaiting SWBT switch to be operational in Manhattan.	7/26/99	No Violation
KCC	Richard	8/3/99	Bonna Cannon 316-562-3403	Billing: Has not received a LD bill since April. Is suppose to receive a prompt pay discount but only gets it after she calls us.	Awaiting records from MCI. Ms. Cannon takes the discount before paying the bill & therefore looks like is underpaid.	8/3/99	No Violation
KCC	Steve	8/23/99	Central States Media 316-684-4049	No Dial Tone - customer has no dial tone on main line.	Appears to be a CPE problem. SWBT Tech was sent out and found no problems. Now has dial tone	8/24/99	
AG Office	Shelley	8/6/99	Deborah K. Pelter-Laman 785-243-4671	No knowledge of Experimental Toll Call Plan & wants refund	The Plan was itemized on every bill; therefore, will not refund before 4/99. No longer customer Addendum: Settled by refunding monthly pmts for Plan ($380) on 4/14	8/20/99	
KCC	Rose M.	8/17/99	Tim Schumacher 785-625-3566	Billing: Received bill for LD calls from a carrier he does not know.	The calls were operator assisted and we have a third party bill them. They are behind in bill this customer	8/23/99	
KCC	Steve	8/30/99	Kerry McKelvy 316-686-1667	IntraLATA pic: requested pic provider on 8/2 and did not get processed until 8/28. Why?	Gave Mr. McKelvy all his IntraLATA calls for the two month free.	8/13/99	No Violation
AG Office	Shelley	8/26/99	Betty Kennard 785-650-0291	Billing: receiving bills from us and no longer has our service.	All lines have been cancelled and charges credited back to her account. Zero balance	9/2/99	
MO PSC	Sheila	9/7/99	Jeff Loretta 314-353-3622	Billing/Taxes: feels he is being assessed the wrong taxes...county instead of city	Explained St. Louis is counted as a county and not a city. Credited back some of the tax charge	9/15/99	
KCC	Richard	9/10/99	Hearts Design 913-327-7187	No Dial Tone - customer has no dial tone at business and needs it ASAP	Facilities based. Worked with SWBT to compare switch set-up. Got them service by end of 9/10/99	9/13/99	No Violation
KCC	Richard	9/14/99	Ms. Pettingill 913-685-8478	LD on Internet - have AOL for Internet & got charged for LD calls, thinks they should be local calls.	They were all 1 + area code + number and therefore have to be charged as LD. Need to contact AOL b/c they did not give them a local # or 800 #.	9/15/99	No Violation
KCC	Don	9/21/99	Rigid Steel 316-273-6860	No Dial Tone - customer has no dial tone on modem, fax and other lines, since 9/20/99	This is a resale line so we had to wait for SWBT to get out and look at. Service returned by approx. 1:00	9/21/99	No Violation
KCC	Richard	10/4/99	Akela Enterprises 913-768-4704	Billing: received an invoice after no longer having service with us.	Invoice was sent out in error and the amount has been credited back to the account. Zero balance	10/6/99	No Violation
KCC	Richard	10/6/99	Harvest Financial Group, Inc. 785-271-1798	Billing: had three additional lines on invoice that are not theirs.	additional lines are for same physical location but different suite. Lines removed from invoice.	10/6/99	No Violation
MO PSC	Evelyn H.	11/16/99	Dana & Lance Davis 816-232-9999	Billing: received an invoice from Cons Comm. Says not their carrier so wont pay & our rep told them not to pay	for operator assisted calls they go through Cons Comm. Customer pay this time & we reimburse. Pay future invoices from Cons Comm	11/17/99	No Violation

Regulatory Body	Contact Person	Date Contacted	Who filed the Complaint	Basis of Complaint	Action Taken	Date Resolved	Comments
KCC	Richard	11/17/99	Carlson Auction 785-478-4250	Dialing: can't dial 1411 or 1-888 or 1-877 numbers. Our dialer is not updated to handle these types of calls from their area.	On 11/19/99 between 12:30 and 1:15 the dialer was updated and everything is ok now.	11/19/99	No Violation
KCC	Richard	11/19/99	Steve Clark 316-342-3061	Billing: Sent payment, then another invoice came not showing payment received.	11/29/99 called Steve and let him know the payment was received and applied.	11/29/99	No Violation
MO PSC	Sandy W.	11/24/99	Latt Copley 816-734-8178	Disconnected Service: Says he has not received a correct invoice since coming to us	Turned on service, talked with him regarding bills, sent copy of all bills for discussion...he changed service	12/10/99	No Violation
KCC	Richard	12/6/99	Chris Naegle 316-945-0232	Call return/three way calls: questioning these charges on invoices. Says he did use these options	Unable to get detailed info from SWBT. Will credit account for charges. Customer needs to have options removed b/c future charges will not be written off.	12/21/99	
AG Office	Teresa S.	12/10/99	Lorraine Donovan 785-233-8201	Slamming: Local and long distance lines converted to Birch with out request.	Request for service form we received had the number on it.	12/20/99	
KCC	Patrick	12/15/99	Marvin Hinton 785-235-1750	Miscellaneous charge: had a $5 charge on invoice for LD even though he has no LD carrier.	Credited his account for the $5.00. He uses the 10-10 dial around to make his calls.	12/15/99	No Violation
KCC	Richard	12/28/99	Arlene Clayton 785-776-3759	Billing: feels that the new invoices is printed a before the old is due...shows balance due.	There is an overlap and we are working on it.	12/29/99	No Violation
KCC	Richard	12/28/99	P&D Repair 785-332-2384	Cable Problems: when there is moisture he hears cross talk.	2 splices repaired and the aerial cable repaired	2/1/00	No Violation
TX PSC	Darren B.	12/28/99	Texas Nurses Association 512-452-0645	Slamming: customer was not contacted about switching to Birch.	Had falsified LOA by a sales rep. The sales rep has been let go and the Assoc. converted back.	per Darryn 1/5/00	
MO PSC	Mary Lou	1/4/00	South & Associates 816-300-7800	Lines not configured right: SWBT says 10-14 days to fix.	Got SWBT to go out tomorrow (1/5) to reconfigure lines. Additional problems after the lines were reconfigured but all is fixed now	1/7/00	No Violation
KCC	Don	1/10/00	Terrance Wood 785-271-0915	Static: had second line installed and now has static on first line.	SWBT tech was sent out and now the static is cleared up.	1/14/00	No Violation
KCC	Richard	1/11/00	PRW Crowder 785-266-2243	Billing: being charged for a service she no longer has.	Ms. Crowder called 1/7/00 to have the feature removed & the invoice was generated 1/4/00 (before call)	1/12/00	No Violation
KCC	Patrick	1/13/00	Drexel Tech Inc. 913-371-4430	Local call problems: incoming calls are being routed to Birch voice mail & the customer is back with SWBT.	Drexel was still on our switch even though they have converted back to SWBT. They have now been removed from our switch & receiving calls.	1/13/00	No Violation
KCC	Patrick	1/13/00	Kelly Blue Print 913-341-2333	Local call problems: unable to reach Drexel Tech and when calling home gets cut off.	See above for resolution to Drexel problem. SWBT tech was on site and disconnect problem was fixed.	1/19/00	No Violation

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KCC	Don	1/19/00	William F. Millsap 913-422-2038	Charges: feels Birch over charged him & he didn't get the saving promised.	See Mark Manns outline of the charges in file. Savings would have been 13% if stayed.	1/20/00	No Violation
KCC	Steve	1/25/00	Dera's Fast Lane 785-537-6896	Line restriction: Advanced refusing to accept responsibility to lift	KCC finally convinced Advanced and it lifted the restriction	2/1/00	No Violation
KCC	Steve	1/25/00	Gaye Horn 316-722-9601	IntraLATA PIC: billed by Advanced; supposed to be Birch	For unknown reason SWB had switched service from Birch to Advanced; we had already fixed it in 12/99 upon advice from customer	2/3/00	No Violation
KCC	Richard	1/30/00	Deborah Zimmerman 913-294-3806	Billing: Being charged the PICC fees on her number with the former exchange (duplicate)	Customer called Birch and KCC on same day. We had issued a $24 credit for the duplicate billing on 01/28/00	2/2/00	No Violation
FCC		2/2/00	Kathryn Jacobs 913-727-2388	Internet: Overall complaint of poor service and allegations of misrepresentations by Birch personnel	Per Wm Craft, problems caused by no POP in Leavenworth; only promise was one would be installed, and now has been; so reported to FCC	2/24/00	
KCC	Steve	2/4/00	Troy Henry, d/b/a TNC Tire Company 800-827-6096	Lost toll-free service: Service switched **from** Birch to Qwest reseller Impact Services of Ohio, resulting in disconnect	Service has been restored and both KCC and customer understand we had no control, as switch was made via SMS/800. (As a side issue: Will follow up with SMS/800 on question of fraud.)	2/11/00	No Violation
MO PSC	Sheila	2/8/00	Cindy Wilson/Auto Craft 636-461-0030	Local service problems: At peak periods can't dial out (NDT) or receive calls	Customer doesn't see this as our fault, hoped PSC would refer this to Bell; Sheila confirmed. Patti Kettler obtained official word from Bell about its plans for "Imperial build-out," and we reported same to PSC and customer.	2/14/00	No Violation
MO PSC	Mary Lou	2/9/00	Deborah Ogletree 816-763-8926	No dial tone: Problem resolved itself	There is a history of problems with this line. The customer is to call Barb if she experiences NDT again.	2/10/00	No Violation
KCC	Patrick	2/18/00	Debbie Davis 316-343-7468	Billing: Being charged for auto redial since 7/99; has never had that service; promise to remove not fulfilled	She was only billed for actual usage. Allegedly took 30 days for Bell to get restriction on line for usage sensitive features; account credited for $17.25; reported to Patrick	2/21/00	No Violation
KCC	Steve	2/21/00	Jan Feaster 316-272-0180	Anonymous/harassing calls: Wants stopped	Never reported to Birch, just Bell. Ron Knisely, Security Director, wants her to authorize him to put a trace on line. Provided his name and number to Steve for customer.	2/21/00	No Violation
MO PSC	Mary Lou	2/25/00	WOW Trucking 816-232-2600	Line restriction: AT&T alleged a freeze on line prevented transfer of LD service to it, blamed Birch; customer LD service out	Asked ex-customer to call 700-555-1414 (from Sharon Gooding) for identity of current LD carrier; AT&T on both lines; sent ex-customer back to AT&T to resolve; advised Mary Lou	2/25/00	No Violation

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KCC	Richard	3/3/00	Margaret Siegrist 785-823-5241	Billing: Hasn't received a bill this month. (Complaint prompted by fact she couldn't get through Birch toll-free line. All checked out; presuming misdial.)	Billing advises that processing has been very slow. Upgrades to the system now made. Bill will go out Monday or Tuesday, and should be back on schedule going forward. Advised customer and Richard.	3/3/00	No Violation
FCC	n/a	3/6/00	Kenneth Rishel 316-272-9879	Charges: wants refund of $1,025.97 as of 10/98 for unauthorized international information calls	[on hold for now - have requested sufficient information to identify the account]	4/3/00	No Violation
MO AG	Sheri	3/6/00	Doris Morgan 913-897-2543	Slamming: switched from Birch back to Bell, then Birch "pirated" the line	Customer lost DT when she insisted we disconnect her; Bell wrote ticket to restore DT as if requested by Birch; caused misunderstanding; advised MO A-G by letter	3/13/00	No Violation
KCC	Richard	3/8/00	Cybernet BBS 316-662-4272	Insufficient notice of suspension: Not given 10 days notice; notice misaddressed; Birch won't accept faxed copy of check as proof payment will be made	Notice sent 2/25/00, sent to address provided by customer in 12/99, suspension 3/8/00; payment received 3/9/00 and service restored; advised Richard	3/9/00	No Violation
TX PUC	Kelle	3/2/00;3/20/00	J. Jackson Construction 512-281-5522	Service outage: allegedly due to poor quality of cable	Customer was not complaining about Birch service; knows it's Bell's cable and Bell's responsibility; sent letter to TX PUC advising of same	3/28/00	No Violation
TX PUC	Betty	3/6/00;3/16/00	Hal Kooistra 316-662-4272	Telephone solicitation: complaint vs. customer Quality Siding; wants his name removed from all call lists	Customer contact faxed confirmation of removal of Kooistra from call list; sent letter to TX PUC advising of same	3/28/00	No Violation
TX PUC	Kelle	3/10/00;3/21/0	Charles McDonald, Attorney 254-754-7317	Disconnected Service: claims disputed bill and disconnect without notice	When AE advised of dispute on 3/10/00, he referred customer to CRC, but customer never followed up with CRC; suspension notice 2/11 and suspended 2/21; he has now paid 8/99 through 1/00 bills, dispute moot?	3/28/00	No Violation
KCC	Patrick	3/21/00	Waddell & Reed 316-662-4272	LD double billing: due to Birch dialers not being removed after switched to AT&T	Had not actually received bill from AT&T; anticipates problem; will advise KCC when AT&T bill received if duplicate charges appear per Patrick	3/24/00	No Violation
KCC	Patrick	3/21/00	O. G. Hill 316-225-4253	Call center queue too long: Didn't want to wait 22 minutes; calls not returned after message left	Queue problem being addressed; customer called by CC rep and inquiry answered; Patrick advised	3/21/00	No Violation
KCC	Richard	3/23/00	Norma Creek 785-246-3253	Call center inaccessible via local number: wants someone to call her re new calling card	Customer called by CC rep and request for calling card fulfilled; advised Richard	3/23/00	No Violation

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MO PSC	Beverly	3/23/00	Magee Safe & Lock 636-296-3339	Toll charges: customer billed for intraLATA calls despite metro call area service	Our records show we have never billed for toll charges, but Mr. Magee wouldn't return my calls to verify this; advised Beverly	3/30/00	No Violation
KCC	Steve	3/28/00 4/14/00	Living Oak Trust/Delores Matzke 785-456-7240	Overbilling: for long distance calls	Customer has old Lucky 13 plan; calls properly calculated; explained plan to Steve 4/14: Steve called back; she wasn't happy w/ resolution; I called to explain Lucky 13 Plan, that we had calculated correctly, and if she had made timely payments, we'd have given prompt payment discounts; she said she'd switched, but there's no record in VLSYS that she has; advised Steve	3/30/00 4/20/00	No Violation
MO PSC	Mary Lou	29/2000; 3/30/	Judgment Enforcement Service 816-348-0043	Billing: billed for custom features for months after removal requested	Fully investigated; his allegations don't match the facts; only entitled to credit back to 3/21/00; have advised Mary Lou who has requested I put my findings in writing***	***	No Violation
KCC	Richard	3/31/00	Nancy G. Maxwell 785-273-1698	Acct name/billing: name misspelled; late notices despite auto pay (Richard contacted customer for authority release info-see below)	"Mancy" corrected to "Nancy" prior to complaint; newer account did not have auto pay, older account did and no notices were ever sent on that account; advised Richard	4/3/00	No Violation
KCC	Richard	3/31/00	Terry Curry 785-233-6868	Billing: late notices received despite auto pay (this person initially called to make the Maxwell complaint)	Our records don't show late notices ever having been sent or her calling to complain; advised Richard and asked for copies of any such notices	4/3/00	No Violation
TX PUC	Kelle	3/31/00	R and B Answering Service 361-664-9424	Slamming: switched to Birch without authorization	This was not a slam; LOA for Birch intraLATA, took awhile to get all lines switched to new carrier (poor customer service)	4/4/00	No Violation
KCC	Patrick	4/4/00	Charlene Allen 316- 627-2359	Call center queue too long: didn't want to wait; call not returned after message left	Customer was assisted fairly quickly; advised Patrick customer's questions had been answered.	4/4/00	No Violation
MO PSC	Mary Lou	4/3/00; 4/10/00	Master Pitching Machine 816-452-0228	Frequent outages: caused by Bell's above-ground line (complaint was sent to Bell, too)	Our system notes indicate the Bell has told us its plan of action is to place the line underground; will advise Mary Lou when she returns my call left 4/11/00	***	No Violation
KS AG	Teresa S.	4/6/00; 4/7/00	Leo Miller 785-267-7434	Slamming: called for info re LD services and was slammed by Birch	Technically, this was a slam due to improper procedures in place for LD only service; moot problem because we will cease offering residential LD only service soon; letter sent to KS A-G explaining in best light possible and apologizing	4/13/00	

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MO PSC	Michelle	4/7/00	Larry Farrell/Farrell & Assoc. 314-721-1111	Disconnected Service: claims disputed bill and disconnect without notice	Payment rec'd 4/6/00, and we were already working to get his service back up; advised Michelle when service was back up and that he needed to pay the undisputed charges and I would follow up on call waiting feature	4/7/00	No Violation
KCC	Richard	4/11/00	Cybernet BBS 316-662-4272	No notice of suspension: notice misaddressed; payment allegedly lost by Birch; Birch won't accept promise of payment	Notice sent 3/24, sent to address provided by customer in 12/99, suspension 4/11; payment received 4/12 and service restored; suite designation dropped; advised Richard	4/12/00	No Violation
MO PSC	Beverly	4/17/00	Linda Governick 314-772-1555	Overbilling: for long distance calls	Customer doesn't know how to convert partial minutes to decimals and off the record claims we've switched to 30-second minimum, but can't cite instance; explained calculation to Beverly who says PSC engineer will call customer to explain; customer seems satisfied re no 30-second minimum for now (she has better-than-tariff deal)	4/19/00	No Violation
TX PUC	Betty	4/18/00	J. Jackson Construction 512-281-5522	Service outage: allegedly due to poor quality of cable - second complaint	Customer is still not complaining about Birch service; believes Bell is playing games; problem reported 4/12 resolved itself 4/13; nothing further can be done; written report *******still to be sent to Betty	4/26/00	No Violation
KCC	Steve	4/25/00	Paul Queen 316-686-9143	PIC Changes: not switched to Qwest per prior request	Second line not properly switched to Qwest as previously requested; has now been rectified/verified; advised Steve	4/26/00	No Violation
MO PSC	Sheila	4/27/00	Growth Networks/Jerry Cox 314-962-5444	Disconnected service: 3X wrongfully in two-week period	First and third times disconnected per request and second time in error, although w/ contact's approval; allowing two different contacts to place requests; ******	****	No Violation
MO PSC	Michelle	4/28/00	Sharon McGahan 314-832-5253	Slamming: LS only without consent	Incorrectly converted and included her residential line with others of a business customer; already switched back to SWB; there was no account and there will be no bill; advised Michelle	4/28/00	No Violation