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QUÉBEC-TÉLÉPHONE

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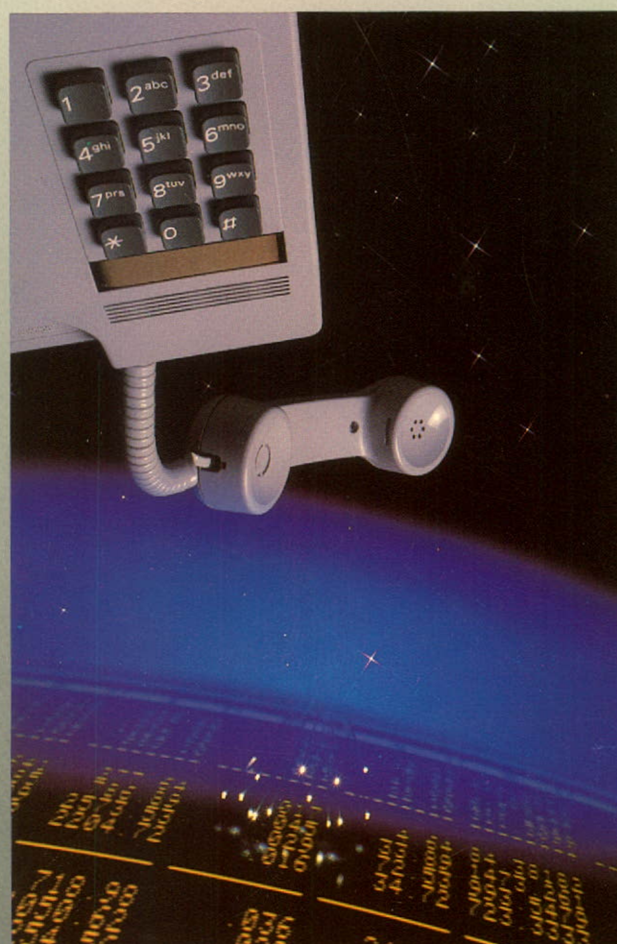

59th ANNUAL REPORT

CORPORATE PROFILE

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On peut obtenir des exemplaires français de ce rapport à l'adresse suivante:

Le secrétaire
Québec-Téléphone
6, rue Jules-A.-Brillant
Rimouski (Québec)
G5L 7E4

As a link in a worldwide network, Québec-Téléphone guarantees since 1927 permanent and dependable services to its subscribers in their communications between themselves and with the rest of the world. To do so, the Company applies the best proven technologies to adequately serve more than half a million people living in areas around Québec City and in the Lower St.Lawrence, Gaspé and North Shore regions.

With the dedication of its 2,000 employees as its main asset, Québec-Téléphone asserts its competence in sectors as diversified as telephony, computer communications, word processing, mobile radio and paging systems as well as the transmission of data, radio and television programs.

The Company's continued leadership as provider of a wide range of products and services meets the expectations and needs of its different stakeholders: for customers, the benefits of highly efficient communications equipment; for shareholders, a fair return on their investments; for employees, sound career opportunities.

HIGHLIGHTS

		1985	1984	Increase (Decrease)
Financial statements (thousands of dollars)	Operating revenues	$ 176,525	$ 164,066	7.6 %
	Operating expenses	130,794	120,138	8.9 %
	Net income	21,663	19,345	12.0 %
	Dividends on Common shares	13,908	12,334	12.8 %
	Gross capital expenditures	39,255	31,734	23.7 %
	Telecommunications property, at cost*	506,072	477,267	6.0 %
	Total assets	336,633	332,886	1.1 %
Financial statistics	Earnings per Common share	$ 3.97	$ 3.71	7.0 %
	Dividends declared per Common share	$ 2.69	$ 2.53	6.3 %
	Common equity per share*	$ 27.10	$ 25.64	5.7 %
	Return on average Common share equity	15.0 %	15.0 %	—
	Return on average invested capital	12.6 %	13.0 %	(3.1 %)
Other statistics	Average number of Common shares (thousands)	5,170	4,870	6.1 %
	Number of Common shareholders*	5,806	6,312	(8.0 %)
	Subscriber lines in service*	221,471	215,751	2.7 %
	Terminals in service*	290,597	290,892	(0.1 %)
	Toll messages handled (thousands)	32,903	31,099	5.8 %
	Number of employees*	1,972	1,993	(1.1 %)

* At December 31

Québec-Téléphone attained unequaled results in 1985. Operating revenues exceeded 175 million dollars and net income totalled 21 million dollars. We attribute this strong performance to our ongoing efforts to control operating costs and continued growth in the use of our services by customers. For example, nearly 33 million long-distance messages have originated from our territory in 1985.

A Modern Network

The transmission network carrying this growing volume of communications covers a territory of 272,000 square kilometers (105,000 square miles). Considering that 18 % of this network is already converted to digital technology and that this figure will be 60 % by 1989, the vigour of our modernization program can be fully appreciated.

Nearly 70 % of our switching network's access lines will be served by digital equipment by the end of the present decade. At that time, single-line service will be available to 92 % of our customers living in rural areas. The penetration of this service which was 64 % in 1984 reached 72 % in 1985 and will attain 85 % in 1986.

This data is clearly indicative of our determination to rapidly implement the most innovative technologies. By investing each year around 40 million dollars in the expansion and modernization of our infrastructures, we increase the capacity of our switching systems through digitization and the versatility of our transmission network through fiber optics. These advanced systems will permit easier integration of voice, data and images on the telephone network; they will also enable us to increase the profitability of our investments in switching and transmission facilities.

Continued innovation seems more and more essential for serving our customers efficiently. To this effect, we concluded several commercial agreements with renowned manufacturers during the year 1985.

A Global Market

At the dawn of the information age, the evolution of communications needs offers a considerable challenge. In the past, telecommunications, data processing and office automation were three distinct entities. Each activity was carried out in its own well-defined market. But the situation is changing radically. From now on, these functions are merging to form an intelligent digital universe. In this new environment, no telecommunications company can be successful by focusing only on one narrow, limited field. Competition keeps growing at a time when everyone tries to outdo his rivals through innovation.

In order to successfully meet this competition, we constantly strive to make our procedures even more flexible to assure continued responsible management of our assets. Our present leadership is attributable to the emphasis we placed on our contacts with customers, a fundamental objective we have been trying to achieve throughout 1985 with the creation of eight new regional distribution agencies.

A Year of Synergy

By mid-1985, several departments from different work locations throughout Rimouski were regrouped in the recently-enlarged headquarters building. A staff reorganization completed in September contributed to a more efficient administrative structure with the elimination of one supervisory level. Our employees showed adaptability and willingness to cooperate in the implementation of these changes which should improve our collective effectiveness.

The enthusiasm and team spirit which marked one of our major successes in 1985 are noteworthy: the integrated digitization of several switching offices on the south shore of the St.Lawrence River in the vicinity of Québec City. The success of these cutovers which required two years of minutely-detailed preparation is largely attributable to the harmonious combination of expertise and energy deployed by our dedicated personnel.

In Quest of Excellence

The strategy to better combine our personnel efforts and our Company's corporate objectives requires nothing less than a total commitment towards excellence. This is much more than a simple efficiency program but rather a global effort which focuses on three major elements: a continuous comparison with competitors, a search to increase the quality of our services and the dedicated support of all our employees.

In the development of our markets, our goal is definitely first place. And the will to fully satisfy our customers' expectations justifies the development of aggressive programs to promote the quality of our services at the expense of a generalized training and motivation effort. The ultimate objective is to produce zero-defect work in all areas of the organization.

Our successes are not due to hazard. They are based, as in the past, on the energy and dynamism deployed daily by our 2,000 employees towards the efficient operation of Québec-Téléphone. On behalf of the members of the Board, I wish to express our admiration and appreciation to them for a job well done. I also wish to extend our gratitude to three directors who retired from the Board after several years of invaluable guidance and judicious advice. Many thanks to Messrs. Roger Charbonneau, Roger DeSerres and William E. Starkey.

Raymond Sirois
Chairman of the Board,
President and Chief Executive Officer

The Chairman of the Board,
President and
Chief Executive Officer

Raymond Sirois

Raymond Sirois
February 5, 1986

The talent, ingenuity and dedication of Québec-Téléphone's 2,000 employees assure continued success in the efficient serving of its markets. In a business environment more attentive to the human element, this key resource was prioritized during the year.

Personnel Appraisal

Québec-Téléphone was the recipient of an IRIS trophy, awarded annually by the *Association des professionnels en ressources humaines du Québec*. The prize was presented in the category of large companies for the development and implementation of an innovative management system: the Company's appraisal program for management and professional employees.

From its introduction, this new assessment tool was recognized within the Company as a consistent and objective process centered on results to be attained and relying on measurable performance indices. The system covers the identification of employees' development needs relative to their present jobs and career plans. Favoring the acquisition of new management abilities, the program was well received by supervisors and their employees who find in its use concrete means to increase the dynamism and effectiveness of their dialogue.

Training

Pursuing its major objective to improve and adapt the technical and administrative competence of employees, the Training Department designed a number of innovative programs in 1985. Several new administrative courses were designed and implemented using diversified techniques including presentations, lectures, workshops, seminars, case studies and role playing. The main themes were labour relations, appraisal and development interviews, economic studies, speech delivery and written reports.

The concern for promoting optimal utilization of office automation capabilities led to the development of six new courses intended for secretaries and clerks. The priority was given to

Using video in support of administrative training.

word processing techniques while a second phase will cover electronic mail methodology.

The introduction of new technologies requires an intensification of technical training. The needs to develop new skills and knowledge were met in such sectors as installation and repair of new electronic telephone systems, updating of EPABX software as well as interfacing and multiplexing techniques for new fiber-optic networks.

Reorganization

In September 1985, Québec-Téléphone introduced a modified, leaner management structure eliminating one supervisory level and bringing decision centers closer to the action. The new organization helped better define the respective lines of authority of managers and professional employees. The new structure also meets two major needs: adapting to the requirements of new technology and adjusting tasks to new trends within the communications market.

Retirement

In line with the reorganization, an optional early retirement plan was offered to 40 management employees 55 years of age or older. More than one third of them accepted the Company's offer.

Moreover, improvements were brought to the pension plan of all managers and professionals not covered by a collective agreement. Effective September 1985, the pension formula was increased from 1.75 % to 2 % for each year of service giving right to pension. Also, the pension for the surviving spouse was increased from 33 ⅓ % to 50 %, with a retroactive effect for those presently participating in the plan.

The retirement preparation program developed by Québec-Téléphone for its 50-year old employees and their spouse fostered great enthusiasm. In assessing the series of courses, future retirees insisted they were better informed about all aspects of their future retirement life and more aware of the importance of planning for its success.

Word processing, the first phase of office automation.

Handicapped Persons

In the fall of 1985, the Company introduced a plan to recruit and integrate handicapped persons. This was accomplished in the spirit of the law governing its application. The object of the plan is to remove the psychological and material barriers which hinder the normal development of any person's abilities in any job appropriate to his or her condition. The measures contained in this plan will be gradually introduced over a period ending December 31, 1987.

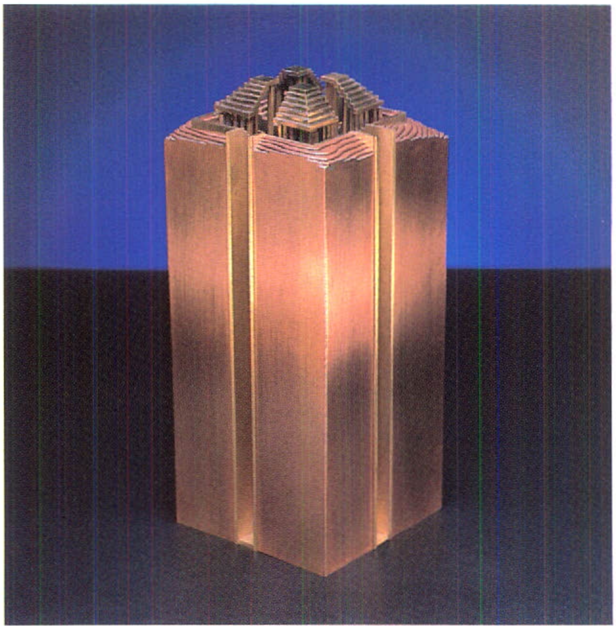
Labour Relations

The collective agreements covering three employee groups including telephone operators, clerical employees and technicians and craft workers, represented by the *Syndicat des employés d'exécution de Québec-Téléphone* expired on November 12, 1985. The negotiation process was initiated on November 11, 1985. The Labour General Commissioneer had previously approved a request for affiliation of these groups to the Canadian Union of Public Employees to form local 5044 (CUPE). Certification units nevertheless remain the same.

Employees on Loan

In order to participate more actively in the national planning of telecommunications services and to encourage certain persons to acquire enriching experiences, Québec-Téléphone loaned three of its employees to Telecom Canada. During a three-year term, they will share their skills and knowledge with colleagues from various Canadian provinces. Participating in the analysis of new situations in a multidisciplinary context, these employees will acquire precious expertise and a vision which should be beneficial to Québec-Téléphone upon their return with the Company.

The 1985 IRIS award of excellence in recognition for innovative management of human resources



To better demonstrate its presence and involvement in its service areas, Québec-Téléphone emphasized the projection of its corporate image in the medias as well as its support to cultural and educational organizations.

Reaching the Youth

Under the International Year of the Youth celebrated in 1985, several company programs were intensified. More specifically, some 50 summer jobs were created. The Company also participated in various Career Seminars to improve communications between employers and future graduates. Besides offering scholarships, it opened its doors to students looking for help and reference material for their school work and research on communications. Québec-Téléphone also contributed to various university foundations and sponsored numerous activities in the field of arts and sciences.

Public Communications

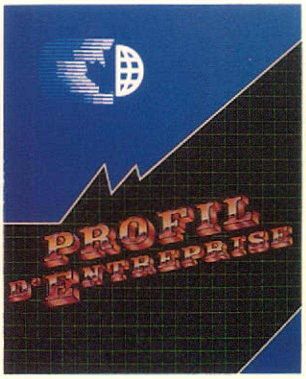
Through an intensive promotion campaign on the *Télé-Capitale* network, Québec-Téléphone outlined the scope of its activities for a large TV audience in Québec, Rimouski, Sept-Îles and Carleton. The Company also sponsored on three CBC regional stations (Rimouski, Matane and Sept-Îles) a series of twelve TV programs on wildlife preservation and the protection of natural sites in Eastern Québec.

Moreover, the Company produced an appealing corporate brochure, increased the content of its quarterly business magazine and advertised in national publications. It also participated to a greater number of commercial shows in most cities within its territory.

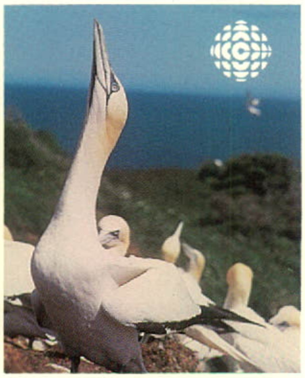
Internal Communications

The adjustment of the Company's employee newspaper to the expectations of its readers led to the addition in 1985 of a feature on excellence at work. Through a survey of 200 randomly-chosen persons within the Company, it was possible to identify those employees who, in the opinion of their colleagues, are exceptional performers. The article includes comments of exemplary employees on their job motivation. So far, the quality of attention given to customers and a genuine concern for their communications needs are frequently highlighted.

Youth movements deliver telephone directories to support their educational activities.



An intensive campaign on the Télé-Capitale TV network to highlight the Company's activities.



Programs on wildlife and natural sites sponsored by Québec-Téléphone on the CBC French TV network.

Québec-Téléphone maintains its leadership not only through the quality of its services and products to its 205,000 subscribers but also for its numerous points of service in several regions. A constant thrust towards innovation allows the Company to remain the major supplier of telecommunications services within its territory.

Plug-in Telephones

The program to convert telephone connections to the plug-in concept has already attained more than 100,000 installations. The 50,000 jacks and mini-plugs installed in 1985 will bring about substantial savings in annual operating expenses.

The recent creation of eight agencies for distributing and exchanging leased telephones has significantly encouraged the participation of subscribers in the thrifty management of their service.

Touch Calling

Following an intensive promotional campaign, over 12,000 subscribers changed from standard dial service to lines specially equipped for push-button calling. The customer attraction to this service was emphasized by the appearance and functionality of the Harmony and Unity 1 telephone sets which met outstanding public acceptance.

Designed to evolve in rhythm with network modernization and user needs, these two new products of Canadian technology were launched with strong marketing support. Their immediate acceptance in each household precedes impending arrival of various modems required for the introduction of future computerized services.

Fixed-Rate Agreement

New service rate offerings for certain telephone systems were introduced to provide the Company's business customers with greater flexibility in planning their long-term equipment costs. Consequently, favorable and competitive terms and conditions were established in the agreements. For example, these fixed-rate agreements were successfully used in 75 % of contracts signed in 1985 as compared to 55 % in 1984.

These two-tier agreements include a certain number of advantages normally found in purchasing agreements: pre-established rates,

The cordless telephone, an attractive and functional companion.

A marketing priority: stimulating long-distance calling through contests.

payments over a limited time period and protection against rate increases. They also retain several strong points of the existing leasing agreements: system maintenance by competent technicians throughout the territory, replacement guarantee and continuous personnel training.

Under the new rate structure, customers, large and small, may acquire their equipment at a rhythm compatible with their financial capacity, by exercising their purchase option at any time.

Equipment Demonstration

Since communications systems have become an essential element of productivity, several company heads now demand demonstrations on the operation of these systems. In response, the Sales group of the Marketing Department developed Communications Showrooms first in Sainte-Marie-de-Beauce, then in Rimouski where customers are invited and briefed in a most convenient environment.

New Partnership

In January 1985, a million-dollar distribution agreement was concluded with TIE/communications Canada Inc. for the sale of Mercury digital PABX systems made in Canada. The commitment of TIE Canada to the commercial and technical support of its products combined with the strong market position of Québec-Téléphone should result in a lasting and mutually beneficial relation.

Digital Paging Services

In the coverage areas of Québec and Rimouski, the *Messager* service was equipped with digital controls. Each of the two areas can now serve 7,000 units instead of 1,000 and provide users with new service options.

Datapac Service

At the end of 1985, Québec-Téléphone introduced the marketing of Datapac in six exchanges of its territory: Baie-Comeau, Gaspé, New Carlisle, Rimouski, Saint-Georges and Sept-Îles. Through this new service, customers transmitting small volumes of data will be able to use an economical shared network for packet switching. The Datapac offering is the first step of a vast program to promote voice and data transmission services (Envoy 100 and iNet 2000) which will mark the year 1986.

A sound selection of products guarantees dependability at the best possible cost.

The range of our business telephones: an essential element of productivity.

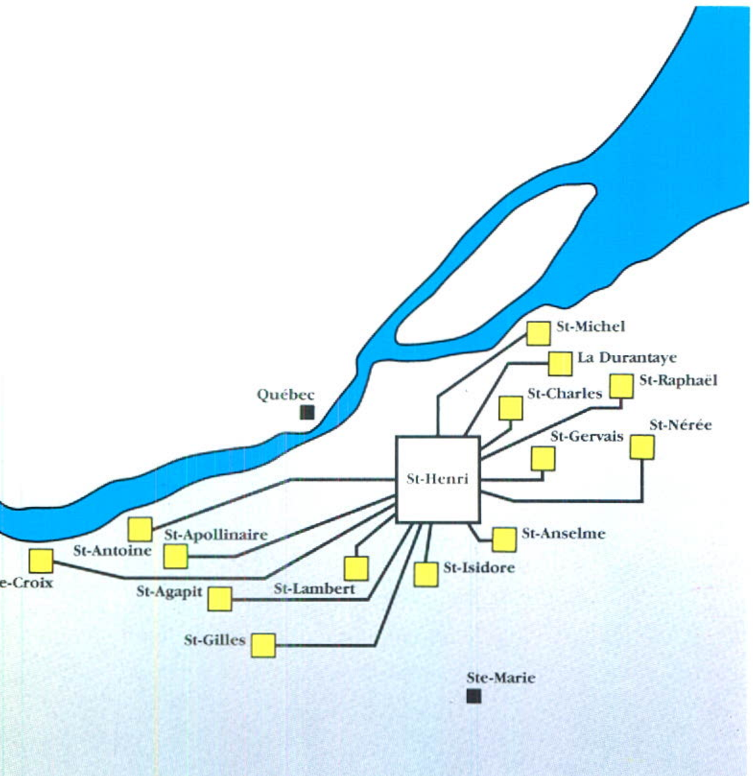
PLANNING FOR THE FUTURE

With the rapid evolution of technology in the field of telecommunications, it is of prime importance for Québec-Téléphone to detect among the emerging trends those more likely to succeed and shape the networks of the future. The planning process within the Company is part of its general commitment to offer innovative services at the lowest cost.

Modernization of Switching Services

Since June 1, 1985, several thousand subscribers living on the south shore of the St.Lawrence River near Québec City (in the counties of Beauce, Lotbinière, Lévis and Bellechasse) benefit from enhanced telephone service featuring maximum dependability. This results from the inauguration by Québec-Téléphone of a large digital switch in the Saint-Henri-de-Lévis' central office and the simultaneous cutover of switching equipment of identical technology in nine distant offices. In Phase II of the program carried out last fall, five additional remote units were also included in the system. When completed in 1986, this improvement in the switching services of that part of our territory will have entailed investments of over $ 11 million.

Digitization of switching systems on the south shore of the Québec Region.



A Wider Range of Services

This new network configuration around Saint-Henri-de-Lévis, an innovative achievement, enabled the establishment of Extended Area Service links between various localities which include Québec City for some of them. Access to single-line service was also extended as a result of this modernization. Also offered in outlying sectors were Automatic Number Identification and Customer Dialing for various types of long-distance calls. Moreover, Touch Calling, Call Forwarding, Speed Calling, Three-Way Calling and Call Waiting were also made available on customer request.

New Optical Routes

In January 1985, Québec-Téléphone unveiled a four-year plan for the construction of new fiber-optic routes in Eastern Québec. This network modernization program, already well advanced in the Beauce and Montmagny districts in the Québec Region, will soon benefit the district of Donnacona as well as those of Rimouski, Matane and New Carlisle. The purchase of optical cable and its installation over some 900 kilometers will require a $ 20 million outlay while the construction of adjacent routes will necessitate an additional investment of $ 5 million.

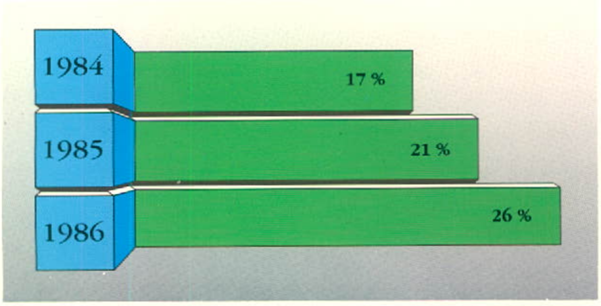
The final steps in the manufacturing of about 200 kilometers of optical cable ordered by the Company for installation in the Beauce and Montmagny areas during the second half of 1985 were carried out in Rimouski. The use of these new fiber-optic trunks has enabled Québec-Téléphone to meet growing long-distance traffic demands and offer subscribers truly exceptional transmission quality.

Preventive Maintenance

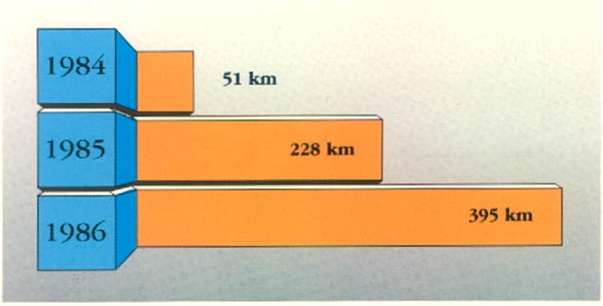
A new type of test set was used to improve the efficiency of step-by-step offices. The functioning of the system is based on a complete computer review of all assigned telephone numbers through normal communication process to analyze equipment performance at varying levels of difficulty. Whenever an abnormal situation occurs, the system indicates the called number and lists the equipment used to establish the communication. Reports of increased accuracy generated by this sophisticated trouble management system also allow a better assessment of the competence and ability of the technical personnel in performing the appropriate clearing measures.

Fiber-optic transmission: a solution to toll traffic growth with a bright future.

Percentage of digital lines on total installed lines



Annual fiber-optic cabling in kilometers



As direct access to many data banks is now available to various departments of the Company, it becomes absolutely necessary to simplify its use for employees. Québec-Téléphone endeavors to maintain increased machine capacity in line with the availability of fourth-generation software.

For example, the Company's main computer which could process 1.6 million instructions per second in early 1985 will soon handle up to 2.8 million instructions per second with a projected 4.8 million by 1987.

Office Automation

The implementation of the Company's office automation master plan in 1985 included the installation of 15 micro-computers and 40 word-processing modules in various Company locations. In parallel with this initial phase, the Management Information Systems Department devised a pilot project for the implementation in 1986 of an electronic mail and office support system. A preliminary trial will be connected in the Marketing Department, where 60 employees – managers, professionals and office technicians – will be assigned terminals connected to a central computer giving all participants access to a wide variety of software applications. One interesting feature of the system is that it will permit interaction between Company headquarters and regional offices.

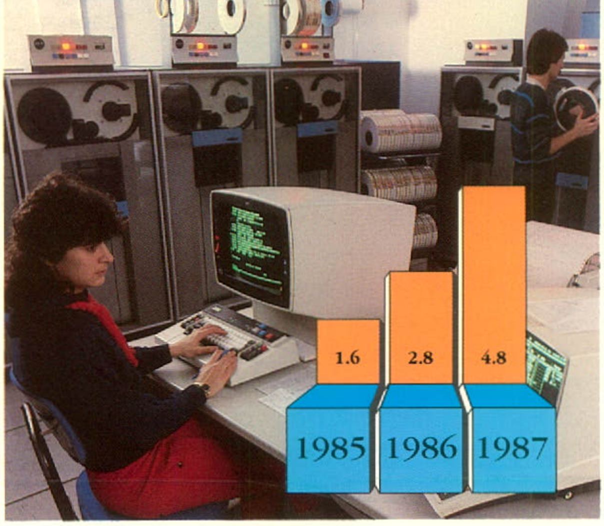
Accounting Records Mechanization

Québec-Téléphone introduced in 1985 an improved General Ledger System to afford on-line consultation of corporate financial and accounting records. The use of advanced software enables faster retrieval of data used in the management of the Company.

Police Car Terminals

A three-party agreement concluded last May between the *Sûreté du Québec*, the *ministère des Communications* of Québec and Québec-Téléphone laid the groundwork for the experimentation of an innovative computerized communication system designed to improve the efficiency of police patrol activities in the Rimouski area. Québec-Téléphone devoted several months of research in developing the software for this program and devised new ways to make divergent protocols compatible thereby permitting exchanges of data between the central computer and a network of mobile terminals operating in an area 550 kilometers away.

A new computerized communications network to enhance police efficiency.



Capacity of the management central processor in mega-instructions per second

The new terminals, which are presently undergoing tests in five patrol cars, ensure patrol officers ultra-fast, confidential access to three data banks, i.e. license plate numbers, driver's licenses and the list of persons sought by the police. Among other things, these systems enable the police to check within seconds the ownership status of vehicles stopped by highway patrol. Another advantage of the system is the greater safety afforded to police officers in the course of potentially dangerous interventions.

The experiment will be conducted until March 1986 to allow for a fair assessment of all system capabilities in real-life situations. Test results are of particular interest to the *ministère des Communications,* in view of possible applications of such systems for the communications needs of various government departments.

New Products

In 1985, Québec-Téléphone introduced the whole new XENIX generation of Rexon business machines to its business clients. The universality of these systems allows the programming in languages such as COBOL, PASCAL and SMC BASIC. Through its acquisition of three licenses for the marketing of managerial and accounting software, the Company is now in a position to complement its line of hardware systems with the supply and support of softwares as part of a global customer package.

A major agreement concluded late in 1985 with IBM Canada Limited makes Québec-Téléphone an authorized distributor of the entire family of personal computers manufactured by this renowned firm.

MAIN EVENTS OF 1985

First Quarter

— Québec-Téléphone unveils a four-year fiber-optic construction plan.
— Renewal of the guardians' and maintenance employees' labor contract for a term expiring May 1, 1987.
— Direct-mail promotion of the plug-in telephone attachment concept for 69 urban exchanges.

Second Quarter

— Québec-Téléphone wins an IRIS award for the quality of its human resources management tools.
— Improved synergy through concentration of services in the new, enlarged headquarters building.
— Simultaneous cutover of a major digital switch in Saint-Henri-de-Lévis and of nine satellite units in remote COs – Phase I.

Third Quarter

— A decision by the *Régie des services publics* establishes final terminal attachment provisions.
— Introduction of a leaner organizational structure.
— Implementation of an experimental innovative computerized communication system for the *Sûreté du Québec.*

Fourth Quarter

— Phase II of Québec Region's south shore digitization program.
— Optical-fiber long-distance circuits installed between Saint-Georges and Sainte-Marie.
— Québec-Téléphone introduces IBM-manufactured personal computers at year end.
— Datapac service launched in six exchanges of the territory.

The rate of return on Québec-Téléphone's average common share equity remained at 15 % for the year 1985, the maximum authorized by the *Régie des services publics* of Québec. The *Régie* further specified on December 4, 1985 that the maximum rate of return authorized had to include the return on non-regulated as well as regulated activities of the Company; this was confirmed in Order 84-052D issued on December 20, 1985. To comply with this rate of return, considered fair and reasonable by the *Régie*, Québec-Téléphone, again this year, charged to its operations an additional depreciation expense applicable to the assets comprised in an accelerated recovery program already submitted to the regulatory body.

Earnings

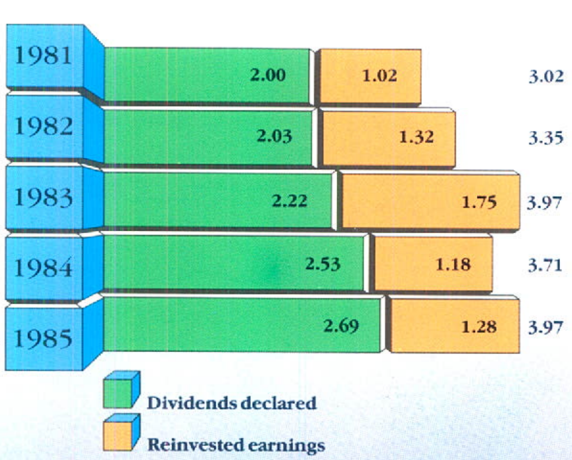
Net income for the year ended December 31, 1985 reached $ 21.7 million, up 12.0 % from $ 19.3 million in 1984. Earnings per common share were $ 3.97 compared with $ 3.71 for 1984 while the average number of common shares outstanding increased by 6.1 % to 5,169,710 from 4,870,496 in 1984. The rate of return on average invested capital was 12.6 % in 1985 compared with 13.0 % last year. Sustained growth in the demand for telecommunications services and the rigorous enforcement of cost-control programs were the leading factors which contributed to the attainment of these results.

The quarterly dividend payable on common shares on July 1, 1985 was raised from $ 0.65 to $ 0.68 per share bringing the annual dividend per share to $ 2.72. Dividends declared on common shares for the elapsed year totalled $ 13.9 million or $ 2.69 per share compared with $ 12.3 million or $ 2.53 per share in 1984. The dividend payout ratio for the last twelve months was 67.8 % in comparison with 68.2 % in 1984.

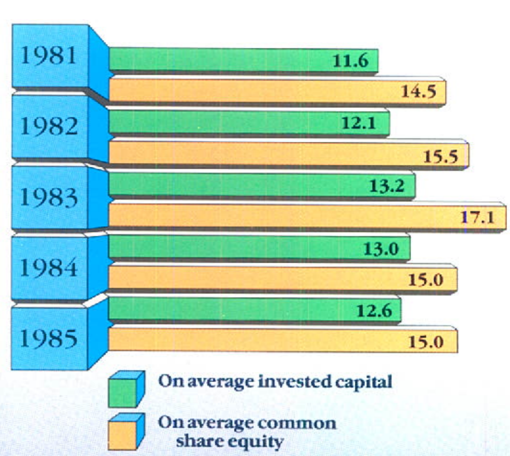
Revenues

Total operating revenues reached $ 176.5 million, an increase of $ 12.4 million or 7.6 % over the previous high of $ 164.1 million in 1984. Revenues from toll services represented 62.1 % of all operating revenues this year — against 61.7 % in 1984 — and amounted to $ 109.6 million, up 8.3 % over the total of $ 101.2 million for the previous year. The volume of billed long-distance messages grew by 6.9 % to 29.3 million while Wide Area Telephone Service (WATS) increased by 17.2 % over last year. Finally, a stronger demand for private line services produced revenues of $ 15.9 million, up 4.6 % compared to 1984. The growth of the local service sector was more modest, generating revenues of $ 58.2 million or 2.3 % over the $ 56.9 million of the previous year.

Earnings and dividends per common share
(dollars)



Rates of return *(%)*



The number of subscriber lines, which is the principal source of local revenues, went up 2.7 % to 221,471 lines in service as at December 31, 1985 compared with 215,751 a year earlier, this increase being attributable almost exclusively to the business market. A slowdown in terminal rental was more than offset by sales of terminal equipment and other competitive products, which account for most of the 43.0 % increase in other revenues which totalled $ 9.2 million this year from $ 6.5 million in 1984.

Expenses

Operating expenses for the year 1985 rose by 8.9 % or $ 10.7 million to reach $ 130.8 million from $ 120.1 million last year. Salaries and fringe benefits were the major contributing factors to this increase. Depreciation expense totalled $ 35.5 million, up 8.6 % over the $ 32.6 million of 1984. This increase of 8.6 % is attributable partly to a 6.0 % addition in total telecommunications property over last year, and partly to an additional depreciation provision of $ 2.8 million with respect to certain assets included in the accelerated depreciation program and for which, since 1984, new acquisitions are expensed. For 1984, this additional special expense was $ 1.4 million.

Financial Expenses

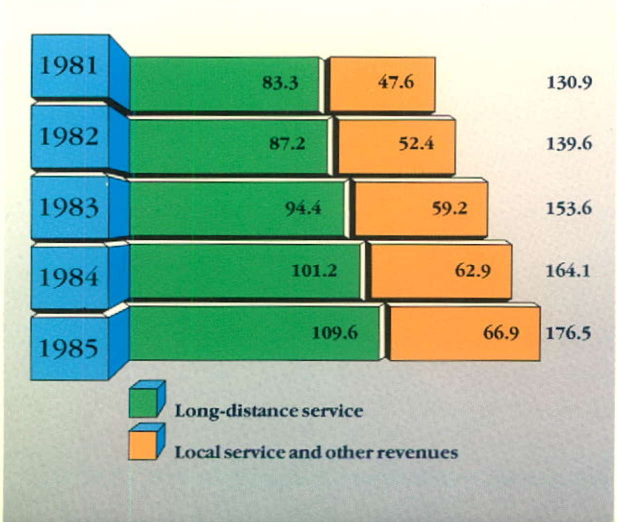
Financial expenses decreased again during the current year to a level of $ 10.3 million, 16.8 % less than in 1984. This decrease results from a reduction of debt and lower interest rates on short-term loans. Proceeds from shares issued pursuant to the various common share purchase plans available to shareholders and employees as well as the surplus of funds from operations over those required for the investment program, contributed to reduce short- and long-term debt from $ 96.1 million as at December 31, 1984 to $ 88.6 million at the end of 1985.

Telecommunications Property

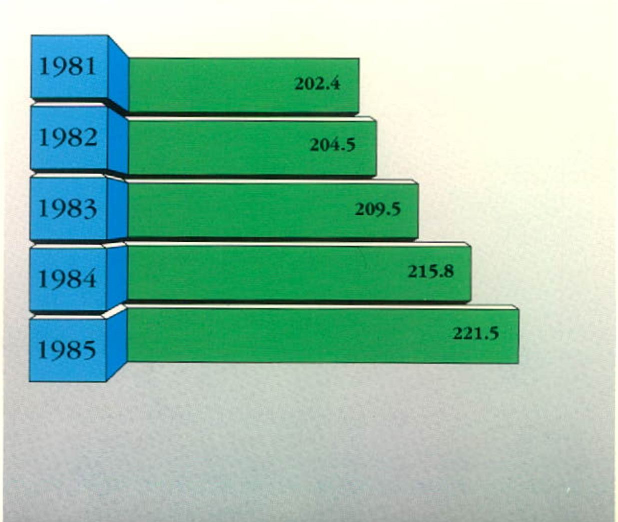
Investments in telecommunications property amounted to $ 39.3 million, $ 7.5 million more than in 1984 and $ 3.3 million over the $ 36.0 million budgeted at the beginning of the year. Due to a higher than anticipated demand for services and to the advanced scheduling of certain projects included in the five-year development plan, the Board of Directors approved additional appropriations of $ 4.0 million on July 20, 1985.

Almost half of the funds used, $ 19.4 million, was allocated to the expansion of basic telephone service by the addition of network access lines. The modernization and improvement of services

Operating revenues
(millions of dollars)



Subscriber lines in service
(thousands)



required $ 15.5 million, of which $ 4.3 million were invested in the rural upgrading program to provide single-line service to more than 5,200 additional subscribers. A further $ 4.4 million was used to purchase vehicles, tools, office automation and conventional office equipment and to complete the extension begun in 1984 of the *Jules-A.-Brillant* building, the Company's headquarters in Rimouski.

Capital Structure

During the year ended December 31, 1985, a total of 110,910 shares were issued under the Dividend Reinvestment, Stock Dividend and Share Purchase plans while 49,670 shares were issued under the Employees' Stock Purchase Plan. The proceeds of $ 5.1 million derived from the sale of the combined total of 160,580 new shares were used entirely to reduce short-term loans.

The great popularity of the Dividend Reinvestment, Stock Dividend and Share Purchase plans since their introduction in 1980 has enabled the Company to attain and even exceed the objective then established to improve the flexibility of its capital structure. Consequently, having generated close to $ 26.4 million through the issue of 1,030,299 shares since their introduction, those plans were terminated on October 2, 1985.

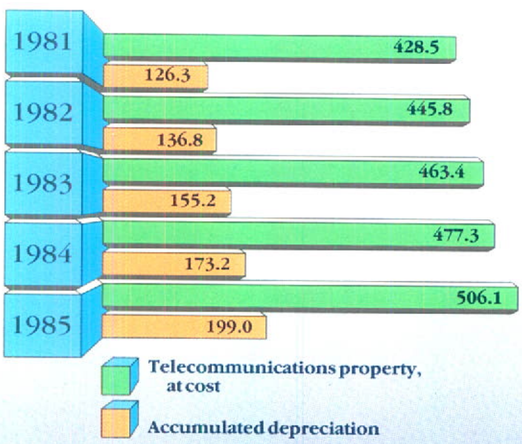
As of December 31, 1985, some 5,800 shareholders — including 500 employees — held 5,212,467 outstanding common shares. The two major shareholders, *La Compagnie de Téléphone Anglo-Canadienne* and *Caisse de dépôt et placement du Québec* owned respectively 50.6 % and 11.9 % of the Company's total shares.

Regulatory Matters

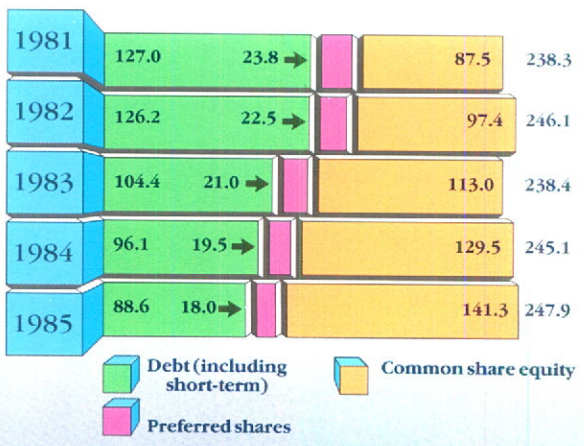
In its Order 84-052D issued on December 20, 1985, the *Régie des services publics* of Québec signified its specific intention to examine the Company's development plan and its financial situation in order to reach a decision on the level of revenues and tariffs for telecommunications services over the 1986-1987 period. In these proceedings, the *Régie* intends to determine a fair and reasonable rate of return on Québec-Téléphone's common share equity for the years 1986 and 1987.

During the hearings preceding the decision which the *Régie* proposes to issue before the end of June 1986, Québec-Téléphone will take all relevant measures and make all necessary efforts to secure a competitive rate of return, comparable to that of companies of similar risk.

Telecommunications property
(millions of dollars)



Capital structure
(millions of dollars)



FINANCIAL STATEMENTS

QUÉBEC-TÉLÉPHONE

MANAGEMENT'S REPORT

QUÉBEC-TÉLÉPHONE

To Our Shareholders:

The consolidated financial statements of Québec-Téléphone as well as the financial information included in this annual report are the responsibility of Management and have been approved by the Board of Directors. These consolidated financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, include amounts that are based on best estimates and judgments. Financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

The Company has a high-quality system of internal control and of audit within the limits of acceptable costs. These controls are designed to provide reasonable assurance that financial transactions are properly recorded and executed in accordance with required approvals, that consolidated financial statements are properly prepared and assets safeguarded.

The Board of Directors fulfils its responsibility with regard to the consolidated financial statements contained in this annual report principally through its Audit Committee, consisting solely of outside directors, which meets periodically with Management as well as with the internal and external auditors. The latter have full and free access to the Audit Committee and meet with it, with and without Management being present, to discuss auditing and financial reporting matters.

On behalf of Management,

Simon Soucy

Simon Soucy
Vice President - Finance
and Treasurer

Raymond Sirois

Raymond Sirois
President and Chief
Executive Officer

AUDITORS' REPORT

To the Shareholders of Québec-Téléphone:

We have examined the consolidated balance sheets of Québec-Téléphone (a Québec company) and subsidiary as of December 31, 1985 and 1984, and the related consolidated statements of income, reinvested earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements appearing on pages 19 to 27 inclusive, present fairly the financial position of Québec-Téléphone and subsidiary as of December 31, 1985 and 1984, and the results of their operations and the changes in their financial position for the years then ended, in accordance with generally accepted accounting principles applied on a consistent basis during the years.

Samson Bélair

Samson Bélair
Chartered Accountants

Arthur Andersen & Cie

Arthur Andersen & Cie
Chartered Accountants

January 24, 1986

STATEMENTS OF INCOME

QUEBEC-TELEPHONE

	For the years ended December 31	1985	1984
		Thousands of dollars	
Revenues	Local service	$ 58,172	$ 56,852
	Long-distance service	109,594	101,240
	Other	9,224	6,452
	Less: uncollectible accounts	465	478
		176,525	164,066
Expenses	Depreciation	35,451	32,635
	Maintenance	36,936	33,895
	Other operating expenses	45,295	40,522
	Taxes other than income taxes	13,112	13,086
		130,794	120,138
Operating income		45,731	43,928
	Other income (Note 4)	1,729	1,598
Income before financial expenses and income taxes		47,460	45,526
Financial expenses (Note 5)		10,286	12,369
Income before income taxes		37,174	33,157
	Income taxes (Note 8)	15,511	13,812
Net income		21,663	19,345
	Dividends on Preferred and Subordinate Preferred shares	1,147	1,270
Net income applicable to Common shares		$ 20,516	$ 18,075
Earnings per Common share		$ 3.97	$ 3.71
Dividends declared per Common share		$ 2.69	$ 2.53
Average number of Common shares (thousands)		5,170	4,870

REINVESTED EARNINGS

For the years ended December 31	1985	1984
	Thousands of dollars	
Balance at beginning of year	$ 54,046	$ 48,305
Net income	21,663	19,345
	75,709	67,650
Less: dividends on Common shares	13,908	12,334
dividends on Preferred and Subordinate Preferred shares	1,147	1,270
	15,055	13,604
Balance at end of year	$ 60,654	$ 54,046

BALANCE SHEETS

QUÉBEC-TÉLÉPHONE

ASSETS

	As at December 31	1985	1984
		Thousands of dollars	
Telecommunications property, at cost	Buildings, plant and equipment	$ 490,366	$ 457,563
	Less: accumulated depreciation (Note 6)	199,023	173,228
		291,343	284,335
	Land	1,924	1,823
	Property under construction	7,983	11,942
	Construction materials, at average cost	5,799	5,939
		307,049	304,039
Investment and other assets	Investment in Common shares of Telesat Canada, at cost	600	600
	Net investment in leases	696	742
		1,296	1,342
Current assets	Accounts receivable	19,152	19,674
	Prepaid expenses and other	2,541	1,196
		21,693	20,870
Deferred charges	Unamortized discount and expenses on long-term debt	826	919
	Unrealized loss on foreign currency	5,414	4,682
	Other	355	1,034
		6,595	6,635
Total assets		$ 336,633	$ 332,886

On behalf of the Board of Directors, February 5, 1986

Raymond Sirois

Raymond Sirois, Director

Hervé Belzile

Hervé Belzile, Director

QUÉBEC-TÉLÉPHONE

SHAREHOLDERS' EQUITY AND LIABILITIES

	As at December 31	1985	1984
		Thousands of dollars	
Shareholders' equity (Note 2)	Common share equity		
	Common shares	**$ 80,610**	$ 75,465
	Reinvested earnings	**60,654**	54,046
		141,264	129,511
	Subordinate Preferred shares	**111**	129
	Preferred shares	**17,921**	19,443
		159,296	149,083
Long-term debt (Note 3)		**87,441**	86,306
Current liabilities	Cheques issued in excess of bank balances	**3,032**	3,069
	Short-term debt (Note 7)	**1,131**	9,766
	Accounts payable		
	Affiliates	**1,744**	791
	Other	**8,384**	6,634
	Advance billing	**3,274**	3,198
	Dividends payable	**3,819**	3,589
	Income taxes payable (Note 8)	**3,605**	723
	Accrued interest	**4,458**	4,211
	Other accrued liabilities	**9,402**	8,647
		38,849	40,628
Deferred income taxes (Note 8)		**51,047**	56,869
Total shareholders' equity and liabilities		**$ 336,633**	$ 332,886

Simon Soucy

Simon Soucy
Vice President - Finance and Treasurer

QUEBEC-TELEPHONE

	For the years ended December 31	1985	1984
		Thousands of dollars	
Operations	Net income applicable to Common shares	$ 20,516	$ 18,075
	Expenses not requiring cash and equivalents		
	Depreciation	35,451	32,635
	Deferred income taxes for the year	(5,459)	(3,043)
	Allowance for funds used during construction	(869)	(528)
	Other	1,442	1,853
		51,081	48,992
	Net change in other current assets and liabilities other than short-term debt (Note 9)	6,070	(6,669)
	Deferred income taxes of prior years	(363)	(1,234)
		56,788	41,089
Financing	Common shares issued	5,127	10,781
	Redemptions of Preferred shares	(1,486)	(1,359)
	Repayments of long-term debt	(185)	(2,965)
	Decrease in short-term notes	(8,605)	(6,790)
		(5,149)	(333)
Investment	Additions to telecommunications property, net	(37,740)	(28,504)
	(Increase) decrease in net investment in leases	46	(305)
		(37,694)	(28,809)
Increase in cash and equivalents before dividends on Common shares		13,945	11,947
Dividends on Common shares		(13,908)	(12,334)
Increase (decrease) in cash and equivalents		37	(387)
Cash and equivalents at beginning of year		(3,069)	(2,682)
Cash and equivalents at end of year		$ (3,032)	$ (3,069)

Note: Cash and equivalents include cash (cheques issued in excess of bank balances) and temporary investments.

QUÉBEC-TELEPHONE

For the years ended December 31, 1985 and 1984

1. Significant Accounting Policies

The financial statements have been prepared in conformity with Canadian generally accepted accounting principles, and in accordance with prevailing practices in the Canadian telecommunications industry. Certain reclassifications were made in the financial statements of the preceding year to conform to the presentation adopted in 1985.

The regulated activities of the Company are subject to regulations of the *Régie des services publics* of Québec. Deregulated activities are not shown separately as they only represent a small portion of the Company's business.

Earnings per Common Share

Earnings per Common share are calculated using the quarterly weighted average number of outstanding Common shares eligible for quarterly dividend.

Consolidation

The financial statements include the accounts of *La Compagnie de Téléphone Bonaventure et Gaspé, Limitée,* an inactive wholly-owned subsidiary.

Telecommunications Property

Telecommunications property is recorded at original cost and includes certain costs related to pension, payroll taxes and funds used during construction, applicable to the construction activity. The original cost of retired telecommunications property is charged to accumulated depreciation or to construction materials, when such property can be re-used; therefore, no gain or loss on retirement is recognized in the statement of income.

Depreciation

Depreciation of telecommunications property is calculated mainly according to the straight-line method using rates based on the estimated service life of the assets. Depreciation of these properties which regroup telephone sets and related wiring, deregulated since July 1983, had been established under a special depreciation plan ending in 1989; the Company charged to its operations in 1985 as in 1984 an accelerated depreciation expense included in this depreciation plan, in order to comply with the authorized maximum return on shareholders' equity. This rate of return must include net income from both regulated and non-regulated operations of the Company.

For 1985, the total depreciation expense was $ 35.5 million, including the accelerated depreciation of $ 2.8 million explained above, in comparison with $ 32.7 million for 1984 (including $ 1.4 million for accelerated depreciation). The composite depreciation rate was 7.51 % in 1985 (7.22 % in 1984).

Investment

The investment in Common shares of Telesat Canada is recorded at original cost. There is no quoted market value for this investment; however, its estimated book value was $ 1,497,000 as at December 31, 1985.

Amortization of Discount and Expenses on Long-Term Debt

Discount and expenses on long-term debt are amortized using the straight-line method over the life of the related debt.

Income Taxes

The Company uses the tax allocation method to account for income taxes.

Long-Distance Service Revenues

The Company receives part of its long-distance service revenues pursuant to agreements with other telecommunications companies for services provided jointly. The Company's actual share of the joint business cannot be specifically determined before the completion of settlement studies. Related provisions are recorded in the books.

Translation of Foreign Currencies

Purchases of materials, operating costs and interest paid in foreign currency are stated in these financial statements in Canadian dollars at the rate of exchange prevailing at the transaction date and resulting gains or losses are included in income of the year in which they occur.

The long-term debt payable in U.S. funds is reflected in the financial statements at the Canadian dollar equivalent at the rate of exchange prevailing at the date of balance sheets. Resulting gains or losses are amortized over the remaining life of this long-term debt.

Leases

Revenues from operating leases are accounted for at the time the services are provided to customers. In the case of sales-type leases, the gain or loss realized on the sale of the product is recorded at the effective date of the lease. Finance income related to sales-type leases is recognized in such a way as to produce a constant rate of return on the residual investment in leases.

2. Shareholders' Equity

Number of Shares at December 31

	Authorized	Outstanding 1985	Outstanding 1984
Common shares without nominal or par value	Unlimited	**5,212,467**	5,050,755
$ 1.68 Cumulative Redeemable Convertible Subordinate Preferred shares Series B of the par value of $ 15 each	541,322	**6,919**	8,051
Cumulative Redeemable Preferred shares of the par value of $ 20 each	1,297,279	**896,064**	972,147

During 1985, transactions related to the capital stock were as follows:

	Common	Subordinate Preferred	Preferred
Shares outstanding at December 31, 1984	5,050,755	8,051	972,147
Issued	160,580	—	—
Redeemed	—	—	(76,083)
Converted	1,132	(1,132)	—
Shares outstanding at December 31, 1985	**5,212,467**	**6,919**	**896,064**

Common Shares

During 1985, 160,580 Common shares were issued for $ 5,127,000 under the following plans intended to shareholders and employees:

a) Common Shareholders' Dividend Reinvestment and Share Purchase Plan;
b) Common Shareholders' Stock Dividend and Share Purchase Plan; and
c) Employees' Stock Purchase Plan.

In addition, 1,132 $ 1.68 Cumulative Redeemable Convertible Subordinate Preferred shares Series B were converted into 1,132 Common shares.

As of December 31, 1985, 32,351 Common shares were reserved for issuance under the Employees' Stock Purchase Plan and for conversion of Subordinate Preferred shares.

Following the suspension in 1984 of the shareholders' option to purchase additional shares through cash payments under the Dividend Reinvestment and the Stock Dividend plans, the Board of Directors decided to terminate both plans as of October 2, 1985.

Subordinate Preferred Shares

The $ 1.68 Cumulative Redeemable Convertible Subordinate Preferred shares Series B are convertible at the option of the holders at any time on or before June 30, 1986, into one Common share for each share so converted.

Since more than 85 % of the original issue has now been converted into Common shares, the Company has the option at any time to redeem all or part of the outstanding Series B shares at the agreed upon redemption price.

Preferred Shares

Series			Shares outstanding at December 31 1985	Shares outstanding at December 31 1984	1985 (Thousands of dollars)	1984 (Thousands of dollars)
1955	5 %	(sinking fund)	**34,794**	36,608	$ **696**	$ 732
1956	5 %	(sinking fund)	**14,054**	14,825	**281**	297
1965	$4 \frac{3}{4}$ %		**400,000**	400,000	**8,000**	8,000
1973	$7 \frac{3}{4}$ %	(purchase fund)	**197,200**	209,450	**3,944**	4,189
1975	$9 \frac{3}{4}$ %	(sinking fund)	—	30,000	—	600
1977	7 %	(sinking fund)	**250,016**	281,264	**5,000**	5,625
					$ **17,921**	$ 19,443

In order to meet the sinking fund requirements for the 1955 and 1956 Series, payments for the next five years will be as follows: $ 23,000 in 1986, $ 46,000 in 1987 and $ 50,000 for each of the years 1988, 1989 and 1990. In addition, the Company must make all reasonable efforts to redeem each year 9,000 Preferred shares Series 1973, at a price not exceeding $ 20.

On October 1, 1986, the Company must call for redemption and redeem at par for cancellation the outstanding Preferred shares Series 1977.

The Company has met all requirements with respect to sinking and purchase funds.

3. Long-Term Debt

First Mortgage Bonds

Series	Rate	Maturing		Issued	1985	1984
					Thousands of dollars	
H	5 1/2 %	June 1,	1987	$ 6,000,000	$ 3,915	$ 4,014
I	6 %	October 15,	1990	5,000,000	4,222	4,322
J	7 %	January 2,	1989	5,000,000	5,000	5,000
L	9 1/8 %	April 15,	1991	7,500,000	358	363
M	8 3/4 %	May 15,	1992	7,500,000	7,500	7,500
N	8 1/2 %	March 15,	1993	8,500,000	8,500	8,500
O	9 3/4 %	July 1,	1994	16,500,000 (U.S.)	23,077	21,768
P	11 7/8 %	October 15,	1995	15,000,000	15,000	15,000
Q	10 5/8 %	December 15,	1996	20,000,000	20,000	20,000
Less: current portion					131	161
					$ 87,441	$ 86,306

The Trust Deeds of the Company require the use of a sinking fund or the pledge of additional unmortgaged property for each of the series as follows:

a) Series H and I
   Annual payment of 1 1/2 % of the principal amount of the bonds issued.

b) Series J, M, N, O, P and Q
   Annual payment of 1 % or additional mortgage of 1 1/2 % of the principal amount of bonds issued; the Company has constantly used the latter alternative.

c) Series L
   Annual payment of $ 8,960 representing 2 % of the aggregate principal amount of bonds issued and not prepaid on April 15, 1975.

To meet the sinking fund requirements and the debt retirements, the following payments will have to be made during the next five years:

Year ending December 31	Thousands of dollars
1986	$ 131
1987	3,924
1988	84
1989	5,084
1990	3,959

First Mortgage Bonds of all series are secured equally and rateably under a fixed and specific hypothec, mortgage, pledge, charge, cession and transfer of/and on all immovable property, such as buildings, equipment, telephone lines and apparatus, rights-of-way and similar rights and a floating charge on all other assets.

4. Other Income

Among others, this caption includes administration costs calculated on accounts receivable, as well as an allowance for funds used during construction. This allowance which amounted to $ 869,000 in 1985 ($ 528,000 in 1984) was applied to the telecommunications property at the rate of 13.00 % (13.18 % in 1984) and credited to other income. This rate reflects the Company's rate of return on total invested capital for the previous year.

5. Financial Expenses

	1985	1984
	Thousands of dollars	
Interest on long-term debt	$ 8,374	$ 8,423
Other interest	1,243	3,071
Unrealized loss on foreign currency	576	775
Amortization of discount and expenses on long-term debt	93	100
	$ 10,286	$ 12,369

6. Accumulated Depreciation

	1985	1984
	Thousands of dollars	
Balance at beginning of year	$ 173,228	$ 155,232
Depreciation of the year	35,451	32,635
Less: buildings, plant and equipment retired (net value)	9,656	14,639
Balance at end of year	$ 199,023	$ 173,228

7. Short-Term Debt

	1985	1984
		Thousands of dollars
Short-term notes		
Bank	$ 1,000	$ 6,605
Promissory notes	—	3,000
Current portion of long-term debt	131	161
	$ 1,131	$ 9,766

The average interest rate on short-term notes was 10.16 % in 1985 and 11.31 % in 1984.

The Company's policy is to utilize short-term debt as interim financing.

The short-term debt is considered in computing the average debt service cost and the rate of return on average invested capital.

8. Income Taxes

The Company has been assessed by the Department of National Revenue up to and including December 31, 1984 and by the *ministère du Revenu* of Québec up to and including December 31, 1983. Audits have not yet been completed by the *ministère du Revenu* of Québec for the fiscal periods 1974 to 1978. Management estimates that no significant liability should ensue.

The reconciliation of the statutory and effective income tax rates is as follows:

	1985	1984
Statutory income tax rate (federal and provincial)	41.5 %	41.5 %
Provision for eventual loss on foreign currency	0.6	1.5
Reversal of deferred income taxes, at historical rates	(1.9)	(1.8)
Federal surtax	1.2	—
Other items	0.3	0.4
Effective income tax rate	41.7 %	41.6 %

Current and deferred income taxes for the years are as follows:

	1985	1984
		Thousands of dollars
Current	$ 20,970	$ 16,855
Deferred	(5,459)	(3,043)
	$ 15,511	$ 13,812

The reconciliation of the income tax accounts shown in the balance sheets is as follows:

	Income taxes payable		Deferred income taxes	
	1985	1984	1985	1984
		Thousands of dollars		Thousands of dollars
Balance at beginning of year	$ 723	$ 6,156	$ 56,869	$ 61,146
Provision	20,970	16,855	(5,459)	(3,043)
Prior years' adjustments	417	931	(363)	(1,234)
Less: payments	18,505	23,219	—	—
Balance at end of year	$ 3,605	$ 723	$ 51,047	$ 56,869

9. Net Change in Other Current Assets and Liabilities Other than Short-Term Debt

	1985	1984
		Thousands of dollars
(Increase) decrease in current assets		
Accounts receivable and other	$ 522	$ (2,474)
Prepaid expenses and other	(1,345)	58
Increase (decrease) in current liabilities		
Accounts payable and other	4,011	1,180
Income taxes payable	2,882	(5,433)
	$ 6,070	$ (6,669)

10. Pension Plan	The Company maintains a pension plan for the benefit of its employees and complies with the requirements of the Québec Supplemental Pension Plans Act. The unfunded liability, determined by actuarial valuation, is funded by annual payments charged to operating expenses in accordance with legal requirements. Based on the actuarial valuation as of December 31, 1984, the unfunded liability was $ 649,000 as of December 31, 1985 and will be amortized by annual instalments of $ 213,000 including interest, up to December 31, 1989. Pension costs were $ 3,097,000 for the year ended December 31, 1985 and $ 2,257,000 for 1984.
11. Remuneration of Directors and Officers	The total direct remuneration, including benefits, paid to directors and officers was $ 777,000 in 1985 and $ 710,000 in 1984.
12. Related Party Transactions	GTE International Incorporated, GTE Service Corporation, *La Compagnie de Téléphone Anglo-Canadienne, Microtel Limitée, GTE Sylvania Canada Limitée* and Dominion Directory Company Limited and their respective subsidiaries are direct or indirect affiliates of the Company. The Company's policy is to purchase high-quality goods and services at the best possible price. Consequently, no advantage is given to affiliates and transactions with these are made on a competitive basis, that is at the same or better conditions which would have prevailed if the parties had not been affiliated. Out of a total disbursement of $ 45.6 million in dividends, goods and services, in 1985, the Company has paid $ 14.2 million to affiliates.

QUARTERLY FINANCIAL DATA 1985 (unaudited)

QUÉBEC-TÉLÉPHONE

Three months ended	March 31	June 30	Sept. 30	Dec. 31
			Thousands of dollars	
Revenues	$ 42,007	$ 44,843	$ 44,793	$ 44,882
Depreciation	8,210	8,255	8,493	10,493
Maintenance	8,819	9,584	9,080	9,453
Other operating expenses	10,208	11,286	11,025	12,776
Taxes other than income taxes	3,453	3,469	3,424	2,766
	30,690	32,594	32,022	35,488
Operating income	11,317	12,249	12,771	9,394
Other income	482	297	485	465
Income before financial expenses and income taxes	11,799	12,546	13,256	9,859
Financial expenses	2,815	2,859	2,686	1,926
Income before income taxes	8,984	9,687	10,570	7,933
Income taxes	3,621	3,978	4,461	3,451
Net income	5,363	5,709	6,109	4,482
Dividends on Preferred and Subordinate Preferred shares	299	288	286	274
Net income applicable to Common shares	$ 5,064	$ 5,421	$ 5,823	$ 4,208
Earnings per Common share	$ 0.99	$ 1.05	$ 1.12	$ 0.81
Dividends declared per Common share	$ 0.65	$ 0.68	$ 0.68	$ 0.68

FIVE-YEAR REVIEW

QUÉBEC-TÉLÉPHONE

		1985	1984	1983	1982	1981
Selected results and reinvested earnings items (thousands of dollars)	Revenues	$ 176,525	$ 164,066	$ 153,596	$ 139,587	$ 130,884
	Operating expenses (excluding depreciation and taxes other than income taxes)	82,231	74,417	67,116	62,534	56,455
	Depreciation	35,451	32,635	28,453	24,627	26,318
	Taxes other than income taxes	13,112	13,086	12,114	11,190	9,115
	Total operating expenses	130,794	120,138	107,683	98,351	91,888
	Financial expenses	10,286	12,369	13,029	13,927	13,119
	Income taxes	15,511	13,812	14,707	13,182	13,821
	Net income	21,663	19,345	19,430	15,634	13,824
	Dividends on Preferred and Subordinate Preferred shares	1,147	1,270	1,385	1,507	1,619
	Net income applicable to Common shares	20,516	18,075	18,045	14,127	12,205
	Dividends on Common shares	13,908	12,334	10,104	8,576	8,089
Selected balance sheet items (thousands of dollars)	Telecommunications property, at cost	$ 506,072	$ 477,267	$ 463,385	$ 445,771	$ 428,517
	Accumulated depreciation	199,023	173,228	155,232	136,819	126,325
	Common share equity	141,264	129,511	112,966	97,431	87,461
	Preferred and Subordinate Preferred shares	18,032	19,572	20,986	22,480	23,814
	Long-term debt	87,441	86,306	85,235	116,465	115,329
	Short-term debt	1,131	9,766	19,212	9,770	11,706
Financial statistics	Earnings per Common share	$ 3.97	$ 3.71	$ 3.97	$ 3.35	$ 3.02
	Dividends declared per Common share	$ 2.69	$ 2.53	$ 2.22	$ 2.03	$ 2.00
	Dividend payout ratio	67.8 %	68.2 %	56.0 %	60.7 %	66.3 %
	Common equity per share (1)	$ 27.10	$ 25.64	$ 24.11	$ 22.35	$ 21.36
	Common share market price (2)					
	High	$ 45.00	$ 34.00	$ 31.50	$ 20.875	$ 20.875
	Low	$ 33.50	$ 28.875	$ 19.75	$ 15.75	$ 16.50
	Close	$ 43.50	$ 34.00	$ 30.00	$ 20.875	$ 17.00
	Return on average Common share equity	15.0 %	15.0 %	17.1 %	15.5 %	14.5 %
	Return on average invested capital (3)	12.6 %	13.0 %	13.2 %	12.1 %	11.6 %
	Average debt service cost (3)	10.5 %	10.8 %	10.2 %	10.6 %	10.6 %
	Debt ratio (3)	35.7 %	39.2 %	43.8 %	51.3 %	53.3 %
	Interest coverage on long-term debt (times)	5.44	4.94	4.17	3.54	3.45
Other statistics	Average number of Common shares (thousands)	5,170	4,870	4,547	4,222	4,044
	Number of Common shareholders (1)	5,806	6,312	3,955	3,617	3,295
	Number of employees (1)	1,972	1,993	2,023	2,036	2,166
	Salaries and wages (thousands of dollars)	$ 59,577	$ 56,879	$ 52,605	$ 50,213	$ 48,389
	Gross capital expenditures (thousands of dollars)	$ 39,255	$ 31,734	$ 29,190	$ 34,869	$ 44,550
	Telecommunications property per subscriber line in service (1)	$ 2,285	$ 2,212	$ 2,212	$ 2,180	$ 2,117
	Subscriber lines in service (1)	221,471	215,751	209,492	204,455	202,419
	Terminals in service (1)	290,597	290,892	290,713	287,318	284,458
	Toll messages handled (thousands)	32,903	31,099	29,501	28,175	30,002

(1) At December 31
(2) Valuation day value (December 22, 1971): $ 13.75 per share
(3) See note 7 to financial statements

BOARD OF DIRECTORS

Hervé Belzile †
Chairman of the Board
Alliance compagnie mutuelle d'assurance-vie
(Director since 1971)

Jean Gaulin *
President
Ultramar Canada, Inc.
(Director since 1985)

John E. Houghton ‡
President and Chief Executive Officer
The Ontario Paper Company Limited
and *La Compagnie de Papier Q.N.S., Limitée*
(Director since 1985)

James L. Johnson
President -
Telephone Operating Group
GTE Service Corporation
(Director since 1980)

Charles Mercier *
Vice President -
Marketing and Customer Service
Québec-Téléphone
(Director since 1975)

Roger Néron †
President and Chief Executive Officer
Culinar Inc.
(Director since 1983)

Bernard Panet-Raymond * †
President
O.R.C. Canada Inc.
(Director since 1968)

Claude Pratte, Q.C. * ‡
Advocate
(Director since 1964)

Raymond Sirois * *
Chairman of the Board,
President and Chief Executive Officer
Québec-Téléphone
(Director since 1969)

Kent B. Foster
Group Vice President -
Telephone Operating Group
GTE Service Corporation
(Director since 1985)

Antoine Turmel, O.C. ‡
Administrator
(Director since 1973)

** president of executive committee
* member of executive committee
† member of audit committee
‡ member of compensation committee

OFFICERS

Raymond Sirois
President and Chief Executive Officer

Charles Mercier
Vice President -
Marketing and Customer Service

Ghislain Bouchard
Vice President -
Human Resources and Legal Affairs,
Secretary

Robert Duchesne
Vice President -
Network Engineering and Construction

Simon Soucy
Vice President -
Finance and Treasurer

Gilles Laroche
Vice President -
Business Development

Andrée Bélanger
Assistant Secretary

INFORMATION TO SHAREHOLDERS

Head Office
6, rue Jules-A.-Brillant
Rimouski, Québec G5L 7E4

Incorporation and Regulation
Québec-Téléphone is incorporated under the laws of Québec by Letters Patent dated June 7, 1927 and its regulated activities are subject to the regulatory authority of the *Régie des services publics* of Québec.

Major Shareholder
As at December 31, 1985, *La Compagnie de Téléphone Anglo-Canadienne,* 8750, chemin de la Côte-de-Liesse, Saint-Laurent, Québec owned 2,639,949 Common shares of Québec-Téléphone, or 50.6 % of outstanding Common shares.

Dividends
Dividends on Common, Preferred and Subordinate Preferred shares are usually payable on the first day of January, April, July and October of each year.

Listing of Shares
Common shares, 4 ¾ % Preferred shares Series 1965, 7 ¾ % Preferred shares Series 1973 and $ 1.68 Cumulative Redeemable Convertible Subordinate Preferred shares Series B are listed on the Montréal and Toronto stock exchanges. The 5 % Preferred shares Series 1955 and 1956 are listed on the Montréal stock exchange.

Stock Transfer Offices
Trust Général du Canada, 1100, rue University, Montréal, Québec H3B 2G7, is the Registrar and Transfer Agent for all classes of shares of the Company. *Compagnie Trust Royal* is the Co-Transfer Agent and Registrar for the 4 ¾ % Preferred shares Series 1965, at its offices in Toronto and Winnipeg, and is the Co-Transfer Agent and Registrar for the 7 ¾ % Preferred shares Series 1973, for the $ 1.68 Cumulative Redeemable Convertible Subordinate Preferred shares Series B and for the Company's Common shares at its offices in Saint John, N.B., Toronto, Winnipeg, Regina, Calgary and Vancouver.

Valuation Day
The value of a Common share of the Company on valuation day, December 22, 1971, recognized by the Department of National Revenue for capital gains tax purposes, was $ 13.75.

Trustee for Bonds
Trust Général du Canada
1100, rue University
Montréal, Québec H3B 2G7

Bankers
Banque Nationale du Canada
Banque de Montréal

Publications Available to Shareholders
Interim Reports are published quarterly and sent to shareholders in February, May, August and November. The Annual Report is mailed to registered shareholders in March along with the notice of annual general meeting.

Duplicate Shareholder Information
Every effort is made to eliminate duplication in our shareholders mailing list. However, if a shareholder has more than one holding, duplication cannot be avoided unless he requires the Company or its Transfer Agent to merge his accounts under exactly the same name and address.

Annual Meeting
Usually, the annual meeting is held in April; this year, the meeting will take place at 11:00 a.m., E.S.T., Tuesday, April 1, 1986 at *Hôtel St-Louis,* 214, rue St-Edmond, Rimouski, Québec.

In each of its three administrative regions, Québec-Téléphone observed evident signs of economic growth in 1985. The chief indicators were the stability and confidence within the financial community; the efforts of the various governments to counter unemployment as well as the creativity deployed by many enterprises to regain their market share.

In the residential construction sector, the same optimism prevailed. Much of it stems from the positive impact of lower interest rates for home-building. In an environment more favorable to business, Québec-Téléphone also experienced growth in the number of lines in service and in the total volume of long-distance calls.

Additionally, the Company anticipates strong job creation dynamism in its outlying sectors from a number of mover projects to be implemented soon. These major projects are: the operation of the Muscocho gold mine in Montauban; the opening of a wood preparation center and a specialized equipment plant (Nardeux) in Matane; the completion of the *Centre de recherches Maurice-Lamontagne* near Mont-Joli; the construction of a penitentiary in Donnacona; and capacity increases for the Manic V hydroelectric station. Altogether these projects will create 1,600 jobs and require a global investment of $ 640 million.

Demographic Evolution

Québec-Téléphone's latest demographic report for the next fifteen years indicates a slow population growth gradually diminishing in time. Throughout the territory, estimates show an increase in the number of households of over 2.2 % in 1986. However, this progression will slow over the years to a mere 0.7 % by the end of the century.

From now to the year 2000, the Québec Region is expected to record the highest demographic increase. The growth will be lower on the North Shore while the Lower St.Lawrence and Gaspé areas will slowly correct the population exodus trend of the last two decades.

Territorial map

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QUÉBEC-TÉLÉPHONE

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