(10) Allowance for Doubtful Accounts

The activity in the allowance for doubtful accounts for the years ended December 31, 1997 and 1998 is as follows:

	1997	1998
Allowance for doubtful accounts at beginning of year	$ 399,216	$ 1,781,335
Additions charged to bad debt expense	1,382,119	1,649,773
Write-downs charged against the allowance, net of recoveries	—	(2,721,167)
Allowance for doubtful accounts at end of year	$1,781,335	$ 709,941

(11) Lease Contracts

The Company provides telecommunications services to various customers under operating leases. The services include agreements to lease capacity to customers over the fiber optic line, communications equipment, line/satellite charges and/or maintenance charges. These leases impose certain obligations on both the lessor and lessee, which must be met during the term of the lease.

A significant portion of these services requires that the Company have access to international communication satellites. The Company has contracted with a Russian entity for rights to access its portion of an international communications satellite. The Company has agreed to pay a recurring monthly fee to the entity based on the amount of satellite space segment utilized by each lessee. Additionally, the Company has sold communication equipment to the entity. The Company utilizes those facilities to provide communication services to various United States energy and oil and gas companies and other customers doing business in Russia.

The following is a summary of expected revenue to be earned during the next five years by the Company on lease agreements executed on or before December 31, 1998.

Year ending December 31:	
1999	$ 8,051,952
2000	7,243,418
2001	4,569,128
2002	3,622,862
2003	3,182,282
Thereafter	5,244,940
Total	$31,914,582

(12) Stockholders' Equity

Initial Public Offering

The Company, through its wholly owned subsidiary — IWL, completed an initial public offering ("IPO") of common stock on June 12, 1997, issuing 1,450,000 shares at $6.00 per share. The proceeds, net of commissions and expenses, from this IPO totaled $6,996,505. In July 1997, the underwriters exercised an over allotment option and purchased an additional 62,496 shares resulting in net proceeds of $337,473.

Common Stock

CapRock was incorporated as a Texas corporation on February 3, 1998, to serve as a holding company for the operations of Telecommunications, Partnership and IWL after completion of their business combination (note 2) in conformance with the provisions of their Agreement and Plan of Merger dated February 16, 1998.

The Company issued 28,910,221 common shares in exchange for the outstanding common shares of Telecommunications, Partnership and IWL.

Telecommunications Employee Stock Option Plan

In September 1997, Telecommunications adopted a stock option plan (the "Telecommunication Plan") pursuant to which the Company's Board of Directors may grant nonqualified options to employees. The Telecommunications Plan authorized grants of options to purchase up to 10% of the common shares outstanding. All Telecommunications stock options have a ten-year term and cannot be exercised prior to September 1, 1998. The options vest in 20% increments over a five-year period. All options expire August 31, 2007. Upon consummation of the merger, the outstanding stock options under this plan were converted at the exchange factor (note 2) into options to purchase shares of CapRock common stock.

In 1997, Telecommunications granted 380,899 nonqualified stock options under the Telecommunications Plan with an exercise price of $1.00 per share. The Company recorded deferred compensation of $417,100 related to these stock option grants, which will be recognized over the vesting period. As of December 31, 1998, 34,501 of the options previously granted were forfeited and canceled, 17,504 options were exercised and 328,894 options were outstanding.

IWL Incentive Stock Option Plan

In 1996, IWL adopted an Employee Incentive Stock Option Plan ("IWL Incentive Plan"). The option price per share could not be less than the fair market value of a share on the date the option is granted. Options under such plan generally vest at the rate of 20% per year over a five year period; however, the Board at its discretion may accelerate the vesting schedule. All options granted under the IWL Incentive Plan on or prior to the IPO date, June 12, 1997, vested in full on the offering date. IWL granted 342,214 options under the plan. The stock options expire ten years from the date of grant. Upon consummation of the merger, the outstanding stock options under this plan were converted at a one to one ratio to purchase shares of CapRock common stock.

As of December 31, 1998, 24,000 of the options previously granted were forfeited, 50,141 options were exercised and 268,073 options were outstanding. No additional options are available for grant under the IWL Incentive Plan.

Warrants

The Company issued to its investment bankers warrants to purchase up to 145,000 shares of common stock, at an exercise price equal to 120% of the IPO price. Upon consummation of the merger, the outstanding warrants were converted at a one to one ratio to purchase shares of CapRock common stock. All of the warrants were outstanding as of December 31, 1998.

The warrants have certain demand and "piggy-back" registration rights that may require the Company to register for resale the shares of Common Stock issuable under the warrants. The warrants are exercisable for a period of four years, beginning June 12, 1998.

CapRock Equity Incentive Plan

On August 26, 1998, in connection with the approval of the merger, the shareholders of the Company approved an equity incentive plan (the "CapRock Plan"). The CapRock Plan authorized the granting of awards, which would allow up to an aggregate of 5,000,000 share of common stock to be acquired by participants and provides that a maximum of 2,500,000 shares of common stock may be issued to any one participant. All prospective equity grants will be issued from the CapRock Plan. The awards under the Plan may take the form of stock options, stock appreciation rights, restricted stock awards, deferred stock, stock reload options, stock appreciation rights, restricted stock awards, deferred stock, stock related options and other stock based awards.

Stock options granted under the CapRock Plan may be either options that are intended to qualify for treatment as incentive stock options under Section 422 of the IRS tax code or options that do not so qualify (non-qualified stock options). Options under the Plan may be granted to any person who is an officer or other employee or consultants of the Company or any of its subsidiaries. The exercise price of incentive stock options must be at least the fair value of a share of the common stock on the date of grant (and not less than 110% of the fair market value of a share of the common stock on the date of grant). The exercise price of non-qualified stock options may be less than 100% of the fair market value of a share of the common stock on the date of grant. The term of the option may not exceed 10 years (5 years in the case of incentive stock options granted to an optionee owning 10% or more of the common stock).

During 1998, the Company granted 1,681,600 options under this plan and these options vest over five years. As of December 31, 1998, 48,700 of the options granted were forfeited and canceled, none of the options granted had been exercised and 1,632,900 of the options were outstanding.

Director Stock Option Plan

On August 26, 1998, in connection with the approval of the merger, the shareholders of the Company approved the Director Stock Option Plan (the "CapRock Director Plan"). All options to be granted under the CapRock Director Plan will be non-qualified stock options. A total of 400,000 shares of common stock have been reserved for issuance under the CapRock Director Plan. Each option will expire ten years from the date of grant and the options vest over three years. Outstanding options will expire earlier if an optionee terminates service as a director before the end of the first ten-year term. As of December 31, 1998, the Company granted 30,000 options under this plan and all were outstanding as of December 31, 1998.

The remaining options available for future grant as of December 31, 1998 are 3,363,586 options under the CapRock Plan and 370,000 under the CapRock Director Plan.

A summary of options activity under the plans described above is as follows:

	Number of options	Weighted-average exercise price
Balance at December 31, 1996	160,614	$3.62
Options granted	552,499	2.25
Options exercised	(13,919)	3.56
Options forfeited	(8,275)	.56
Balance at December 31, 1997	690,919	2.56
Options granted	1,721,600	6.58
Options exercised	(53,726)	3.04
Options forfeited	(98,926)	4.80
Balance at December 31, 1998	2,259,867	$5.51

A summary of options outstanding as of December 31, 1998 is as follows:

Exercise price	Number of Options outstanding	Weighted-average remaining contractual life	Number of options exercisable
$ .56	328,894	8.77	52,241
3.56	109,918	6.92	109,918
4.49	10,555	7.36	10,555
6.00	132,600	8.40	28,167
6.25	5,000	8.63	1,000
6.50	1,662,900	9.79	—
20.25	10,000	9.22	—
	2,259,867	9.40	201,881

The Company applied the intrinsic value method prescribed by APB Opinion No. 25 in accounting for its plans. SFAS No. 123 requires disclosure of the compensation cost for stock-based incentives granted based upon the fair value at grant date for awards. Applying SFAS No. 123 would result in pro forma net income and earnings per share ("EPS") amounts as follows:

		1996	1997	1998
Net income (loss)	As reported	$323,591	$2,561,767	$223,093
	Pro forma	319,000	2,385,000	(762,238)
Basic EPS	As reported	$ 0.01	$ 0.09	$ 0.01
	Pro forma	0.01	0.09	(0.03)
Diluted EPS	As reported	$ 0.01	$ 0.09	$ 0.01
	Pro forma	0.01	0.08	(0.03)

The fair value of each option grant was estimated using the Black-Scholes option pricing model with the following assumptions: risk free interest rates of 5.8%, 5.8% and 5.75%; expected option lives of 2.5, 2.5 and 3 years; expected volatility of 55%, 55% and 52%, and no expected dividend yield, in 1996, 1997 and 1998, respectively.

(13) Income Taxes

	Year ended December 31, 1996			
	U.S. Federal	Foreign	State	Total
Current	$ 175,404	$149,832	$ —	$ 325,236
Deferred	(87,737)	—	(10,351)	(98,088)
Total	$ 87,667	$149,832	$(10,351)	$ 227,148

	Year ended December 31, 1997			
	U.S. Federal	Foreign	State	Total
Current	$ 946,703	$112,659	$ 69,952	$1,129,314
Deferred	364,993	—	19,254	384,247
Total	$1,311,696	$112,659	$ 89,206	$1,513,561

	Year ended December 31, 1998			
	U.S. Federal	Foreign	State	Total
Current	$ —	$ —	$ 60,632	$ 60,632
Deferred	896,739	134,442	174,675	1,205,856
Total	$ 896,739	$134,442	$235,307	$1,266,488

Foreign income taxes results from taxes withheld on sales related to Russian operations. Operating income (loss) from such operations for the years ended December 31, 1996, 1997 and 1998 were $436,000 and $555,000 and $(441,000), respectively.

Income tax expense differs from the amount computed by applying the federal income tax rate of 34% to earnings before taxes, as follows:

	1996	1997	1998
Income tax provision at 34%	$187,251	$1,385,612	$ 506,458
Merger expenses not deductible for tax purposes	—	—	612,000
Expenses not deductible for tax purposes	11,990	33,094	28,488
State income tax expense, net of federal effect	(10,351)	89,206	155,303
Effect of foreign operations, including foreign tax credits	(53,071)	(49,326)	—
Exclusion of Partnership income tax benefit	84,000	39,000	—
Other	7,329	15,975	(35,761)
Total	$227,148	$1,513,561	$1,266,488

Effective January 1, 1998, the Partnership elected to be taxed as a corporation. As such, deferred taxes and tax provisions have been established in 1998. The pro forma tax benefit in 1996 and 1997 was approximately $84,000 and $39,000, respectively, if the partnership would have been taxed as a C corporation in those years.

The tax effects of temporary differences and carryforwards, which result in a significant portion of the deferred tax assets and liabilities are as follows:

	1997		1998	
	Assets	Liabilities	Assets	Liabilities
Effect on deferred taxes of carryforwards	$116,958	$ —	$2,035,899	$ —
Foreign tax credit	25,600	—	207,235	—
Allowance for doubtful accounts	654,875	—	245,263	—
Unearned compensation	7,717	—	—	16,864
Deferred revenue	7,142	—	—	1,906,520
Accrued vacation pay	27,200	—	39,560	—
Property, plant and equipment	—	968,265	—	1,960,602
Other	9,311	—	30,711	—
Total deferred taxes	$848,803	$968,265	$2,558,668	$3,883,986

A net operating loss of $5,278,132 was generated in 1998 and the operating loss will be used to offset future taxable income. The net operating loss carryforward will expire in year 2013; however, management believes that this carryforward will be utilized prior to expiration. No valuation allowance for deferred taxes at December 31, 1997 and 1998 is considered necessary as management has determined that it is more likely than not that these assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considered the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

(14) Commitments

The Company has an agreement with various vendors, which require minimum usage. In the event such monthly commitments are not met, the Company is required to remit to the vendor the difference between the commitments and the actual usage. Such amount, if necessary, would be recorded as cost of revenue in the period incurred.

The Company entered into a volume purchase commitment of $13 million relating to the purchase of telecommunications equipment. In the event the $13 million commitment is not fulfilled by CapRock, the Company shall pay the vendor a penalty ranging from 3%-13% of the purchase commitment. The Company believes that no penalties will be incurred under this contract.

(15) 401(k) Plans

The Company and a subsidiary offer its qualified employees the opportunity to participate in one of its defined contribution retirement plans qualifying under the provisions of Section 401(k) of the Internal Revenue Code. Each employee may contribute on a tax deferred basis a portion of annual earnings not to exceed $9,500. The Company matches individual employee contributions in certain plans, up to a maximum level, which in no case exceeds 6%. The Company's matching contributions to the Plan (after forfeitures) for the years ended December 31, 1996, 1997 and 1998 were $23,367, $30,287 and $81,086, respectively.

(16) Acquisition

In January 1998, the Company completed the acquisition of Integrated Communications and Engineering, Ltd. ("ICEL"), a communications systems integrator and maintenance provider in Aberdeen, Scotland. The Company paid a total purchase price of approximately $2.2 million comprised of approximately $610,000 in cash and 207,266 shares of the Company's common stock. The acquisition was accounted for as a purchase business combination, and accordingly the purchase price was allocated to assets acquired and liabilities assumed. Approximately $ 1.6 million was recorded as goodwill and $300,000 was allocated to contracts as a result of the transaction.

The following summarizes the unaudited consolidated data as though the acquisition of ICEL occurred as of the January 1, 1997:

	Historical	Pro Forma
Revenue	$75,349,466	$78,676,598
Net income	2,561,767	2,681,147
Earnings per share	0.09	0.10

(17) Subsequent Events

In February 1999, the Company entered into a joint build arrangement with Enron Communications, Inc., a wholly owned subsidiary of Enron Corp., to jointly build approximately 1,050 miles of fiber optic network within the state of Texas. The build plan includes four conduit ducts to be placed throughout the 1,050 miles, with one and one-quarter conduits to be owned and funded by CapRock and one and one-quarter conduits to be owned and funded by Enron Communications, Inc., and one and one-half conduits to be owned and funded by a limited partnership formed by CapRock and Enron Communications, Inc. The limited partnership will sell a specified amount of fiber usage rights and CapRock will own 48 fibers.

The total required capital contributions will depend on the costs to construct the segment. CapRock and Enron are committed to each contribute equally to fund the construction. The total construction costs for the 1,050 miles are estimated at approximately $100 million.

(18) Segment Reporting and Concentration of Customers

In June 1997, the Financial Accounting Standards Board issued Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information,* which the Company has adopted in 1998. The Company identifies such segments based on management responsibility. The Company measures segment profit as operating income, which is defined as income before interest expense and income taxes. The service revenue from the Telecommunications Division include all revenues generated from the sale of telecommunications products to business and residential customers. These products include local, long distance, Internet, data and private line services. The Fiber Division includes the operating activity and the assets relating to the fiber build out. The revenues for the Fiber Division primarily relate to the sale of dark fiber through IRUs. The product and service revenue from the Services Division include revenues generated from the design, installation, leasing and sale of voice and data systems and products, primarily to companies in the oil and gas industry. The Corporate Division includes certain general and administrative functions and operating expenses and the merger related expenses of $2.3 million, which comprise the segment operating loss of $3.5 million in 1998. The general and administrative expenses were allocated to each of the respective divisions prior to 1998. Information regarding operating segments is as follows (amounts are in thousands):

	Year Ended December 31, 1996				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenue from external customers	$23,174	$—	$27,796	$—	$50,970
Depreciation and amortization	479	54	1,003	—	1,536
Operating income	44	(228)	1,278	—	1,094
Total assets	7,356	8,757	12,409	—	28,522
	Year Ended December 31, 1997				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenue from external customers	$46,745	$1,945	$26,659	$—	$75,349
Depreciation and amortization	694	902	1,750	—	3,346
Operating income	3,226	671	1,562	—	5,459
Total assets	13,327	9,779	26,283	—	49,389
	Year Ended December 31, 1998				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenue from external customers	$75,768	$11,930	$34,798	$(722)	$121,774
Depreciation and amortization	1,113	744	2,993	37	4,887
Operating income	3,280	8,128	(55)	(3,528)	7,825
Total assets	26,929	39,175	34,064	91,798	191,966

All significant transactions and agreements of the Company, with the exception of the operations of ICEL (Scotland) are generated in U.S. dollars. The pertinent data relating to foreign operations is as follows (amounts are in thousands):

	Year Ended December 31, 1996				
	U.S.	Mexico	Russia	International	Consolidated
Revenue to external customers	$44,285	$1,761	$2,281	$2,643	$50,970
Operating income (loss)	451	273	436	(66)	1,094
Long-lived assets	15,901	—	—	—	15,901

	Year Ended December 31, 1997				
	U.S.	Mexico	Russia	International	Consolidated
Revenue to external customers	$57,706	$6,495	$1,905	$9,243	$75,349
Operating income	3,464	1,216	555	224	5,459
Long-lived assets	27,341	—	—	—	27,341

	Year Ended December 31, 1998						
	U.S.	Mexico	India	Russia	Scotland	International	Consolidated
Revenue to external customers	$79,185	$16,611	$4,766	$2,312	$5,207	$13,693	$121,774
Operating income (loss)	3,766	1,920	415	(441)	8	2,157	7,825
Long-lived assets	58,893	—	—	—	2,508	—	61,401

All revenue was derived from unaffiliated customers. For the years ended December 31, 1996 and 1997 one customer provided $11,681,000 (or 23%) and $9,349,000 (or 12%) of the Company's revenue, respectively. For the year ended December 31, 1998, one customer provided $13,985,000 (or 11%) and another customer provided $12,344,000 (or 10%) of the Company's revenue.

(19) Quarterly Results

The Company's unaudited quarterly results are as follows (amounts are in thousands, except share data):

	For the 1997 Quarter Ended			
	March 31	June 30	Sept. 30	Dec. 31
Revenue	$17,022	$18,649	$19,039	$20,640
Gross profit	4,197	5,631	6,109	6,941
Net income	115	721	970	756
Basic and diluted earnings per share	—	0.03	0.03	0.03

	For the 1998 Quarter Ended			
	March 31	June 30	Sept. 30	Dec. 31
Revenue	$24,412	$27,008	$35,284	$35,070
Gross profit	8,183	9,202	9,309	11,860
Net income (loss)	1,358	1,515	(1,650)	(1,000)
Basic and diluted earnings (loss) per share	0.05	0.10	(0.06)	(0.03)

COMMUNICATIONS

We Go Beyond

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 1999

or

[ ] 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: 0-24581

CAPROCK COMMUNICATIONS CORP.
(Exact name of registrant as specified in its charter)

Texas	**75-2765572**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

15601 Dallas Parkway, Suite 700
Dallas, Texas 75248
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(972) 982-9500**

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

The number of shares of the registrant's Common Stock outstanding as of April 30, 1999 was 29,017,843.

CAPROCK COMMUNICAITONS CORP.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1999

INDEX

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

CAPROCK COMMUNICATIONS CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 1998	March 31, 1999 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 293,860	$ 4,447,375
Marketable securities	97,019,789	47,040,582
Accounts receivable and unbilled services, less allowance for doubtful accounts of $709,941 and $2,524,521 at December 31, 1998 and March 31, 1999, respectively	19,936,214	35,443,827
Income tax receivable	1,405,000	2,020,920
Costs and estimated earnings in excess of billings	7,238,402	3,574,090
Inventory	1,301,726	1,273,344
Prepaid expenses and other	706,775	1,088,901
Deferred income taxes	1,989,250	2,122,499
Total current assets	129,891,016	97,011,538
Property, plant and equipment	71,968,047	92,685,506
Accumulated depreciation	(12,361,295)	(13,823,888)
Property, plant and equipment, net	59,606,752	78,861,618
Other assets	2,468,000	18,011,450
Total assets	$191,965,768	$193,884,606
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 26,850,525	$ 31,264,428
Unearned revenue	551,341	539,096
Total current liabilities	27,401,866	31,803,524
Senior notes, net of unamortized debt issuance costs	145,187,039	145,308,334
Deferred income taxes	3,314,568	2,334,172
Total liabilities	175,903,473	179,446,030
Stockholders' equity:		
Preferred stock, $.01 par value; 20,000,000 shares authorized; none issued	-	-
Common stock, $.01 par value; 200,000,000 shares authorized; issued and outstanding, 28,932,395 and 28,952,747shares at December 31, 1998 and March 31, 1999, respectively	289,377	289,593
Additional paid-in capital	10,521,713	10,607,199
Retained earnings	5,608,237	3,902,925
Accumulated other comprehensive income	8,878	468
Unearned compensation	(329,070)	(308,214)
Treasury stock, at cost	(36,840)	(53,395)
Total stockholders' equity	16,062,295	14,438,576
Total liabilities and stockholders' equity	$191,965,768	$193,884,606

See accompanying notes to consolidated financial statements.

CAPROCK COMMUNICATIONS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended March 31, 1998	Three Months Ended March 31, 1999
Revenues:		
Carriers' carrier	$ 12,763,105	$ 24,452,165
Integrated services	4,268,888	4,504,312
System services	7,380,369	8,079,814
Total revenues	24,412,362	37,036,291
Cost of services	16,229,745	22,381,068
Gross profit	8,182,617	14,655,223
Operating expenses:		
Selling, general and administrative	4,435,250	12,550,949
Depreciation and amortization	1,063,677	1,480,163
Total operating expenses	5,498,927	14,031,112
Operating income	2,683,690	624,111
Interest expense	(482,015)	(4,255,475)
Interest income	31,704	845,051
Other income (expense)	548	(19,419)
Income (loss) before income taxes	2,233,927	(2,805,732)
Income tax expense (benefit)	875,779	(1,100,420)
Net income (loss)	$ 1,358,148	$ (1,705,312)
Earnings (loss) per common share:		
Basic	$ 0.05	$ (0.06)
Diluted	$ 0.05	$ (0.06)
Weighted average shares outstanding:		
Basic	28,835,994	28,942,571
Diluted	29,448,890	28,942,571

See accompanying notes to consolidated financial statements.

CAPROCK COMMUNICATIONS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW

(unaudited)

	Three Months Ended March 31, 1998	Three Months Ended March 31, 1999
Cash flows from operating activities:		
Net income (loss)	$ 1,358,148	$ (1,705,312)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,063,677	1,480,163
Deferred income taxes	(45,462)	(1,113,645)
Equity earnings of unconsolidated joint venture	-	46,120
Amortization of debt issuance costs, included in interest expense	-	121,295
Changes in operating assets and liabilities:		
Accounts receivable and unbilled services	(2,275,475)	(15,507,613)
Inventory	24,927	28,382
Costs and earnings in excess of billings	-	3,664,312
Prepaid expenses and other	(125,887)	(487,998)
Accounts payable and accrued liabilities	629,220	4,413,903
Income taxes receivable	542,486	(615,920)
Unearned revenue	92,559	(12,245)
Net cash provided by (used in) operating activities	1,264,193	(9,688,558)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(3,525,641)	(23,819,240)
Proceeds from sale of marketable securities	-	49,979,207
Proceeds from disposal of property, plant and equipment	73,300	3,136,000
Investment in unconsolidated subsidiary	-	(15,514,631)
Purchase of ICEL	(609,822)	-
Net cash provided by (used in) investing activities	(4,062,163)	13,781,336
Cash flows from financing activities:		
Principal payments on notes payable	(4,074,495)	-
Proceeds from line of credit	19,223,971	-
Principal payments on line of credit	(14,457,241)	-
Purchase of treasury stock	-	(16,555)
Proceeds from issuance of common stock	20,883	85,702
Principal payments under capital lease obligations	(57,165)	-
Net cash provided by financing activities	655,953	69,147
Effect of exchange rate on cash and cash equivalents	-	(8,410)
Net increase (decrease) in cash and cash equivalents	(2,142,017)	4,153,515
Cash and cash equivalents at beginning of period	3,520,017	293,860
Cash and cash equivalents at end of period	$ 1,378,000	$ 4,447,375
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 455,915	$ 8,950,000
Cash paid for income taxes	$ 290,000	$ -
Non-cash investing activity:		
Issuance of stock for ICEL acquisition	$ 1,577,814	$ -

See accompanying notes to consolidated financial statements.

(1) *Summary of Significant Accounting Policies*

(a) Basis of Presentation and Nature of Business

The consolidated financial statements include CapRock Communications Corp. ("CapRock" or the "Company") and its majority owned subsidiaries. The Company was formed on February 3, 1998, to serve as a holding company for the operations of CapRock Telecommunications Corp., a Texas corporation ("Telecommunications"), CapRock Fiber Network Ltd., a Texas limited partnership ("Partnership"), and IWL Communications, Incorporated, a Texas corporation ("IWL"), and its wholly owned subsidiaries upon the consummation of the business combination of those companies (the "Combination"). All significant inter-company transactions are eliminated in the consolidation. The equity method is used to account for unconsolidated investments in companies in which the Company exercises significant influences over operating and financial policies, but does not have a controlling interest. On August 26, 1998, pursuant to the Agreement and Plan of Merger and Plan of Exchange dated February 16, 1998, as amended (the "Merger Agreement"), among the Company, Telecommunications, the Partnership, IWL and certain other parties, the Company completed the Combination (note 2).

The Company is a regional facilities-based integrated communications provider offering local, long distance, Internet, data and private line services to small and medium-sized businesses. The Company also provides switched and dedicated access, regional and international long distance, private lines and dark fiber to carrier customers. The Company is in the process of building an advanced fiber network throughout Texas, Louisiana, Oklahoma, Arkansas and New Mexico. Additionally, the Company, through its wholly owned subsidiary - IWL, provides communications solutions to customers with operations in remote, difficult-access regions. The Company markets its services through its internal sales representatives and a network of independent agents.

The accompanying consolidated financial statements, which should be read in conjunction with the consolidated financial statements and footnotes included in the Company's 1998 Annual Report on Form 10-K, have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three months ended March 31, 1999 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 1999.

(2) Business Combination

On August 26, 1998, pursuant to the Merger Agreement, the Company completed the Combination with Telecommunications, the Partnership and IWL. Accordingly, the Consolidated Balance Sheets as of December 31, 1998 and March 31, 1999 and the Consolidated Statements of Operations and Consolidated Statements of Cash Flows for the three months ended March 31, 1998 and 1999 include Telecommunications, the Partnership and IWL as though these entities had always been a part of CapRock.

Upon the consummation of the Combination, all previously outstanding shares of IWL common stock ceased to exist and each such share was converted into and became exchangeable for one share of CapRock common stock, and all previously outstanding shares of Telecommunications common stock ceased to exist, and each such share was converted into and became exchangeable for 1.789030878 shares of CapRock common stock and each one percent (1%) of the Partnership interests issued and outstanding was exchanged for 63,194.54 shares of CapRock common stock. The Company issued 28,910,221 common shares in the Combination. Additionally, outstanding employee stock options of IWL and Telecommunications were converted at the above exchange factors into options to purchase shares of

CapRock common stock. The mergers and interest exchange constituted a tax-free reorganization and was accounted for as a pooling of interests.

In May 1998, IWL changed its fiscal year end to coincide with the fiscal years of CapRock, Telecommunications and the Partnership. The Consolidated Statement of Operations for the three months ended March 31, 1998 and 1999 combine the operating activity for all three entities for these periods.

The transactions between Telecommunications, IWL and the Partnership have been eliminated for all respective periods presented. Certain reclassifications were made to IWL's financial statements to conform to CapRock's presentations.

The results of operations for the separate companies and the combined amounts presented in the Consolidated Financial Statements for periods prior to the Combination follow:

	Three Months Ended March 31, 1998
Net Sales:	
Telecommunications	$ 15,776,950
Partnership	580,895
IWL	8,054,517
Combined	$ 24,412,362
Net Income:	
Telecommunications	$ 897,241
Partnership	70,322
IWL	390,585
Combined	$ 1,358,148

3) Earnings per share

The following table sets forth the computation of basic and diluted income (loss) per share:

	Three Months Ended March 31, 1998	Three Months Ended March 31, 1999
Numerator:		
Net income (loss)	$ 1,358,148	$ (1,705,312)
Denominator:		
Denominator for basic earnings (loss) per share-weighted average shares outstanding	28,835,994	28,942,571
Effect of dilutive securities:		
Employee stock options	612,896	-
Denominator for diluted earnings (loss) per share-weighted average shares outstanding	29,448,890	28,942,571
Basic and diluted earnings (loss) per share	$ .05	$ (.06)

4) Segment Reporting

In June 1997, the Financial Accounting Standards Board issued Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, which the Company adopted in 1998. The Company identifies such segments based on management responsibility. The Company measures segment profit as operating income, which is defined as income before interest expense and income taxes. The service revenue from the Telecommunications Division includes all revenues generated from the sale of telecommunications products to business and residential customers. These products include local, long distance, Internet, data and private line services. The Fiber Division includes the operating activity and the assets relating to the fiber build out. The revenues for the Fiber Division primarily relate to the sale of dark fiber through IRUs. The product and service revenue from the Services Division includes the revenues generated from the design, installation, leasing and sale of voice and data systems and products, primarily to companies in the oil and gas industry. The Corporate Division includes certain general and administrative functions and operating expenses. Information regarding operating segments is as follows:

	Quarter Ended March 31, 1998				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenue from external customers	$ 15,770,312	$ 587,533	$ 8,054,517	$ -	$ 24,412,362
Depreciation and amortization	231,420	184,927	647,330	-	1,063,677
Operating income	1,560,999	323,948	798,743	-	2,683,690
Total assets	14,552,339	9,948,579	29,833,549	-	54,334,467

	Quarter Ended March 31, 1999				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenue from external customers	$ 17,304,671	$11,651,806	$ 8,079,814	$ -	$ 37,036,291
Depreciation and amortization	532,603	208,000	739,560	-	1,480,163
Operating income	(2,687,535)	7,697,874	343,869	(4,730,097)	644,111
Total assets	30,334,464	65,406,316	32,532,702	65,611,124	193,884,606

All revenue was derived from unaffiliated customers.

5) Fiber Build Agreement

In February 1999, the Company entered into a joint build arrangement with Enron Communications, Inc., a wholly owned subsidiary of Enron Corp., to jointly build approximately 1,050 miles of fiber optic network within the state of Texas. The build plan includes four conduits to be placed throughout the 1,050 miles, with one and one-quarter conduits to be owned and funded by CapRock and one and one-quarter conduits to be owned and funded by Enron Communications, Inc., and one and one-half conduits to be owned and funded by a limited partnership formed by CapRock and Enron Communications, Inc. The limited partnership will sell a specified amount of fiber usage rights and CapRock will own 48 fibers.

The total required capital contributions will depend on the costs to construct the segment. CapRock and Enron are committed to each contribute equally to fund the construction. The total construction costs for the 1,050 miles are estimated at approximately $100 million.

6) Secondary Public Offering

On May 6, 1999, the Company entered into an underwriting agreement with various underwriters to sell 4,000,000 shares of its common stock at a price of $22.00 per share in a public offering. The registration statement for the equity offering was declared effective by the SEC on May 6, 1999 and closed on May 12, 1999. The net proceeds after the underwriters discount from the sale of the stock was approximately $82.7 million and the expenses associated with offering are estimated at approximately $1.2 million.

7) Senior Note Offering

The Company is in process of selling securities through a private placement under Section 4(2) and Rule 144A under the Securities Act of 1933. The $210 million aggregate principal senior notes (the "Senior Notes") were priced at an interest rate of 11 1/2% on May 13, 1999. The private placement is scheduled to close on or about May 18, 1999. The estimated net proceeds to the Company after deducting the initial purchasers' discount and estimated offering expenses are approximately $200.7 million. The proceeds will be used to fund capital expenditures for the construction of the fiber optic network, switching equipment and other capital expenditures and to expand its sales offices, for potential acquisitions and for general working capital purposes. The funds will be invested in high-grade liquid securities classified as available for sale. The Company is required under the proposed indenture to file a registration statement to register the Senior Notes within 90 days of the closing of the transaction.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with CapRock's consolidated financial statements and notes thereto for the year ended December 31, 1998. The Company believes that all necessary adjustments (consisting of normal recurring adjustments) have been included in the amounts stated below to present fairly the following quarterly information. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results for interim periods are not necessarily indicative of results to be expected for the year. In this Form 10-Q, the "Company," "CapRock," "we," "us" and "our" refer to CapRock and its subsidiaries, including Telecommunications, the Partnership and IWL, which are our three predecessor companies, as well as CapRock Network Services, L.P., CapRock Telecommunications Leasing Corp. and CapRock Design Services, L.P., unless the context otherwise requires.

Forward Looking Information

This Quarterly Report on Form 10-Q includes forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about CapRock, including:

- our anticipated growth strategies,
- anticipated trends in our business, including trends in technology and the growth of communications network products and services,
- future expenditures for capital projects, and
- our ability to continue to control costs and maintain quality.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including risks related to, among other things, building a fiber network (including obtaining the necessary rights-of-way, permits and regulatory approvals), supply and demand for data services, competition, the need for additional capital, debt and interest payment obligations, restrictions in our senior note indenture, rapid growth, dependence on local telephone companies and long distance carriers, our information systems, retention of key personnel, dependence on major customers, year 2000 problems, the continued integration of our predecessor companies, service interruptions, potential liability as an internet service provider and protection of our intellectual property.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Because of these risks, uncertainties and assumptions, the forward-looking events discussed in this Form 10-Q might not occur.

Overview

We own and operate a scalable long-haul fiber network which upon completion is expected to cover approximately 5,500 route miles throughout the Southwest region, which includes Texas, Louisiana, Arkansas, Oklahoma and New Mexico. This fiber network supports the voice, data, bandwidth and dark fiber services we provide to our carrier and retail customers.

In August 1998, we announced that we had completed a business combination transaction in which our predecessor companies combined to form our company as it exists today. The combination was accounted for as a pooling of interests. Accordingly, our consolidated results include our three predecessor companies (i.e., Telecommunications, the Partnership and IWL) as though these entities had always been a part of CapRock.

We intend to be the premier provider of carriers' carrier services and the leading facilities-based integrated communications provider in the Southwest region. To measure our progress, we classify our revenues in three categories: carriers' carrier, integrated services and systems services. Our carriers' carrier revenues include domestic and international long distance, bandwidth and dark fiber services sold to telecommunications carriers and other wholesale customers. Currently, we have over 100 carrier customers, including AT&T, MCI WorldCom, Sprint Corporation and Qwest Communications, as well as many regional independent companies such as Century Tel, Inc. and Lufkin Conroe Telephone. Our integrated services revenues reflect our local, long distance, Internet, data and private line products provided to over 5,000 small and medium-sized businesses on a single bundled bill. Lastly, our systems services revenues represent the voice and data systems and services we provide primarily to the oil and gas industry offshore in and along the Gulf of Mexico.

Our proximity to Mexico allows us to directly connect to the fiber networks of multiple Mexican telecommunications carriers. Subject to compliance with certain regulatory requirements, we are capable of providing dark fiber to these carriers at several border crossings enabling them to close open fiber rings in Mexico by using CapRock fiber on the U.S. side of the border. Additionally, our direct connect agreements with foreign carriers position us to capture increased levels of growing international traffic.

In addition, in February 1999, CapRock entered into a joint build agreement with Enron Communications, Inc. to jointly build approximately 1,050 miles of fiber network in Texas. Through this joint build arrangement, we will connect Amarillo, Lubbock, Dallas, Fort Worth, Waco, Bryan, Austin, San Marcos, San Antonio and Houston, Texas. The build plan includes four conduits to be placed throughout the approximately 1,050 miles, with one and one-quarter conduits to be owned and funded directly by us, one and one-quarter to be owned and funded by Enron Communications and one and one-half to be owned and funded by a limited partnership formed by us and Enron Communications. Our agreements with Enron Communications provide that the partnership will install 192 fibers in the first conduit and will sell 96 of the 192 fibers to be installed. Of the remaining 96 fibers, we will own 48 fibers and Enron Communications will own 48 fibers. The joint build arrangement provides several benefits, including reduction of construction costs, accelerated acquisition of right of way and franchise agreements, the majority of which are essentially in place, and the freeing up of resources to potentially accelerate the build of the remaining portion of the network.

Results of Operations

CapRock recognizes revenue from the following sources: carriers' carrier, integrated services and system services.

Carriers' Carrier. Carriers' carrier revenue includes all carrier revenues generated from the sale of domestic and international switched services, from the sale of T-1 and DS-3 broadband capacity and from the sale and lease of dark fiber. The revenue generated from the international switched services represent minutes of long distance traffic terminating in foreign countries, but generated by domestic U.S.-based long distance carriers. Such revenues are recognized when the services are provided. The cost of revenues associated with these services is based primarily on the direct costs associated with owned and leased transmission capacity and the cost of transmitting and terminating traffic on other carriers' facilities. Commissions paid to sales representatives or agents to acquire customer call traffic are expensed in the period when associated call revenues are recognized.

We account for long-term construction contracts relating to the development of telecommunications networks for customers using the percentage-of-completion method, which would include the sale of fiber usage rights through IRUs and the related construction services associated with building the fiber network specified in the IRUs. Our revenues from IRUs will be generated from the amount of fiber we build on our network in excess of that which we intend to retain for our own use. As a result, we expect that revenues from IRUs will diminish over time as our supply of excess fiber is sold. Progress under the percentage-of-completion method is measured based upon costs incurred to date compared with total estimated construction costs. Customers are billed based upon contractual milestones.

Integrated Services. Integrated services revenue includes all revenues generated from the sale of telecommunications products to business and residential customers. These products include local, long distance, Internet, data and private line services.

Systems Services. Systems services revenue includes revenues generated from the design, installation, leasing and sale of voice and data systems and products, primarily to companies in the oil and gas industry.

The following table represents the various sources of revenues:

	Three Months Ended March 31,	
	1998	1999
Revenues:		
Carrier's carrier	$ 12,763,105	$ 24,452,165
Integrated services	4,268,888	4,504,312
System services	7,380,369	8,079,814
Total revenues	$ 24,412,362	$ 37,036,291

The following table sets forth for the periods indicated CapRock's statement of operations as a percentage of its operating revenues:

	Three Months Ended March 31,	
	1998	1999
Revenues	100 %	100 %
Cost of services	66 %	60 %
Gross margin	34 %	40 %
Operating expenses:		
Selling, general and administrative	18 %	34 %
Depreciation and amortization	4 %	4 %
Total operating expenses	22 %	38 %
Operating income	12 %	2 %
Interest expense	(2)%	(12)%
Interest income	- %	2 %
Other income (expense)	- %	- %
Income (loss) before income taxes	10 %	(8)%
Income tax expense (benefit)	4 %	(3)%
Net income (loss)	6 %	(5)%

Three Months Ended March 31, 1998 Compared to Three Months Ended March 31, 1999

Revenues. Total revenues increased $12.6 million, or 52%, from $24.4 million during the three months ended March 31, 1998 to $37 million during the three months ended March 31, 1999. This increase was attributable to increases of 92% in carriers' carrier, 6% in integrated services and 9% in systems services revenue for the comparable periods.

Carriers' carrier revenue increased $11.7 million from $12.8 million during the three months ended March 31, 1998 to $24.5 million during the three months ended March 31, 1999. The 92% increase resulted primarily from the sale of IRUs and dark fiber leases. Fiber related revenues increased $11.1 million from $588,000 during the three months ended March 31, 1998 to $11.7 million during the three months ended March 31, 1999. The Company anticipates recurring fiber related revenue relating to IRUs and dark fiber leases to continue through the remainder of the year. However, period-to-period fluctuations can be expected as this type of revenue is affected by the negotiation and terms of these contracts and the build out of our network.

Integrated services revenue increased $235,000 from $4.3 million during the three months ended March 31, 1998 to $4.5 million during the three months ended March 31, 1999. The 6% increase was attributable to growth in the number of business and residential customers both from increased penetration in our existing markets and from the deployment of our network into new markets. Additionally, CapRock recognized local telephone revenue for the three months ended March 31, 1999 as compared to no such revenue during the three months ended March 31, 1998.

Systems services revenue increased $700,000 from $7.4 million during the three months ended March 31, 1998 to $8.1 million during the three months ended March 31, 1999. The 9% increase was attributable to moderate growth associated with the leasing and sale of voice and data systems products and projects involving the engineering and integration of telecommunications systems and sales, service and maintenance of telecommunications equipment. The Company anticipates quarterly systems services revenue for the remainder of the year to remain at comparable levels.

Costs of Services. Cost of services increased $6.2 million, or 38%, from $16.2 million during the three months ended March 31, 1998 to $22.4 million during the three months ended March 31, 1999. The growth in cost of services was primarily attributable to the continued growth in all three revenue categories. The six percentage point increase in gross margin from 34% to 40% resulted primarily from favorable pricing attributable to the higher traffic and the sale of dark fiber. The increase in the gross margin during the three months ended March 31, 1999 was partially offset by lower margins attributable to Mexico and other international traffic, which carry a lower gross margin percentage. Gross margins may vary in future periods as a result of these and other factors.

Selling, General and Administrative Expenses. Selling, general and administrative expenses ("SG&A") include salaries, benefits, occupancy costs, commissions, sales and marketing expenses and administrative expenses. SG&A increased $8.1 million, or 183%, from $4.4 million during the three months ended March 31, 1998 to $12.6 million during the three months ended March 31, 1999. The increase resulted primarily from the additional personnel required to support CapRock's growth, advertising to increase name recognition and brand awareness and additional sales commission payments.

Depreciation and Amortization Expense. Depreciation and amortization expense increased $416,000, or 39%, from $1.1 million during the three months ended March 31, 1998 to $1.5 million during the three months ended March 31, 1999. This increase resulted primarily from purchases of additional equipment and other fixed assets to accommodate CapRock's growth. CapRock expects that depreciation and amortization expense will continue to increase in subsequent periods as CapRock continues to expand its facilities.

Interest Expense. Interest expense increased $3.8 million from $482,000 during the three months ended March 31, 1998 to $4.3 million during the three months ended March 31, 1999. The increase resulted from interest expense related to the Company's senior notes. See "-- Liquidity and Capital Resources."

Interest Income. Interest income increased \$813,000 from \$32,000 during the three months ended March 31, 1998 to \$845,000 during the three months ended March 31, 1999. The increase was attributable to the interest and investment accretion associated with the marketable securities purchased with the proceeds from the Company's senior notes issued in July 1998. See " -- Liquidity and Capital Resources."

Income Taxes (Benefits). During the three months ended March 31, 1998, the Company incurred income tax expense of \$876,000 compared to an income tax benefit of \$1.1 million for the three months ended March 31, 1999. The expense or benefit resulted from the income or loss for the respective periods. The effective tax rate for both periods was 39%.

Net Income (Loss). Net income decreased \$3.1 million, or 226%, from \$1.4 million during the three months ended March 31, 1998 to a net loss of \$1.7 million during the three months ended March 31, 1999 as a result of the factors discussed above.

Liquidity and Capital Resources

CapRock had cash and cash equivalents of \$294,000 at December 31, 1998, as compared with \$4.4 million at March 31, 1999 and marketable securities of \$97 million at December 31, 1998 as compared to \$47 million at March 31, 1999. CapRock had working capital of \$102.5 million at December 31, 1998 as compared to working capital of \$65.2 million at March 31, 1999. The decrease in working capital was attributable to the utilization of working capital for the build out of the fiber optic network and increase in corporate overhead to support the Company's growth.

CapRock's cash flow provided from operating activities for the three months ended March 31, 1998 was \$1.3 million as compared to \$9.7 million used in operating activities during the three months ended March 31, 1999. The change was primarily attributable to an increase in accounts receivable and unbilled services, and the timing of certain capital expenditure payments to vendors relating to the fiber optic network build out.

Cash used in investing activities during the three months ended March 31, 1998 was \$4.1 million as compared to cash provided by investing activities during the three months ended March 31, 1999 of \$13.8 million. Capital resources used for the purchase of property and equipment increased \$20.3 million from \$3.5 million during the three months ended March 31, 1998 to \$23.8 million during the three months ended March 31, 1999. This increase primarily related to the purchase of telecommunications equipment and costs incurred with the build out of the fiber optic network. During the three months ended March 31, 1999, the Company received \$50 million from the sale of marketable securities as compared to no such sales during the three months ended March 31, 1998.

In January 1998, CapRock completed the acquisition of Integrated Communications and Engineering, Ltd., a communications systems integrator and maintenance provider in Aberdeen, Scotland. CapRock paid a total purchase price of approximately \$2.2 million comprised of approximately \$610,000 in cash and 207,266 shares of CapRock's Common Stock.

In July 1998, CapRock issued \$150 million aggregate principal amount of its senior notes. Interest on the senior notes is payable semi-annually in arrears on January 15 and July 15 of each year, commencing January 15, 1999, at the rate of 12% per year. A portion of the net proceeds from the offering of the senior notes was used to repay all existing debt obligations, totaling \$26.8 million. The remaining proceeds, net of transaction costs, have been, or will be, used to fund additional capital expenditures for the construction of CapRock's fiber optic network, switching equipment and other capital expenditures to expand its sales offices, for potential acquisitions and for general working capital purposes. The funds are invested in high-grade liquid securities classified as available for sale. The indenture governing the issuance of the senior notes contains certain restrictive operating and financial covenants, including restrictive covenants relating to borrowing additional money, paying dividends or making other distributions to our shareholders, limiting the ability of subsidiaries to make payments to us, making certain investments, creating certain liens on our assets, selling certain assets and using the proceeds from those sales for certain purposes, entering into transactions with affiliates, and engaging in certain mergers or consolidations. All of the covenants are subject to a number of important qualifications and exceptions. These covenants may adversely affect CapRock's ability to finance its future operations or capital needs or to engage in other business activities that may be in the best interests of CapRock.

CapRock expects to require significant financing for future capital expenditure and working capital requirements. By the end of the year 2000, CapRock intends to build out its fiber optic network to approximately 5,500 route miles throughout the Southwest region. CapRock intends to use advanced fiber capable of supporting dense wave division multiplexing with an OC-48 backbone scalable to OC-192, and intends to install 96 fibers throughout most of its network and intends to retain on average 24 fiber strands. CapRock is burying three to four conduits throughout its network. CapRock currently estimates that its aggregate capital requirements will total approximately $250 million for 1999 and approximately $160 million for 2000, including expenditures to be made under the joint build arrangement with Enron Communications. CapRock expects to make substantial capital expenditures thereafter. Capital expenditures will be required to (1) fund the construction and operation of the fiber optic network, including the portion to be constructed through the joint build arrangement with Enron Communications, (2) fund the installation of voice and data switches, and (3) open sales offices and add sales support and customer service personnel in markets throughout Texas, Louisiana, Oklahoma, Arkansas and New Mexico.

On May 6, 1999, CapRock entered into an underwriting agreement with various underwriters to sell 4,000,000 shares of its common stock at a price of $22.00 per share in a public offering. The registration statement for the equity offering was declared effective by the SEC on May 6, 1999 and closed on May 12, 1999. CapRock received net proceeds, after deducting underwriting discounts and expenses payable by CapRock, of approximately $81.5 million from the sale of its common stock (CapRock will receive an additional approximately $2.0 million in net proceeds if the underwriters' over-allotment option to acquire an additional 100,000 shares of common stock from CapRock is exercised in full).

CapRock is currently offering securities through a private placement under Section 4(2) and Rule 144A under the Securities Act of 1933. The $210 million aggregate principal senior notes (the "Senior Notes") were priced at an interest rate of 11 1/2% on May 13, 1999. The private placement is scheduled to close on May 18, 1999. CapRock expects to receive net proceeds after deducting the initial purchasers' discount and estimated expenses payable by CapRock, of approximately $200.7 million. CapRock expects that the proposed Senior Notes will have a maturity date of ten (10) years after their issuance with interest payable semi-annually after the date of issuance. The proposed notes will be senior unsecured obligations and as such will rank *pari passu* in right of payment with CapRock's existing senior notes issued in July of 1998 and with all CapRock's future unsecured and unsubordinated indebtedness. CapRock anticipates that the indenture governing such notes will have restrictions similar to those, which currently exist for CapRock's existing senior notes. There is no assurance that the terms of the proposed notes actually offered and sold, if any, will not vary significantly from those described above. The proceeds will be used to fund capital expenditures for the construction of the fiber optic network, switching equipment and other capital expenditures and to expand its sales offices, for potential acquisitions and for general working capital purposes. The funds will be invested in high-grade liquid securities classified as available for sale. The Company is required under the proposed indenture to file a registration statement to register the Senior Notes within 90 days of the closing of the transaction.

CapRock is also considering various alternatives under a revolving credit facility. CapRock anticipates that this credit facility, if obtained, would range from approximately $50 to $100 million. The proceeds from this credit facility would be used in a similar manner to the uses discussed for the Senior Notes.

CapRock believes that its cash and marketable securities, cash flow from operations and sales of dark fiber, the net proceeds from the May 1999 equity offering and the expected net proceeds from the private placement of Senior Notes will be sufficient to fund completion of its planned network. However, no assurances can be made as to whether additional sources of capital will be needed to complete the network and if such sources are needed, but CapRock is unable to obtain them, CapRock may have to curtail or delay the build out of its fiber network and its level of capital expenditures. CapRock's EBITDA was $3.7 million for the three months ended March 31, 1998 and EBITDA of $2.1 million for the three months ended March 31, 1999.

CapRock may require additional capital in the future for new business activities related to its current and planned businesses, or in the event it decides to make additional acquisitions or enter into joint venture and strategic alliances. Sources of additional capital may include cash flow from operations, public or private equity and debt financings, bank debt, vendor financings and indefeasible right to use contracts. In addition, CapRock may enter into joint construction agreements with carriers, thereby reducing its capital expenditure requirements. However, we cannot assure you that CapRock will be successful in producing sufficient cash flow or raising sufficient debt or equity capital to meet its strategic business objectives or that such funds, if available, will be available on a timely basis and on terms that are acceptable to CapRock. If CapRock is unable to obtain such capital, the build out of portions of its expanded network may be significantly delayed, curtailed or abandoned. In addition, CapRock may accelerate the rate of deployment of its network, which in turn may accelerate CapRock's need for additional capital. CapRock's actual capital requirements will also be affected, possibly materially, by various factors, including the timing and actual cost of the deployment of CapRock's network, the timing and cost of expansion into new markets, the extent of competition and the pricing of dark fiber and telecommunications services in its markets.

New Accounting Pronouncements

In June 1998, the FASB issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activity* ("SFAS 133") which requires that all derivatives be recognized in the statement of financial position as either assets or liabilities and measured at fair value. In addition, all hedging relationships must be designated, reassessed and documented pursuant to the provisions of SFAS No. 133. SFAS 133 is effective for fiscal years beginning after June 15, 1999. The adoption of SFAS 133 will not have an impact on CapRock's results of operations, financial position or cash flow.

Contingencies

CapRock is party to ordinary litigation incidental to its business. No currently pending litigation is expected to have a material adverse effect on our results of operations, financial condition or cash flow.

Year 2000

The year 2000 problem is the inability of a meaningful portion of the world's computers, software applications and embedded semiconductor chips to cope with the change of the year from 1999 to 2000. This issue can be traced to the infancy of computing, when computer data and programs were designed to save disk space by truncating the date field to just six digits (two for the day, two for the month and two for the year). Therefore, information applications automatically assumed that the two-digit year field represented a year within the 1900's. As a result of this, systems could fail to operate or fail to produce correct results when dates roll over to the year 2000.

State of Readiness

The year 2000 problem affects computers, software and other equipment used, operated or maintained by CapRock for itself and its customers. CapRock has substantially completed the process of assessing the potential impact of, and the costs of remediating, the year 2000 problem for its internal systems, facilities systems and equipment.

CapRock's business depends upon the operation of computer systems. CapRock has established a year 2000 committee made up of leaders from the operational areas of CapRock to assess CapRock's year 2000 problem. The committee has the involvement of senior management and the Board of Directors and its objectives are a top priority. CapRock has undertaken various initiatives intended to provide computer equipment and software that will function properly with respect to dates in the year 2000 and thereafter. Computer equipment and software include systems that are commonly thought of as Information Technology, or IT, systems, including accounting, data processing, telephone/PBX systems, scanning equipment and other miscellaneous systems, as well as systems that are not commonly thought of as IT systems, such as alarm systems, fax machines or other miscellaneous systems. Based upon its identification and assessment efforts to date, CapRock believes that certain computer equipment and software it currently uses will require replacement or modification. In addition, in the ordinary course of replacing computer equipment and software, CapRock will obtain replacements that are warranted to be year 2000 compliant. CapRock currently estimates that the year 2000 identification, assessment, remediation and testing efforts will be substantially complete by June 30, 1999 and that such efforts will be completed before any currently anticipated impact on its computer equipment and software. CapRock has substantially completed the identification and assessment process. CapRock estimates that it currently has completed approximately 80% of the initiatives that it believes will be necessary to address potential year 2000 issues relating to its computer equipment and software. The projects comprising the remaining 20% of the initiative are in process and are expected to be complete on or about September 30, 1999.

Year 2000 Initiative	Time Frame
Identification and assessment regarding IT system issues	Completed
Remediation and testing regarding critical system issues	6/98-5/99
Identification, assessment, remediation and testing regarding desktop and individual system issues	6/98-6/99
Identification and assessment regarding non-IT system issues	8/98-5/99
Remediation and testing regarding non-IT systems	11/98-6/99
Contingency plans regarding critical systems	5/99-9/99

CapRock has mailed questionnaires to its significant vendors, service providers and customers with whom CapRock's systems electronically interface to determine the extent to which such interfaces and system processes are vulnerable to year 2000 issues and whether the products and services of such entities are year 2000 compliant. Substantially all of the parties have responded to the request and no significant matters were noted from these responses. However, the information contained in a number of the responses was generic in nature and did not specifically address the stage of their year 2000 initiatives. CapRock will continue seeking alternate vendors in advance of December 31, 1999 in the event satisfactory responses are not received.

CapRock has evaluated its systems and has identified the following systems and functions as mission critical:

- switching systems,
- network operations and fiber,
- satellite/microwave transmission equipment and satellite service providers,
- billing and call record collection systems, and
- supply chain (vendor provider of switched services).

Switching Systems:

Switching equipment is used to connect calls to their destination, while performing other advanced features and recording call record information for future billing. The switch opens or closes circuits or selects the paths or circuits to be used for the transmission of information. CapRock currently owns seven switches, three of which are physically located in Dallas, Texas (two are calling card platforms), two in Houston, Texas, one in Victoria, Texas and one in Phoenix, Arizona. CapRock also manages a switch in Jersey City, New Jersey. CapRock has completed the assessment and certain test procedures relating to the switching equipment and has identified certain non-compliant features, which were remediated through software upgrades provided by the respective manufacturers.

The remainder of the testing procedures for the switching equipment were substantially complete for all switches which were in service as of March 31, 1999. The switches which have not been placed in service will be subject to integrated test procedures prior to being placed in service. The test will incorporate the call collection processes and the interfaces with the billing system. The test will involve simulating date changes with the switch, such that the call records will be processed, rated and properly captured in the billing system as a billable transaction.

The test procedures consist of the following:

- process flow analysis,
- documentation of overall integrated test strategy,
- documentation and test case plans at an individual component level,
- committee agreement regarding the test plan,
- execution of the integrated test plan, and
- documentation regarding the results of test procedures.

Network Operations and Fiber:

CapRock currently owns and operates an 800-route mile fiber optic network, which was substantially completed by December 31, 1998. Approximately 260 miles were completed and placed in service in January 1997. The network is currently being expanded to 5,500 route miles (which CapRock expects to be completed by the end of the year 2000). The fiber optic network is designed to be scalable and will include network-advanced fiber, which is capable of supporting dense wave division multiplexing with an OC-48 backbone scalable to OC-192. The fiber optic network will include electronic equipment, which regenerates and transports the voice, data and other information. A detailed assessment of the network operations and fiber equipment has been performed and no significant non-compliant issues have been identified.

Satellite/Microwave Transmission Equipment and Satellite Service Providers:

CapRock utilizes satellite service providers to provide communications services to certain customers in remote locations. CapRock has sent correspondence to each of the three vendors supplying the satellite services. Each of the satellite service providers has responded. None of them noted any significant non-compliant issues. CapRock is continuing to pursue additional information and test data from these providers and will seek new providers, if necessary.

Billing and Call Record Collection Systems:

CapRock handles its provisioning, customer care, billing and traffic reporting functions on a proprietary software platform developed by RiverRock Systems, Ltd., a Texas limited partnership in which CapRock has a 49% ownership interest. These operations support systems, or OSS systems, and other back office systems are used to enter, schedule and track a customer's order from the point of sale to the installation and testing of service. The systems also include or interface with trouble management, inventory, billing, collection and customer service systems. The test procedures relating to the billing system and call record collection processes were performed in conjunction with the switching equipment test procedures and are substantially completed.

CapRock believes that substantially all of the hardware, database platform and operating systems impacting the billing system function will not be materially affected by Year 2000 issues.

Supply Chain (Vendor Provider of Switch Services):

CapRock is dependent upon a number of telecommunications carriers during the process of initiating and terminating calls to end-users. CapRock has sent correspondence to each of the significant suppliers regarding their year 2000 status and has received responses from substantially all of these suppliers. However, the information contained in a number of the responses was generic in nature and did not specifically address the stage of their year 2000 initiatives. CapRock will seek alternate suppliers in advance of December 31, 1999 in the event satisfactory responses are not received.

Based upon CapRock's current assessment and responses from vendors, CapRock believes that the risks associated with the year 2000 problem relating to domestic traffic and terminations are not significant. CapRock is in the process of evaluating the impact of year 2000 as it relates to the termination of traffic in international locations, and specifically third world and developing countries.

Non-IT Systems:

CapRock continues to evaluate non-information technology, or non-IT, systems. Based on current results and other factors, CapRock does not anticipate finding any material embedded system issues in its non-IT systems.

Costs

CapRock anticipates that costs of replacing or remediating non-compliant systems will not exceed $500,000 (remediation costs incurred to date have been less than $100,000). Such expenditures represent less than 1% of 1999 projected capital expenditures and will be funded out of cash flow from operations.

Risks

CapRock is in the process of preparing a comprehensive analysis of the problems and costs, including loss of revenues, that would be reasonably likely to result from the failure by CapRock or certain third parties to complete the efforts necessary to achieve year 2000 compliance on a timely basis.

CapRock has not yet completed its identification of the most likely worst case scenario. However, CapRock believes that the most reasonably likely worst case scenario would involve loss of revenues relating to traffic terminating in certain developing third world countries, which have not adequately prepared for the year 2000. CapRock relies upon certain vendors to supply international services and the possibility exists that some of the traffic in these developing third world countries may not be able to be completed. The estimated loss of revenue, if any, has not been determined, and we may not be able to identify the amount of any loss by the year 2000. Depending on the systems affected, the failure of any contingency plans developed by CapRock, if implemented, could have a material adverse effect on CapRock's financial condition and results of operations.

Contingency Plans

The contingency plans include a proactive analysis of countries that are actively pursuing year 2000 remediation. CapRock is using outside consultants to assist with an analysis of countries that are not actively pursuing year 2000 compliance and remediation. Contingency plans include identifying these countries noted with substantial risk and potentially redirecting the sales and marketing efforts to other countries less likely to be affected by year 2000 problems.

CapRock is still formulating contingency plans relating to the use of the satellite service providers. CapRock continues to actively pursue receiving test data and procedures from these service providers regarding year 2000 compliance. CapRock will consider utilizing other service providers if the current service providers cannot demonstrate compliance to CapRock's satisfaction by June 30, 1999.

CapRock is still formulating contingency plans regarding significant suppliers of telecommunication services, which may suffer a year 2000-related failure. CapRock utilizes a number of different service providers and the contingency plan will include re-routing traffic from a vendor which experiences a year 2000 systems failure to one or more other vendors.

Disclaimer

The discussion of CapRock's efforts, and management's expectations, relating to year 2000 compliance are forward-looking statements and the dates on which CapRock believes it will complete such efforts are based upon management's best estimates. These estimates were derived using numerous assumptions regarding future events, including the continued availability of certain resources and other factors. We cannot assure you that these estimates will prove to be accurate, and our actual results could differ materially from those currently anticipated. Specific factors that could cause such material differences include, but are not limited to the availability and cost of personnel trained in year 2000 issues, the ability to identify, assess, remediate and test all relevant computer codes and embedded technology and similar uncertainties. In addition, variability of definitions of "compliance with year 2000" relating to products and services sold by CapRock may lead to claims whose impact on CapRock is currently not estimable. We cannot assure you that the aggregate cost of defending and resolving such claims, if any, will not materially adversely affect our results of operations.

ITEM 3. Quantitative and Qualitative Disclosure About Market Risk

CapRock is exposed to market risk from changes in marketable securities (which consist of money market and commercial paper). At March 31, 1999, marketable securities of CapRock were recorded at a fair value of approximately $47 million, with an overall weighted average return of approximately 5% and an overall weighted average life of less than 1 year. The marketable securities held by CapRock have exposure to price risk, which is estimated as the potential loss in fair value due to a hypothetical change of 50 basis points (10% of CapRock's overall average return on marketable securities) in quoted market prices. This hypothetical change would have an immaterial effect on the recorded value of the marketable securities.

CapRock is not exposed to material future earnings or cash flow fluctuations from changes in interest rates on long-term debt since 100% of its long-term debt is at a fixed rate as of March 31, 1999. The fair value of CapRock's long-term debt at March 31, 1999 was estimated to be $152.6 million based on the overall rate of the long-term debt of 12% and an overall maturity of 9.3 years compared to terms and rates currently available in long-term financing markets. Market risk is estimated as the potential decrease in fair value of CapRock's long-term debt resulting from a hypothetical increase of 120 basis points in interest rates (ten percent of CapRock's overall borrowing rate). Such an increase in interest rates would result in approximately a $9.5 million decrease in fair value of CapRock's long-term debt. To date, CapRock has not entered into any derivative financial instruments to manage interest rate risk and is currently not evaluating the future use of any such financial instruments.

CapRock conducts business in Aberdeen, Scotland, through a wholly owned subsidiary. However, the business transacted by this subsidiary is in the local functional currency. Therefore, CapRock does not currently have any exposure to foreign currency transaction gains or losses. All other business transactions are in U.S. dollars. To date, CapRock has not entered into any derivative financial instrument to manage foreign currency risk and is currently not evaluating the future use of any such financial instruments.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information pertaining to this item is incorporated herein from Part I. Financial Information (Item 2-Management's Discussion and Analysis of Financial Condition and Results of Operations-Contingencies).

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

3.1 Articles of Incorporation of the Company ((incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-4, as amended, SEC Registration No. 333-57365) (the "Merger Form S-4")).

3.2 Bylaws of the Company ((incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-4, as amended, SEC Registration No. 333-64699) (the "Exchange Offer Form S-4")).

4.1 Specimen certificate for the Common Stock of the Company (incorporated by reference to Exhibit 4.3 to the Merger Form S-4).

4.2 Indenture dated as of July 16, 1998, among CapRock Communications Corp., CapRock Telecommunications Corp., CapRock Fiber Network, Ltd., IWL (defined below), and PNC Bank, National Association, Trustee (Incorporated by reference to Exhibit 4.1 to the Exchange Offer Form S-4).

4.3 Registration Rights Agreement dated July 16, 1998, among CapRock Communications Corp., CapRock Telecommunications Corp., CapRock Fiber Network, Ltd., and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Donaldson, Lufkin & Jenrette Securities Corporation and BancOne Capital Markets, Inc. (Incorporated by reference to Exhibit 4.2 to the Exchange Offer Form S-4).

4.4 Form of Warrant Agreement between IWL and Cruttenden Roth Incorporated. (Incorporated by reference to Exhibit 1.2 to the IWL Communications, Incorporated ("IWL") Registration Statement on Form S-1, as amended, SEC Registration No. 333-22801.)

4.5 Registration Rights Agreement dated January 22, 1998 between IWL and Nera Limited. (Incorporated by reference to Exhibit 4.5 to the Merger Form S-4.)

4.6 Registration Rights Agreement dated January 22, 1998 by and among IWL, Thomas Norman Blair and Margaret Helen Blair. (Incorporated by reference to Exhibit 4.6 to the Merger Form S-4.)

10.1 Amendment to Addison Circle One Office Lease Agreement. (Incorporated by reference to Exhibit 10.60 to the Registration Statement on Form S-1, as amended, of the Registrant, File No. 333-74735.)

+27.1 Financial Data Schedule.

+ Filed herewith.

(b) Reports on Form 8-K

None.

CAPROCK COMMUNICAITONS CORP.

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

CAPROCK COMMUNICATIONS CORP.

By: /s/ MATTHEW M. KINGSLEY
Matthew M. Kingsley
Corporate Controller
(Principal Accounting Officer)

Date: May 14, 1999

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 1999

or

[ ] 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: 0-24581

CAPROCK COMMUNICATIONS CORP.
(Exact name of registrant as specified in its charter)

Texas	**75-2765572**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

15601 Dallas Parkway, Suite 700
Dallas, Texas 75248
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(972) 982-9500**

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

The number of shares of the registrant's Common Stock outstanding as of July 31, 1999 was 33,038,600.

CAPROCK COMMUNICATIONS CORP.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 1999

INDEX

CAPROCK COMMUNICATIONS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1999	1998	1999
Revenues:				
Carriers' carrier	$ 15,678,344	$ 25,310,226	$ 28,441,449	$ 49,762,391
Integrated services	3,855,662	4,643,366	8,124,550	9,147,678
Systems services	7,473,680	7,606,334	14,854,049	15,686,148
Total revenues	27,007,686	37,559,926	51,420,048	74,596,217
Cost of services	17,805,618	22,538,163	34,035,363	44,919,231
Gross profit	9,202,068	15,021,763	17,384,685	29,676,986
Operating expenses:				
Selling, general and administrative	5,124,429	12,461,013	9,559,679	25,011,962
Depreciation and amortization	1,186,691	1,857,185	2,250,368	3,337,348
Total operating expenses	6,311,120	14,318,198	11,810,047	28,349,310
Operating income	2,890,948	703,565	5,574,638	1,327,676
Interest expense	(476,312)	(5,880,292)	(958,327)	(10,135,767)
Interest income	7,247	2,156,543	38,951	3,001,594
Other income (expense)	104,376	(115,596)	104,924	(135,015)
Income (loss) before income taxes	2,526,259	(3,135,780)	4,760,186	(5,941,512)
Income tax expense (benefit)	1,011,539	(1,234,623)	1,887,318	(2,335,043)
Net income (loss)	$ 1,514,720	$ (1,901,157)	$ 2,872,868	$ (3,606,469)
Earnings (loss) per common share:				
Basic	$ 0.05	$ (0.06)	$ 0.10	$ (0.12)
Diluted	$ 0.05	$ (0.06)	$ 0.10	$ (0.12)
Weighted average shares outstanding:				
Basic	28,863,014	31,700,270	28,849,504	30,321,420
Diluted	29,481,602	31,700,270	29,465,246	30,321,420

See accompanying notes to consolidated financial statements.

CAPROCK COMMUNICATIONS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Six Months Ended June 30, 1998	1999
Cash flows from operating activities:		
Net income (loss)	$ 2,872,868	$ (3,606,469)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,250,368	3,337,348
Gain on sale of assets	(23,990)	(3,314)
Deferred income taxes	657,509	(2,569,446)
Equity earnings (loss) of unconsolidated joint venture	(83,750)	98,291
Compensation expense related to stock option grants	41,712	-
Amortization of debt issuance costs, included in interest expense	-	392,594
Changes in operating assets and liabilities:		
Accounts receivable and unbilled services	(2,131,659)	(26,059,905)
Inventory	(69,544)	52,143
Costs and earnings in excess of billings	(1,355,000)	6,905,134
Prepaid expenses and other	(1,405,769)	(1,371,682)
Accounts payable and accrued liabilities	3,270,013	5,013,586
Income taxes receivable	(332,238)	-
Billings in excess of costs and estimated earnings	211,997	2,848,647
Unearned revenue	(215,107)	66,538
Net cash provided by (used in) operating activities	3,687,410	(14,896,535)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(8,654,989)	(45,716,670)
Purchase of marketable securities	-	(283,613,169)
Proceeds from sale of marketable securities	-	73,199,025
Proceeds from disposal of property, plant and equipment	201,365	4,749,200
Investment in unconsolidated subsidiary	-	(6,787,651)
Purchase of ICEL	(609,822)	-
Net cash used in investing activities	(9,063,446)	(258,169,265)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	9,978,143	-
Principal payments on notes payable	(8,782,224)	-
Proceeds from issuance of senior notes, net of debt issuance	-	201,431,919
Proceeds from line of credit	31,611,788	-
Principal payments on line of credit	(30,162,438)	-
Purchase of treasury stock	-	(124,324)
Proceeds from issuance of common stock	61,790	82,564,088
Principal payments under capital lease obligations	(116,253)	-
Net cash provided by financing activities	2,590,806	283,871,683
Effect of exchange rate on cash and cash equivalents	6,892	(14,171)
Net increase (decrease) in cash and cash equivalents	(2,778,338)	10,791,712
Cash and cash equivalents at beginning of period	3,520,017	293,860
Cash and cash equivalents at end of period	$ 741,679	$ 11,085,572
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 943,377	$ 8,950,000
Cash paid for income taxes	$ 1,250,000	$ -
Non-cash investing activity:		
Issuance of stock for ICEL acquisition	$ 1,577,814	$ -

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation and Nature of Business

The consolidated financial statements include CapRock Communications Corp. ("CapRock" or the "Company") and its majority owned subsidiaries. The Company was formed on February 3, 1998, to serve as a holding company for the operations of CapRock Telecommunications Corp., a Texas corporation ("Telecommunications"), CapRock Fiber Network Ltd., a Texas limited partnership ("CapRock Fiber"), and IWL Communications, Incorporated, a Texas corporation, doing business as CapRock Services Corp. ("CapRock Services") and its wholly owned subsidiaries upon the consummation of the business combination of those companies (the "Combination"). All significant inter-company transactions are eliminated in the consolidation. The equity method is used to account for unconsolidated investments in companies in which the Company exercises significant influences over operating and financial policies, but does not have a controlling interest. On August 26, 1998, pursuant to the Agreement and Plan of Merger and Plan of Exchange dated February 16, 1998, as amended (the "Merger Agreement"), among the Company, Telecommunications, CapRock Fiber, CapRock Services and certain other parties, the Company completed the Combination (note 2).

The Company is a regional facilities-based integrated communications provider offering local, long distance, Internet, data and private line services to small and medium-sized businesses. The Company also provides switched and dedicated access, regional and international long distance, private lines and dark fiber to carrier customers. The Company is in the process of building an advanced fiber network throughout Texas, Louisiana, Oklahoma, Arkansas, New Mexico and Arizona. Additionally, the Company, through its wholly owned subsidiary – CapRock Services, provides communications solutions to customers with operations in remote, difficult-access regions. The Company markets its services through its internal sales representatives and a network of independent agents.

The accompanying consolidated financial statements, which should be read in conjunction with the consolidated financial statements and footnotes included in the Company's 1998 Annual Report on Form 10-K, have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the six months ended June 30, 1999 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 1999.

(2) Business Combination

On August 26, 1998, pursuant to the Merger Agreement, the Company completed the Combination with Telecommunications, CapRock Fiber and CapRock Services. Accordingly, the Consolidated Balance Sheets as of December 31, 1998 and June 30, 1999 and the Consolidated Statements of Operations and Consolidated Statements of Cash Flows for the six months ended June 30, 1998 and 1999 include Telecommunications, CapRock Fiber and CapRock Services as though these entities had always been a part of CapRock.

Upon the consummation of the Combination, all previously outstanding shares of CapRock Services common stock ceased to exist and each such share was converted into and became exchangeable for one share of CapRock common stock, and all previously outstanding shares of Telecommunications common stock ceased to exist, and each such share was converted into and became exchangeable for 1.789030878 shares of CapRock common stock and each one percent (1%) of CapRock Fiber interests issued and outstanding was exchanged for 63,194.54 shares of CapRock common stock. The Company issued

28,910,221 common shares in the Combination. Additionally, outstanding employee stock options of CapRock Services and Telecommunications were converted at the above exchange factors into options to purchase shares of CapRock common stock. The mergers and interest exchange constituted a tax-free reorganization and was accounted for as a pooling of interests.

In May 1998, CapRock Services changed its fiscal year end to coincide with the fiscal years of CapRock, Telecommunications and CapRock Fiber. The Consolidated Statement of Operations for the six months ended June 30, 1998 and 1999 combine the operating activity for all three entities for these periods.

The transactions between Telecommunications, CapRock Services and CapRock Fiber have been eliminated for all respective periods presented. Certain reclassifications were made to CapRock Services' financial statements to conform to CapRock's presentations.

The results of operations for the separate companies and the combined amounts presented in the Consolidated Financial Statements for periods prior to the Combination follow:

	Three Months Ended June 30, 1998	Six Months Ended June 30, 1998
Net sales:		
Telecommunications	$ 16,446,136	$ 32,223,086
CapRock Fiber	1,970,442	2,551,337
CapRock Services	8,591,108	16,645,625
Combined	$ 27,007,686	$ 51,420,048
Net income (loss):		
Telecommunications	$ 888,033	$ 1,785,274
CapRock Fiber	799,982	870,304
CapRock Services	(173,295)	217,290
Combined	$ 1,514,720	$ 2,872,868

3) Secondary Public Offering

On May 6, 1999, the Company entered into an underwriting agreement with various underwriters to sell 4,000,000 shares of its common stock at a price of $22.00 per share in a public offering. The registration statement for the equity offering was declared effective by the SEC on May 6, 1999 and closed on May 12, 1999. The net proceeds after the underwriter's discount and the expenses associated with offering from the sale of the stock were approximately $82.0 million.

4) Senior Note Offering

On May 18, 1999, the Company issued $210 million aggregate principal amount of private senior notes (the "1999 Senior Notes") due May 1, 2009. Interest on the 1999 Senior Notes is payable semi-annually in arrears on May 1 and November 1 of each year, commencing November 1, 1999, at the rate of 11½% per year. The Company received net proceeds from the offering, after deducting the initial purchasers' discount and expenses, of approximately $201.4 million. The 1999 Senior Notes are senior unsecured obligations and as such rank *pari passu* in right of payment with the Company's existing senior notes issued in July 1998 (the "1998 Senior Notes") and with all the Company's future unsecured and unsubordinated indebtedness. The indenture governing the 1999 Senior Notes has restrictions similar to those which currently exist for the Company's 1998 Senior Notes. The proceeds have been, and will be, used to fund capital expenditures for the construction of the fiber optic network, switching equipment and other capital expenditures and to expand its sales offices, for potential acquisitions and for general working capital purposes. Unutilized funds have been invested in short-term, high-grade investment securities classified as available for sale.

In July 1999, the Company filed an Exchange Offer Registration Statement with the SEC for the registration of $210 million of principal amount of its registered senior notes due May 1, 2009 (the "Exchange Notes") to be offered in exchange for the 1999 Senior Notes (the "Exchange Offer"). The Exchange Offer Registration Statement was declared effective by the SEC on July 30, 1999 and the Exchange Offer has commenced. The Exchange Offer expires on September 1, 1999, unless extended. The terms of the Exchange Notes will be identical in all material respects to the 1999 Senior Notes except that the Exchange Notes have been registered under the Securities Act of 1933, as amended.

5) **Earnings per share**

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1999	1998	1999
Numerator:				
Net income (loss)	$ 1,514,720	$ (1,901,157)	$ 2,872,868	$ (3,606,469)
Denominator:				
Denominator for basic earnings (loss) per share-weighted average shares outstanding	28,863,014	31,700,270	28,849,504	30,321,420
Effect of dilutive securities:				
Employee stock options	618,588	-	615,742	-
Denominator for diluted earnings (loss) per share-weighted average shares outstanding	29,481,602	31,700,270	29,465,246	30,321,420
Basic and diluted earnings (loss) per share	$ 0.05	$ (0.06)	$ .10	$ (.12)

6) Segment Reporting

In June 1997, the Financial Accounting Standards Board issued Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, which the Company adopted in 1998. The Company identifies such segments based on management responsibility. The Company measures segment profit as operating income, which is defined as income before interest expense and income taxes. The service revenue from the Telecommunications Division includes all revenues generated from the sale of telecommunications products to business and residential customers. These products include local, long distance, Internet, data and private line services. The Fiber Division includes the operating activity and the assets relating to the fiber build out. The revenues for the Fiber Division primarily relate to the sale of dark fiber through IRUs. The product and service revenue from the Services Division includes the revenues generated from the design, installation, leasing and sale of voice and data systems and products, primarily to companies in the oil and gas industry. The Corporate Division includes certain general and administrative functions and operating expenses. Information regarding operating segments is as follows:

	Three Months Ended June 30, 1998				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenues	$ 16,452,774	$ 1,963,804	$ 8,591,108	$ -	$ 27,007,686
Depreciation and amortization	252,941	211,926	721,824	-	1,186,691
Operating income	1,516,842	1,500,059	(125,953)	-	2,890,948
Total assets	16,593,523	13,724,448	29,728,156	2,000	60,048,127

	Three Months Ended June 30, 1999				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenues	$ 18,245,203	$ 11,708,389	$ 7,606,334	$ -	$ 37,559,926
Depreciation and amortization	802,803	286,184	768,198	-	1,857,185
Operating income	(5,666,467)	9,266,669	28,671	(2,925,308)	703,565
Total assets	38,193,619	81,443,332	27,964,220	331,931,694	479,532,865

	Six Months Ended June 30, 1998				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenues	$ 32,223,086	$ 2,551,337	$ 16,645,625	$ -	$ 51,420,048
Depreciation and amortization	484,361	396,853	1,369,154	-	2,250,368
Operating income	3,077,841	1,824,007	672,790	-	5,574,638
Total assets	16,593,523	13,724,448	29,728,156	2,000	60,048,127

	Six Months Ended June 30, 1999				
	Telecommunications	Fiber	Services	Corporate	Consolidated
Revenues	$ 35,549,874	$ 23,360,195	$ 15,686,148	$ -	$ 74,596,217
Depreciation and amortization	1,335,406	494,184	1,507,758	-	3,337,348
Operating income	(8,354,002)	16,964,543	372,540	(7,655,405)	1,327,676
Total assets	38,193,619	81,443,332	27,964,220	331,931,694	479,532,865

All revenue was derived from unaffiliated customers.

7) Fiber Build Agreement

In February 1999, the Company entered into a joint build arrangement with Enron Communications, Inc., a wholly owned subsidiary of Enron Corp., to jointly build approximately 1,050 miles of fiber optic network within the state of Texas. The build plan includes four conduits to be placed throughout the 1,050 miles, with one and one-quarter conduits to be owned and funded by CapRock and one and one-quarter conduits to be owned and funded by Enron Communications, Inc., and one and one-half conduits to be owned and funded by a limited partnership formed by CapRock and Enron Communications, Inc. The limited partnership will sell a specified amount of fiber usage rights and CapRock will own 48 fibers.

The total required capital contributions will depend on the costs to construct the segment. CapRock and Enron are committed to each contribute equally to fund the construction. The total construction costs for the 1,050 miles are estimated at approximately $100 million.

8) Fiber Network Expansion

In June 1999, the Company publicly announced that it extended the planned build out of its fiber network to include Arizona. When completed, this expansion will increase the Company's fiber network by approximately 600 route miles to approximately 6,100 route miles and connect Phoenix and Tucson, Arizona with El Paso, Texas and the Company's previously planned five-state network. The Company anticipates completion of the Arizona portion of its network in the first half of 2000.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with CapRock's consolidated financial statements and notes thereto for the year ended December 31, 1998. The Company believes that all necessary adjustments (consisting of normal recurring adjustments) have been included in the amounts stated below to present fairly the following quarterly information. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results for interim periods are not necessarily indicative of results to be expected for the year. In this Form 10-Q, the "Company," "CapRock," "we," "us" and "our" refer to CapRock and its subsidiaries, including Telecommunications, CapRock Fiber and CapRock Services, which are our three predecessor companies, as well as CapRock Network Services, L.P., CapRock Telecommunications Leasing Corp. and CapRock Design Services, L.P., unless the context otherwise requires.

Forward Looking Information

This Quarterly Report on Form 10-Q includes forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about CapRock, including:

- our anticipated growth strategies,
- anticipated trends in our business, including trends in technology and the growth of communications network products and services,
- future expenditures for capital projects, and
- our ability to continue to control costs and maintain quality.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including risks related to, among other things, building a fiber network (including obtaining the necessary rights-of-way, permits and regulatory approvals), supply and demand for data services, competition, the need for additional capital, debt and interest payment obligations, restrictions in our senior note indenture, rapid growth, dependence on local telephone companies and long distance carriers, our information systems, retention of key personnel, dependence on major customers, year 2000 problems, the continued integration of our predecessor companies, service interruptions, potential liability as an internet service provider and protection of our intellectual property.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Because of these risks, uncertainties and assumptions, the forward-looking events discussed in this Form 10-Q might not occur.

Overview

We own and operate a scalable long-haul fiber network which upon completion is expected to cover approximately 6,100 route miles throughout the Southwest region, which includes Texas, Louisiana, Arkansas, Oklahoma, New Mexico and Arizona. This fiber network supports the voice, data, bandwidth and dark fiber services we provide to our carrier and retail customers.

In August 1998, we announced that we had completed a business combination transaction in which our predecessor companies combined to form our Company as it exists today. The combination was accounted for as a pooling of interests. Accordingly, our consolidated results include our three predecessor companies (i.e., Telecommunications, CapRock Fiber and CapRock Services) as though these entities had always been a part of CapRock.

We intend to be the premier provider of carriers' carrier services and the leading facilities-based integrated communications provider in the Southwest region. To measure our progress, we classify our revenues in three categories: carriers' carrier, integrated services and systems services. Our carriers' carrier revenues include domestic and international long distance, bandwidth and dark fiber services sold to telecommunications carriers and other wholesale customers. Currently, we have over 120 carrier customers, including AT&T, MCI WorldCom, Sprint Corporation and Qwest Communications, as well as many regional independent companies such as Century Tel, Inc. and Lufkin Conroe Telephone. Our integrated services revenues reflect our local, long distance, Internet, data and private line products provided to over 7,000 small and medium-sized businesses on a single bundled bill. Lastly, our systems services revenues represent the voice and data systems and services we provide primarily to the oil and gas industry offshore in and along the Gulf of Mexico.

Our proximity to Mexico allows us to directly connect to the fiber networks of multiple Mexican telecommunications carriers. Subject to compliance with certain regulatory requirements, we are capable of providing dark fiber to these carriers at several border crossings enabling them to close open fiber rings in Mexico by using CapRock fiber on the U.S. side of the border. Additionally, our direct connect agreements with foreign carriers position us to capture increased levels of growing international traffic.

In addition, in February 1999, CapRock entered into a joint build agreement with Enron Communications, Inc. to jointly build approximately 1,050 miles of fiber network in Texas. Through this joint build arrangement, we will connect Amarillo, Lubbock, Dallas, Fort Worth, Waco, Bryan, Austin, San Marcos, San Antonio and Houston, Texas. The build plan includes four conduits to be placed throughout the approximately 1,050 miles, with one and one-quarter conduits to be owned and funded directly by us, one and one-quarter to be owned and funded by Enron Communications and one and one-half to be owned and funded by a limited partnership formed by us and Enron Communications. Our agreements with Enron Communications provide that the partnership will install 192 fibers in the first conduit and will sell 96 of the 192 fibers to be installed. Of the remaining 96 fibers, we will own 48 fibers and Enron Communications will own 48 fibers. The joint build arrangement provides several benefits, including reduction of construction costs, accelerated acquisition of right of way and franchise agreements, the majority of which are essentially in place, and the freeing up of resources to potentially accelerate the build of the remaining portion of the network.

Results of Operations

CapRock recognizes revenue from the following sources: carriers' carrier, integrated services and systems services.

Carriers' Carrier. Carriers' carrier revenue includes all carrier revenues generated from the sale of domestic and international switched services, from the sale of T-1 and DS-3 broadband capacity and from the sale and lease of dark fiber. The revenue generated from the international switched services represent minutes of long distance traffic terminating in foreign countries, but generated by domestic U.S.-based long distance carriers. Such revenues are recognized when the services are provided. The cost of revenues associated with these services is based primarily on the direct costs associated with owned and leased transmission capacity and the cost of transmitting and terminating traffic on other carriers' facilities. Commissions paid to sales representatives or agents to acquire customer call traffic are expensed in the period when associated call revenues are recognized.

We account for long-term construction contracts relating to the development of telecommunications networks for customers using the percentage-of-completion method, which would include the sale of fiber usage rights through IRUs and the related construction services associated with building the fiber network specified in the IRUs. Our revenues from IRUs are generated from the amount of fiber we build on our network in excess of that which we intend to retain for our own use. As a result, we expect that revenues from IRUs will diminish over time as our supply of excess fiber is sold. Progress under the percentage-of-completion method is measured based upon costs incurred to date compared with total estimated construction costs. Customers are billed based upon contractual milestones.

Integrated Services. Integrated services revenue includes all revenues generated from the sale of telecommunications products to business and residential customers. These products include local, long distance, Internet, data and private line services.

Systems Services. Systems services revenue includes revenues generated from the design, installation, leasing and sale of voice and data systems and products, primarily to companies in the oil and gas industry.

The following table represents the various sources of revenues:

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1999	1998	1999
Revenues:				
Carrier's carrier	$ 15,678,344	$ 25,310,226	$ 28,441,449	$ 49,762,391
Integrated services	3,855,662	4,643,366	8,124,550	9,147,678
Systems services	7,473,680	7,606,334	14,854,049	15,686,148
Total revenues	$ 27,007,686	$ 37,559,926	$ 51,420,048	$ 74,596,217

The following table sets forth, for the periods indicated, CapRock's statement of operations as a percentage of its operating revenues:

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1999	1998	1999
Revenues	100 %	100 %	100 %	100 %
Cost of services	66 %	60 %	66 %	60 %
Gross profit	34 %	40 %	34 %	40 %
Operating expenses:				
Selling, general and administrative	19 %	33 %	19 %	34 %
Depreciation and amortization	4 %	5 %	4 %	4 %
Total operating expenses	23 %	38 %	23 %	38 %
Operating income	11 %	2 %	11 %	2 %
Interest expense	(2)%	(16)%	(2)%	(14)%
Interest income	- %	6 %	- %	4 %
Other income (expense)	- %	- %	- %	- %
Income (loss) before income taxes	9 %	(8)%	9 %	(8)%
Income tax expense (benefit)	4 %	(3)%	4 %	(3)%
Net income (loss)	5 %	(5)%	5 %	(5)%

Three Months Ended June 30, 1998 Compared to Three Months Ended June 30, 1999

Revenues. Total revenues increased $10.6 million, or 39%, from $27.0 million during the three months ended June 30, 1998 to $37.6 million during the three months ended June 30, 1999. This increase was attributable to increases of 61% in carriers' carrier, 20% in integrated services and 2% in systems services revenue for the comparable periods.

Carriers' carrier revenue increased $9.6 million from $15.7 million during the three months ended June 30, 1998 to $25.3 million during the three months ended June 30, 1999. The 61% increase resulted primarily from the sale of IRUs and dark fiber leases. Fiber related revenues, attributed to dark fiber leases or IRUs, increased $9.7 million from $2.0 million during the three months ended June 30, 1998 to $11.7 million during the three months ended June 30, 1999. The Company anticipates recurring fiber related revenue relating to IRUs and dark fiber leases to continue through the remainder of the year. However, period-to-period fluctuations can be expected as this type of revenue is affected by the negotiation and terms of these contracts and the build out of our network. The Company derived approximately $5.1 million and $6.5 million or 19% and 17% of its revenue from traffic terminated to international countries for the three months ended June 30, 1998 and 1999, respectively. Revenue per minute for a majority of the international countries, particularly Mexico, continues to decrease as a result of deregulation in the countries and competition. We anticipate this pricing trend for international traffic to continue.

Integrated services revenue increased $788,000 from $3.8 million during the three months ended June 30, 1998 to $4.6 million during the three months ended June 30, 1999. The 20% increase was attributable to growth in the number of business and residential customers both from increased penetration in our existing markets and from the deployment of our network into new markets. The Company anticipates increased revenue from integrated services as its sales force for this revenue segment continues to grow.

Systems services revenue increased $133,000 from $7.5 million during the three months ended June 30, 1998 to $7.6 million during the three months ended June 30, 1999. The 2% increase was attributable to moderate growth associated with the leasing and sale of voice and data systems products and projects involving the engineering and integration of telecommunications systems and sales, service and maintenance of telecommunications equipment. The Company anticipates quarterly systems services revenue for the remainder of the year to remain at comparable levels.

Costs of Services. Cost of services increased $4.7 million, or 27%, from $17.8 million during the three months ended June 30, 1998 to $22.5 million during the three months ended June 30, 1999. The growth in cost of services was primarily attributable to the continued growth in all three revenue categories. The six percentage point increase in gross margin from 34% to 40% resulted primarily from favorable pricing attributable to the higher traffic and the sale of dark fiber. The increase in the gross margin during the three months ended June 30, 1999 was partially offset by lower margins attributable to Mexico and other international traffic, which carry a lower gross margin percentage. Gross margins may vary in future periods as a result of these and other factors.

Selling, General and Administrative Expenses. Selling, general and administrative expenses ("SG&A") include salaries, benefits, occupancy costs, commissions, sales and marketing expenses and administrative expenses. SG&A increased $7.3 million, or 143%, from $5.1 million during the three months ended June 30, 1998 to $12.4 million during the three months ended June 30, 1999. The increase resulted primarily from the additional personnel required to support CapRock's growth, advertising to increase name recognition and brand awareness and additional sales commission payments.

Depreciation and Amortization Expense. Depreciation and amortization expense increased $670,000, or 57%, from $1.2 million during the three months ended June 30, 1998 to $1.9 million during the three months ended June 30, 1999. This increase resulted primarily from purchases of additional equipment and other fixed assets to accommodate CapRock's growth. CapRock expects that depreciation and amortization expense will continue to increase in subsequent periods as CapRock continues to expand its facilities.

Interest Expense. Interest expense increased $5.4 million from $476,000 during the three months ended June 30, 1998 to $5.9 million during the three months ended June 30, 1999. The increase resulted from interest expense related to the Company's senior notes. See "-- Liquidity and Capital Resources."

Interest Income. Interest income increased $2.2 million from $7,000 during the three months ended June 30, 1998 to $2.2 million during the three months ended June 30, 1999. The increase was attributable to the interest and investment accretion associated with the marketable securities purchased with the proceeds from the Company's senior notes issued in July 1998 and May 1999. See " -- Liquidity and Capital Resources."

Income Taxes (Benefits). During the three months ended June 30, 1998, the Company incurred income tax expense of $1.0 million compared to an income tax benefit of $1.2 million for the three months ended June 30, 1999. The expense or benefit resulted from the income or loss for the respective periods. The effective tax rate for both periods was approximately 40%.

Net Income (Loss). Net income decreased $3.4 million from a net income of $1.5 million during the three months ended June 30, 1998 to a net loss of $1.9 million during the three months ended June 30, 1999 as a result of the factors discussed above.

Six Months Ended June 30, 1998 Compared to Six Months Ended June 30, 1999

Revenues. Total revenues increased $23.2 million, or 45%, from $51.4 million during the six months ended June 30, 1998 to $74.6 million during the six months ended June 30, 1999. This increase was attributable to increases of 75% in carriers' carrier, 13% in integrated services and 6% in systems services revenue for the comparable periods.

Carriers' carrier revenue increased $21.3 million from $28.4 million during the six months ended June 30, 1998 to $49.7 million during the six months ended June 30, 1999. The 75% increase resulted primarily from the sale of IRUs and dark fiber leases. Fiber related revenues, attributed to dark fiber leases or IRUs, increased $20.8 million from $2.6 million during the six months ended June 30, 1998 to $23.4 million during the six months ended June 30, 1999. The Company anticipates recurring fiber related revenue relating to IRUs and dark fiber leases to continue through the remainder of the year. However, period-to-period fluctuations can be expected as this type of revenue is affected by the negotiation and terms of these contracts and the build out of our network. The Company derived approximately $10.7 million and $12.1 million or 21% and 16% of its revenue from traffic terminated to international countries for the six months ended June 30, 1998 and 1999, respectively. Revenue per minute for a majority of the international countries, particularly Mexico, continues to decrease as a result of deregulation in the countries and competition. We anticipate this pricing trend for international traffic to continue.

Integrated services revenue increased $1.0 million from $8.1 million during the six months ended June 30, 1998 to $9.1 million during the six months ended June 30, 1999. The 13% increase was attributable to growth in the number of business and residential customers both from increased penetration in our existing markets and from the deployment of our network into new markets. The Company anticipates increased revenue from integrated services as its sales force for this revenue segment continues to grow.

Systems services revenue increased $832,000 from $14.9 million during the six months ended June 30, 1998 to $15.7 million during the six months ended June 30, 1999. The 6% increase was attributable to moderate growth associated with the leasing and sale of voice and data systems products and projects involving the engineering and integration of telecommunications systems and sales, service and maintenance of telecommunications equipment. The Company anticipates quarterly systems services revenue for the remainder of the year to remain at comparable levels.

Costs of Services. Cost of services increased $10.9 million, or 32%, from $34.0 million during the six months ended June 30, 1998 to $44.9 million during the six months ended June 30, 1999. The growth in cost of services was primarily attributable to the continued growth in all three revenue categories. The six percentage point increase in gross margin from 34% to 40% resulted primarily from favorable pricing attributable to the higher traffic and the sale of dark fiber. The increase in the gross margin during the six months ended June 30, 1999 was partially offset by lower margins attributable to Mexico and other international traffic, which carry a lower gross margin percentage. Gross margins may vary in future periods as a result of these and other factors.

Selling, General and Administrative Expenses. SG&A increased $15.5 million, or 162%, from $9.5 million during the six months ended June 30, 1998 to $25.0 million during the six months ended June 30, 1999. The increase resulted primarily from the additional personnel required to support CapRock's growth, advertising to increase name recognition and brand awareness and additional sales commission payments.

Depreciation and Amortization Expense. Depreciation and amortization expense increased $1.0 million, or 48%, from $2.3 million during the six months ended June 30, 1998 to $3.3 million during the six months ended June 30, 1999. This increase resulted primarily from purchases of additional equipment and other fixed assets to accommodate CapRock's growth. CapRock expects that depreciation and amortization expense will continue to increase in subsequent periods as CapRock continues to expand its facilities.

Interest Expense. Interest expense increased $9.2 million from $958,000 during the six months ended June 30, 1998 to $10.1 million during the six months ended June 30, 1999. The increase resulted from interest expense related to the Company's senior notes issued in July 1998 and May 1999. See "— Liquidity and Capital Resources."

Interest Income. Interest income increased $3.0 million from $39,000 during the six months ended June 30, 1998 to $3.0 million during the six months ended June 30, 1999. The increase was attributable to the interest and investment accretion associated with the marketable securities purchased with the proceeds from the Company's senior notes issued in July 1998 and May 1999. See " — Liquidity and Capital Resources."

Income Taxes (Benefits). During the six months ended June 30, 1998, the Company incurred income tax expense of $1.9 million compared to an income tax benefit of $2.3 million for the six months ended June 30, 1999. The expense or benefit resulted from the income or loss for the respective periods. The effective tax rate for both periods was approximately 40%.

Net Income (Loss). Net income decreased $6.5 million from net income of $2.9 million during the six months ended June 30, 1998 to a net loss of $3.6 million during the six months ended June 30, 1999 as a result of the factors discussed above.

Liquidity and Capital Resources

CapRock had cash and cash equivalents of $294,000 at December 31, 1998, as compared with $11.1 million at June 30, 1999 and marketable securities of $97.0 million at December 31, 1998 as compared to $307.4 million at June 30, 1999. CapRock had working capital of $102.5 million at December 31, 1998 as compared to working capital of $337.6 million at June 30, 1999. The increase in working capital was attributable to the Company's debt and equity offerings completed during the second quarter of 1999, discussed in more detail later in this section. This increase was partially offset by the utilization of working capital for the build out of the fiber optic network and increase in corporate overhead to support the Company's growth.

CapRock's cash flow provided from operating activities for the six months ended June 30, 1998 was $3.7 million as compared to $14.9 million used in operating activities during the six months ended June 30, 1999. The change was primarily attributable to an increase in accounts receivable and unbilled services, and the timing of certain capital expenditure payments to vendors relating to the fiber optic network build out. IRU transactions typically have longer payment terms than other accounts receivable activity due to contractual milestones that must be met before payments are made.

Cash used in investing activities during the six months ended June 30, 1998 was $9.1 million as compared to cash used in investing activities during the six months ended June 30, 1999 of $258.2 million. Capital resources used for the purchase of property, plant and equipment increased $37.0 million from $8.7 million during the six months ended June 30, 1998 to $45.7 million during the six months ended June 30, 1999. This increase primarily related to the purchase of telecommunications equipment and costs incurred with the build out of the fiber optic network. During the six months ended June 30, 1999, the Company used $283.6 million to invest in marketable securities while it received $73.2 million from the sale of marketable securities as compared to no such investments or sales during the six months ended June 30, 1998.

In January 1998, CapRock completed the acquisition of Integrated Communications and Engineering, Ltd., a communications systems integrator and maintenance provider in Aberdeen, Scotland. CapRock paid a total purchase price of approximately $2.2 million comprised of approximately $610,000 in cash and 207,266 shares of CapRock's Common Stock.

In July 1998, CapRock issued $150 million aggregate principal amount of its 1998 Senior Notes. Interest on the 1998 Senior Notes is payable semi-annually in arrears on January 15 and July 15 of each year, which commenced January 15, 1999, at the rate of 12% per year. A portion of the net proceeds from the offering of the 1998 Senior Notes was used to repay all existing debt obligations, totaling $26.8 million. The remaining proceeds, net of transaction costs, have been, or will be, used to fund additional capital expenditures for the construction of the Company's fiber optic network, switching equipment and other capital expenditures to expand its sales offices, for potential acquisitions and for general working capital purposes. Unutilized funds have been invested in short-term, high-grade investment securities classified as available for sale. The indenture governing the issuance of the 1998 Senior Notes contains certain restrictive operating and financial covenants, including restrictive covenants relating to borrowing additional money, paying dividends or making other distributions to our shareholders, limiting the ability of subsidiaries to make payments to us, making certain investments, creating certain liens on our assets, selling certain assets and using the proceeds from those sales for certain purposes, entering into transactions with affiliates and engaging in certain mergers or consolidations. All of the covenants are subject to a number of important qualifications and exceptions. These covenants may adversely affect CapRock's ability to finance its future operations or capital needs or to engage in other business activities that may be in the best interests of CapRock.

On May 6, 1999, CapRock entered into an underwriting agreement with various underwriters to sell 4,000,000 shares of its common stock at a price of $22.00 per share in a public offering. The registration statement for the equity offering was declared effective by the SEC on May 6, 1999 and closed on May 12, 1999. CapRock received net proceeds, after deducting underwriting discounts and expenses payable by CapRock, of approximately $82.0 million from the sale of its common stock.

On May 18, 1999, the Company issued $210 million aggregate principal amount of its 1999 Senior Notes. Interest on the 1999 Senior Notes is payable semi-annually in arrears on May 1 and November 1 of each year, commencing November 1, 1999, at the rate of 11½% per year. The Company received net proceeds from the offering, after deducting the initial purchasers' discount and estimated expenses, of approximately $201.4 million. The 1999 Senior Notes are senior unsecured obligations and as such rank *pari passu* in right of payment with the Company's existing 1998 Senior Notes and with all the Company's future unsecured and unsubordinated indebtedness. The proceeds have been, and will be, used to fund capital expenditures for the construction of the fiber optic network, switching equipment and other capital expenditures and to expand its sales offices, for potential acquisitions and for general working capital purposes. Unutilized funds have been invested in short-term, high-grade investment securities classified as available for sale. The indenture governing the 1999 Senior Notes has restrictions and covenants similar to those which currently exist for the Company's 1998 Senior Notes. All of the covenants are subject to a number of important qualifications and exceptions. These covenants may adversely affect CapRock's ability to finance its future operations or capital needs or to engage in other business activities that may be in the best interests of CapRock.

In July 1999, the Company filed an Exchange Offer Registration Statement with the SEC for the registration of $210 million of principal amount of its Exchange Notes to be offered in exchange for the 1999 Senior Notes. The Exchange Offer Registration Statement was declared effective by the SEC on July 30, 1999 and the Exchange Offer has commenced. The Exchange Offer expires on September 1, 1999, unless extended. The terms of the Exchange Notes will be identical in all material respects to the 1999 Senior Notes except that the Exchange Notes have been registered under the Securities Act of 1933, as amended.

CapRock is also considering various alternatives under a revolving credit facility. CapRock anticipates that this credit facility, if obtained, would be approximately $100 million. The proceeds from this credit facility would be used in a similar manner to the uses discussed for the notes issued by CapRock.

CapRock expects to require significant financing for future capital expenditure and working capital requirements. By the end of the year 2000, CapRock intends to build out its fiber optic network to approximately 6,100 route miles throughout the Southwest region. CapRock intends to use advanced fiber capable of supporting dense wave division multiplexing with an OC-48 backbone scalable to OC-192, and intends to install 96 fibers throughout most of its network and intends to retain on average 24 fiber strands. CapRock is burying three to four conduits throughout its network. CapRock currently estimates that its aggregate capital requirements will total approximately $250 million for 1999 and approximately $205 million for 2000, including expenditures to be made under the joint build arrangement with Enron Communications. Capital expenditures will be required to (1) fund the construction and operation of the fiber optic network, including the portion to be constructed through the joint build arrangement with Enron Communications, (2) fund the installation of voice and data switches, and (3) open sales offices and add sales support and customer service personnel in markets throughout Texas, Louisiana, Oklahoma, Arkansas, New Mexico and Arizona.

CapRock believes that its cash and marketable securities, cash flow from operations and sales of dark fiber will be sufficient to fund completion of its planned network. However, no assurances can be made as to whether additional sources of capital will be needed to complete the network and if such sources are needed, but CapRock is unable to obtain them, CapRock may have to curtail or delay the build out of its fiber network and its level of capital expenditures. CapRock's earnings before interest, income taxes, depreciation and amortization ("EBITDA") was $7.8 million for the six months ended June 30, 1998 and EBITDA was $4.7 million for the six months ended June 30, 1999. EBITDA for the three months ended June 30, 1998 and 1999 was $4.1 million and $2.6 million, respectively.

CapRock may require additional capital in the future for new business activities related to its current and planned businesses, or in the event it decides to make additional acquisitions or enter into joint venture and strategic alliances. Sources of additional capital may include cash flow from operations, public or private equity and debt financings, bank debt, vendor financings and indefeasible right to use contracts. In addition, CapRock may enter into joint construction agreements with carriers, thereby reducing its capital expenditure requirements. However, we cannot assure you that CapRock will be successful in producing sufficient cash flow or raising sufficient debt or equity capital to meet its strategic business objectives or that such funds, if available, will be available on a timely basis and on terms that are acceptable to CapRock. If CapRock is unable to obtain such capital, the build out of portions of its expanded network may be significantly delayed, curtailed or abandoned. In addition, CapRock may accelerate the rate of deployment of its network, which in turn may accelerate CapRock's need for additional capital. CapRock's actual capital requirements will also be affected, possibly materially, by various factors, including the timing and actual cost of the deployment of CapRock's network, the timing and cost of expansion into new markets, the extent of competition and the pricing of dark fiber and telecommunications services in its markets.

New Accounting Pronouncements

In June 1998, the FASB issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activity* ("SFAS 133") which requires that all derivatives be recognized in the statement of financial position as either assets or liabilities and measured at fair value. In addition, all hedging relationships must be designated, reassessed and documented pursuant to the provisions of SFAS No. 133. SFAS 133 is effective for fiscal years beginning after June 15, 2000. The adoption of SFAS 133 will not have an impact on CapRock's results of operations, financial position or cash flow.

Contingencies

CapRock is party to ordinary litigation incidental to its business. No currently pending litigation is expected to have a material adverse effect on our results of operations, financial condition or cash flow.

Year 2000

The year 2000 problem is the inability of a meaningful portion of the world's computers, software applications and embedded semiconductor chips to cope with the change of the year from 1999 to 2000. This issue can be traced to the infancy of computing, when computer data and programs were designed to save disk space by truncating the date field to just six digits (two for the day, two for the month and two for the year). Therefore, information applications automatically assumed that the two-digit year field represented a year within the 1900's. As a result of this, systems could fail to operate or fail to produce correct results when dates roll over to the year 2000.

State of Readiness

The year 2000 problem affects computers, software and other equipment used, operated or maintained by CapRock for itself and its customers. CapRock has substantially completed the process of assessing the potential impact of, and the costs of remediating, the year 2000 problem for its internal systems, facilities systems and equipment.

CapRock's business depends upon the operation of computer systems. CapRock has established a year 2000 committee made up of leaders from the operational areas of CapRock to assess CapRock's year 2000 problem. The committee has the involvement of senior management and the Board of Directors and its objectives are a top priority. CapRock has undertaken various initiatives intended to provide computer equipment and software that will function properly with respect to dates in the year 2000 and thereafter. Computer equipment and software include systems that are commonly thought of as Information Technology, or IT, systems, including accounting, data processing, telephone/PBX systems, scanning equipment and other miscellaneous systems, as well as systems that are not commonly thought of as IT systems, such as alarm systems, fax machines or other miscellaneous systems. Based upon its identification and assessment efforts to date, CapRock believes that certain computer equipment and software it currently uses will require replacement or modification. In addition, in the ordinary course of replacing computer equipment and software, CapRock will obtain replacements that are warranted by the manufacturer to be year 2000 compliant. CapRock currently estimates that the year 2000 identification, assessment, remediation and testing efforts will be substantially complete by August 31, 1999 and that such efforts will be completed before any currently anticipated impact on its computer equipment and software. CapRock has substantially completed the identification and assessment process. CapRock estimates that it currently has completed approximately 80% of the initiatives that it believes will be necessary to address potential year 2000 issues relating to its computer equipment and software. The projects comprising the remaining 20% of the initiative are in process and are expected to be complete on or about September 30, 1999.

Year 2000 Initiative	Time Frame
Identification and assessment regarding IT system issues	Completed
Remediation and testing regarding critical system issues	6/98-8/99
Identification, assessment, remediation and testing regarding desktop and individual system issues	6/98-8/99
Identification and assessment regarding non-IT system issues	8/98-8/99
Remediation and testing regarding non-IT systems	11/98-8/99
Contingency plans regarding critical systems	5/99-9/99

CapRock has mailed questionnaires to its significant vendors, service providers and customers with whom CapRock's systems electronically interface to determine the extent to which such interfaces and system processes are vulnerable to year 2000 issues and whether the products and services of such entities are year 2000 compliant. Substantially all of the parties have responded to the request and no significant matters were noted from these responses. However, the information contained in a number of the responses was generic in nature and did not specifically address the stage of their year 2000 initiatives. CapRock will continue seeking alternate vendors in advance of December 31, 1999 in the event satisfactory responses are not received.

CapRock has evaluated its systems and has identified the following systems and functions as mission critical:

- switching systems,

- network operations and fiber,
- satellite/microwave transmission equipment and satellite service providers,
- billing and call record collection systems, and
- supply chain (vendor provider of switched services).

Switching Systems:

Switching equipment is used to connect calls to their destination, while performing other advanced features and recording call record information for future billing. The switch opens or closes circuits or selects the paths or circuits to be used for the transmission of information. CapRock currently owns seven switches, three of which are physically located in Dallas, Texas (two are calling card platforms), two in Houston, Texas, one in Victoria, Texas and one in Phoenix, Arizona. CapRock also manages a switch in Jersey City, New Jersey. CapRock has completed the assessment and certain test procedures relating to the switching equipment and has identified certain non-compliant features, which were remediated through software upgrades provided by the respective manufacturers.

The remainder of the testing procedures for the switching equipment were substantially complete for all switches which were in service as of June 30, 1999. The switches which have not been placed in service will be subject to integrated test procedures prior to being placed in service. The test will incorporate the call collection processes and the interfaces with the billing system. The test will involve simulating date changes with the switch, such that the call records will be processed, rated and properly captured in the billing system as a billable transaction.

The test procedures consist of the following:

- process flow analysis,
- documentation of overall integrated test strategy,
- documentation and test case plans at an individual component level,
- committee agreement regarding the test plan,
- execution of the integrated test plan, and
- documentation regarding the results of test procedures.

Network Operations and Fiber:

CapRock currently owns and operates a 1,200-route mile fiber optic network, which was substantially completed by June 30, 1999. Approximately 400 miles were completed and placed in service in the first six months of 1999. The network is currently being expanded to 6,100 route miles (which CapRock expects to be completed by the end of the year 2000). The fiber optic network is designed to be scalable and will include network-advanced fiber, which is capable of supporting dense wave division multiplexing with an OC-48 backbone scalable to OC-192. The fiber optic network will include electronic equipment, which regenerates and transports the voice, data and other information. A detailed assessment of the network operations and fiber equipment has been performed and no significant non-compliant issues have been identified.

Satellite/Microwave Transmission Equipment and Satellite Service Providers:

CapRock utilizes satellite service providers to provide communications services to certain customers in remote locations. CapRock has sent correspondence to each of the three vendors supplying the satellite services. Each of the satellite service providers has responded. None of them noted any significant non-compliant issues. CapRock is continuing to pursue additional information and test data from these providers and will seek new providers, if necessary.

Billing and Call Record Collection Systems:

CapRock handles its provisioning, customer care, billing and traffic reporting functions on a proprietary software platform developed by RiverRock Systems, Ltd., a Texas limited partnership in which CapRock has a 49% ownership interest. These operations support systems, or OSS systems, and other back office systems are used to enter, schedule and track a customer's order from the point of sale to the installation and testing of service. The systems also include or interface with trouble management, inventory, billing, collection and customer service systems. The test procedures relating to the billing system and call record collection processes were performed in conjunction with the switching equipment test procedures and are substantially completed.

CapRock believes that substantially all of the hardware, database platform and operating systems impacting the billing system function will not be materially affected by Year 2000 issues.

Supply Chain (Vendor Provider of Switch Services):

CapRock is dependent upon a number of telecommunications carriers during the process of initiating and terminating calls to end-users. CapRock has sent correspondence to each of the significant suppliers regarding their year 2000 status and has received responses from substantially all of these suppliers. However, the information contained in a number of the responses was generic in nature and did not specifically address the stage of their year 2000 initiatives. CapRock will seek alternate suppliers in advance of December 31, 1999 in the event satisfactory responses are not received.

Based upon CapRock's current assessment and responses from vendors, CapRock believes that the risks associated with the year 2000 problem relating to domestic traffic and terminations are not significant. CapRock is in the process of evaluating the impact of year 2000 as it relates to the termination of traffic in international locations, and specifically third world and developing countries.

Non-IT Systems:

CapRock continues to evaluate non-information technology, or non-IT, systems. Based on current results and other factors, CapRock does not anticipate finding any material embedded system issues in its non-IT systems.

Costs

CapRock anticipates that costs of replacing or remediating non-compliant systems will not exceed $500,000 (remediation costs incurred to date have been less than $100,000). Such expenditures represent less than 1% of 1999 projected capital expenditures and will be funded out of cash flow from operations.

Risks

CapRock is in the process of preparing a comprehensive analysis of the problems and costs, including loss of revenues, that would be reasonably likely to result from the failure by CapRock or certain third parties to complete the efforts necessary to achieve year 2000 compliance on a timely basis.

CapRock has not yet completed its identification of the most likely worst case scenario. However, CapRock believes that the most reasonably likely worst case scenario would involve loss of revenues relating to traffic terminating in certain developing third world countries, which have not adequately prepared for the year 2000. CapRock relies upon certain vendors to supply international services and the possibility exists that some of the traffic in these developing third world countries may not be able to be completed. The estimated loss of revenue, if any, has not been determined, and we may not be able to identify the amount of any loss by the year 2000. Depending on the systems affected, the failure of any contingency plans developed by CapRock, if implemented, could have a material adverse effect on CapRock's financial condition and results of operations.

Contingency Plans

CapRock's year 2000 contingency planning effort is designed to provide immediate response and subsequent recovery from any unplanned business interruption due to failure of technical infrastructure resulting from the year 2000. Contingency planning is a process that aids in determining the most effective actions, identifies when contingent actions should be taken and helps to ensure those resources necessary for response are available.

The contingency plans include a proactive analysis of countries that are actively pursuing year 2000 remediation. CapRock is using outside consultants to assist with an analysis of countries that are not actively pursuing year 2000 compliance and remediation. Contingency plans include identifying these countries noted with substantial risk and potentially redirecting the sales and marketing efforts to other countries less likely to be affected by year 2000 problems.

CapRock is still formulating contingency plans relating to the use of the satellite service providers. CapRock continues to actively pursue receiving test data and procedures from these service providers regarding year 2000 compliance. CapRock will consider utilizing other service providers if the current service providers cannot demonstrate compliance to CapRock's satisfaction by August 31, 1999.

CapRock is still formulating contingency plans regarding significant suppliers of telecommunication services, which may suffer a year 2000-related failure. CapRock utilizes a number of different service providers and the contingency plan will include re-routing traffic from a vendor which experiences a year 2000 systems failure to one or more other vendors. These contingency plans are expected to be completed by August 31, 1999.

Disclaimer

The discussion of CapRock's efforts, and management's expectations, relating to year 2000 compliance are forward-looking statements and the dates on which CapRock believes it will complete such efforts are based upon management's best estimates. These estimates were derived using numerous assumptions regarding future events, including the continued availability of certain resources and other factors. We cannot assure you that these estimates will prove to be accurate, and our actual results could differ materially from those currently anticipated. Specific factors that could cause such material differences include, but are not limited to, the availability and cost of personnel trained in year 2000 issues, the ability to identify, assess, remediate and test all relevant computer codes and embedded technology and similar uncertainties. In addition, variability of definitions of "compliance with year 2000" relating to products and services sold by CapRock may lead to claims whose impact on CapRock is currently not estimable. We cannot assure you that the aggregate cost of defending and resolving such claims, if any, will not materially adversely affect our results of operations.

ITEM 3. Quantitative and Qualitative Disclosure About Market Risk

CapRock is exposed to market risk from changes in marketable securities (which consist of money market and commercial paper). At June 30, 1999, marketable securities of CapRock were recorded at a fair value of approximately $307 million, with an overall weighted average return of approximately 5% and an overall weighted average life of less than 1 year. The marketable securities held by CapRock have exposure to price risk, which is estimated as the potential loss in fair value due to a hypothetical change of 50 basis points (10% of CapRock's overall average return on marketable securities) in quoted market prices. This hypothetical change would have an immaterial effect on the recorded value of the marketable securities.

CapRock is not exposed to material future earnings or cash flow fluctuations from changes in interest rates on long-term debt since 100% of its long-term debt is at a fixed rate as of June 30, 1999. The fair value of CapRock's long-term debt at June 30, 1999 was estimated to be $366.6 million based on the overall rate of the long-term debt of 11.71% and an overall maturity of 9.5 years compared to terms and rates currently available in long-term financing markets. Market risk is estimated as the potential decrease in fair value of CapRock's long-term debt resulting from a hypothetical increase of 117 basis points in interest rates (ten percent of CapRock's overall borrowing rate). Such an increase in interest rates would result in approximately a $22.6 million decrease in fair value of CapRock's long-term debt. To date, CapRock has not entered into any derivative financial instruments to manage interest rate risk and is currently not evaluating the future use of any such financial instruments.

CapRock conducts business in Aberdeen, Scotland, through a wholly owned subsidiary. However, the business transacted by this subsidiary is in the local functional currency. Therefore, CapRock does not currently have any exposure to foreign currency transaction gains or losses. All other business transactions are in U.S. dollars. To date, CapRock has not entered into any derivative financial instrument to manage foreign currency risk and is currently not evaluating the future use of any such financial instruments.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information pertaining to this item is incorporated herein from Part I. Financial Information (Item 2-Management's Discussion and Analysis of Financial Condition and Results of Operations-Contingencies).

Item 2. Changes in Securities and Use of Proceeds

On May 6, 1999 (the "Effective Date"), the Company's Registration Statement on Form S-1 (Registration No. 333-74735) relating to its public offering (the "Offering") was declared effective and the offering of up to 4,600,000 shares of the Company's Common Stock covered by such Registration Statement commenced. The Offering was managed by Merrill Lynch & Co., as the representative (the "Representative") of the several underwriters (the "Underwriters") of the Offering. Pursuant to the Offering, 4,000,000 shares were sold on May 12, 1999 (the "Offering Date"). From the Effective Date of the Offering until June 30, 1999, total expenses of approximately $6.0 million were incurred for the Company's account in connection with the Common Stock sold in the Offering, which expenses consisted of: (i) $5.3 million representing underwriters discounts and commissions paid to the Underwriters; and (ii) other offering expenses, including without limitation attorney's fees, accountant's fees, printing costs and filing fees, of approximately $750,000. None of such expense payments were direct or indirect payments to directors or officers of the Company or their associates or to persons owning 10 percent or more of any class of equity securities of the Company or to affiliates of the Company. The net offering proceeds of the 4,000,000 shares sold by the Company in the Offering, after deducting such expenses, was approximately $82.0 million through June 30, 1999. As of June 30, 1999, the Company had expended $10.2 million on infrastructure, property, plant and equipment. The remaining $71.8 was invested in high-grade liquid securities classified as available for sale pending application of such proceeds by the Company.

Information pertaining to working capital restrictions and other limitations upon the payment of dividends is incorporated herein from Part I. Financial Information (Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources).

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

The Company held its Annual Meeting of Shareholders on May 3, 1999. At the meeting, the shareholders voted in favor of electing as directors the seven nominees named in the Proxy Statement dated April 20, 1999. Also at the meeting, the shareholders voted in favor of ratifying the appointment of KPMG LLP as the Company's independent accountants for the 1999 fiscal year. The number of votes cast for each item was as follows:

I. Election of Directors

Name of Nominee	For	Withheld
Jere W. Thompson, Jr.	23,659,997	--
Ignatius W. Leonards	23,659,997	--
Timothy W. Rogers	23,659,997	--
Mark Langdale	23,659,997	--
Christopher J. Amenson	23,659,997	--
John R. Harris	23,659,997	--
Richard G. Ellenberger	23,659,997	--

II. Ratification of KPMG LLP as Independent Accountants

For	Against	Abstain
23,659,997	--	--

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

3.1 Articles of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-4, as amended, SEC Registration No. 333-57365 (the "Merger Form S-4")).

3.2 Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-4, as amended, SEC Registration No. 333-64699 (the "1998 Exchange Offer Form S-4")).

4.1 Specimen certificate for the Common Stock of the Company (incorporated by reference to Exhibit 4.3 to the Merger Form S-4).

4.2 Indenture dated as of July 16, 1998, among CapRock Communications Corp., CapRock Telecommunications Corp., CapRock Fiber Network, Ltd., IWL (defined below), and PNC Bank, National Association, Trustee (incorporated by reference to Exhibit 4.1 to the 1998 Exchange Offer Form S-4).

4.3 Registration Rights Agreement dated July 16, 1998, among CapRock Communications Corp., CapRock Telecommunications Corp., CapRock Fiber Network, Ltd., and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Donaldson, Lufkin & Jenrette Securities Corporation and BancOne Capital Markets, Inc. (incorporated by reference to Exhibit 4.2 to the 1998 Exchange Offer Form S-4).

4.4 Form of Warrant Agreement between IWL and Cruttenden Roth Incorporated (incorporated by reference to Exhibit 1.2 to the IWL Communications, Incorporated ("IWL") Registration Statement on Form S-1, as amended, SEC Registration No. 333-22801).

4.5 Registration Rights Agreement dated January 22, 1998 between IWL and Nera Limited (incorporated by reference to Exhibit 4.5 to the Merger Form S-4).

4.6 Registration Rights Agreement dated January 22, 1998 by and among IWL, Thomas Norman Blair and Margaret Helen Blair (incorporated by reference to Exhibit 4.6 to the Merger Form S-4).

4.7 Registration Rights Agreement dated May 18, 1999 among the Company, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Chase Securities Inc., Bear, Stearns & Co. Inc., Donaldson, Lufkin & Jenrette Securities Corporation and Goldman, Sachs & Co. (incorporated by reference to Exhibit 4.7 to the Registration Statement on Form S-4, as amended, SEC Registration No. 333-82557 (the "1999 Exchange Offer Registration Statement")).

4.8 Indenture dated as of May 18, 1999 between the Company and Chase Manhattan Trust Company, National Association, Trustee (incorporated by reference to Exhibit 4.8 to the 1999 Exchange Offer Registration Statement).

10.1 Note Purchase Agreement dated May 13, 1999 by and among the Company and various initial purchasers (incorporated by reference to Exhibit 10.61 to the 1999 Exchange Offer Registration Statement).

10.2 Form of Exchange Agent Agreement by and between the Company and Chase Manhattan Trust Company, National Association, Trustee (incorporated by reference to Exhibit 10.62 to the 1999 Exchange Offer Registration Statement).

10.3 Form of Purchase Agreement for May 1999 equity offering (incorporated by reference to Exhibit 1.1 to the Registration Statement on Form S-1, as amended, of the Company, File No. 333-74735).

+27.1 Financial Data Schedule.

+ Filed herewith.

(b) Reports on Form 8-K

Current Report on Form 8-K dated June 11, 1999 regarding expansion of fiber network.

CAPROCK COMMUNICATIONS CORP.

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

CAPROCK COMMUNICATIONS CORP.

By: /s/ MATTHEW M. KINGSLEY
Matthew M. Kingsley
Corporate Controller
(Principal Accounting Officer)

Date: August 4, 1999