

Clear Across The North



1996
ANNUAL REPORT

NORTHERN TELEPHONE LIMITED

About the Company

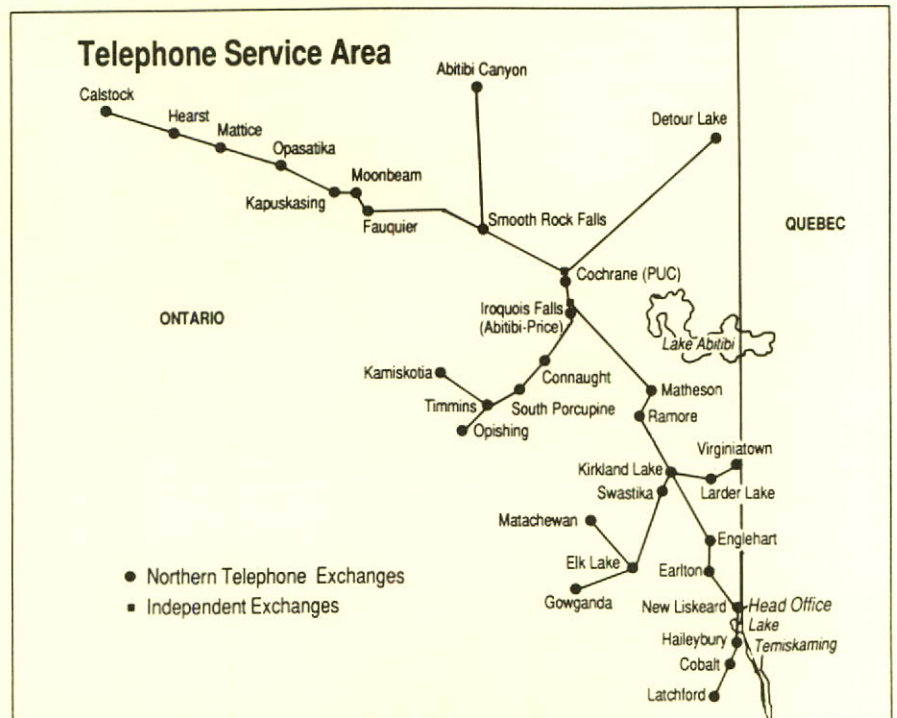
Bell Canada acquired control of Northern Telephone Limited in 1966 following a share purchase offer. Since April, 1983, Northern Telephone has been a subsidiary, directly or indirectly, of BCE Inc.

As it has since it was founded in 1905, Northern Telephone continues to adapt to the needs of its customers and to the changing economic conditions of the vast area it serves in Northern Ontario.

Northern Telephone is primarily engaged in providing local telecommunications services, while the government-owned Ontario Northland Transportation Commission provides long distance services in the region. As of December 31, 1996, Northern Telephone operated 32 exchanges with over 64,000 telephone numbers in a service area covering approximately 83,000 square kilometres.

Northern Telephone is an Internet access provider and its subsidiary, NorTel Mobility, offers cellular and mobile satellite telephone services throughout the system, from Calstock to Latchford.

The past year marked the commencement of a transformation process that will prepare and focus the company to meet the challenges of a rapidly changing telecommunications industry.



Our Cover

Alan Spacek, NorTel Mobility dealer in the Kapuskasing area, typifies the busy Northerner who finds cellular telephone service invaluable in keeping up with a busy schedule. Besides heading a successful business, Mr. Spacek is heavily involved in community work, serving as vice-chair of the Kapuskasing Board of Education and chair of the regional economic development committee. He is also a member of the Kapuskasing Police Services Board and a director of the Kapuskasing and District Chamber of Commerce, which named him Businessperson of the Year in 1996.

Northern Telephone Limited

Head Office
25 Paget Street
New Liskeard, Ontario
P0J 1P0

Annual Meeting

The Annual Meeting of the shareholders will take place on:
Thursday, May 15, 1997
11:30 a.m. at the Company's Head Office in New Liskeard

Transfer Agent

Montreal Trust Company of Canada
Toronto, Ontario
Montreal, Quebec

Trustee

Montreal Trust Company of Canada
Toronto, Ontario
Montreal, Quebec

Auditors

Deloitte & Touche
Chartered Accountants
Toronto, Ontario

Banker

Canadian Imperial Bank of Commerce
New Liskeard, Ontario

In 1996, great strides were made towards transforming Northern Telephone into an even more customer focussed Company, strategically positioned for success in the intensely competitive telecommunications industry.

Many of the industry changes that we anticipated in 1995, when we began our strategic planning process, are already upon us. The Canadian Radio-television Telecommunications Commission's (CRTC) recent regulatory framework decision moved us closer to a more competitive marketplace in our operating territory. Two separate \$2 increases in monthly basic service rates (effective 1 January 1997 and 1 January 1998) will bring rates somewhat closer to the much higher actual costs of providing local service, thereby progressively reducing the need for contribution payments from users of long distance services.

Another major milestone on the path to open competition was the CRTC's decision to no longer regulate the sale, lease and maintenance of competitive terminal equipment. As a result, Northern Telephone will unbundle offerings which combine competitive and monopoly services.

The regulator has also broadened Northern Telephone's allowable rate of return to 11.625% to 13.625% (previously 12.25% to 13.0%) in recognition of the more volatile competitive environment just ahead. And in the coming months we expect other CRTC decisions to provide direction and timing for both long distance and local competition in our territory.

New technology options are also intensifying competition throughout the industry. Cellular and personal communication system networks, direct-to-home satellite TV services, and the recently announced licensing of Local Multi-Point Communication System (LMCS) wireless networks across Canada are examples of how quickly potential alternate communications infrastructures are developing.

During 1996, Northern Telephone undertook a number of strategic initiatives to transform and refocus our company so as to ensure its continuing success in this emerging competitive marketplace. During the year, 21 of the 48 projects contained in our comprehensive Transformation Plan were completed, thereby achieving more than half the goal of improving future financial performance by \$5-\$8 million annually. The remaining projects will be completed during 1997.

The continuing high level of service delivered to our customers throughout this period of profound change is a testimonial to the professionalism and service ethic of our employees.

Throughout 1996, substantial effort was also focussed on developing a comprehensive Strategic Plan to achieve our Vision . . . "To be the preferred supplier of high value multi-media solutions in Northern Ontario for customer advantage and enjoyment."

The Strategic Plan provides the blueprint for continuing to grow our business profitably, by cultivating customer loyalty at every opportunity, by developing the skills of our people to be our primary competitive advantage, and by continually improving the effectiveness and competitiveness of our processes.

The highest priority tactical projects in the Plan are already well underway. Numerous others will be implemented, and closely monitored for success, over the next 2 to 3 years.

While preparing for the challenges and opportunities of the future, Northern Telephone achieved much success in 1996. Consolidated operating revenues increased by 6.2%, reaching \$50,813,000. Consolidated earnings were 86 cents per share, and the return on average common equity was 10.26%. Excluding the effect of our rapidly growing NorTel Mobility cellular subsidiary, earnings were \$1.08 per share, and return on average common equity reached 12.11%. NorTel Mobility's customers totalled 6,617 by year-end, an increase of 85% over 1995.

In June 1996, the President, Jacques J. Levesque, left the Company to assume another senior executive position in the telecommunications industry. Jacques joined Northern Telephone as President in 1993, and also served as Chairman and Chief Executive Officer of NorTel Mobility since its inception in September 1994. The Board of Directors will announce the appointment of a new President in the near future.

In November 1996, the General Manager and Secretary of NorTel Mobility, Michael B. Baker, resigned to accept an executive position with another prominent local business. Effective January 1997, Robert S. Jonkman was appointed to the vacant position. Mr. Jonkman brings 20 years experience in the mobility industry, including senior positions with Bell Mobility Radio and Mobility Canada.

In May 1996, Vice-Chairman Murray Cooper resigned from the Board of Directors of Northern Telephone after more than 40 years in the telecommunications industry, including 15 years as President of Northern Telephone. This vacancy on the Board was filled by Jean-Paul Aube, a respected businessman and community leader in Timmins.

As well, two new Directors were named to the Board of NorTel Mobility in June 1996, namely Gilles Malette, Vice-President of Solid Wood Products, Malette Inc. in Timmins, and John D. McNaughton, Vice-President of Marketing and Customer Solutions at Northern Telephone Limited.

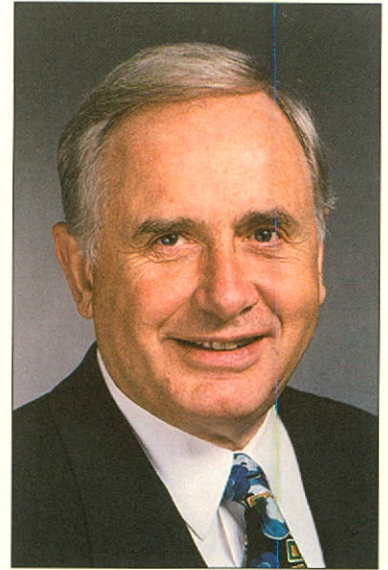
We sincerely thank these departing Officers for their remarkable contribution over the years, and are pleased for the good fortune of attracting talented people to lead us into the future.

Looking back, the past year has been one of profound change, essential preparation, and considerable success for Northern Telephone. I am most grateful to the Board of Directors and the entire employee team for their contributions to these achievements. And I am confident that with their continued support Northern Telephone will advance swiftly along the path towards fulfilling its Vision.



Murray J. Makin
Chairman and Chief Executive Officer

Message from the Chairman



Operational

1996 was definitely challenging, but also a very successful year for Northern Telephone Limited. The company made great strides with the introduction of new products and services, process improvements and transformation activities. Network improvements and technological advancements were aimed at improving the company's competitive position in a rapidly changing telecommunications industry.

Strategic Plan

In 1996, Northern Telephone developed a comprehensive strategic plan which will focus and direct the company for the future. The company's vision and commitment to its customers is "To be the preferred supplier of high value multi-media solutions in Northern Ontario for customer advantage and enjoyment."

The four pillars which support the vision will ensure its long term success. The intent of the "Customers" pillar is to cultivate customer loyalty at every opportunity. The "Employees" pillar will develop our people and culture to be our primary competitive advantage, while "Processes" improves the effectiveness and competitiveness of our processes. The goal of the final pillar, "Shareholders", is to grow our revenues profitably.

The strategies and key tactics necessary for Northern Telephone to prosper in the new marketplace are well under way. Implementation priorities are based on impact, urgency for action, required resource and skill sets. Tracking mechanisms have been designed to measure progress and results as these priorities are pursued.

Transformation Program

In 1996, a transformation program to restructure and focus Northern Telephone into a more compact, highly competitive, customer-focussed organization, achieved excellent results.

The completion of 21 projects provided an annual financial performance improvement of \$3 million in net

operating costs. The work force was reduced by 87 employees, primarily through early retirement and termination incentive packages.

Work activities such as custodial services, facilities management, vehicle maintenance, service bureau and construction of network facilities have been outsourced to local suppliers.

The transformation program continues in 1997, with 27 additional projects expected to be completed.

Process Improvements

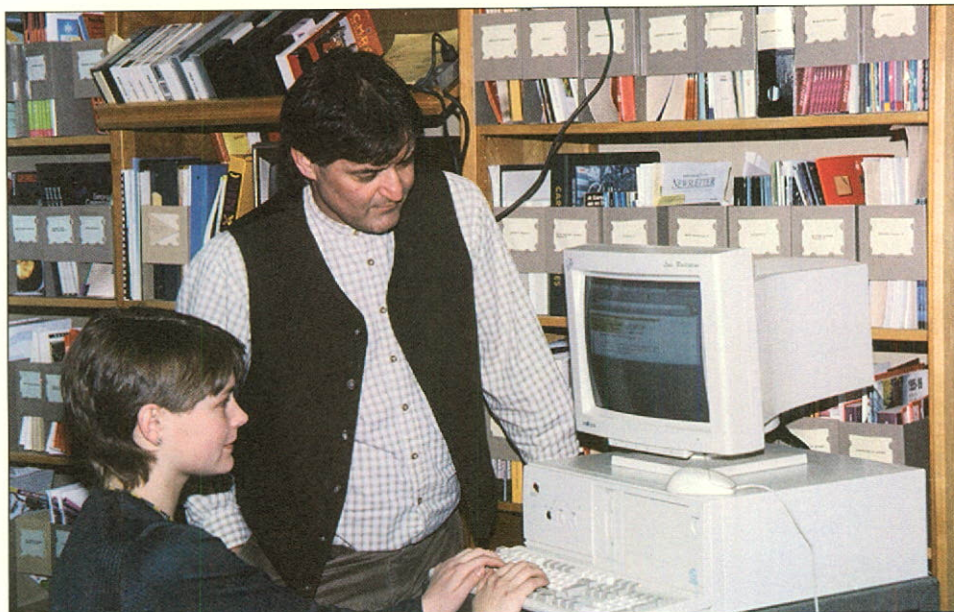
Our continuous improvement philosophy guides the company to improve internal processes, to reduce waste, rework and costs, and be more efficient and effective in delivering customer service. In 1996, the company achieved many such improvements in service delivery.

It is now possible for one company representative to handle all of a customer's on-site service needs through Northern Telephone's multi-skilled technicians initiative. This provides our customers with a much quicker response time.

Another enhancement to our customer response time is the automatic line assignment and service on demand now available in the Northern Telephone service order system. Customers are assured of same day service in most locations.

Our dispatch module provides an additional improvement to customer service. Technicians can now clear orders from the field and receive new orders over an internal voice information system that provides a direct link with the Northern Telephone support network.

The establishment of a remote maintenance, administration and traffic (RMAT) centre gives Northern Telephone the ability to monitor performance and make program changes at a customer's premises without dispatching a technician to the site. By dialing into the customer's telephone system, Northern Telephone technicians can alter various functions, such as voice mail forwarding, extension numbers and key programming.



Internet for Schools

Gaetan Lacoursiere, Product Manager - Internet Services, explains Northern Telephone's Internet for Schools program to Sarah Van Stiphout, a grade 13 student at Ecole Secondaire Saint-Marie in New Liskeard. The initiative provides schools in the company's territory with affordable access to the Internet.

Highlights

Network Development

Modernization of Northern Telephone's exchange at Swastika is only one example of the service improvements made throughout the system during 1996. Individual line customers in that community now have digital service with access to value-added features, such as Call Display, Call Return and Call Waiting. Northern Telephone now has 92% of its customers served with digital switch facilities.

Northern Telephone's newest line feature, Voice Mail, was introduced to individual line business and residential customers in Timmins and Cochrane during 1996 and is growing rapidly in popularity.

Growth on the Internet

The Internet market continued to be the fastest growing and fastest changing sector of the telecommunications industry during the past year, and Northern Telephone's Internet link, NT.NET, established itself as a major force in the Northeastern Ontario market. By the end of 1996, its first full year of operation, NT.NET made rapid strides by more than quadrupling the number of subscribers.

For home, small office and large business, Northern Telephone provides prime Internet connections with local access from 30 communities throughout Northeastern Ontario. Among the features of the service are a customer help desk available seven days a week and a secure server.

In addition, Northern Telephone becomes the Sympatico Internet service provider for Northeastern Ontario in 1997. The Sympatico service is a national leader in the market.

In October, Northern Telephone and NT.NET launched the Internet for Schools program. This major initiative provides primary and secondary schools in our serving territory with affordable access to the Internet.

Expansion at NorTel Mobility

Northern Telephone's cellular subsidiary, NorTel Mobility, continued its expansion program and almost doubled its customer base during 1996. Transmission sites were established at Hearst, Matheson, Ramore, Haileybury and Latchford as part of a plan to improve service throughout the region. In addition to service in all key centres in the region, NorTel Mobility now provides the link for continuous cellular coverage from Timmins to Toronto.

Protecting the Environment

Northern Telephone continued its sponsorship of Earth Day, with even greater participation in the community and by our employees. In the Tri-Town area alone, 23 groups joined in the challenge of improving the local environment and over 70 per cent of the employees took part. The waste minimization program is now operating at all major Northern Telephone locations, recycling office paper, boxboard, cardboard and aluminum cans. Over 60 schools across the company's service area participated in Northern Telephone's directory recovery program in 1996. Each school receives a certificate honouring its efforts.

Impressive Safety Record

The comprehensive safety training program conducted by the company was recognized on May 23, 1996, when Northern Telephone received the Electrical Utilities Safety Association President's Award. This honour was earned when company employees completed the period from July 22, 1995 to April 4, 1996, a total of 500,000 work hours, without a lost time injury.

Community Presence

Northern Telephone continues to play an active role in supporting the quality of life enjoyed by residents of northeastern Ontario. An example is the recognition of local artistic talent through an annual contest to select artwork for use on the cover of the company's telephone directories. NorTel Mobility also maintains a busy schedule of sponsorship participation in winter carnivals and sports events across the region.



HOSPITAL UPGRADE: Ginette Cloutier-Cantin, Senior Receptionist at Notre Dame Hospital in Hearst, uses the Meridian system installed by Northern Telephone to upgrade communications at the health centre. The installation included training and technical support by Northern Telephone specialists.



Centrex Technology

Centrex technology installed by Northern Telephone at the new Government Complex in Timmins provides several ministries with more efficient communications services at a cost effective price. Account Executive, Lynn Rizzuto (standing) describes Centrex features to Frank Cook (left) and Jim Collins of Management Board Secretariat, and Jane Topozini, Communication Co-ordinator for the Government Complex.

Customer Solutions – Our Main Strength

Northern Telephone Limited is an innovative leader in the Northeastern Ontario telecommunications market, effectively providing quality solutions to meet customer needs—large and small, residential and business. The company's strength is superior technical and customer support, combined with an excellent line of telecommunication products and services.

Support and Service

The Northern Telephone Customer Solutions group can provide a full range of services, including needs assessment, product options, sales, installation and maintenance, all supported by an experienced technical team.

The company provides an effective approach to serving its various market segments with special groups organized to serve specific needs. The professional Call Centre handles all residential and single line business requirements, while smaller business customers are supported by a team of friendly and knowledgeable business service representatives in our Business Customer Service Centre.

For large businesses, with more complex and ongoing communications needs, Northern Telephone has an experienced team of account executives with extensive training in telecommunications solutions. The account executive group meets with major accounts on a regular basis in order to fully understand the customer's needs, recommend solutions, and oversee the completion of projects while providing continuing support.

Behind the customer service and account executive teams is a highly qualified technical team which provides expertise in network systems design,

installation, maintenance and repair. This dedicated combination of customer service staff and technical experts can recommend the right products and services for everything from single line home sets, to small office telephone systems and large switches for major corporations.

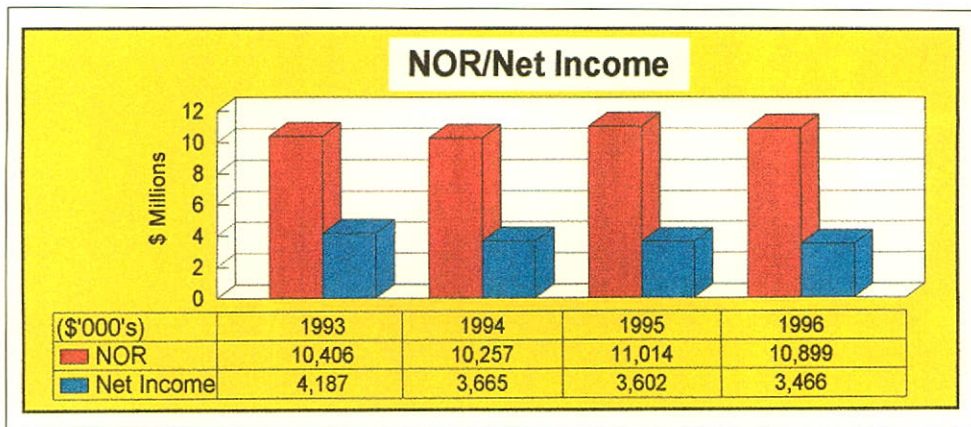
A support team will assess customer needs and recommend telecommunications solutions for all types of voice and data requirements. Northern Telephone also works closely with national and international companies to meet local customer needs when network connectivity back to a parent office is required, anywhere in the world.

Products and Services

Northern Telephone is an authorized dealer for NorTel and Mitel products, both Canadian companies and among the most popular PABX and Key System manufacturers in the world. Products include residential telephone sets, such as the superior Vista line of display phones, including cordless models and two-line sets with hands-free capability. The company also offers an array of value-added network services for corporations. These include Centrex, DS-1, Switch 56, Digital Service and dedicated connections to the Internet.

Small businesses and residential customers benefit from the many value-added network services available through Northern Telephone. Popular features in this category are Call Answer, Call Waiting, Call Display, Call Return, Call Trace, Call Forwarding, Speed Calling and Three-way Calling.

Northern Telephone's Yellow Pages is one of the most powerful advertising media in Northeastern Ontario, with regional directories distributed annually.



Northern Telephone operates solely in Ontario and is regulated by the Canadian Radio-television Telecommunications Commission (CRTC).

The company's consolidated operating revenues reached \$50,813,000 for 1996, with earnings of 86 cents per share and return on average common equity of 10.26%.

Local service revenues for 1996 were \$24,137,000, an increase of 6.6% over 1995, while carrier access and long distance revenues totalled \$17,015,000, up 0.5% over the previous year. The gains in local service income were due mainly to a 1.8% growth in telephone numbers, rate increases for miscellaneous services, and a continued increase in revenues from call management services and touch tone. The company also completed its first full year as an Internet service provider during 1996.

Other operating revenues for 1996 increased by 16.6%, to \$9,661,000, marked by the continued growth of NorTel Mobility revenues, the result of a larger subscriber base and expanded coverage.

Salary and wage compensation expense for 1996 was \$16,002,000, representing an increase over 1995 of \$449,000 or 3.2%. Transformation costs were the primary reason for this increase.

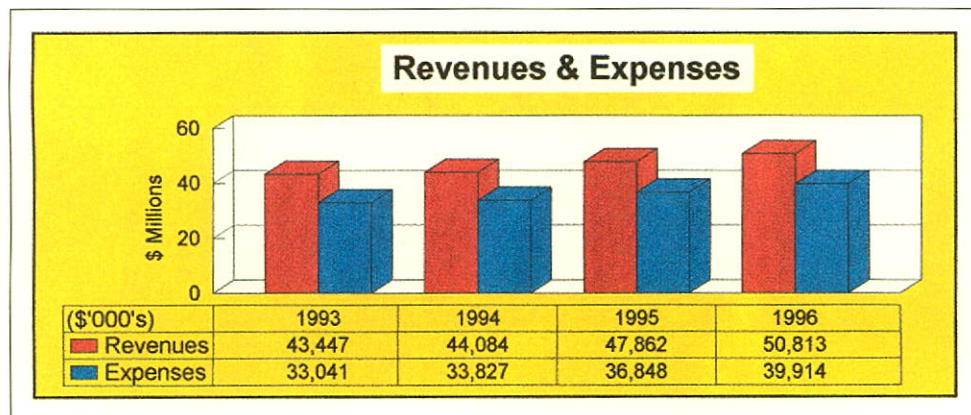
Northern Telephone began a three-year transformation program in 1996, with total cost of the project estimated at \$11.4 million. Approval has been received from the CRTC to amortize these costs.

On December 18, 1996, the company had a debenture issue of \$8,000,000 at an interest rate of 8.02%, maturing on December 18, 2016. Proceeds will be used mainly to support the company's capital program.

A regulatory decision made in August, 1996 will see local exchange rates increase by \$2 per month on January 1, 1997 and a further \$2 per month on January 1, 1998. Another change in 1997 removes the rental of terminal equipment from regulated operations and includes this item in the competitive category.

In 1996, the company achieved a rate of return on regulated operations of 12.6%, which is within the 12.25 to 13.0% range established by the CRTC. The regulated rate of return established for 1997 is from 11.625% to 13.625%.

Financial Highlights



Five Years In Review

	1996	1995	1994	1993	1992
NTL (Consolidated)					
Financial Results (\$)					
Operating revenues	50,812,362	47,861,696	44,084,180	43,447,029	40,228,865
Operating expenses	39,914,737	36,847,907	33,827,525	33,041,505	30,990,955
Other income	(7,220)	(17,971)	16,637	69,593	127,714
Other charges	3,931,697	4,170,871	3,359,904	3,198,327	3,119,590
Income taxes	3,492,823	3,222,955	3,248,539	3,333,740	2,222,627
Income from continuing operations	3,465,855	3,601,992	3,664,849	3,943,050	4,023,407
Net income	3,465,855	3,601,992	3,664,849	4,187,001	4,023,407
Total payroll	16,002,212	15,522,314	14,744,628	14,746,923	14,248,072
Construction expenditures	13,688,445	10,161,480	12,942,193	8,537,446	15,522,131
Financial Ratios (\$)					
Earnings per common share	0.86	0.89	0.90	1.05	1.05
Dividends declared per common share	0.84	0.84	0.84	0.84	0.84
Balance Sheet Data (\$)*					
Total investment in plant & equipment	147,908,598	137,046,786	128,625,087	117,396,856	111,026,445
Plant & Equipment less depreciation	88,239,001	82,736,323	80,126,628	74,386,226	72,189,171
Common equity	29,603,666	29,527,378	29,356,007	29,139,625	28,408,721
Preferred equity	7,564,000	7,564,000	8,124,000	8,204,000	8,284,000
Long-term debt (Including due within 1 year)	43,500,000	36,201,000	28,919,000	23,555,000	25,762,000
NTL (Unconsolidated)					
Additional Statistics					
Number of employees*	266	295	301	286	278
Total telephone numbers*	64,197	63,081	61,467	60,236	59,498
Business	17,359	16,477	15,326	14,459	14,023
Residence	46,838	46,604	46,141	45,777	45,475
Percentage business of total	27.0	26.1	24.9	24.0	23.6
Number of central offices*	31	31	31	31	31
Long distance messages (thousands)	18,149	17,334	15,755	14,095	13,337
Number of shareholders (preferred and common)*					
In Canada	619	660	712	766	842
Elsewhere	17	19	20	21	22
Total Shareholders	636	679	732	787	864

* As at December 31

To the Shareholders of Northern Telephone Limited.

The data contained in this Annual Report of Northern Telephone Limited is the responsibility of management and has been approved by the Board of Directors. The consolidated financial statements are based upon management's best estimates and judgements and have been prepared within the guidelines of generally accepted accounting principles.

To ensure the integrity and objectivity of the data, management maintains a system of internal controls, comprised of written policies, procedures and a comprehensive internal audit program.

The internal audit program provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements, and that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the consolidated financial statements in this Annual Report principally through its Audit Committee. The Audit Committee meets with management and the internal and external auditors to review accounting principles, practices and internal controls.

The shareholders' external auditors meet with the Audit Committee both with and without management present.

These consolidated financial statements have been examined by the shareholders' auditors, Deloitte & Touche, chartered accountants, and their report is presented below.



Murray J. Makin
*Chairman and
Chief Executive Officer*



Dennis D. McCarty
*Treasurer and
Vice-President, Finance & Corporate Services*

To the Shareholders of Northern Telephone Limited

We have audited the consolidated balance sheets of Northern Telephone Limited as at December 31, 1996 and 1995, and the consolidated statements of income, retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and 1995, and the results of its operations and the changes in financial position for the years then ended in accordance with generally accepted accounting principles.

Deloitte & Touche
Chartered Accountants
January 17, 1997

Management Report

Auditors' Report

Consolidated Balance Sheets

As at December 31
(in thousands of dollars)

	<u>1996</u>	<u>1995</u>
ASSETS		
Current		
Accounts receivable (Note 11)	\$ 8,219	\$ 8,381
Inventory	274	299
Income taxes recoverable	148	—
Prepaid and other	486	730
	<u>9,127</u>	<u>9,410</u>
Telecommunications Property - at cost		
Buildings, plant and equipment (Note 4)	146,253	132,833
Less: accumulated depreciation (Note 4)	59,669	54,310
	<u>86,584</u>	<u>78,523</u>
Land	572	545
Plant under construction	1,083	3,669
Materials and supplies	369	462
	<u>88,608</u>	<u>83,199</u>
Other		
Long-term receivables (Note 5)	379	697
Deferred charges		
Pension costs	5,027	4,640
Business transformation costs	1,629	—
Other	429	355
	<u>7,464</u>	<u>5,692</u>
Total Assets	<u>\$105,199</u>	<u>\$ 98,301</u>
LIABILITIES		
Current		
Bank indebtedness	\$ 1,113	\$ 860
Accounts payable and accrued liabilities (Note 11)	9,185	6,946
Advance billing for service	1,095	937
Taxes/income taxes payable	—	9
Dividends payable	847	866
Interest accrued	745	728
Debt due within one year (Note 6)	3,069	5,701
	<u>16,054</u>	<u>16,047</u>
Long-term Debt (Note 7)	<u>42,450</u>	<u>35,500</u>
Deferred Credits		
Income taxes	9,507	9,641
Other	20	22
	<u>9,527</u>	<u>9,663</u>
Shareholders' Equity		
Share capital (Note 8)		
Preference shares	7,564	7,564
Common shares	18,935	18,935
Retained earnings	10,669	10,592
	<u>37,168</u>	<u>37,091</u>
Total Liabilities And Shareholders' Equity	<u>\$105,199</u>	<u>\$ 98,301</u>

Approved by the Board

 Director

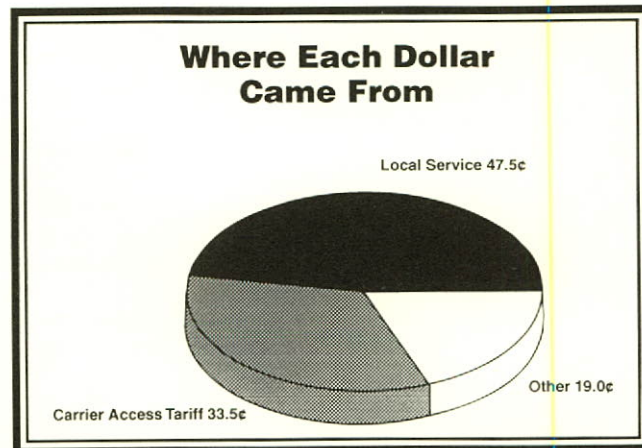
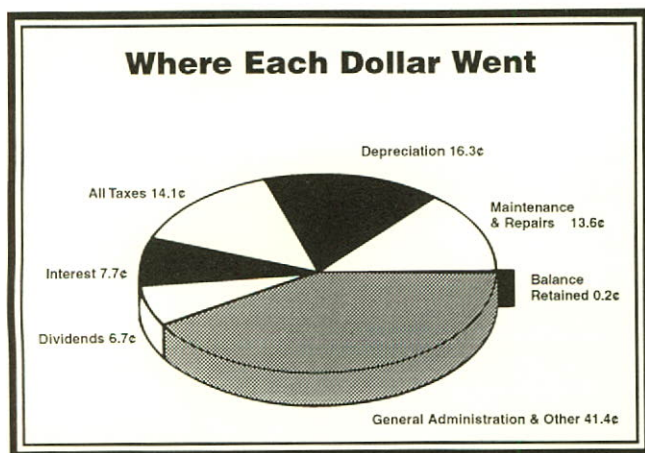
 Director

	<u>1996</u>	<u>1995</u>
Operating Revenues		
Local service	\$ 24,137	\$ 22,641
Carrier access tariff and long distance service (Note 2)	17,015	16,937
Other	9,661	8,284
Total Operating Revenues	50,813	47,862
Operating Expenses		
Maintenance and repairs	6,886	7,272
Depreciation	8,299	7,663
Taxes other than income taxes	3,667	3,575
General administration and other	21,062	18,338
Total Operating Expenses	39,914	36,848
Net Operating Revenues	10,899	11,014
Other Expense	(7)	(18)
Income Before Underlisted Items	10,892	10,996
Interest Charges		
Interest on long-term debt	3,480	3,321
Other	453	850
Total Interest Charges	3,933	4,171
Income Before Income Taxes	6,959	6,825
Income Taxes (Note 3)	3,493	3,223
Net Income	3,466	3,602
Dividends On Preference Shares	409	450
Net Income Applicable To Common Shares	\$ 3,057	\$ 3,152
Net Earnings Per Common Share	\$ 0.86	\$ 0.89
Dividends Declared Per Common Share	\$ 0.84	\$ 0.84
Average Common Shares Outstanding (Thousands)	3,548	3,548

Consolidated Statements of Income

Year ended December 31

(in thousands of dollars except per share data)



Consolidated Statements of Retained Earnings

Year ended December 31
(in thousands of dollars)

	1996	1995
Balance, Beginning Of Year	\$ 10,592	\$ 10,421
Add: net income	3,466	3,602
	14,058	14,023
Deduct:		
Dividends on preference shares	409	450
Dividends on common shares	2,980	2,981
	3,389	3,431
Balance, End Of Year	\$ 10,669	\$ 10,592

Consolidated Statements of Changes in Financial Position

Year ended December 31
(in thousands of dollars)

	1996	1995
Net Inflow (Outflow) Of Cash Related To The Following Activities		
Operating		
Net income	\$ 3,466	\$ 3,602
Items not affecting cash		
Depreciation	8,299	7,663
Deferred income taxes	(134)	(536)
Deferred charges - pension costs	(387)	(797)
- business transformation costs	45	—
Other	(2)	(23)
Decrease (increase) in operating working capital (Note 10)	2,669	(71)
Cash flow from operations	13,956	9,838
Investing		
Capital expenditures - net	(13,708)	(10,356)
Reduction in investment in common control enterprise	—	280
(Increase) decrease in other assets	(1,315)	517
	(15,023)	(9,559)
Dividends Declared	(3,389)	(3,431)
Free Cash Flow	(4,456)	(3,152)
Financing		
Proceeds from issue of long-term debt, net of issue costs	7,885	13,849
(Decrease) increase in bankers' acceptances	(3,500)	5,000
Increase (decrease) in note payable	519	(7,000)
Repayment of long-term debt	(701)	(6,718)
Redemption of preference shares	—	(560)
	4,203	4,571
Net Cash Flow	(253)	1,419
Bank Indebtedness, Beginning Of Year	(860)	(2,279)
Bank Indebtedness, End Of Year	\$ (1,113)	\$ (860)

1. Accounting Policies

The Company is subject to regulation, including examination of accounting practices, by the Canadian Radio-television and Telecommunications Commission (CRTC). The system of accounts and accounting practices are similar to those being used by other companies in the telecommunications industry.

Consolidation

In 1994 the Company formed a wholly owned subsidiary, NorTel Mobility Inc., to set up and operate a cellular telephone network in the region of Northeastern Ontario currently serviced by Northern Telephone Limited.

The consolidated statements include the accounts and results of the subsidiary.

Business Transformation Program

In 1996, the Company announced that, as a key element in its three-year transition plan to restore its financial strength, it would be implementing a business transformation program which is expected to result in substantial on-going cash benefits through cost structure reduction. Consistent with the methodology directed by the CRTC for workforce reduction programs, workforce transition and process optimization costs will be deferred and amortized over the five years commencing the month in which they are incurred.

During 1996, \$1,674 thousand of workforce reduction and process optimization costs were incurred and deferred, of which \$45 thousand was amortized as operating expenses.

Depreciation

Depreciation for telephone operations is charged on a straight-line basis using rates, which are approved by the CRTC, by class of property, determined by a continuing program of studies. When depreciable telecommunications property is retired, the amount at which such property has been carried in telecommunications property is charged to accumulated depreciation.

These rates provide for depreciation of assets over their estimated service lives and resulted in the composite depreciation rate of 5.94% for the year ended December 31, 1996 (1995 - 5.99%).

Income taxes

The Company uses the tax allocation basis of accounting for income taxes. Deferred income taxes result principally from deductions for tax purposes, in respect of telecommunications property, being in excess of amounts currently charged to operations.

The Company's deferred income tax liability was reduced in 1991 and 1992, with the approval of the Ontario Telephone Service Commission, to record the liability at the enacted corporate income tax rate at that time. No further adjustments to the deferred income tax liability have been made to reflect changes in the tax rate.

Pensions and other post-retirement benefits

The Company has contributory defined benefit plans which provide for service pensions based on length of contributory service and rates of pay for substantially all its employees.

The policy is to fund pension costs through Company contributions based on actuarial cost methods as permitted by pension regulatory bodies. Such contributions reflect actuarial assumptions regarding salary projections and future service benefits. Plan assets are represented primarily by bonds, debentures and common stocks.

The Company also provides certain health care and life insurance benefits for employees on retirement. The cost of these benefits, excluding life insurance, is recorded in operating expenses as paid. Life insurance for retired employees is largely funded during their working lives.

Inventory

Inventory for resale is recorded at the lower of cost and net realizable value.

Financial instruments

The carrying amounts in the consolidated balance sheets for accounts receivable, long-term receivables, bank indebtedness and accounts payable and accrued liabilities approximate fair value. The fair value of long-term debt is disclosed in Note 7.

Notes to the Consolidated Financial Statements

December 31, 1996 and 1995

Notes to the Consolidated Financial Statements

2. Carrier Access Tariff and Long Distance Service Revenue

Long distance telephone service in the Company's serving territory is carried by Ontario Northland Transportation Commission ("ONTC"). The Company provides access and local service to its own customers and interconnects with the ONTC system. The Company also performs the customer billing and collection functions for ONTC.

Until April 30, 1995, the Company's revenues included its negotiated share of total long distance service revenue. From May 1, 1995, the Company's revenue has been determined using a Carrier Access Tariff ("CAT"), which has received interim regulatory approval.

Included in Carrier Access Tariff and long distance service revenue is \$17,015 thousand (1995 - \$12,033) of CAT revenue and \$Nil (1995 - \$4,904 thousand for 4 months) of the Company's negotiated share of long distance revenue.

3. Income Taxes

A reconciliation of the statutory income tax rate to the effective income tax rate is as follows:

	<u>1996</u>	<u>1995</u>
	%	%
Statutory income tax rate	44.6	44.6
Large corporations tax and other	5.6	2.6
Effective income tax rate	50.2	47.2

Details of the Company's income tax provision are as follows:

	<i>(thousands of dollars)</i>	
	<u>1996</u>	<u>1995</u>
Current	\$ 3,627	\$ 3,188
Deferred	(134)	35
Total	\$ 3,493	\$ 3,223

4. Telecommunications Property

Buildings, plant and equipment consist of:

	<i>(thousands of dollars)</i>					
	<u>1996</u>			<u>1995</u>		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Buildings	\$ 11,144	\$ 2,906	\$ 8,238	\$ 10,598	\$ 2,622	\$ 7,976
Central office equipment	54,986	19,794	35,192	48,411	17,987	30,424
Outside plant	55,359	24,378	30,981	50,032	22,891	27,141
Other	24,764	12,591	12,173	23,792	10,810	12,982
	\$146,253	\$59,669	\$86,584	\$132,833	\$54,310	\$78,523

5. Long-Term Receivables

Long-term receivables consist of:

	<i>(thousands of dollars)</i>	
	<u>1996</u>	<u>1995</u>
Total lease payments receivable	\$ 795	\$ 1,422
Less: unearned interest income	107	220
Net investment in leases	688	1,202
Less: current portion of lease payments included in accounts receivable	309	505
Total	\$ 379	\$ 697

Finance income related to these leases is recognized over the term of the lease.

Future minimum lease payments receivable under sales-type leases are:

<i>(thousands of dollars)</i>	
1997	\$377
1998	\$243
1999	\$131
2000	\$ 31
2001	\$ 13

6. Debt Due Within One Year

	<i>(thousands of dollars)</i>	
	1996	1995
Long-term debt due within one year (Note 7)	\$ 1,050	\$ 701
Bankers' acceptances	1,500	5,000
Bank demand notes	519	—
Total	\$ 3,069	\$ 5,701

The interest rate on the bankers' acceptances at December 31, 1996 was 3.55% (1995 - 6.75%).

Notes to the Consolidated Financial Statements

7. Long-Term Debt

			<i>(thousands of dollars)</i>	
<u>Maturity Date</u>	<u>Rate of Interest</u>	<u>Series</u>	1996	1995
15 Year Serialized Debentures May 31, 1997	17.50%	L	\$ 500	\$ 1,000
20 Year Serialized Debentures October 15, 2009	11.00%	N	8,000	8,000
20 Year Serialized Debentures June 1, 2012	10.25%	O	5,000	5,000
20 Year Serialized Debentures April 15, 2014	9.214%	P	8,000	8,000
5 Year Serialized Debentures September 21, 2000	8.37%	Q	7,000	7,000
10 Year Serialized Debentures September 21, 2005	8.80%	R	7,000	7,000
20 Year Serialized Debentures December 18, 2016	8.02%	S	8,000	—
Promissory Note January 1, 1996	8.90%		—	201
Total			43,500	36,201
Less: long-term debt due within one year (Note 6)			1,050	701
Total			\$42,450	\$35,500

Maturity payments required in the following years with respect to the above debt are:

<i>(thousands of dollars)</i>	
1997	\$ 1,050
1998	\$ 550
1999	\$ 550
2000	\$ 7,550
2001	\$ 550
2002 - 2006	\$ 9,750
2007 - 2011	\$ 4,750
2012 - 2016	\$18,750

The estimated fair value of the Company's long-term debt (including long-term debt due within one year) is \$49,693 thousand (1995 - \$40,555 thousand). This estimate is based upon the future cashflows associated with each instrument, discounted using a current market rate for a similar debt instrument of comparable maturity. These estimates are subjective in nature and often cannot be determined with precision.

Notes to the Consolidated Financial Statements

8. Share Capital

	No. of Shares	Series	Dividend Per Share \$	(thousands of dollars)	
				Share Capital 1996	1995
Authorized Preference shares - voting					
First preference	500,000	—	—	\$10,000	\$10,000
Second preference	128,200	—	—	2,564	2,564
Total preference	<u>628,200</u>			<u>\$12,564</u>	<u>\$12,564</u>
Common shares	<u>6,500,000</u>			<u>\$35,000</u>	<u>\$35,000</u>
Issued and outstanding Preference shares					
First preference - cumulative, redeemable	75,000	A	1.10	\$ 1,500	\$ 1,500
	50,000	B	1.10	1,000	1,000
	100,000	C	1.10	2,000	2,000
	25,000	D	1.10	500	500
	<u>250,000</u>			<u>5,000</u>	<u>5,000</u>
Second preference - cumulative, redeemable	7,853	A	1.00	157	157
	120,347	B	1.05	2,407	2,407
	<u>128,200</u>			<u>2,564</u>	<u>2,564</u>
Total preference	<u>378,200</u>			<u>\$ 7,564</u>	<u>\$ 7,564</u>
Common shares	<u>3,548,071</u>			<u>\$18,935</u>	<u>\$18,935</u>

All the preference shares are redeemable at the Company's option at \$20.40 per share.

9. Pensions

The following table presents the financial position of the Company's pension plans:

	(thousands of dollars)	
	1996	1995
Pension plan assets at market related value	\$39,867	\$33,328
Actuarial present value of accrued pensions benefits as at December 31	32,904	28,614
Surplus	<u>\$ 6,963</u>	<u>\$ 4,714</u>
Total pension expense for the year	<u>\$ 829</u>	<u>\$ 448</u>

10. Statement of Changes in Financial Position

(thousands of dollars)

	<u>1996</u>	<u>1995</u>
(Increase) decrease in operating working capital provided by change in:		
Accounts receivable	\$ 162	\$ (450)
Inventory	25	(26)
Income taxes recoverable	(148)	—
Prepaid and other	244	84
Accounts payable and accrued liabilities	2,239	167
Advance billing for service	158	3
Taxes/income taxes payable	(9)	9
Dividends payable	(19)	(13)
Interest accrued	17	155
	<u>\$ 2,669</u>	<u>\$ (71)</u>
(Increase) decrease in operating working capital		

Notes to the Consolidated Financial Statements

11. Related Party Transactions

As at December 31, 1996, the accounts receivable from common control enterprises were \$5 thousand (1995 - \$26 thousand). The amount payable to BCE Inc., the parent, and common control enterprises was \$1,847 thousand (1995 - \$2,636 thousand).

For the year ended December 31, 1996, the Company purchased goods and services amounting to \$6,689 thousand (1995 - \$8,464 thousand) from the parent and common control enterprises and the Company sold to common control enterprises goods and services in the amount of \$339 thousand (1995 - \$327 thousand). For the year ended December 31, 1996, the Company incurred interest expense on a promissory note to the parent company of \$Nil (1995 - \$6 thousand).



Board of Directors

Members of the Northern Telephone Limited Board of Directors are, seated, from left: David A. Lazzarato, Vice-President and Comptroller, BCE Inc., Montreal; Murray J. Makin, Chairman of the Board, Northern Telephone, Toronto; Charles A. Labarge, President and Chief Executive Officer, Mobility Canada, Toronto. Standing, from left: Gaston Malette, Chairman of the Board, Chief Executive Officer and President, Malette Inc., Timmins; Jean-Paul Aube, Owner-Operator, McDonald's Restaurant, Timmins; J. Dean Archer, President, Archer's Dairy Limited, Kirkland Lake; Brock Smith, Acting President and Chief Executive Officer, Ontario Workers' Compensation Board, Toronto; Jacqueline Guertin, retired business woman, Kapuskasing; Graydon T. Bowman, Owner, Bowmanlea Farms, Thornloe.



Officers

Officers of Northern Telephone Limited are, seated, from left: Dennis D. McCarty, Treasurer and Vice-President, Finance and Corporate Services, New Liskeard; Murray J. Makin, Chief Executive Officer, Toronto. Standing, from left: Jeff Laferriere, Secretary, New Liskeard; John D. McNaughton, Vice-President, Marketing and Customer Solutions, Timmins; Linda Campbell, Vice-President, Operations and Network Management, New Liskeard.

Corporate Governance

The Board of Directors' stewardship responsibilities include:

- Overseeing the conduct of the business, and supervising management which is responsible for conducting the day-to-day affairs of the business.
- Setting standards of conduct for the enterprise which reflect the moral and ethical tone of business practices, standards for financial practices and reporting, and qualitative standards for the products of the business.
- Assessing and managing the risks of the corporation's business with the objective of preserving the corporation's assets.

Principal responsibilities are:

- Adoption of a strategic planning process, approval of the strategy and long-term goals as they evolve, and monitoring management's success in implementing the strategy.
- Understanding the principal risks of the business, and achieving a proper balance between the risks incurred and the potential returns to the shareholder. This requires the Board to ensure that systems are in place to effectively monitor and manage these risks with a view to the long term viability of the operation.
- Ensuring management of the highest calibre in appointing, training, assessing and providing for succession.
- Approving a policy to enable the corporation to communicate effectively with its various stakeholders including shareholders and the general public.
- Ensuring itself of the integrity of corporate internal control and management information systems.

The Board is comprised of nine directors, seven of whom are independent (unrelated). BCE Inc. owns, directly or indirectly, approximately 93% of the company's outstanding common and preferred shares, and has two representatives on the Board.

The Board's Chairman, Murray J. Makin, is also the Chief Executive Officer and a member of both committees.

There are two committees of the Board

1. The Operations and Audit Committee is comprised of five directors, three of whom are independent. This committee meets a minimum of twice a year and is responsible for reviewing financial statements and key operating indicators, the system of internal control, the external audit function, the selection and remuneration of the shareholders' auditor, and the annual budget process.
 2. The Resources and Nominating Committee is composed of five directors, four of whom are independent. This committee meets a minimum of twice a year and is responsible for corporate governance, including standards of performance for directors, assessment of Board of Directors, the selection of nominees for officers and directors of the corporation, succession planning for officers, and compensation policies of the organization.
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NORTHERN TELEPHONE LIMITED
QUALITY  SERVICE
OUR COMMITMENT