

Report on Operations

We're Making Excellent Progress with Operations Nationwide

We made excellent progress developing WinStar's nationwide operations in 1997, and equally impressive strides in the first months of 1998. WinStar has extremely ambitious goals, and our employees are rising to these challenges with great enthusiasm and ingenuity.

Looking at revenues, our core telecommunications business began to take on significant scale in 1997; we ended the calendar year at a \$62 million annualized revenue run rate, as the growth in CLEC operations more than compensated for an anticipated \$21 million decline in our residential long distance business, which is no longer an area of focus for the company.

It was also an outstanding year for WinStar's information services business, where sales soared 182%, or almost \$27 million over 1996. This was due to excellent demand for information content developed by our New Media subsidiary, and to the acquisition of Telebase, a leading developer of online business information services.

Total operating revenues reached approximately \$80 million, a gain of more than 60% from the prior year. At the end of the 1998 first quarter, the revenue run rate for our consolidated operations had risen to \$230 million as a result both of internal



NATHAN KANTOR

WinStar's telecommunications *network* has grown substantially since the installation of our first local network switch only 17 months ago. Looking toward the end of this year, we plan to have 23 Lucent 5ESS switches installed, and an additional 29 ATM switches and 17 frame relay switches in service. This extensive switching capability should increase again in 1999.

We're Fielding a Direct Sales Force of Trained Professionals

To generate traffic for WinStar's expanding network, we've built a professional field sales force to call directly on potential business customers. More than 800 WinStar sales and service representatives have been trained to assist customers with total solutions to their telecommunications needs; including data specialists and salespeople concentrating solely on large businesses.

The rewards of this investment have come in the form of continually rising flows of line orders and installations. Cumulative line orders reached 118,000 at the end of 1997, an encouraging conclusion for a 12-month period that started with only about 6,000 ordered lines. We achieved further gains in the first quarter of 1998, when cumulative orders rose to nearly 200,000. Our base of installed lines expanded over thirty-fold, from 4,400 at the beginning of 1997, to 82,000 as of December 31, to 145,000 at the end of the first quarter of 1998. The cumulative orders and installations reported for March 1998 included some 24,500 lines acquired with our new broadband data businesses. However, WinStar's ongoing rate of installation already exceeds 40,000 lines per quarter. The number of quarterly installations should continue to rise as our services come on stream in additional major cities.

We're Gaining Momentum with Hub Sites, Access Rights & Interconnect Agreements

Creating hub sites, to collect traffic from customer buildings and route it to our switches, is essential to the successful buildout of our network. From no completed hubs at the beginning of 1997, within 15 months we had over 50 in service. Meeting our target for 1998 will bring the total to more than 100.

Wireless connectivity to our hubs hinges on our success in obtaining building access rights to install a small antenna and radio atop customer buildings. This makes access rights a second critical factor in deploying our wireless network nationwide. Accordingly, we're giving this effort a significant amount of focused attention. During 1997, the number of building access rights held by WinStar climbed to 2,100, versus 800 in 1996. We are finding that building owners increasingly recognize the value of having broadband telecommunications services available to tenants within their buildings. In 1998, we're broadening our rights acquisition program to include negotiations with REITs and other property owners and managers who control large numbers of commercial office buildings. By year-end, we expect to have gained access to a total of 4,000 locations.

Clearly, WinStar's network cannot be of true value without connecting it to the national telecommunications system. Doing so requires us to negotiate individual agreements with the Regional Bell Operating Companies (RBOCs) and other established local and long distance carriers. It's well worth noting that WinStar has made interconnect agreements that today cover 44 of the top 50 U.S. markets. Additionally, the company has peering arrangements with more than 130 U.S. and foreign Internet service providers.

CLEC authorizations represent a fourth crucial building block for a national telecommunications provider like WinStar, and our progress here has been very satisfactory. We currently have authorizations applying to 48 of the largest markets in the country. That's up considerably from 30 markets at the end of 1996.

We're Investing Heavily in Customers and the Future

The fact is, WinStar's combination of innovative service offerings, value-based pricing and passion for customer satisfaction is being met with great enthusiasm in the marketplace. We have quickly built a solid base of more than 7,000 customers. Our rate of customer acquisition remains on a strong upswing, and our services are being enhanced by the most advanced operational and business support systems in the industry. This is a critical area for the company, and we continue to make substantial investments in order entry, order provisioning, billing and network management systems. We have also designed new network elements to support the deployment of WinStar's point-to-multipoint technology, commencing later this year. It is equally gratifying to report that WinStar's wireless network achieved a 99.999% ("five-nines") level of availability in 1997. This accomplishment proved that our unique approach to providing broadband connectivity is of the utmost quality and reliability.

WinStar's success is being further supported by an aggressive marketing program which incorporates media advertising and a wide range of special activities conducted inside our target buildings. Our marketing themes differentiate WinStar from other service providers and encourage heightened expectations among our potential customers. Once they experience WinStar's services, we work with our customers to handle an increasing amount of their communications requirements, and integrate WinStar into their business. This approach has been highly effective.

We're looking ahead and working toward even greater achievements in 1998. We're supremely confident about the unique and talented group of employees we have at WinStar, and the bright new people we are attracting, who are delivering on our promise: "See things from a phone company you've never seen before."



NATHAN KANTOR
PRESIDENT & CHIEF OPERATING OFFICER

Getting More Businesses & People Into the Fast Lane

With the deployment of our revolutionary point-to-multipoint (PMP) technology, there are hundreds of thousands of buildings we can reach and connect with high-speed telecommunications services. We're going to bring the people in those buildings all the features and benefits of today's and tomorrow's Information Superhighway.

This rich, new and extremely robust networking approach significantly expands our ability to service many more customers, and dramatically lowers the cost of reaching them. It also creates a totally new paradigm for broadband local networks: marking the first time that voice, data and video capabilities have been integrated into one network.

Point-to-Multipoint is a *line-of-sight* technology. It begins at our hub sites, where we have a universe of buildings in our sight, a universe that includes customers located in buildings as small as 20,000 square feet. It's an affordable and relatively easy-to-install alternative to the higher cost, old wireline technology systems offered by the country's entrenched monopoly carriers. When the buildout of the company's hubs is complete in our 50 major target markets, we'll be able to see from our hub sites and reach close to 75% of all commercial office buildings in these cities.

Lacking broadband connectivity, these buildings can be classified as "access disadvantaged." As such, they're perfect candidates to benefit from our PMP "on ramp," which will be able to connect them - with bandwidth-on-demand - to the nation's telecommunications infrastructure, and to the current and future Information Superhighway.

WinStar's hub sites each provide line-of-sight to hundreds of buildings which can be served by the company's wireless broadband network.

Fixed wireless broadband communications is not cellular service. It's a high capacity communications channel that matches the performance and quality of fiber-based networks and systems. Connections are made through the air by way of antennae on building roofs. Service is delivered faster and less expensively than by fiber, and isn't vulnerable to construction-related outages involving cut cables. With point-to-multipoint technology, WinStar doesn't have to build specific pipes to each building, or try to fill them. Our virtual "pipe" can get bigger or smaller as demand increases or lessens; the cost to our customer is based on actual bandwidth use, not on capacity that is unused. These significant cost advantages, coupled with our strong service edge, make a compelling argument for customers to switch to WinStar from other local exchange carriers.

Connecting Children's Minds

Education in America is undergoing a transformation, aimed at improving children's learning and giving them the skills they need to succeed in tomorrow's world. This transformation represents an evolution from "products of the muscle" to "products of the mind." In the future, the ability to access information, and use the tools of technology to analyze and creatively solve problems, will be the defining factor in determining who succeeds. WinStar is an active part of this big and important picture, guiding schools through the sea of new technology.

The Seven "C's" of Education and the Internet

WinStar has a strong and socially responsible vision for America's schools, intended to build the foundation of a nationwide community of lifelong learners. It begins with *connectivity*: getting schools connected to the Internet. Here, our Wireless Fiber service is an ideal technology, providing high-speed connectivity at a fraction of the price of conventional alternatives. *Content*: once connected, content is the critical issue. Our *NewsNow* program enables children to publish their content on the Web. *Context*: Our *LivingPage* enables schools to create their own electronic library, and students' electronic bibliographies for Web-based research. *Collaboration*: the true power of the Web is connecting minds to other minds. Programs like our *WebBoard*, *MindsEye Monster Exchange* and *The Journey* are bringing thousands of children from hundreds of schools around the world into collaboration. *Creativity*: essential to creating value. We're building a suite of creative problem-solving tools, and working with top experts in the field to develop an Internet curriculum. *Commerce*: children must learn the fundamentals of electronic commerce. We'll be introducing tools and programs to give them great hands-on experience. *Community*: we're dedicated to improving communities through the creative use of telecommunications. In the nation's capital, we took the lead in forming a broad business and community coalition involving D.C. public schools, the D.C. public library and various foundations and groups, with the goal of making a significant difference, and closing the "digital divide" for inner city families. Vice President Al Gore hailed it as a model for the nation.

Everyone focuses on the content, yet that's only 10% of the equation. 90% is the process of collaboration. It's not about connecting children with other computers and Web pages, it's about connecting their minds with other minds. This is the true power of the Internet.

Creating a Model for America's Communities

We're about to link an inner city housing project in Washington, D.C. with neighborhood elementary, middle and high schools, and a local senior citizens home. The Internet environment we're creating is extending the schools into the home, and opening the door to rich, cross-generational communication between seniors and children. WinStar is today's new phone company not only in terms of its technology, but also in terms of our passionate sense of social responsibility to the country's schools and communities.

Consolidated Statements of Operations

(In thousands, except per share data)

	FOR THE TEN		FOR THE YEAR ENDED	
	MONTHS ENDED		DECEMBER 31.	
	1995	1996	1996	1997
Operating revenues				
Telecommunications services — commercial	\$ 130	\$ 4,487	\$ 29,796	
Telecommunications services — residential	13,007	29,482	8,481	
Information services	2,648	14,650	41,354	
Operating expenses				
Cost of services and products	12,073	38,233	81,017	
Selling, general and administrative expenses	13,617	62,365	156,959	
Depreciation and amortization	1,027	4,501	29,701	
Operating loss	(10,932)	(56,480)	(188,046)	
Other (expense) income				
Interest expense	(7,186)	(36,748)	(77,257)	
Interest income	2,890	10,515	17,577	
Other (expense) income	(866)	—	2,219	
Loss from continuing operations before income tax benefit	(16,094)	(82,713)	(245,507)	
Income tax benefit	—	—	2,500	
Loss from continuing operations	(16,094)	(82,713)	(243,007)	
Income (loss) from discontinued operations	237	(1,010)	(6,477)	
Net loss	(15,857)	(83,723)	(249,484)	
Preferred stock dividends	—	—	(5,879)	
Basic and diluted income (loss) per share:				
From continuing operations	\$ (0.71)	\$ (2.96)	\$ (7.49)	
From discontinued operations	0.01	(0.04)	(0.19)	

(Please refer to the company's Form 10-K for complete financial information)

Consolidated Balance Sheets

(In thousands)

	DECEMBER 31, 1996	DECEMBER 31, 1997
ASSETS		
Current assets		
Cash and cash equivalents	\$ 95,490	\$ 402,359
Short term investments	26,997	16,903
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Cash, cash equivalents and short term investments	122,487	419,262
Investments in equity securities	688	—
Accounts receivable, net of allowance for doubtful accounts of \$852 and \$3,819, respectively	13,150	30,328
Inventories	5,009	10,296
Prepaid expenses and other current assets	15,969	8,985
Net assets of discontinued operations	3,814	2,105
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Total current assets	161,117	470,976
Property and equipment, net	62,572	284,835
Licenses, net	27,434	174,763
Intangible assets, net	12,955	14,293
Deferred financing costs, net	10,535	27,463
Other assets	4,176	4,071
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LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Current portion of long-term debt	\$ 19,901	\$ 386
Account payable and accrued expenses	29,442	97,714
Current portion of capitalized lease obligations	3,110	6,848
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Total current liabilities	52,453	104,948
Capitalized lease obligations, less current portion	10,846	21,823
Long-term debt, less current portion	265,161	768,469
Deferred income taxes	—	24,000
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Series C exchangeable redeemable preferred stock, liquidation preference of \$175,000 plus accumulated dividends	—	175,553
Commitments and contingencies		
Stockholders' equity (deficit)		
Series A preferred stock issued and outstanding 3,910 shares at December 31, 1997	—	39
Common stock, par value \$.01; authorized 200,000 shares, issued and outstanding 28,989 and 34,610, respectively	290	346
Additional paid-in-capital	75,436	255,741
Accumulated deficit	(125,034)	(374,518)
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Unrealized loss on investments	(49,308)	(118,392)
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	(363)	—

Consolidated Statements of Cash flows

(In thousands)

	FOR THE TEN		FOR THE YEAR ENDED	
	MONTHS ENDED		DECEMBER 31.	
	1995	1996	1996	1997
Cash flows from operating activities:				
Net loss	\$ (15,857)	\$ (83,723)	\$ (249,484)	
Adjustments to reconcile net loss to net cash used in operating activities:				
Net (income) loss from discontinued operations	(237)	1,010	6,477	
Depreciation and amortization	1,117	5,977	32,360	
Deferred income tax benefit	—	—	(2,500)	
Provision for doubtful accounts	855	1,562	5,674	
Equity in unconsolidated results of AGT	866	—	—	
Non cash interest expense	6,151	35,040	53,506	
Decrease (increase) in operating assets:				
Accounts receivable	(4,216)	(3,838)	(24,026)	
Inventories	(991)	(1,897)	(9,217)	
Prepaid expenses and other current assets	(2,342)	(13,442)	510	
Other assets	(865)	(1,940)	(178)	
Increase in accounts payable and accrued expenses	4,911	9,795	50,306	
Net assets provided by (used in) discontinued operations	90	(1,481)	(4,559)	
Other, net	179	186	—	
Cash flows from investing activities:				
Investment in and advances to AGT	(5,704)	—	—	
Decrease (increase) in short-term investments, net	(73,594)	46,597	10,094	
Decrease (increase) in other investments, net	(7,497)	6,447	—	
Purchase of property and equipment, net	(8,138)	(47,842)	(213,356)	
Acquisition of licenses and other	—	(2,121)	(40,190)	
Other, net	(499)	(1,619)	2,494	
Cash flows from financing activities:				
Proceeds from (repayments) of long-term debt, net	224,200	(2,778)	410,585	
Net proceeds from redeemable preferred stock	—	—	168,138	
Net proceeds from equity transactions	11,259	6,295	104,781	
Proceeds from equipment lease financing	6,998	8,345	9,912	
Payment of capital lease obligations	(676)	(2,080)	(4,141)	
Other, net	(898)	(1,010)	(317)	
Net increase (decrease) in cash and cash equivalents	135,112	(42,517)	306,869	
Cash and cash equivalents at beginning of period	2,895	138,007	95,490	
Cash and cash equivalents at end of period	138,007	95,490	402,359	
Short-term investments at end of period	73,595	26,997	16,903	

(Please refer to the company's Form 10-K for complete financial information)

Corporate Information

Board of Directors

William J. Rouhana, Jr.
Chairman & Chief Executive Officer
WinStar Communications, Inc.

Nathan Kantor
President & Chief Operating Officer
WinStar Communications, Inc.

Steven G. Chrust
Vice Chairman
WinStar Communications, Inc.

James I. Cash, Jr.
The James E. Robison Professor of
Business Administration
Graduate School of Business
Administration
Harvard University

Steven B. Magyar
Financial Consultant

William J. vanden Heuvel
Of Counsel
Stroock & Stroock & Lavan
Sr. Advisor
Allen & Company

Bert W. Wasserman
Executive Vice President &
Chief Financial Officer (retired)
Time Warner

Officers

William J. Rouhana, Jr.
Chairman & Chief Executive Officer

Nathan Kantor
President & Chief Operating Officer

Steven G. Chrust
Vice Chairman

Charles T. Dickson
Executive Vice President &
Chief Financial Officer

Timothy R. Graham
Executive Vice President &
General Counsel

David W. Ackerman
Executive Vice President
Business Development

Robert K. McGuire
President & Chief Operating Officer
WinStar Wireless

Stuart B. Rekant
President
WinStar New Media

David R. Schmieg
President & Chief Operating Officer
WinStar Telecommunications

Howard E. Taylor
President & Chief Operating Officer
WinStar Broadband Services

Richard J. Uhl
President & Chief Operating Officer
WinStar for Buildings

Ruth A. Shields
Executive Vice President &
Chief Operating Officer
WinStar New Media

SEC FORM 10-K AND STOCKHOLDER INQUIRES

Copies of the Company's Form 10-K for the fiscal year ended December 31, 1997, as filed with the Securities and Exchange Commission, can be obtained without charge upon written request to: Manager of Investor Relations, WinStar Communications, Inc., 230 Park Avenue, Suite 2700, New York, New York 10169 Tel. (212) 584-4053 Fax. (212) 867-1565

INDEPENDENT AUDITORS

Grant Thornton LLP, New York, New York

TRANSFER AGENT AND REGISTRAR

Continental Stock Transfer and Trust Company, New York, New York

ANNUAL MEETING

Shareholders are invited to WinStar's Annual Meeting which will be held at 10:00 a.m. on Wednesday, June 10, 1998 at the Hotel Inter-Continental, 111 East 48th Street, New York, New York 10017

Except for any historical information contained herein, the matters discussed in this document contain forward-looking statements that involve risks and uncertainties.