QUÉBEC-TÉLÉPHONE

ANNUAL REPORT 1979

Québec-Téléphone at a Glance

Founded in 1927, Québec-Téléphone is the principal telecommunications utility under provincial jurisdiction with 265,337 telephones in service, a staff of 2,209 employees, annual revenues of $101.3 million and a telephone plant of $353.1 million.

With headquarters in Rimouski, Québec-Téléphone provides telecommunications services to a population of over 500,000 over an area of about 272,000 km². Three hundred and twenty-seven municipalities are served by 136 telephone exchanges in the Lower St. Lawrence region, the Gaspé Peninsula, the North Shore up to Labrador as well as in numerous counties on the north and south shores of the St. Lawrence River in the Québec region.

Besides conventional telephone service, Québec-Téléphone offers a wide range of modern telecommunications services including telex, circuit rental for cable television, transmission of voice, data, radio and television programs, mobile radio communications, paging systems, data processing and computer communications.

The two major holders of the Company's common shares are La Compagnie de Téléphone Anglo-Canadienne with 53.8 percent and Caisse de dépôt et placement du Québec with 14.8 percent.

Our cover page

In the overall harmony of its forms, Québec-Téléphone's business office in Baie Comeau proudly keeps pace with an urban renewal movement.

The successful combination of glass and aluminum symbolizes the transparency of human relationships and the powerful momentum of an enterprise well adapted to its environment.

Report In Brief

	1979	1978	1977
Financial (thousands of dollars)			
Operating revenues	$101,303	$ 84,136	$ 77,191
Operating expenses	69,082	56,761	50,801
Salaries and benefits	39,645	33,422	30,398
Net income applicable to Common shares	9,020	7,496	6,311
Common share dividends	5,875	5,119	3,957
Funds used for Construction	33,651	45,425	37,645
Telephone plant, at cost[1]	353,101	335,539	295,069
Shareholders items			
Earnings per Common share	$ 2.72	$ 2.49	$ 2.59
Dividends declared per Common share	$ 1.77	$ 1.70	$ 1.625
Common equity per Common share[1]	$ 19.16	$ 18.21	$ 17.32
Per cent return on average Common share equity	14.6%	14.0%	15.5%
Average number of Common shares	3,318,706	3,010,975	2,431,980
Number of Common shareholders[1]	1,876	1,878	1,877
Other statistics			
Telephone gain for the year	11,483	12,872	14,378
Telephones in service[1]	265,337	253,854	240,982
Toll messages (in thousands)	27,929	26,015	24,265
Number of employees[1]	2,209	2,199	2,081

1. Year-end

53rd Annual Directors' Report

In 1979, the economy was characterized by escalating interest rates, high levels of inflation and unemployment, and a rather moderate rate of economic growth, but these factors did not prevent Québec-Téléphone from achieving further progress during the year.

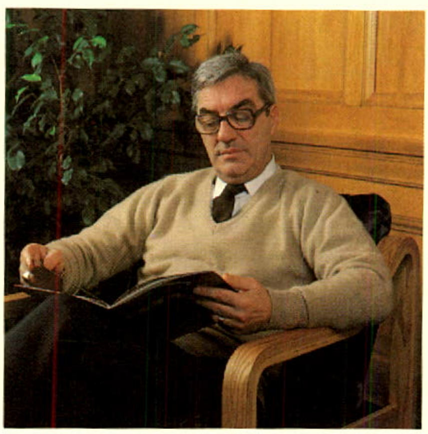
The operating revenues increased by 20.4 percent, from \$84.1 million in 1978 to \$101.3 million in 1979. This growth is mainly due to a tariff adjustment put into effect on April 1, 1979, a 7.4 percent increase in the volume of long-distance messages and the addition of 11,483 telephones.

At the end of 1979, the rate of return on average common share equity was 14.6 percent compared with 14.0 percent and the earnings per common share amounted to \$2.72 in comparison with \$2.49 in 1978, despite a 10.2 percent increase in the average number of common shares outstanding.

Customers

In March 1979, the Régie des services publics du Québec authorized Québec-Téléphone to raise its general tariff to generate \$8.1 million in additional revenues for the last nine months of 1979. Although public acceptance was mixed, the new rates nevertheless enabled the Company to maintain its financial good health and undertake measures to benefit customers.

For example, the week-end discount period was extended to cover two thirds of the day on Saturdays, encouraging greater use of long-distance services. In accordance with the policies of the Régie des services publics du Québec, the Company has also committed itself to developing its network to offer private or two-party line service to more than 90 percent of its customers by 1985. This program is aimed at eliminating the disparities between rural and urban sectors.



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

Service

In order to make the toll network more accessible, Québec-Téléphone installed computerized display units which accelerates the routing of calls by the operator while reducing the service's operating costs.

On one hand, the Company has facilitated direct dialing for various types of calls in over two thirds of the territory served; on the other, it has made Direct Distance Dialing available to

100 percent of its customers. Concurrently, the proportion of its customers benefiting from Automatic Number Identification has reached 67 percent, the service having been extended to four new exchanges.

Since July, the addition of the Inward Wide Area Telephone Service (numbers 1-800), toll free for any caller, has made it possible for businesses to extend their services to distant customers. Moreover, long-distance dialing for hotel clients has been simplified through the installation of direct lines linked to the Company's central offices. Also, three new types of private electronic branch exchanges have replaced and modernized the range of equipment available to business customers.

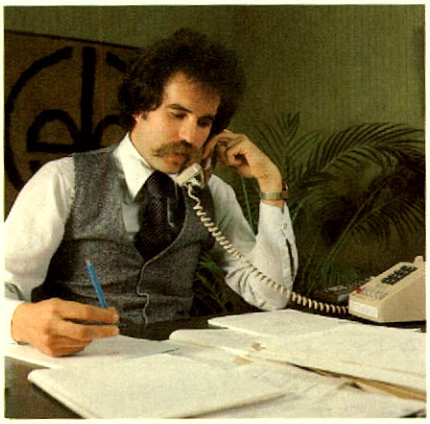
Personnel

In line with its program to develop employee potential initiated in 1978, Québec-Téléphone held a number of meetings to measure the impact of technological changes on its current work force. This planning resulted in an analysis of career plans which includes three stages: personal involvement of management personnel, collection of data on the positions and the individuals, and finally, the designing of a mechanized system to process the information related to the management of human resources.

As regards training, the Company's management employees were offered new courses on interpersonal communication, time management and the holding of meetings. At the same time, more than 1,400 employees participated in various technical courses and training programs.

Labour Relations

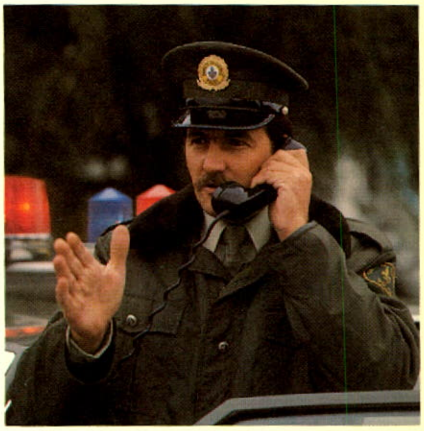
In the labour relations sector, on February 19, 1979, Québec-Téléphone and Local 2200 of The International Brotherhood of Electrical Workers renewed their collective agreement covering the Company's craft employees. This contract will expire on October 10, 1980. Negotiations concerning the operators' collective agreement, which expired May 12, 1979, was the topic of several sessions at the end of the year. Also, the renewal of the office employees' and technicians' contract has involved various meetings after the agreement expired on November 12, 1979.



At home, in a dynamic business environment as well as in emergency situations, Québec-Téléphone shares its know-how in many ways.

Network

To bring itself into closer contact with customers and to adapt to ever-changing technology, Québec-Téléphone modified in September the structure of its administrative regions. While maintaining decentralized operations throughout the territory, the Company established three specialized units: Customer Services, Switching, and Outside Plant.



Another important innovation is the installation of a Network Analysis and Co-ordination Centre in which two mini-computers monitor from a distance the proper operation of equipment on a company-wide scale. By increasing tenfold the reaction time to any abnormal situation, this constant analysis of technological data is in keeping with a general mechanization process.

In the data processing sector, through the use of special terminals and the addition of certain equipment, users may have direct access to the computers. In this manner, a user may accurately retrieve a variety of data regarding, for instance, the availability of manpower, the state of equipment inventories and the routing of service orders in real time.

Growth

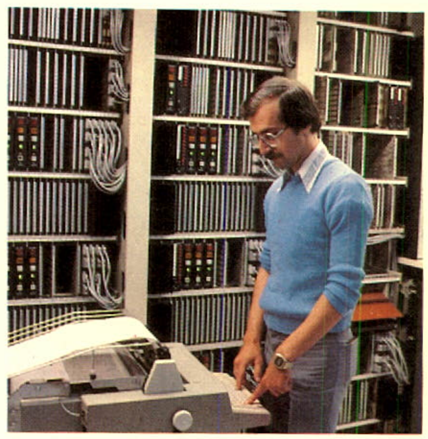
Regarding capital investment, gross additions amounting to $36.0 million were made over the year for the expansion and improvement of the telephone network. Most of this money was used for additions of switching equipment, local and long-distance circuits ($11.6 million), for the outside plant ($9.6 million), for the provision and connection of customer equipment ($8.7 million), and lastly, for the purchase of furniture, office equipment, vehicles and tools ($2.2 million).

These investments, the use of the most promising developments in advanced technology, and the on-going commitment of qualified personnel enable Québec-Téléphone to guarantee a service of the highest quality, well in line with the needs of the community and modern society, and oriented towards growth and innovation.

On behalf of the Board of Directors

Raymond Sirois

Raymond Sirois
Chairman of the Board
February 5, 1980



Serious, competent and eager to serve, Québec-Téléphone employees display inventiveness in complex tasks.

Financial Review

Earnings and Dividends

For the year ended December 31, 1979, net income applicable to common shares amounted to $9,019,821, a growth of 20.3% compared with the previous year. This increase in net income is mainly due to the combined effect of the growth in revenues and the decline in the amount of dividends paid to preferred shareholders following the conversion of convertible preferred shares, Series B, into common shares, and to the redemption of preferred shares for sinking fund purposes. Earnings per common share, which were $2.49 in 1978, reached $2.72 in 1979 despite a 10.2% increase in the average number of common shares outstanding. During the year, 2,689 convertible subordinate preferred shares, Series B, were converted into 2,689 common shares and 24,224 common shares were issued under the «Employees' 1978 Stock Purchase Plan». The rate of return on average common share equity rose from 14.0% in 1978 to 14.6% in 1979.

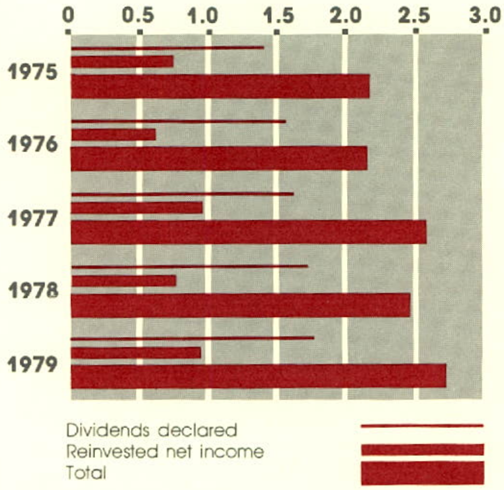
Quarterly dividends were paid during the past year to all common, preferred and subordinate preferred shareholders of the Company. On August 7, 1979, the Board of Directors raised the quarterly dividend per common share from 42½ cents to 46 cents. This increase brought the total dividends declared on common shares in 1979 to $1.77 per share, compared with $1.70 for 1978.

Operating Revenues

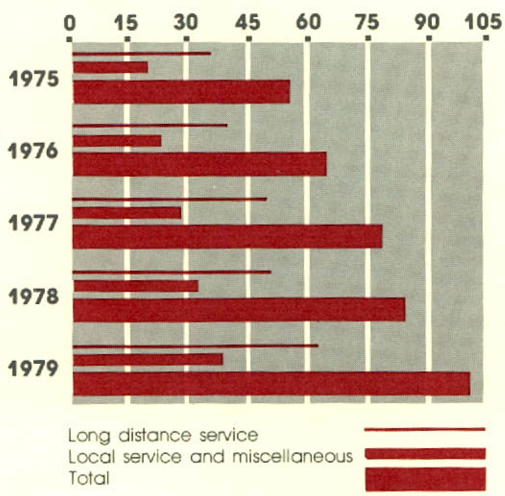
Operating revenues for 1979 totalled $101.3 million, compared with $84.1 million in 1978, an overall increase of $17.2 million or 20.4%. This increase comes from a growing demand for all our telecommunications services and a rate adjustment authorized by the Régie des services publics du Québec on April 1, 1979.

Local service revenues increased by 19.8% to attain $37.7 million, while long-distance service revenues amounted to $62.7 million, up 20.8% compared with 1978. During the year, 11,483 telephones were added to our network, stations in service reaching 265,337 on December 31, 1979. During the same twelve-month period, long-distance calls handled numbered 27.9 million, a 7.4% increase compared with 1978, while the growth rate for the two preceding years had been 7.2% and 4.7% respectively.

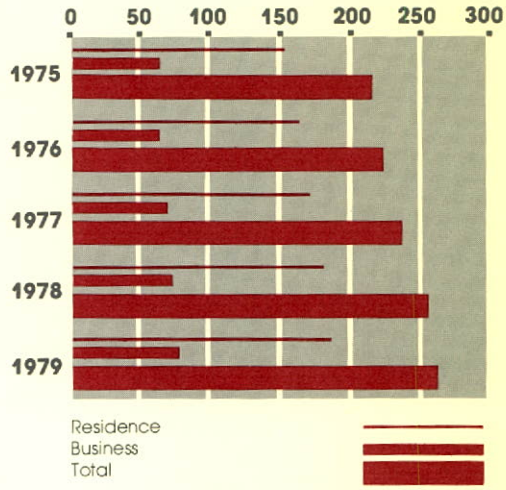
Earnings per common share
In dollars



Operating revenues
Millions of dollars



Telephones in service
Thousands



Operating Expenses

Over the past twelve months, operating expenses, excluding depreciation and general taxes, reached $42.0 million compared with $34.1 million in 1978, an increase of 23.2%. Besides the normal rise in costs due to the expansion of our telephone network, the operating expenses also reflect inflationary pressures experienced throughout the year.

Following additions to our telephone plant, depreciation expenses add up to $20.8 million for 1979, a 12.6% growth over the preceding year.

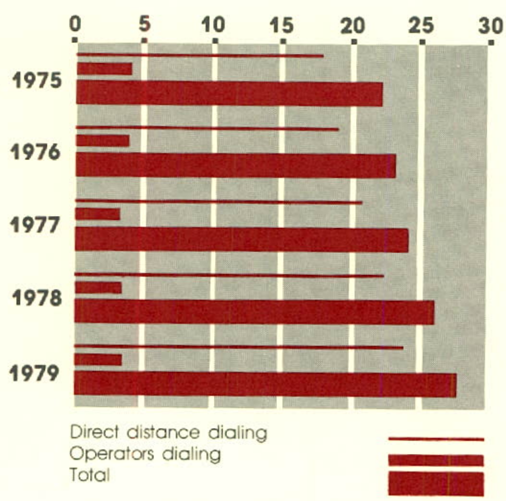
There was also a very noteworthy growth in general taxes which rose to $6.2 million in 1979, a $2.1 million or 50.9% increase from 1978. This large increase in our tax burden mainly stems from the effects of the amendment to the Real Estate Assessment Act which came into force on January 1, 1979. This amendment to the Act replaced the 10% tax on net revenues from telephone and telecommunications network operations by a 5% tax on gross revenues.

Finance

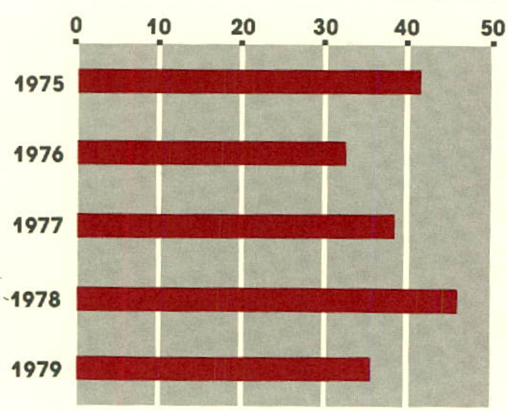
During 1979, the Company did not turn to any long-term external financing to support its construction and expansion program. Of the Company's total capital requirements for new construction during the past year, 85.1% were generated from operations.

Over the next five years, the Company plans to spend $268 million to continue its facilities expansion and modernization program and to meet the demand for telecommunications services. These capital expenditures will require about $85 million in external financing. 32%

Toll messages
Millions



Construction expenditures
Millions of dollars

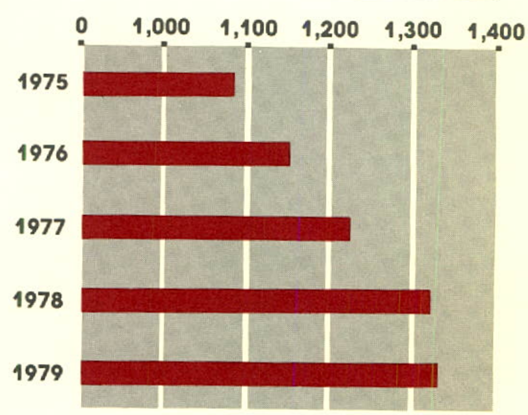


Common Shareholders' Dividend Reinvestment and Share Purchase Plan

On November 6, 1979, the Board of Directors approved a Common Shareholders' Dividend Reinvestment and Share Purchase Plan.

This new plan gives common shareholders the opportunity to increase their common share equity in the Company by investing the dividends paid on their common shares, in full or in part, and by making cash payments up to $3,000 per quarter. The price of common shares, purchased by investing dividends and through cash payments, will be 100% of the average market price according to the plan. The participating shareholders will have no brokerage fees to pay and all administrative charges will be borne by the Company. Moreover, the additional common shares purchased under the terms of the Plan will constitute securities which may be invested as part of a Stock Savings Plan under the Taxation Act (Québec).

Plant investment per telephone



Statement of Income and Reinvested Earnings

for the year ended December 31

QUÉBEC-TÉLÉPHONE

	1979	1978
Operating revenues		
Local service	$ 37,709,850	$31,470,730
Long distance service	62,709,506	51,903,683
Miscellaneous	1,238,463	1,093,805
Uncollectible operating revenues	(354,650)	(332,464)
	101,303,169	84,135,754
Operating expenses (Note 4)		
Maintenance	17,232,620	14,017,254
Depreciation	20,838,869	18,513,733
Traffic	3,903,158	3,940,511
Customer services and marketing	5,732,072	4,734,319
Administrative and other expenses	12,942,652	9,976,920
Pension plans and other employee benefits (Note 5)	2,229,749	1,468,040
General taxes (Note 6)	6,203,156	4,109,807
	69,082,276	56,760,584
Operating income	32,220,893	27,375,170
Other income (Note 7)	1,043,560	1,869,351
Income before interest charges and income taxes	33,264,453	29,244,521
Interest charges		
Interest on long-term debt	11,283,577	8,876,150
Interest on short-term notes	893,516	1,938,402
Amortization of discount and expenses on long-term debt	170,247	121,159
	12,347,340	10,935,711
Income before income taxes	20,917,113	18,308,810
Income taxes (Note 13)	10,015,345	8,718,445
Net income	10,901,768	9,590,365
Preferred and Subordinate Preferred share dividends	1,881,947	2,094,221
Net income applicable to Common shares	9,019,821	7,496,144
Reinvested earnings at beginning of year	24,340,984	22,117,017
	33,360,805	29,613,161
Common share dividends	5,874,899	5,118,668
Commission and expenses on sale of shares	—	153,509
	5,874,899	5,272,177
Reinvested earnings at end of year	$ 27,485,906	$24,340,984
Earnings per Common share	$ 2.72	$ 2.49
Dividends declared per Common share	$ 1.77	$ 1.70
Average number of Common shares	3,318,706	3,010,975

The accompanying notes are an integral part of these financial statements.

Balance Sheet

December 31

QUÉBEC-TÉLÉPHONE

ASSETS

		1979	1978
Telephone plant, at cost (Note 10)	17562	$353,100,762	$335,539,162
Accumulated depreciation (Note 11)	9257	(93,083,461)	(83,825,763)
		260,017,301	251,713,399
Investment in Common shares of Télésat Canada, at cost		600,000	600,000
Current assets			
Cash		949,082	652,879
Accounts receivable		12,185,480	10,461,457
Material and supplies, at average cost		8,395,693	6,414,367
Prepaid expenses		620,259	447,875
		22,150,514	17,976,578
Deferred charges			
Unamortized discount and expenses on long-term debt		1,678,145	1,828,396
Other		321,949	334,093
		2,000,094	2,162,489
Total assets		$284,767,909	$272,452,466

On behalf of the Board of Directors, February 5, 1980:

Raymond Sirois, Director

Hervé Belzile, Director

QUEBEC-TELEPHONE

CAPITALIZATION AND LIABILITIES

	1979	1978
Capitalization (per accompanying statement)		
Common share equity	$ 63,863,748	$ 60,225,347
Subordinate Preferred shares	265,700	308,763
Preferred shares	25,524,630	26,916,220
Long-term debt	116,018,918	116,391,526
	205,672,996	203,841,856
Current liabilities		
Short-term debt (Note 12)	8,710,838	7,315,748
Accounts payable		
Affiliates	170,896	188,050
Other	5,234,608	4,446,153
Income taxes payable (Note 13)	3,406,085	31,570
Dividends payable	1,991,076	1,893,490
Accrued interest	2,286,012	2,298,784
Other accrued liabilities	3,325,019	2,883,379
Unearned revenues	1,888,127	1,549,024
	27,012,661	20,606,198
Deferred income taxes (Note 13)	52,082,252	48,004,412
Total capitalization and liabilities	$284,767,909	$272,452,466

The accompanying notes are an integral part of these financial statements.

Statement of Capitalization (Note 2)

December 31

QUÉBEC-TÉLÉPHONE

		1979		1978	
Capitalization					
Common share equity					
Common shares without nominal or par value		$ 36,377,842		$ 35,884,363	
Authorized	5,000,000				
Outstanding (1978: 3,306,471)	3,333,384				
Reinvested earnings (see accompanying statement)		27,485,906		24,340,984	
		63,863,748	31%	60,225,347	30%
Subordinate Preferred shares of the par value of $15 each					
Authorized	1,000,000				
Outstanding (1978: 19,280)	16,591				
$1.68 Cumulative Redeemable Convertible, Series B		248,865		289,200	
Premium on Subordinate Preferred shares, Series B		16,835		19,563	
		265,700	–%	308,763	-%
Cumulative Redeemable Preferred shares of the par value of $20 each					
Authorized	1,682,898				
Outstanding (1978: 1,407,824)	1,337,951				
Series					
1955 5% (sinking fund)		896,680		897,180	
1956 5% (sinking fund)		458,260		458,260	
1965 4¾%		8,000,000		8,000,000	
1973 7¾% (purchase fund)		5,054,000		5,226,000	
1975 9¾% (sinking fund)		3,600,000		4,200,000	
1977 7% (sinking fund)		8,750,080		9,375,040	
Sinking fund payments		(1,234,390)		(1,240,260)	
		$ 25,524,630	13%	$ 26,916,220	13%

					Issued	1979		1978	
Long-term debt									
First Mortgage Bonds									
	Series	Rate	Maturing						
	F	5⅝%	December 1,	1984	$ 3,000,000 (U.S.)	$ 2,513,516		$ 2,562,164	
	G	5½%	October 15,	1982	5,000,000	3,567,000		3,648,000	
	H	5½%	June 1,	1987	6,000,000	4,455,000		4,545,000	
	I	6 %	October 15,	1990	5,000,000	4,700,000		4,775,000	
	J	7 %	January 2,	1989	5,000,000	5,000,000		5,000,000	
	L	9⅛%	April 15,	1991	7,500,000	404,000		414,000	
	M	8¾%	May 15,	1992	7,500,000	7,500,000		7,500,000	
	N	8½%	March 15,	1993	8,500,000	8,500,000		8,500,000	
	O	9¾%	July 1,	1994	16,500,000 (U.S.)	15,920,850		15,920,850	
	P	11⅞%	October 15,	1995	15,000,000	15,000,000		15,000,000	
	Q	10⅝%	December 15,	1996	20,000,000	20,000,000		20,000,000	
	R	10½%	December 2,	1983	25,000,000	25,000,000		25,000,000	
	Sinking fund payments					(266,448)		(273,488)	
						112,293,918		112,591,526	
General Mortgage Bonds									
	Series	Rate	Maturing						
	D	5¾%	April 1,	1983	5,000,000	3,800,000		3,867,000	
	Sinking fund payment					(75,000)		(67,000)	
						3,725,000		3,800,000	
						116,018,918	56%	116,391,526	57%
Total capitalization						$205,672,996	100%	$203,841,856	100%

The accompanying notes are an integral part of these financial statements.

Statement of Source of Funds used for Construction

for the year ended December 31

QUEBEC-TÉLÉPHONE

	1979	1978
Source of Funds		
From operations		
Net income applicable to Common shares	$ 9,019,821	$ 7,496,144
Expenses not requiring cash outlay		
Depreciation	20,838,869	18,513,733
Deferred income taxes	3,990,383	5,972,404
Other expenses	646,732	430,314
Less: Common share dividends	5,874,899	5,118,668
	28,620,906	27,293,927
Net change in working capital other than short-term debt (Note 14)	837,437	(3,629,185)
Increase (decrease) in deferred income taxes — prior years (Note 13)	87,457	(647,558)
Net proceeds from sale of a coaxial cable network	4,023,637	—
Net proceeds from financing		
Common shares	450,416	9,158,758
First Mortgage Bonds	—	24,754,447
Change in short-term notes	1,400,000	(9,685,000)
Less: redemptions of Preferred shares and long-term debt	1,769,108	1,820,008
	81,308	22,408,197
	$33,650,745	$45,425,381
Funds used for Construction		
Gross plant additions	$36,043,592	$46,420,994
Less: additions not requiring cash outlay	2,392,847	995,613
	$33,650,745	$45,425,381

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

for the years ended December 31, 1979 and 1978

QUÉBEC-TÉLÉPHONE

1. Summary of Significant Accounting Policies

The following summary of significant accounting policies is included in order to facilitate the reading of the financial statements. The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles, and in conformity with prevailing practices in the Canadian telecommunications industry.

EARNINGS PER COMMON SHARE

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

PRINCIPLES OF CONSOLIDATION

These financial statements are consolidated and include the accounts of La Compagnie de Téléphone Bonaventure et Gaspé, Limitée, a wholly-owned subsidiary, which is presently inactive.

ACCOUNTING FOR CERTAIN DISBURSEMENTS CHARGED TO CONSTRUCTION

The Company, together with other telecommunications companies and with the concurrence of the Régie des services publics du Québec, has changed the accounting for certain disbursements. Certain costs that had been capitalized in prior years and charged to income through depreciation, are now being expensed directly, resulting in an increased charge to operating expenses of approximately $1,210,000 in 1979.

TELEPHONE PLANT

Telephone plant is recorded at original cost and includes certain costs related to pension, payroll taxes, funds used during construction and general overheads applicable to the construction activity. In conformity with the prevailing practice in the Canadian telecommunications industry, the Company charges to operating expenses the costs of maintenance of property and replacement and renewals of items that are not units of property. Additions, replacements and renewals of property considered to be units of property are charged to telephone plant accounts. The original cost of telephone plant retired is charged to accumulated depreciation or transferred to material and supplies when such plant can be re-used; therefore, no gain or loss on retirement is recognized in the statement of income.

DEPRECIATION

Depreciation is computed on the straight-line method using rates based on the estimated useful lives of the assets. The composite depreciation rate was 6.38% in 1978 and 6.37% in 1979.

INVESTMENT

The investment in Common shares of Télésat Canada is recorded at original cost since the Company has no significant influence over the operating and financial decisions of the investee. If this investment had been recorded using the equity method, its estimated carrying value as at December 31, 1979 would be $890,000.

AMORTIZATION OF DISCOUNT AND EXPENSES ON LONG-TERM DEBT

The discount and expenses on long-term debt are amortized over the life of each series of bonds and the amortization is included in interest charges.

DEFERRED INCOME TAXES

Deferred income taxes result from the difference between depreciation of the telephone plant charged in the accounts and the capital cost allowance claimed for tax purposes and the deduction for tax purposes of the allowance for funds used during construction and other capitalized expenditures.

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 until several months after the completion of studies which are made three times a year. However, revenues are recorded on estimated bases. In management's opinion such revenues as recorded are reasonable estimates of the amounts ultimately accruing to the Company.

PENSION PLANS

The Company maintains funded pension plans for the benefit of all employees and meets the requirements of the Québec Supplemental Pension Plans Act. The Company requires an actuarial study to be conducted each year. The resulting surplus or deficiency, if any, is amortized over a period of five years, beginning with the year following any such study unless such surplus or deficiency is considered immaterial by management, in which case it is charged to operations in the year the results of any such study are known.

2. Capitalization

CAPITAL STOCK

During 1979, transactions related to the issued capital stock of the Company were as follows:

	Common	Subordinate Series B	Preferred
Shares outstanding at December 31, 1978	3,306,471	19,280	1,407,824
Issued	24,224	—	—
Redeemed	—	—	(69,873)
Converted	2,689	(2,689)	—
Shares outstanding at December 31, 1979	3,333,384	16,591	1,337,951

COMMON SHARES

As of December 31, 1979, 111,135 Common shares were reserved for conversion of the Convertible Subordinate Preferred shares and for issuance under the Employees' Stock Purchase Plan. In 1979, 24,224 Common shares were issued under the Employees' 1978 Stock Purchase Plan.

SUBORDINATE PREFERRED SHARES

The $1.68 Cumulative Redeemable Convertible Subordinate Preferred shares Series B are convertible at the option of the holders thereof 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 their prevailing redemption price.

PREFERRED SHARES

In order to meet the sinking fund requirements for the 1955 and 1956 series, payments for the next five years will be as follows: $9,430 in 1980, $48,835 in 1981 and $50,000 for each of the years 1982, 1983 and 1984.

In addition, the Company must redeem each year 30,000 Preferred shares series 1975 at the par value and make all reasonable efforts to redeem each year 9,000 Preferred shares series 1973, at a price not exceeding $20.

The Company must call for redemption and redeem 31,248 Preferred shares Series 1977 on October 1, in each of the years 1980 to 1985 inclusive, and the remaining 250,016 Preferred shares Series 1977 on October 1, 1986 at their par value.

LONG-TERM DEBT

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 F, G, H and I, First Mortgage and Series D, General Mortgage:
Annual payment of 1½% of the principal amount of the bonds issued.

b) Series J, M, N, O, P, Q and R, First Mortgage:
Annual payment of 1% or additional mortgage of 1½% of the principal amount of bonds issued. During the previous years, the Company used the latter alternative.

c) Series L, First Mortgage:
Annual payment of $8,960 representing 2% of the aggregate principal amount of bonds issued less the principal amount 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	Requirements: Sinking fund payments	Debt retirements
	(thousands of dollars)	
1980	$342	$ —
1981	373	—
1982	298	3,425
1983	223	28,575
1984	174	2,319

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. The security provided for the General Mortgage Bonds is similar but subordinated to that provided for the First Mortgage Bonds.

TRANSLATION OF FOREIGN CURRENCIES

The sole exposure of the Company to fluctuations in exchange rates is relative to its 5⅝% First Mortgage Bonds, Series F due December 1, 1984 and its 9¾% First Mortgage Bonds, Series O due July 1, 1994, which principal and interest are payable in United States funds. The outstanding principal of the Series F Bonds is translated into Canadian funds on the basis of $1.00 Canadian = $0.925 U.S., the rate of exchange prevailing before the Canadian dollar was floated on June 1, 1970, and the principal of the Series O Bonds is translated on the basis of $1.00 Canadian = $1.0364 U.S., the effective rate at time of issue. At the rate of exchange prevailing on December 31, 1979, the amounts of $2,513,516 for the Series F Bonds and $15,920,850 for the Series O Bonds would stand at $2,712,345 and $19,248,900 respectively. The Company accounts for exchange gains and losses when they take place upon the payment of interest and sinking fund payments.

3. Construction Program

The cost of the Company's program for improvements and construction of new plant and facilities in 1980, as now planned, is estimated at $44 million, including the cost of material and equipment that will be re-used; purchase commitments amounting to approximately $9 million have been made in connection therewith as of December 31, 1979.

4. Operating Expenses

Traffic expenses represent mainly operators' wages incurred in handling telephone calls; customer services and marketing expenses represent costs incurred in business relations with customers, advertising and directories; administrative and other expenses include principally accounting, data processing, budget, internal auditing and engineering costs incurred for planning and administrative purposes.

5. Pension Plans and other Employee Benefits

This account includes the following costs:

	1979	1978
	(thousands of dollars)	
Pension plans		
Current service	$1,186	$1,000
Experience surplus	(32)	(171)
Past service	502	184
	1,656	1,013
Other employee benefits	574	455
	$2,230	$1,468

Based upon an actuarial study dated July 12, 1979, operations of the Company's pension fund during 1978 resulted in an experience surplus of $1,489,928 which is amortized over a five-year period commencing with 1979. The portion of the experience surplus charged to operations in 1979 is partially offset by the amortization of the last portion of the experience deficiency as of December 31, 1974. Due to improvements made to the pension plans during 1979, the estimated liability not recorded for past service increased from $1,639,158 as of December 31, 1978 to $3,524,889 as of December 31, 1979. The estimated liability for past service together with interest thereon will be amortized by equal instalments of $364,830 up to December 31, 1990 and of $318,159 for each of the three succeeding years.

6. General Taxes

General taxes were as follows:

	1979	1978
	(thousands of dollars)	
Tax on capital	$ 702	$ 423
Education tax	—	704
Telephone plant real estate tax	3,995	1,657
Other real estate tax	385	346
Payroll taxes	1,391	1,240
Other taxes	44	51
	6,517	4,421
Portion capitalized	(314)	(311)
	$6,203	$4,110

7. Other Income

This account includes an allowance for the cost of funds used during construction. For the year ended December 31, 1979, $377,935 ($1,247,271 in 1978) was applied to the telephone plant at the rate of 10.34% (10.56% in 1978) and credited to other income. This rate is computed using the cost of capital for the preceding year.

8. Remuneration of Directors and Senior Officers

The total direct remuneration of the directors and senior officers was $441,345 in 1979 ($487,874 in 1978).

9. Long-term Leases

The Company has no material contingent liability with respect to long-term leases.

10. Telephone Plant

At December 31, the telephone plant included:

	1979	1978
	(thousands of dollars)	
Buildings	$ 31,412	$ 28,291
Switching equipment	145,797	141,516
Subscribers' equipment	65,758	60,218
Outside plant	93,757	89,241
Others	10,861	9,291
Depreciable telephone plant	347,585	328,557
Land	1,496	1,147
Plant under construction	4,020	5,835
	$353,101	$335,539

11. Accumulated Depreciation

Changes in the accumulated depreciation account were as follows:

	1979	1978
	(thousands of dollars)	
Beginning of year	$83,826	$69,811
Depreciation charged to operations	20,839	18,514
Depreciation on motor vehicles, tools and others	1,060	665
Telephone plant retired (net)	(12,642)	(5,164)
End of year	$93,083	$83,826

12. Short-Term Debt

At December 31, short-term debt included:

	1979	1978
	(thousands of dollars)	
Short-term notes		
Bank	$4,135	$4,235
La Compagnie de Téléphone Anglo-Canadienne	3,000	—
Promissory notes	—	1,500
	7,135	5,735
Sinking fund payments on Cumulative Redeemable Preferred shares	1,234	1,240
Sinking fund payments on long-term debt	342	341
	$8,711	$7,316

The average interest rate on short-term notes was 12.07% in 1979 and 9.10% in 1978.

The Company's policy is to employ interim short-term financing mainly to finance its construction program pending long-term financing. In computing the rate of return on average invested capital and interest as a percentage of average debt, short-term debt is included in total capitalization.

13. Income Taxes

The Company has been assessed by the Department of National Revenue and by the Minister of Revenue of Québec up to and including the year ended December 31, 1978. The Company will be reassessed by the Minister of Revenue of Québec following filing notices of objection for the years 1972 and 1975. No material adjustments affecting reported income are expected.

Current and deferred income taxes for the year were as follows:

	1979	1978
	(thousands of dollars)	
Current	$ 6,025	$2,746
Deferred	3,990	5,972
	$10,015	$8,718

The reconciliation of the income tax accounts shown in the balance sheet is presented below:

	Current income taxes		Deferred income taxes	
	1979	1978	1979	1978
	(thousands of dollars)			
Beginning of year	$ 32	$2,775	$48,004	$42,680
Payments	2,665	6,005	—	—
Provision	6,025	2,746	3,990	5,972
Prior years' adjustments	14	516	88	(648)
End of year	$3,406	$ 32	$52,082	$48,004

14. Net Change in Working Capital other than Short-term Debt

The increase (decrease) in working capital is accounted for by:

	1979	1978
	(thousands of dollars)	
Increase (decrease) in current assets		
Cash	$ 296	$ (188)
Accounts receivable	1,724	1,064
Material and supplies	1,981	344
Prepaid expenses	173	66
(Increase) decrease in current liabilities		
Accounts payable and other accrued liabilities	(1,637)	(400)
Income taxes payable	(3,374)	2,743
Increase (decrease) in working capital	$ (837)	$3,629

Auditors' Report

QUÉBEC-TÉLÉPHONE

To the Shareholders of Québec-Téléphone:

We have examined the consolidated balance sheet and consolidated statement of capitalization of Québec-Téléphone (a Québec company) and subsidiary as of December 31, 1979 and 1978, and the related consolidated statements of income and reinvested earnings and source of funds used for construction 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 present fairly the financial position of Québec-Téléphone and subsidiary as of December 31, 1979 and 1978, and the results of their operations and the source of funds used for construction for the years then ended, in accordance with generally accepted accounting principles applied on a consistent basis during the periods.

ARTHUR ANDERSEN & CIE
Chartered Accountants

SAMSON, BÉLAIR & ASSOCIÉS
Chartered Accountants

January 25, 1980.

Five Years of Progress

QUÉBEC-TÉLÉPHONE

	1979	1978	1977	1976	1975
Selected results and reinvested earnings items (thousands of dollars)					
Operating revenues	$ 101,303	$ 84,136	$ 77,191	$ 64,692	$ 56,570
Operating expenses (excluding depreciation and general taxes)	42,040	34,137	31,156	27,254	23,448
Depreciation of telephone plant	20,839	18,514	16,240	12,971	11,114
General taxes	6,203	4,110	3,405	3,073	2,686
Operating expenses	69,082	56,761	50,801	43,298	37,247
Interest charges	12,347	10,936	10,846	9,450	7,679
Income taxes	10,015	8,718	8,045	6,418	6,373
Net income	10,902	9,590	8,643	6,919	6,523
Dividends on Preferred and Subordinate Preferred shares	1,882	2,094	2,332	1,823	1,406
Net income applicable to Common shares	9,020	7,496	6,311	5,096	5,117
Common share dividends	5,875	5,119	3,957	3,655	3,290
Reinvested net income	3,145	2,224	2,306	1,312	1,751
Selected balance sheet items (thousands of dollars)					
Telephone plant, at cost	$ 353,101	$ 335,539	$ 295,069	$ 262,041	$ 236,355
Accumulated depreciation	93,083	83,826	69,811	57,716	49,655
Capitalization	205,673	203,842	169,107	138,463	133,213
Common share equity	63,864	60,225	45,668	38,945	37,551
Preferred and Subordinate Preferred shares	25,790	27,225	31,682	27,381	20,723
Long-term debt	116,019	116,392	91,757	72,137	74,939
Short-term debt	8,711	7,316	17,019	32,253	30,024
Financial statistics					
Average number of Common shares	3,318,706	3,010,975	2,431,980	2,358,103	2,350,179
Earnings per Common share	$ 2.72	$ 2.49	$ 2.59	$ 2.16	$ 2.18
Dividends declared per Common share	$ 1.77	$ 1.70	$ 1.625	$ 1.55	$ 1.40
Per cent net income applicable to Common shares paid in dividends	65.1%	68.3%	62.7%	71.7%	64.3%
Value of Common shares issued					
Equity per Common share[1]	$ 19.16	$ 18.21	$ 17.32	$ 16.51	$ 15.95
Market value (high-low)[2]	$ 26-21½	$ 24½-20½	$ 21-16½	$ 18-14½	$ 17⅞-13½
Per cent return on average Common share equity	14.6%	14.0%	15.5%	13.3%	14.2%
Per cent return on average invested capital[3]	10.9%	10.3%	10.7%	9.9%	9.7%
Interest in percentage of average debt[3]	10.0%	9.5%	9.9%	9.2%	8.6%
Per cent long-term debt to total capitalization	56%	57%	54%	53%	56%
Times interest earned before taxes	2.85	3.06	2.93	3.06	3.43
Number of Common shareholders	1,876	1,878	1,877	1,901	1,969
Other statistics					
Number of employees[1]	2,209	2,199	2,081	2,054	2,055
Salaries and benefits (thousands of dollars)	$ 39,645	$ 33,422	$ 30,398	$ 27,185	$ 24,061
Funds used for construction (thousands of dollars)	$ 33,651	$ 45,425	$ 37,645	$ 30,995	$ 39,750
Plant investment per telephone[1]	$ 1,330.76	$ 1,321.78	$ 1,224.45	$ 1,156.38	$ 1,088.60
Telephones in service[1]	265,337	253,854	240,982	226,604	217,118
Per cent A.N.I.	66.5%	64.8%	62.4%	53.5%	46.5%
Toll messages (thousands)	27,929	26,015	24,265	23,184	22,122

1. Year-end.
2. Valuation day value (December 22, 1971): $13.75 per share.
3. See Note 12 to the accompanying financial statements.

Board of Directors

Hervé Belzile†
President
Alliance Compagnie mutuelle d'assurance-vie

Roger Charbonneau*
President
Laboratoires Anglo-French Limitée

Roger DeSerres*
President
Omer DeSerres Ltée

John Jay Douglas
Vice Chairman
General Telephone & Electronics Corporation

Charles Mercier*
Vice President — Marketing and Customer Service
Québec-Téléphone

M. Brian Mulroney*
President
Iron Ore Company of Canada

Bernard Panet-Raymond†
Executive Vice President
La Compagnie de Papier Q.N.S. Limitée

Claude Pratte, Q.C.†
Advocate

William C. Rowland
Executive Vice President — Telephone Operating Group
General Telephone & Electronics Corporation

Raymond Sirois**
President and Chairman of the Board
Québec-Téléphone

Antoine Turmel*
Chairman and Chief Executive Officer
Provigo Inc.

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

Officers

Raymond Sirois
President and Chief Executive Officer

Charles Mercier
Vice President — Marketing and Customer Service

Jean-Marc Tremblay
Vice President — Human Resources and Legal Affairs, Secretary

Denis Mercier
Vice President — Network Engineering and Construction

Simon Soucy
Vice President — Finance and Treasurer

Henri Dionne
Vice President — Public Relations

Ghislain Bouchard
General Counsel and Assistant Secretary

General Information

Québec-Téléphone is incorporated under the laws of Québec by Letters Patent dated June 7, 1927 and is subject to the regulations of the Régie des services publics du Québec.

Major Shareholder
As at December 31, 1979, La Compagnie de Téléphone Anglo-Canadienne, 715 Victoria Square, Montréal, Québec, owned 1,792,940 Common shares of Québec-Téléphone, or 53.8% of outstanding Common Shares.

Listing of Shares
Common shares, 4¾% Preferred shares, 1965 Series, 7¾% Preferred shares, 1973 Series and $1.68 Cumulative Redeemable Convertible Subordinate Preferred shares, Series B are listed on the Montréal and Toronto Stock Exchanges. The 5% Preferred shares, 1955 and 1956 Series, are listed on the Montréal Stock Exchange.

Stock Transfer Offices
Trust Général du Canada, 10 ouest, rue Saint-Jacques, Montréal, Québec, 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 4¾% Preferred shares, 1965 Series, at its offices in Toronto and Winnipeg, and is the Co-Transfer Agent and Registrar for the 7¾% Preferred shares 1973 Series, 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.

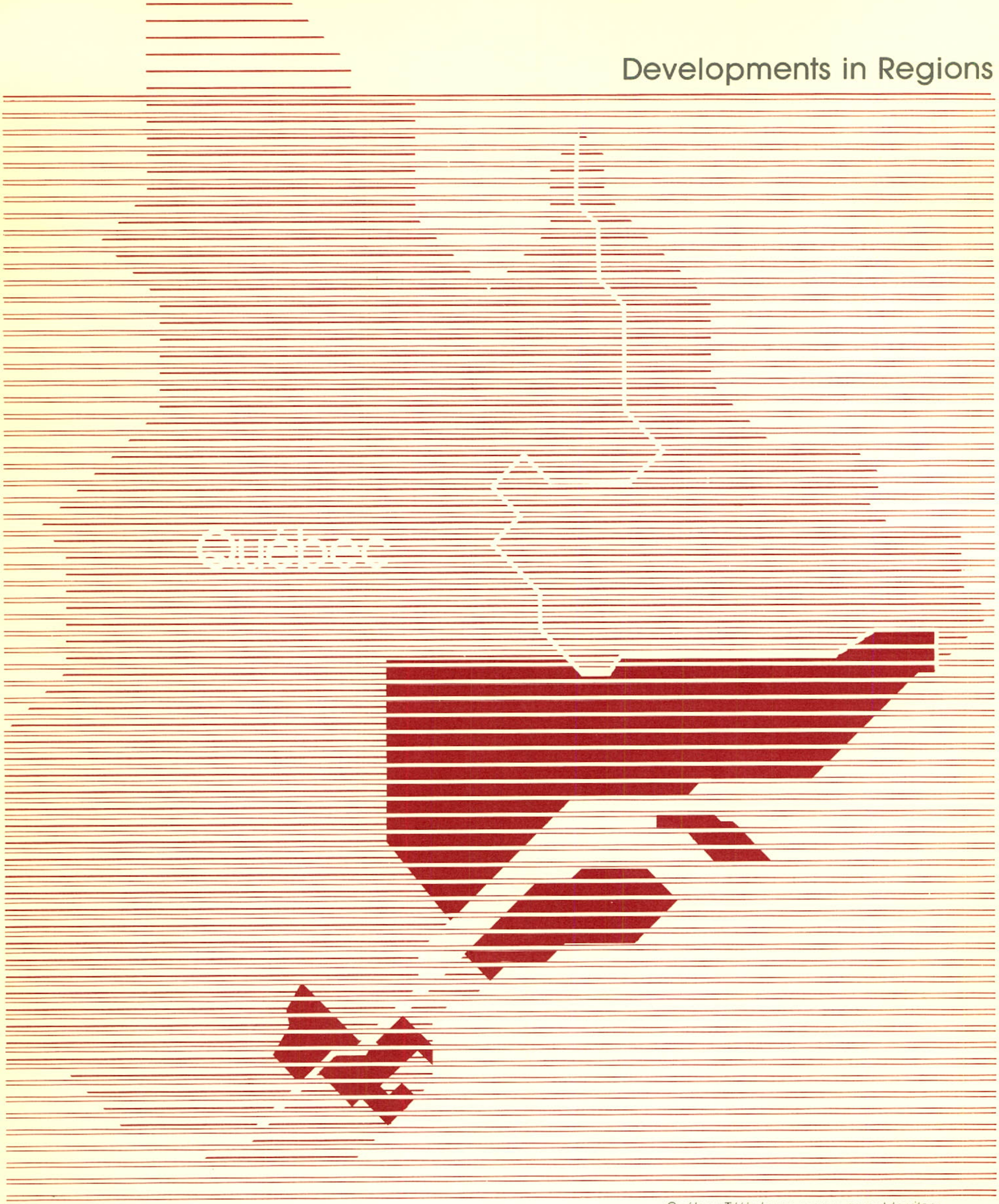
Trustee for Bonds
Trust Général du Canada
10 ouest, rue Saint-Jacques
Montréal, Québec

Bankers
Banque Nationale du Canada
Banque de Montréal

Subsidiary
La Compagnie de Téléphone Bonaventure et Gaspé, Limitée, New Carlisle, Québec

Annual Meeting
Your Directors appreciate the interest shown by shareholders who attend the Annual General Meetings and who participate in the discussion of the Company's affairs. This year the meeting will be held on April 21, 1980, in Rimouski, Québec. All shareholders who find it possible to attend are urged to do so.

Developments in Regions



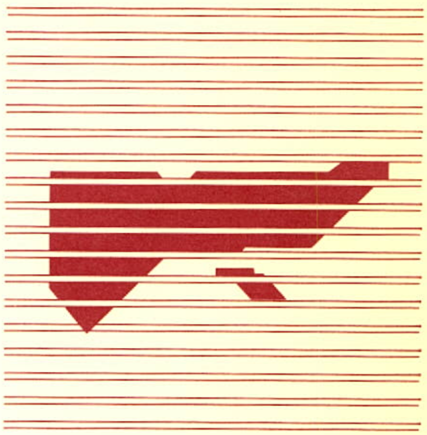
Québec-Téléphone serves a vast territory divided into three administrative regions covering 271,845 km².

North Shore Region

A new electronic switching system was put into service in Baie Comeau at the beginning of the year and this high-technology equipment was installed in an entirely renovated service building. This modernization further involved the installation of new digital-type private branch exchanges in the main companies in the area.

In Pentecôte, the establishment of a microwave radio infrastructure successfully completed the modernization of the Sept-Îles district toll network undertaken in 1974.

The Régie des services publics du Québec, after having cancelled the Ungava Telephone Company's permit on May 15, 1979, entrusted Québec-Téléphone with the responsibility of the telecommunications network which runs parallel to the railway line between Schefferville and Sept-Îles.



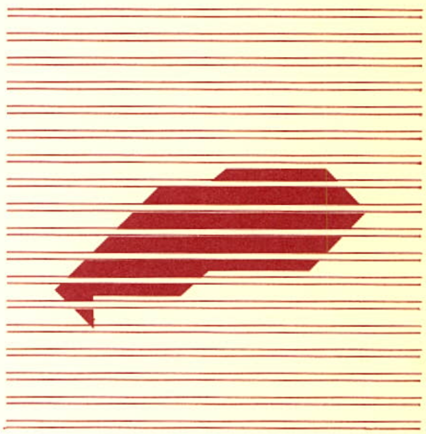
St. Lawrence Region

The improvement of a microwave route between Carleton and Rimouski in May, 1979 made it possible to double toll traffic transmission capacity between the Baie-des-Chaleurs and the Lower St. Lawrence.

A Plant Analysis and Coordination Centre equipped with two mini-computers was established in Rimouski this year. Experts can now monitor at a distance the operation of the equipment in the territory served and rapidly cope with any abnormal situation.

In New Carlisle the building of a $390,000 multi-purpose service centre has improved the working environment, while adding to the space used for storing equipment and preventive vehicle maintenance.

The setting up of a microwave link between Grosses-Roches and Sauvé has facilitated the successful completion of the Radio-Canada Matane TV transmitters rearrangement program in the northern Gaspé region.

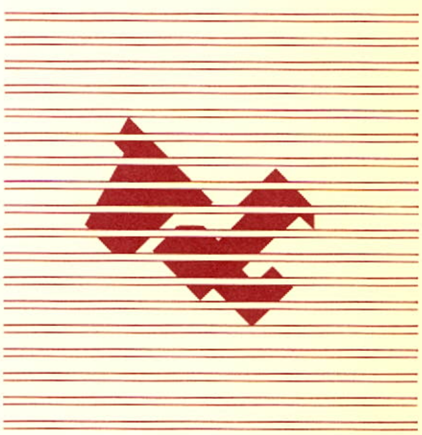


Québec Region

The extending of the paging service throughout the Beauce justified the implementation of two parallel transmission systems. This regional innovation was favorably received by business customers.

The rapid growth of the Québec Urban Community's industrial park in Saint-Augustin and the development of a regional community of interests with various Québec City south shore localities have resulted in the elimination of some long-distance costs. This broader service was also set up in various areas of the Beauce during the year.

In Saint-Stanislas, the replacement of a step-by-step system by electronic equipment has increased the switching capacity of the exchange while facilitating its maintenance. This accomplishment warranted a $750,000 investment.



Services for Special Needs

The society in which we find ourselves today is paying more and more attention to the fact that human needs vary, to such an extent that physical handicaps are no longer considered a liability preventing a person from leading a normal life.

Aware of its responsibilities to serve the entire community, Québec-Téléphone has marshalled its technology so that, on the street, in the home, and at the office, any person, in whatever condition, can enjoy conversing at a distance.

This concern with providing a versatile service has been expressed in many ways: for instance, improved access to buildings and public telephones.

Over the last few months, low-gradient ramps have been installed at the entrances of several Company buildings in an attempt to eliminate the architectural barriers which have made life difficult for some people.

Conveived in the same spirit, specialized telephone booths have also begun to appear in various public places of our regions.

Concern with finding a satisfactory solution to the special problems in day-to-day living has increasingly warranted the offer and promotion of specialized equipment. The following are examples:

For hearing
— a special receiver emitting a magnetic field which can be picked up by a hearing aid;
— a signal light substituted for the ringing bell, and a button to regulate the loudness of the voice coming out of the receiver;

For voice
— an amplifier with adjustable volume control for proper voice transmission;
— an electronic larynx emitting vibrations which make conversation possible when it is placed against the throat;

Whatever his condition, any Québec-Téléphone customer can count on a series of devices adapted to his particular needs.

For sight
— a touch-button telephone which eliminates the need for counting on the dial when dialing a number;

For mobility
— an automatic dialer which quickly traces frequently used numbers without fatigue or risk of error;
— a combination microphone-loudspeaker which makes it possible for a person to talk without using the hands to lift the receiver.

With the effective support of its technology, Québec-Téléphone is developing a program which is helping all of its customers

to achieve the highest degree of individual autonomy in the practice of communication. This is a fine challenge which must be taken up in relation with the needs of the community.

Computer Communications and the Future

Telephone and television are already well-integrated parts of our daily lives. Yet, it is difficult to imagine what new dimensions the combining of these two media will bring to community life by the end of the century. This is really and truly the dawning of a new era.

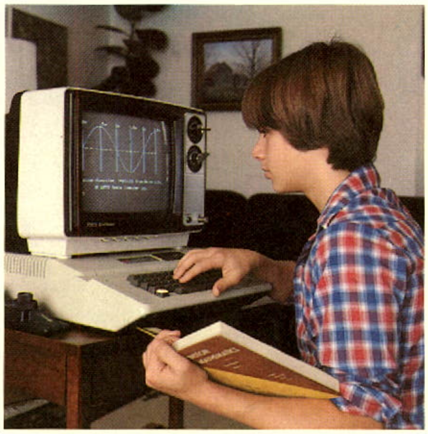
In the business world as in private life, the classical television set will gradually be transformed into an information production system. The development of interactive computer communications will be channelled through telephone and bi-directional video cable lines or will take the form of light pulse signals transmitted through fibre optics.

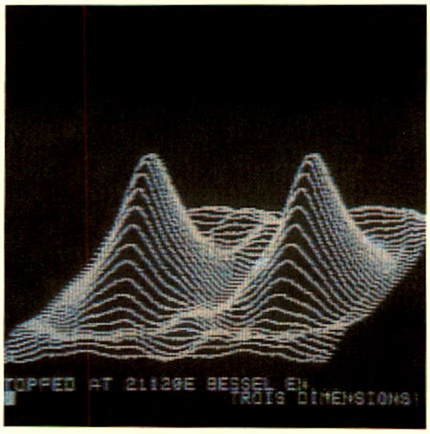
Perceiving these media in a new light, future man will have access to an evergrowing mass of information, in the form of texts, diagrams or photos, at the simple touch of a few buttons. Within the broad spectrum of human needs, each person will be able, from his home console, to reach communication media in order to select and purchase goods, hire services, pay bills, or even sell ideas.

In a computer society, the individual will be able to increase his scope of knowledge infinitely by plugging into a memory set up in such a way as to enable him to systematically seek out increasingly detailed information.

The universal access to information will have various implications on patterns of community living, on a person's private life as well as on his independence. Consideration of these new environmental data will require an intensive collective effort.

Moreover, the creation in this country of a healthy computer industry, well tuned to the needs of our times, will demand a sense of the future, an acceptance of innovation, and an ability to adapt which extends way beyond the present demands of competition in this ever-widening world.

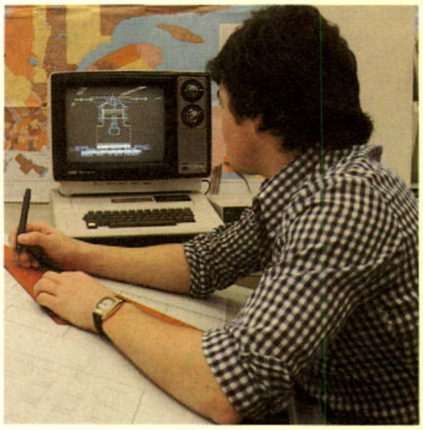




The new resources of computer communications have come out in the business world; they will soon find applications in our homes.

As it adjusts to this challenge, Québec-Téléphone will formulate a program enabling it to offer its customers the benefits of the exhaustive research currently taking place in the field of computer communications.

The future seems promising. Still, we will have to absorb the changes which undoubtedly will upset our world, this universe in constant search of wholeness. We must strive to build this future in a totally human way, with courage and intelligence.



A single word is all you need
To shatter the walls of loneliness.
And a voice will come.
But first you must have faith
In its reality.

Si vous préférez un exemplaire du rapport en français, veuillez écrire à:

Québec-Téléphone
Le secrétaire,
Siège social: 6, rue Saint-Jean, Dép. 4
Rimouski, Québec
G5L 7E4
Téléphone: (418) 723-2271

QUÉBEC-TÉLÉPHONE

Head Office: 6, rue Saint-Jean, Rimouski, Québec, G5L 7E4