

C

NORTHERN TELEPHONE LIMITED

ANNUAL REPORT 1986



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Corporate Information

ADDRESS

25 Paget Street
New Liskeard, Ontario
P0J 1P0

TRANSFER AGENT

CENTRAL TRUST
COMPANY
Toronto

TRUSTEE

THE CANADA
TRUST COMPANY
Toronto and Montreal

AUDITORS

ROSS, POPE & COMPANY
Chartered Accountants,
Timmins, Ontario

BANKER

CANADIAN IMPERIAL
BANK OF COMMERCE
New Liskeard, Ontario

Corporate Profile

Northern Telephone Limited, a subsidiary of Bell Canada Enterprises Inc., provides local telephone service, leases, sells and maintains a broad range of telecommunication services and office automation equipment in Northeastern Ontario and provides data processing services throughout Ontario. Long distance telephone facilities are owned and operated by the Ontario Northland Transportation Commission. Northern Telephone receives commissions on long distance tolls.

The Company's service area, stretching along the Highway 11 corridor from Latchford in the southeast to Calstock near Hearst in the northwest and branching to Kirkland Lake and Timmins, covers approximately 83,000 square kilometres of Northeastern Ontario. At December 31, 1986, there were 31 exchanges with 52,110 telephone numbers in service. The Head Office is in New Liskeard.

The Company was originally incorporated as the Temiskaming Telephone Company Limited on April 5, 1905, in New Liskeard and opened its first exchange there the same year. By the end of that year, a second exchange had been opened in Cobalt.

The Company steadily extended service and, by the end of 1928, was serving Cobalt, Haileybury, New Liskeard, Englehart, Kirkland Lake, Rouyn-Noranda, Timmins, Schumacher, South Porcupine and Kapuskasing. In that same year, the name of the Company changed to Northern Telephone Company, Limited.

In the 1960's the Company served the Kenora, Red Lake and Atikokan areas in Northwestern Ontario, the area north of Sault Ste. Marie along the Algoma Central Railway to Hearst and most of the area from Hearst in the west, to Chibougamau, in Northeastern Quebec, and south to Latchford in Ontario. In 1960, due to reorganizations and amalgamations, the corporate name changed to Northern Telephone Limited.

Bell Canada acquired control of Northern Telephone in 1966 as a result of a share purchase offer. In 1969, the Company's Northwestern Ontario assets were sold to Bell Canada and, in 1976, the Company sold its Quebec subsidiary, Northern Quebec Telephone Inc., to Telebec Ltée in Quebec.



Northern Telephone's Head Office, "The McKelvie Building", located in New Liskeard, named in honour of Donald McKelvie, former President and Past Chairman of the Board, who served the Company for 47 years.

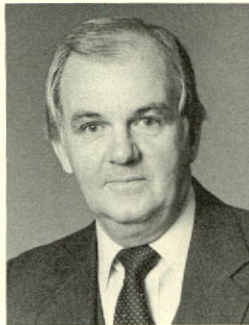
Directors



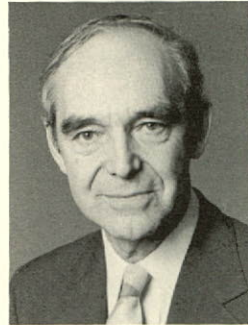
J.D. Archer
Chairman of the Board
Northern Telephone
Limited
President and
General Manager
Archers Dairy Limited



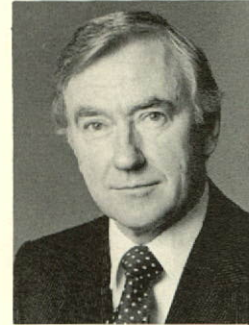
G.T. Bowman*
Owner
Bowmanlea Farms



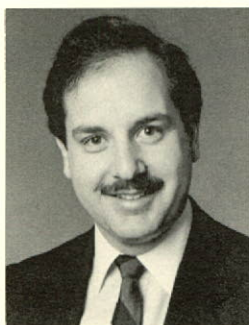
V.E. Brown*
President
Mike's Supermarket
(1962) Limited



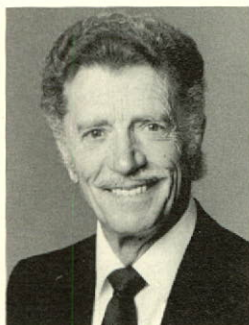
R. Brunelle**
Director and Consultant
Spruce Falls Pulp & Paper



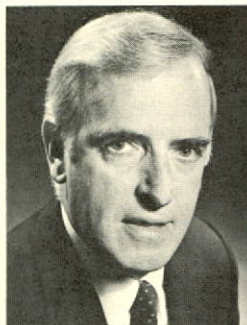
M.W. Cooper
President and
Chief Executive Officer
Northern Telephone Limited



D.O. Jarvis**
Executive Vice President
Finance
BCE Development Corporation



J.C. Lavigne**
Former Chairman
of the Board
Northern Telephone
Limited



O.W. McAleer
Vice-Chairman
of the Board
Northern Telephone
Limited
Vice-President
Network Services
Bell Canada



D.R. Newman**
Vice-President
and Comptroller
Bell Canada
Enterprises Inc.

*Member of Audit Committee
**Member of Resources Committee

President and Department Heads

Murray W. Cooper
President & Chief Executive Officer

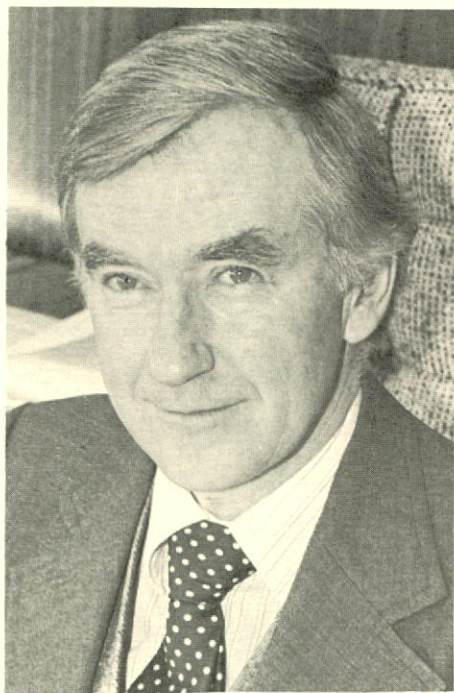
Dennis D. McCarty
Director - Customer Services &
Business Information Systems

John A. Parker
Director -
Operations

Thomas J. McKenney
Secretary-Treasurer &
Director - Administration

D. Brien Sirola
Director -
Engineering

Message from the President and Chief Executive Officer



The year 1986 was an eventful time for Northern Telephone, one that served to strengthen the Company's leadership position in the supply of telecommunications equipment and services to people of the North.

The Company continues to do well in the competitive arena, maintaining the majority of business customers through a host of quality products, flexible payment options and reliable customer service support from our dedicated employees.

There were many milestones for Northern Telephone in 1986. Our Rural Upgrade Program was completed, providing improved telephone service for more than 3,800 rural customers across our service area at a cost of approximately \$11-million.

The Company entered into an agreement with the Ontario Northland Transportation Commission to install state-of-the-art digital switching equipment in New Liskeard, Haileybury, Cobalt, Earleton and Latchford. This is a significant agreement. Both organizations and our customers will benefit from this joint project which is due to be completed by the end of 1987.

The Company became the authorized sales and service dealer for office automation equipment manufactured by AES Data Incorporated, a well-known and highly-regarded Canadian company. The dealership includes, in addition to Northern Telephone's territory, the North Bay, Sudbury and Sault Ste. Marie areas. A further expansion of service offerings occurred when the Company became a distributor of Gandalf products, which include data communication equipment and information network systems.

On the financial side, local service revenues for 1986 were \$14,524,500. Higher rates effective January 1, 1986 were estimated to provide additional local revenues of \$713,000; however, the lease and outright sales in the business sector and customer ownership of telephone sets in the residential sector reduced the rental revenue base, resulting in a net gain of \$523,300, or 3.7% over 1985. Long distance revenues increased by \$700,400 or 6.5 percent to \$11,405,300 in 1986. This increase is mainly due to increased growth in long distance messages.

At December 31st, Northern Telephone had 52,110 telephone numbers in service, an increase of 614 or 1.2 percent over 1985.

Our employees continue to make a significant contribution to the Company's ongoing success. Northern Telephone recognizes the value of well-trained, professional employees and continues to offer opportunities for training and self-development. In 1986, employees received approximately 519 days of training in various technical, management and safety-related areas. In-house First Aid and Defensive Driving accounted for 175 days. This training helps the employee both on and off the job.

On July 15, 1986, employees reached another safety milestone by accumulating 252,616 hours of work without a lost-time injury. In honour of this achievement, the Electrical Utilities Safety Association presented employees with their fourteenth President's Award. This is a record in itself, as no other organization in the association has received this many President's Awards.

Our employees recognize that "safety comes first in the performance of every job" and this has certainly contributed to a reduction in the Workers' Compensation Board rate assessed the Company effective in 1986. I sincerely thank all employees for maintaining a "safety first" attitude.

In 1986, Northern Telephone held its first employee driving competition, termed a Driver's Road-ee. Competitions were held regionally in New Liskeard, Kirkland Lake, Kapuskasing and Timmins. In October, all regional winners convened at the Timmins Work Centre for the championship event. Four champions were declared - a Grand champion and one each in the Heavy Truck, Sedan, and Van competitions. A family safety day was held in conjunction with the event, with various companies and associations providing displays, exhibits and presentations.

Teams organized by and comprised of Company employees have participated in curling bonspiels, men's hockey and ladies' broomball tournaments for industry employees. The ladies' broomball team won the championship title in the 1986 President's Tournament held in Scarborough.

We embarked on a program to convert our familiar orange vehicles to a new silver grey. A fluorescent red Company decal and rear vehicle markings further adds to the safety of our employees.

Northern Telephone continues to be involved in the communities it serves, through financial donations and other contributions to a number of organizations. During the past year, the Company was well-represented in trade shows throughout our service area; a number of student groups toured our facilities and the Company continued to provide training and telephone sets to area learning institutions.

My thanks is extended to the many employees who assisted in endeavours for the continued betterment of the communities in our serving area.

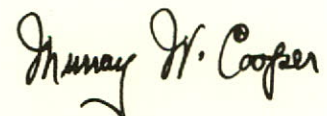
A Temiskaming District Art Contest was announced by Northern Telephone in 1986. The Company will reproduce the winning artwork on the cover of its 1988 telephone directories. This contest will provide an excellent showcase for our resident artists and for the scenic beauty of our area.

During 1986, the Company played an active role as a member of the Ontario Telephone Association, an association comprised of independent telephone systems in Ontario. This involvement continues to be beneficial to the Company.

H.A. "Bert" Roth retired from Northern Telephone's Board of Directors on May 4, 1986, after 11 years service. Mr. Roth joined Northern Telephone's Board as a Bell Canada Vice-President and quickly displayed his keen interest in the Company and its serving territory. He served as President from 1976 to 1978; Vice-Chairman and Chief Executive Officer from 1978 to 1983; Chairman from 1984 to 1985 and Vice-Chairman from 1985 to his retirement in 1986.

J. Dean Archer was re-elected Chairman of the Board and O.W. McAleer was elected Vice-Chairman at the 1986 annual meeting.

Summing up, 1986 proved to be a very challenging year which saw continuing changes in the way we operate, while maintaining our commitment to providing good quality telecommunications services to people of the North. Our employees have made Northern Telephone what it is today and our customers will continue to be well-served through their on-going efforts.



Murray W. Cooper
President & Chief Executive Officer



N  **EXPANDING YOUR LINES OF**
Communication!

Salute to Employees

Company employees continued to contribute to Northern Telephone's successes in 1986. Photographs on this page depict employees at work or engaged in job-related activities across the North.



Clockwise, from top left are: Walter Troke, Kirkland Lake Installation and Repair — New Quarter Century Club members in 1986 included, front row, from left, Mac Campbell, Helen Jordan, Al Lee, and Ron Giroux; back row, from left, Tom Wilson, Glen Thompson, Lee Huff, Keith Windsor, Jim Harman and Clarence Swanson. Missing when photograph was taken were Madeleine Smith and Brett Medland — Manfred Lurz, Kapuskasing Central Office — Angie Breault, New Liskeard Business Office — Northern Telephone's championship-winning ladies' broomball team — Participants in Northern Telephone's first annual Driver's Road-eo included Jim Wilson, New Liskeard Installation and Repair, and judges Byron Parkin, New Liskeard Engineering, and Sue Muraska, New Liskeard Accounting — Participants in a Life Planning Seminar included, front row, from left, Lucy and Tony Majnarich, (Timmins Central Office) and Heather Renaud, Health Department, back row, from left, Mac Hamilton, Human Resources, and course leader Dr. Debby Vigoda — Pat Meunier, New Liskeard Buildings and Vehicles and Supplies, centre, and Bob Milliard, New Liskeard Installation and Repair, right, accept the President's Award from Electrical Utilities Safety Association Director Bob Williams.



Improving Services

In order to ensure good quality telecommunication service to its customers, it is necessary for Northern Telephone to invest in capital programs which will maintain, improve and enhance the various services offered and modernize equipment used to provide these services.

In 1986, capital expenditures amounted to \$7,310,000, with the Rural Upgrade Program accounting for \$862,700. 1986 was the final year of this 11-year modernization program which cost a total of \$10,694,400 and improved or provided telephone service for 3,823 customers. Previously, some rural lines served as many as ten customers per line and this upgrading ensures customers share a line with no more than three other customers.

The Company is continuing to extend telephone service to new areas. In the Finn Road area twenty-five customers were connected to the Connaught exchange.

The Digital Switching Program, which involves the replacement of electromechanical switching equipment with computerized digital switching equipment in order to meet service and growth demand, resulted in 1986 capital expenditures of \$2,563,300, for 1,903 digital telephone lines. Completed work included extensions in Timmins and Hearst, the beginning of a joint Tri-Town area modernization project and further work on the South Porcupine Central Office.

Also included in 1986 projects was the modernization of the Calstock Rurax exchange with a DMS-10 switch. The Calstock project introduced new service features such as seven-digit dialing, direct distance dialing and direct access to emergency numbers.

Northern Telephone now has 7,863 installed digital lines, which represents 14.4 percent of total installed lines, up from 11 percent in 1985.

During the year, Northern Telephone Limited and the Ontario Northland Transportation Commission (ONTC) agreed on a joint project which will provide for an accelerated rate of modernization for both the local and long distance central office switching equipment in the Tri-Town area. When completed in late 1987, the entire project will have cost both organizations an estimated \$7,175,000, providing for a complete replacement of the electromechanical switching equipment with computerized digital switching equipment in New Liskeard, Haileybury, Cobalt, Belle Vallee, Earlton and Latchford.

The state-of-the-art technology provided by this joint project will reduce maintenance costs, improve customer services through better quality transmission and, depending on demand, offer new services such as INWATS (1-800) and custom-calling features. In addition, the cost-sharing provisions of the agreement with the ONTC will lessen requirements for future rate increases.

Staying First in Communications

Northern Telephone maintained its leadership in the telecommunications services and equipment industry in the North in 1986.

The Company continued to retain the major share of competitive business involving PABX and Key Telephone Systems. In the residential sector, three promotional campaigns were conducted throughout the year which served to strengthen the Company's position and retain revenues. In the outright sale marketplace, the Company continued to provide a quality line of telephone products designed to meet the needs of customers who prefer to own their telephone equipment.

The Company is continuing to seek out new products and services to better meet the needs of people in the North. One such expansion occurred in 1986 when Northern Telephone became the sole authorized sales and service dealer in its area as well as the North Bay, Sudbury and Sault Ste. Marie areas for AES Data Incorporated. The AES line includes word processors, personal computers, peripheral equipment and machine supplies.

A further expansion of service offerings occurred as Northern Telephone became a distributor of Gandalf quality products, which include data communication equipment and information network systems.

A new single-line feature telephone, the Signature, was introduced in 1986. This Touch Tone set is offered as a premium rental telephone to both residence and business customers. In addition, Touch Tone telephone service was extended to customers in the Kirkland Lake, Swastika and Elk Lake exchanges.

Northern Telephone installed a computerized Northern Telecom SL1 telephone system at its Head Office in New Liskeard. One of four such systems in Northern Telephone's service area, it offers advanced features such as call detail recording, ring again, speed call and call waiting.

The Company also developed and sold a complete software system to a local firm.

Meeting the Financial Challenge

Careful planning and proper utilization of resources is necessary to ensure Northern Telephone remains a financially stable operation and one which provides a fair investment for its shareholders. As an independent telephone company which operates solely in Ontario, the Company is regulated by the Ontario Telephone Service Commission (OTSC). Regulation continues to play a major role in the Company's ongoing financial and service matters.

Northern Telephone was granted additional local revenues of \$713,000 annually, effective January 1, 1986, as a result of a rate application filed with the OTSC. The additional revenue granted was to allow the Company to earn a rate of return on average common equity on telephone operations of 14.5 percent for the year, 1986.

A ruling by the Canadian Radio-television and Telecommunications Commission (CRTC) ordered Bell Canada to reduce Ontario and Quebec long distance rates by 20 percent, effective January 1, 1987. These reduced rates, passed on to Northern Telephone customers by the ONTC, will decrease estimated long distance charges billed to customers by approximately \$3.7-million in 1987. As a result of the impact this will have on the financial integrity of the Company, an application was filed in

November, 1986 requesting adjustments in rates which would increase charges billed to customers by approximately \$1.2-million. If these additional revenues are granted in full as requested, customers will still realize a saving of an estimated \$2.5 million in charges in 1987. The OTSC is currently reviewing the Company's application.

In regard to the impact of the CRTC's decision on Ontario independent telephone systems, the Ontario Telephone Service Commission conducted a public hearing in Toronto on December 9, 1986, to review certain aspects of the Traffic Agreement between Bell Canada, Ontario Northland Transportation Commission and the Independent Telephone Systems under its jurisdiction. Northern Telephone participated at that hearing to express concern as to the Company's urgent requirement for obtaining additional revenues.

As a result of continued growth during the year, the exchanges in the City of Timmins surpassed the 20,000 telephone number milestone in November of 1986. The exchanges qualified for upgrouping of basic exchange rates from Rate Group 7 to Rate Group 8, which was implemented January 1, 1987.

Effective January 1, 1986, the Workers' Compensation Board established a new classification for firms engaged in the provision of telephone, telegraph and cable television services, separating them from the hydro utilities and construction firms. Movement of Northern Telephone into this new classification resulted in a decreased assessment rate, affording substantial savings in 1986.

The Company is continuing with its efforts to modernize procedures and make Company operations more efficient. The Business Information Systems Steering Committee has produced a four-year plan for further development of mechanized systems. The next three years will see a planned transition, whereby company personnel will have access to the central computer to perform various on-line functions.

The growth and use of micro computers within Northern Telephone continued, as well as upgrading of the Company's central computer. These enhancements allow for more efficiency in the Business Information Systems area. Further enhancements in this area are expected in 1987.

Management Report

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 financial statements are based upon management's best estimates and judgements and have been prepared within the guidelines of generally accepted accounting principles.

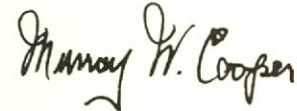
To ensure the integrity and objectivity of the data, management maintains a system of internal controls, comprised of written policies, procedures, and a

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 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 financial statements have been examined by the shareholders' auditors Ross, Pope and Company, chartered accountants and their report is presented on the following page.



Murray W. Cooper
President and Chief Executive Officer



Thomas J. McKenney
Secretary-Treasurer

Auditors' Report

*To the Shareholders of
Northern Telephone Limited*

We have examined the balance sheet of Northern Telephone Limited as at December 31, 1986 and the statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was 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, these financial statements present fairly the financial position of the company as at December 31, 1986 and the results of its operations and the changes in its financial position for the

year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ROSS, POPE & COMPANY,
CHARTERED ACCOUNTANTS.

Timmins, Ontario,
January 26, 1987.

Balance Sheet

As At December 31

Assets	1986	1985
Current Assets		
Temporary investments (Note 10) _____	\$ 3,500,000	\$ —
Accounts receivable (Note 10) _____	5,117,715	5,796,369
Investment redeemable within one year _____	3,122,700	785,000
Other _____	294,821	372,095
	<u>12,035,236</u>	<u>6,953,464</u>
Telecommunication Property, At Cost		
Buildings, plant and equipment _____	78,440,752	73,851,080
Less: Accumulated depreciation _____	27,023,845	25,807,555
	<u>51,416,907</u>	<u>48,043,525</u>
Land _____	458,118	460,231
Plant under construction _____	1,668,450	2,424,022
Materials and supplies _____	693,211	766,716
	<u>54,236,686</u>	<u>51,694,494</u>
Investments, At Cost (Note 3) _____	<u>5,096,000</u>	<u>14,325,540</u>
Other Assets		
Long-term receivables (Note 4) _____	1,235,715	1,140,833
Deferred charges _____	219,158	243,962
	<u>1,454,873</u>	<u>1,384,795</u>
Total Assets _____	<u>\$72,822,795</u>	<u>\$74,358,293</u>

On behalf of the Board of Directors:

G.T. Bowman, Director

J.C. Lavigne, Director

Liabilities and Shareholders' Equity	Current Liabilities	1986	1985
	Bank indebtedness _____	\$ 69,351	\$ 316,435
	Accounts payable (Note 10) _____	4,629,027	4,595,073
	Advance billing for service _____	575,296	540,396
	Dividends payable _____	3,735,846	736,340
	Income taxes payable _____	229,099	657,256
	Interest accrued _____	488,355	522,860
	Debt due within one year (Note 7) _____	<u>5,400,000</u>	<u>2,214,000</u>
		15,126,974	9,582,360
	Long-term Debt (Note 6) _____	<u>16,700,000</u>	<u>22,100,000</u>
	Deferred Credits		
	Income taxes _____	10,209,701	9,765,716
	Other _____	<u>86,420</u>	<u>92,408</u>
		10,296,121	9,858,124
	Shareholders' Equity		
	Capital Stock (Note 5)		
	Preference shares _____	8,764,000	8,844,000
	Common shares _____	14,934,772	14,934,772
	Retained earnings _____	<u>7,000,928</u>	<u>9,039,037</u>
		30,699,700	32,817,809
	Total Liabilities and Shareholders' Equity _____	<u>\$72,822,795</u>	<u>\$74,358,293</u>

T.J. McKenney, Secretary-Treasurer

Statement of Income

For The Years Ended December 31

	1986	1985
Operating Revenues		
Local service _____	\$14,524,533	\$14,001,219
Long distance service _____	11,405,286	10,704,856
Other _____	3,548,119	3,417,552
Total Operating Revenues _____	29,477,938	28,123,627
Operating Expenses		
Maintenance and repairs _____	4,890,360	4,616,268
Depreciation _____	4,850,531	4,499,462
Taxes other than income taxes _____	2,050,874	2,058,775
Other _____	9,018,657	8,416,122
Total Operating Expenses _____	20,810,422	19,590,627
Net operating revenues _____	8,667,516	8,533,000
Other Income		
Dividends _____	569,798	1,019,860
Debenture interest and other income _____	708,518	909,750
Total Other Income _____	1,278,316	1,929,610
Income before underlisted items _____	9,945,832	10,462,610
Interest Charges		
Interest on long-term debt _____	2,547,310	2,786,784
Other _____	175,630	157,830
Total Interest Charges _____	2,722,940	2,944,614
Income before income taxes _____	7,222,892	7,517,996
Income taxes (Note 2) _____	3,527,431	3,367,406
Net Income _____	3,695,461	4,150,590
Dividends on preference shares _____	528,917	536,517
Net Income Applicable to Common Shares _____	\$ 3,166,544	\$ 3,614,073
Earnings per Common Share _____	\$ 1.04	\$ 1.19
Dividends declared per common share* _____	\$ 0.71	\$ 0.75
Average common shares outstanding _____	3,043,657	3,043,657

*excludes special dividend of \$1.00 per share in 1986 (\$0.86 in 1985)

Statement of Changes in Financial Position

For the Years Ended December 31

	1986	1985*
Cash Provided From (Used For) Operating Activities		
Net Income _____	\$ 3,695,461	\$ 4,150,590
Items not affecting cash		
Depreciation _____	4,850,531	4,499,462
Deferred income taxes _____	443,985	466,424
Other _____	13,114	17,155
Increase in operating working capital (Note 9) _____	<u>3,361,626</u>	<u>28,896</u>
	<u>12,364,717</u>	<u>9,162,527</u>
Cash Provided From (Used For) Financing Activities		
Reduction of long-term debt _____	(1,337,000)	(3,194,000)
Redemption of preference shares _____	(80,000)	(80,000)
Reduction of bank demand notes _____	<u>(877,000)</u>	<u>(221,000)</u>
	<u>(2,294,000)</u>	<u>(3,495,000)</u>
Cash Provided From (Used For) Investing Activities		
Capital expenditures (net) _____	(7,392,723)	(7,334,081)
Reduction in investment in affiliated company _____	6,891,840	7,762,150
Increase in other assets _____	<u>(89,180)</u>	<u>(312,891)</u>
	<u>(590,063)</u>	<u>115,178</u>
Dividends Declared _____	<u>(5,733,570)</u>	<u>(5,436,804)</u>
Temporary Investments and Bank Indebtedness		
Change during the year _____	3,747,084	345,901
At beginning of year _____	<u>(316,435)</u>	<u>(662,336)</u>
At end of year _____	<u>\$ 3,430,649</u>	<u>\$ (316,435)</u>

*restated

Statement of Retained Earnings

For the Years Ended December 31

	1986	1985
Balance at Beginning of Year _____	\$ 9,039,037	\$10,325,251
Add:		
Net Income _____	<u>3,695,461</u>	<u>4,150,590</u>
	12,734,498	14,475,841
Deduct:		
Dividends on preference shares _____	528,917	536,517
Dividends on common shares		
Regular _____	2,160,996	2,282,742
Special - \$1.00 per share in 1986 (\$0.86 in 1985) _____	<u>3,043,657</u>	<u>2,617,545</u>
	5,733,570	5,436,804
Balance At End of Year _____	<u>\$ 7,000,928</u>	<u>\$ 9,039,037</u>

Notes to Financial Statements

1. Accounting Policies

The Company is subject to regulation, including examination of accounting practices, by the Ontario Telephone Service Commission for the Province of Ontario. The system of accounts and accounting practices are similar to those being used by other companies in the telecommunications industry.

Leases

The sales revenue, for leases which qualify as sales-type leases, is recorded at the inception of the lease.

Depreciation

Depreciation is charged on a straight line basis using rates, which are approved by the Ontario Telephone Service Commission, by classes of property, determined by a continuing program of engineering studies. When depreciable telecommunication property is retired, the amount at which such property has been carried in telecommunication 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 5.86% for the year ended December 31, 1986 (5.78% in 1985).

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 telecommunication property, being in excess of amounts currently charged to operations.

2. Income Taxes

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

	1986	1985
Statutory income tax rate	53.3%	51.9%
i) Non taxable dividend income	(4.2)	(7.0)
ii) Other	(0.3)	(0.1)
Effective income tax rate	<u>48.8%</u>	<u>44.8%</u>

Details of the Company's income taxes are as follows:

Current	\$3,083,446	\$2,900,982
Deferred	<u>443,985</u>	<u>466,424</u>
Total	<u>\$3,527,431</u>	<u>\$3,367,406</u>

3. Investments Investments, at cost, in Telebec Ltée, an affiliated company:

	1986	1985
Debentures*	\$ 8,218,700	\$ 9,003,700
First Preferred Shares		
Series 1, cumulative, dividend of \$2.625, redeemable at \$25.00 each (227,288 in 1985)**	—	5,682,200
Series 2, non-cumulative, dividend of \$0.60, redeemable at \$10.00 each (42,464 in 1985)**	—	424,640
Total	8,218,700	15,110,540
Less: Portion of debentures redeemable within one year	3,122,700	785,000
Total	<u>\$ 5,096,000</u>	<u>\$14,325,540</u>

*The weighted average interest rate on these debentures at December 31, 1986 was 8.52% (8.57% in 1985).

At December 31, 1986, the amount of debenture redemptions receivable in the following years are: \$3,122,700 in 1987; \$756,000 in 1988; \$756,000 in 1989; \$756,000 in 1990; \$756,000 in 1991; and \$2,072,000 in 1992-95.

**On December 1, 1986, Telebec Ltée redeemed, at its option, all its Preferred Shares held by the Company.

**4. Long-term
Receivables**

Long-term receivables consist of:

	1986	1985
Total lease payments receivable	\$2,238,782	\$2,046,564
Less: Unearned interest income	<u>646,858</u>	<u>623,562</u>
Net investment in leases	1,591,924	1,423,002
Less: Current portion of lease payments included in accounts receivable	<u>356,209</u>	<u>311,810</u>
	1,235,715	1,111,192
Mortgage receivable	<u>—</u>	<u>29,641</u>
Total	<u>\$1,235,715</u>	<u>\$1,140,833</u>

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

Future minimum lease payments receivable under sales-type leases are: \$604,248 in 1987; \$580,209 in 1988; \$524,758 in 1989; \$338,096 in 1990; \$158,078 in 1991; and \$33,393 in 1992-93.

5. Capital Stock

	No. of Shares	Series	Dividend Per Share \$	1986	1985
Authorized Preference Shares					
First preference	500,000	—	—	\$10,000,000	\$10,000,000
Second preference	128,200	—	—	2,564,000	2,564,000
Total preference	<u>628,200</u>	—	—	<u>\$12,564,000</u>	<u>\$12,564,000</u>
Common shares	<u>6,500,000</u>	—	—	<u>\$35,000,000</u>	<u>\$35,000,000</u>
Issued and outstanding Preference shares					
First preference - cumulative, redeemable					
75,000	75,000	A	1.10	\$ 1,500,000	\$ 1,500,000
50,000	50,000	B	1.10	1,000,000	1,000,000
100,000	100,000	C	1.10	2,000,000	2,000,000
25,000	25,000	D	1.10	500,000	500,000
60,000*	60,000*	E	1.90	1,200,000	1,280,000
	<u>310,000</u>			<u>6,200,000</u>	<u>6,280,000</u>
*64,000 in 1985					
Second preference - cumulative, redeemable					
7,853	7,853	A	1.00	157,060	157,060
120,347	120,347	B	1.05	2,406,940	2,406,940
	<u>128,200</u>			<u>2,564,000</u>	<u>2,564,000</u>
Total preference	<u>438,200</u>			<u>\$ 8,764,000</u>	<u>\$ 8,844,000</u>
Common shares	<u>3,043,657</u>			<u>\$14,934,772</u>	<u>\$14,934,772</u>

All the preference shares, with the exception of the First Preference Series "E" shares, are redeemable at the Company's option at \$20.40 per share.

The First Preference Series "E" shares were not redeemable, except for sinking fund purposes, prior to October 1, 1983, but may be redeemed thereafter, at the Company's option, at \$20.00 per share plus a premium of 7% diminishing by 1% in each subsequent year to October 1, 1990 and thereafter at \$20.00 per share. Pursuant to the conditions attached to the issue of these shares, the Company shall call for redemption for sinking fund purposes, on the first day of October of each year, 4,000 of these shares at a price of \$20.00 per share plus any accrued and unpaid dividends to the date of redemption. To meet this requirement, on October 1, 1986, 4,000 shares were redeemed (4,000 in 1985).

6. Long-term Debt	Maturity Date	Rate of Interest	Series	1986	1985
	20 year Sinking Fund Debentures				
	May 1, 1987	6.5 %	H	\$ 4,050,000	\$ 4,062,000
	20 year Serialized Debentures				
	April 30, 1993	8.25%	I	4,900,000	5,600,000
	January 15, 1995	11.0 %	K	3,600,000	4,000,000
	15 year Serialized Debentures				
	May 31, 1997	17.5 %	L	3,550,000	3,775,000
	November 1, 1999	13.75%	M	<u>6,000,000</u>	<u>6,000,000</u>
	Total			<u>22,100,000</u>	<u>23,437,000</u>
	Less: Debt due within one year (Note 7)			<u>5,400,000</u>	<u>1,337,000</u>
	Total			<u>\$16,700,000</u>	<u>\$22,100,000</u>

Sinking fund and maturity payments required in the following years with respect to the above debt are: \$5,400,000 in 1987; \$1,350,000 in 1988; \$1,675,000 in 1989; \$1,675,000 in 1990; \$1,700,000 in 1991; \$6,200,000 in 1992-96; and \$4,100,000 in 1997-99.

7. Debt Due Within One Year		1986	1985
	Long-term debt due within one year	\$ 5,400,000	\$ 1,337,000
	Bank demand notes	<u>—</u>	<u>877,000</u>
	Total	<u>\$ 5,400,000</u>	<u>\$ 2,214,000</u>

8. Pensions

The Company has contributory plans which provide for service pensions for its employees. Total contributions to these plans by the Company during the year were \$830,081 (\$1,016,004 in 1985).

As at December 31, 1986, unfunded liabilities for these plans, as determined by actuarial valuations, due to improvements in benefits and early retirements amount to approximately \$765,000 (\$474,000 in 1985).

9. Statement of Changes in Financial Position		1986	1985
Decrease (increase) in operating working capital provided by change in			
Accounts receivable	\$ 678,654	\$ (911,699)	
Other current assets	77,274	62,054	
Accounts payable	33,954	282,722	
Advance billing for service	34,900	31,771	
Dividends payable	2,999,506	23,297	
Income taxes payable	(428,157)	560,506	
Interest accrued	<u>(34,505)</u>	<u>(19,755)</u>	
Decrease (increase) in operating working capital	<u>\$3,361,626</u>	<u>\$ 28,896</u>	

10. Related Party Transactions **Temporary Investments**
As at December 31, 1986, the Company held \$3,500,000 interest bearing promissory notes receivable from Bell Canada Enterprises Inc. (BCE), the parent company. These were repaid by January 15, 1987.

Accounts Receivable and Accounts Payable

As at December 31, 1986, the accounts receivable from affiliated companies were \$236,074 (\$412,762 in 1985). The net amount payable to BCE, the parent company, was \$3,598,386 (\$616,080 in 1985) and to other affiliated companies was \$428,460 (\$321,189 in 1985).

Goods and Services

For the year ended December 31, 1986, the Company purchased goods and services amounting to \$37,880 (\$40,729 in 1985) from BCE, the parent company and \$4,536,230 (\$4,514,742 in 1985) from other affiliated companies.

Investment Transactions

For the year ended December 31, 1986, the Company declared dividends of \$5,316,723 (\$5,010,933 in 1985) and paid net short-term investment interest of \$85,502 (\$46,891 in 1985) to BCE, the parent company. The Company earned \$569,798 (\$1,019,860 in 1985) in preferred share dividends and \$715,427 (\$862,730 in 1985) in debenture interest from Telebec Ltée, an affiliated company.

Statistics

	1986	1985	1984	1983	1982
Financial Results (\$)					
Operating revenues	29,477,938	28,123,627	25,912,005	23,609,038	21,052,296
Operating expenses	20,810,422	19,590,627	18,280,495	16,988,806	15,353,732
Other income	1,278,316	1,929,610	2,280,314	2,441,780	2,564,694
Other charges	2,722,940	2,944,614	2,603,427	2,580,185	2,471,602
Income taxes	3,527,431	3,367,406	3,105,112	2,682,495	2,308,376
Net income	3,695,461	4,150,590	4,203,285	3,799,332	3,483,280
Total payroll	10,294,758	9,885,634	9,677,460	9,064,900	8,171,997
Construction expenditures	7,310,000	7,701,000	6,901,000	5,944,000	7,742,000
Financial Ratios (\$)					
Earnings per common share	1.04	1.19	1.20	1.07	.96
Dividends declared per common share	1.71	1.61	1.7125	.68	.6475
Balance Sheet Data (\$)*					
Total investment in plant & equipment	80,567,320	76,735,333	72,443,083	68,054,242	64,019,306
Plant & equipment less depreciation	53,543,475	50,927,778	48,023,079	45,483,859	43,158,636
Common equity	21,935,700	23,973,809	25,260,023	26,799,528	25,621,600
Preferred equity	8,764,000	8,844,000	8,924,000	9,004,000	9,084,000
Long-term debt (Including due within 1 year)	22,100,000	23,437,000	26,631,000	23,044,000	25,547,000
Additional Statistics					
Number of employees*	289	290	302	313	311
Total telephone numbers*	52,110	51,496	50,691	49,666	48,856
Business	9,806	9,457	9,113	8,749	8,508
Residence	42,304	42,039	41,578	40,917	40,348
Percentage residence of total	81.2	81.6	82.0	82.4	82.6
Number of central offices*	31	31	31	31	31
Long distance calls (thousands)	7,775	7,499	7,142	6,890	6,756
Number of shareholders (preferred and common)*					
In Canada	1,227	1,324	1,410	1,559	1,625
Elsewhere	29	32	35	36	34
Total shareholders	1,256	1,356	1,445	1,595	1,659

*As At December 31

