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The New Brunswick Telephone Company, Limited



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Annual Report 1986

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COMPANY DESCRIPTION

The New Brunswick Telephone Company, Limited (NBTel) was incorporated in 1888 and is the major supplier of telecommunications services in the Province of New Brunswick. NBTel provides its 276 000 customers with a broad range of modern telecommunications services.

Following a corporate restructuring in July 1985, NBTel became a wholly owned subsidiary of Bruncor Inc. As a result of this restructuring, NBTel's common shares are no longer publicly traded. NBTel's preferred shares continue to be listed on The Toronto Stock Exchange and on The Montreal Exchange.

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Ce rapport est également publié en français.

A DYNAMIC MARKET

New Brunswickers used their telephones more than ever in 1986, resulting in a 5.2-per-cent growth in revenues. Long distance, with increases in both inter- and intra-provincial calling, continued to be the company's major source of revenue, accounting for 56.7 per cent of NBTel's revenue. Although a ruling by the company's regulator, the New Brunswick Board of Commissioners of Public Utilities (PUB), lowered the rates for local exchange residence service beginning in the first quarter of the year, revenues from this source were up by 4.3 per cent in 1986. This increase is attributed to a net gain of 17 052 telephones (13 770 access lines) over year-end 1985.

Net income applicable to common shares for 1986

increased by 9.1 per cent, resulting in a 15.1-per-cent rate of return on average common equity. NBTel's rate of return on its regulated activities was somewhat lower and complies with a late-1985 decision by the PUB which lowered the allowed rate to 13.5 per cent, with an additional one per cent permitted as incentive for management efficiencies.

The main reason for the difference between regulated and unregulated returns was a 1986 investment, the subsequent sale of which generated a non-recurring, after-tax capital gain of approximately \$1.6 million which was accounted for as income from unregulated activities.

COMPARATIVE OPERATING STATISTICS

	1986	1985	1984	1983	1982	% change 1986/1982
Employees at year end	2 530	2 474	2 411	2 477	2 595	(2.5)
Employees/1000 phones	5.3	5.4	5.5	5.9	6.3	(15.9)
Station movement ¹	184.4	176.6	154.7	149.9	144.6	27.5
Long-distance messages ²	67.2	60.4	54.0	49.3	45.0	49.3
Telephones in service ¹	476.1	459.1	439.4	422.5	411.2	15.8
Customer trouble reports ¹	155.9	168.6	162.2	156.4	156.8	(0.6)

¹in thousands ²in millions

OPERATING EXPENSES INCREASE IN RESPONSE TO GROWTH

The strong surge in the number of new telephones placed in service and the associated costs of meeting these service demands caused operating expenses to increase by 6.5 per cent, outpacing current-year revenue gains. Although an immediate impact of the local exchange growth was increased expenses, the additional customers will, over the long term, generate additional income for the company.

Recognizing the importance of controlling expenses

and as part of its ongoing effort to improve productivity and service, NBTel spent nearly \$1 million to introduce corporate office-management systems and to mechanize operations in its telephone-service repair offices. Their implementation has not only assisted the company's managers in developing system-integration skills to increase efficiency, but also improved NBTel's ability to sell similar products to its business customers.

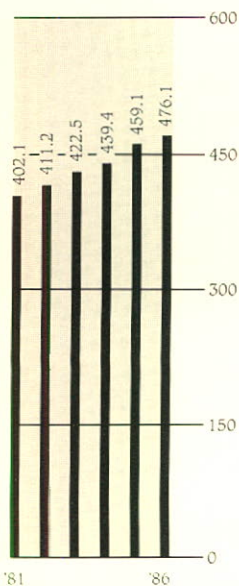
CONSTRUCTION EXPENDITURES: PREPARING FOR THE 21ST CENTURY

Although the year 2000 is more than a decade away, NBTel is already immersed in an ambitious network modernization and expansion program which will enable it to meet the telecommunications needs of its customers well into the next century. In 1986, the thrust of the company's construction activity was directed towards improving and augmenting its equipment and facilities.

A strong emphasis continued to be placed on the conversion of NBTel's network to digital-switching and fibre-optics-transmission systems. Investment in these

two technologies represented approximately 27 per cent of the year's total construction expenditure of \$67.6 million.

In addition to these modernization programs, NBTel spent \$13.8 million meeting customers' day-to-day demands for new business and residence telephone sets, data equipment and mobile telephones. Other major expenditures in 1986 included \$2.0 million to provide service and equipment to larger business customers and \$7.5 million to provide and upgrade service to non-urban customers.



Total Telephones in Service
(in thousands)

\$6-MILLION DIGITAL PROJECT FOR BATHURST

In November, the company completed a \$6-million digital installation program in Bathurst which saw nearly 9 000 business and residence customers have their local service converted to the new technology. As with similar installations in Fredericton, Moncton and Saint John in recent years, the new equipment replaced the conventional analog system which had reached its capacity.

The Bathurst project, coupled with \$6.7 million invested in the expansion of the company's existing digital-switching systems, brings NBTEL's total investment in this technology to \$55.8 million. As the chart below shows, 23 per cent of NBTEL's customers, which

represents the majority of those in urban centres, are now served by the digital network. This figure is expected to double within the next five years.

% OF WORKING MAIN STATIONS IN SERVICE BY TYPE OF EXCHANGE

	1986	1991 ¹
Digital	23	46
Electronic	13	12
Crossbar	29	21
Step-by-Step	35	21

¹Estimated

FIBRE-OPTICS INSTALLATION: PHASE ONE COMPLETED

Construction of the first phase of one of the largest projects ever undertaken by NBTEL, a province-wide, fibre-optics transmission system, was completed in November. The \$5.8-million, 246-kilometre link installed between Moncton and Bathurst will also form part of the \$300-million, trans-Canada fibre-optics route being constructed by the member companies of Telecom Canada.

NBTEL's total commitment to fibre optics will increase to more than \$40 million as the 1 200-kilometre,

provincial network is completed. When the final cables of hair-thin, glass filaments are laid in the early 1990s, this exciting lightwave communications technology will have become the backbone of NBTEL's transmission network, replacing the current microwave system built in the mid-1950s. The installation of fibre optics will enable NBTEL to minimize transmission costs, introduce useful new services — opening up new revenue sources — and provide New Brunswick with a flexible, high-capacity, reliable network for many years to come.

THE YEAR AHEAD: A \$74.5-MILLION CONSTRUCTION PROGRAM

In 1987, NBTEL will persist in its commitment to provide New Brunswickers with telecommunications products and services which are second-to-none. Provincially, the company will invest \$74.5 million in capital expenditures to meet the growing needs of its customers.

Emphasis will continue to be placed on NBTEL's program of upgrading the provincial switching and transmission networks with digital and fibre-optics technologies. Construction of the \$6.4-million second phase of the fibre-optics system, which will join New Brunswick's network to the trans-Canada fibre-optics route at the Nova Scotia and Quebec borders, will begin in the spring. Another \$6.1 million will be spent

installing a fibre-optics route between Moncton and Saint John and a local link between Fredericton and Oromocto.

Throughout the year, digital expansions, amounting to a total expenditure of \$6.7 million, will take place in Bathurst, Fredericton, Moncton and Saint John to accommodate expected growth in these areas. As well, in Saint John, NBTEL will undertake the largest facilities-oriented project in its history, with the \$9.0-million installation of digital equipment specially designed to process long-distance calls. More than 10 000 long-distance circuits, representing approximately 80 per cent of the company's total toll-circuit capacity, will be connected to this equipment.

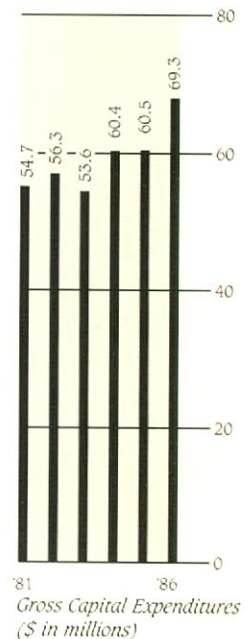
REGULATOR RULES ON INTERCONNECT

NBTEL believes that the proliferation of customer-owned telephone equipment will not, in the long run, either improve the quality of telecommunications services or result in significant savings to the customer.

Coupled with this belief is NBTEL's main concern that, in the interconnect environment, the responsibility for service will become divided. When the tele-

phone equipment and the telephone network are not provided by the same supplier, NBTEL believes that customers will ultimately have to be responsible for the quality and maintenance of their service.

This controversial issue of interconnect was addressed in a June 16 decision by NBTEL's regulator. In its ruling, which followed an in-depth public hearing in 1984,



the PUB allowed the attachment of customer-owned, single-line and multi-line equipment to NBTEL's network. Previously, the company was the sole provider

of the main telephone and the attachment of customer-owned equipment as extensions only was allowed.

COMPANY FILES TARIFF REVISIONS

In September, NBTEL filed a revised tariff, designed, as directed by the PUB, to fairly and reasonably charge customers accessing the company's network with their own equipment, without imposing a burden on its full-service customers.

NBTEL's current pricing policy on local exchange service is based on charging customers a flat rate each month, regardless of how much they use their telephones. However, NBTEL believes the time has come to begin charging customers based on their usage of its network and, as a result, has proposed to introduce this concept by charging usage-sensitive or measured rates for multi-line business customers choosing

to connect their own equipment to the company's facilities. These rates would apply whether the equipment was purchased from NBTEL or from another supplier.

The company has also asked for permission to introduce a flat-rated, network-access service for the connection of single-line residence and business main telephones and to implement a special service charge for service calls which are caused by faults in equipment not owned by NBTEL.

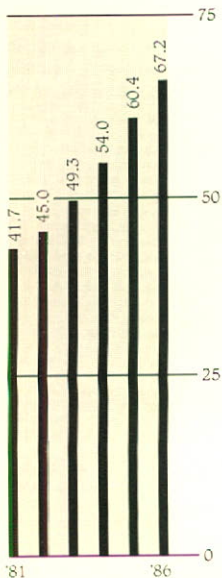
A public hearing into the proposed tariff revisions was held in February 1987 in Saint John.

TO BECOME EFFECTIVE COMPETITOR

With the sale of terminal equipment soon to be open to increased competition, the company plans to be a very assertive and effective competitor. NBTEL believes its full-service offerings provide the greatest overall advantage to its customers and that the strengths and experience of the company as a telecommunications provider are well proven. After nearly 100 years of service to the people of New Brunswick, NBTEL believes it stands alone in being able to offer its customers:

- *complete*, high-quality, modern and affordable tele-

- communications services;
- protection from equipment obsolescence;
- demonstrated maintenance support of all services throughout the province;
- knowledgeable employees who are experienced in consulting and in supporting the evolution of telecommunications services; and
- a reputable, stable company that will be here in the future to effectively serve its customers.



Annual Long-Distance Messages (in millions)

A BANNER YEAR FOR BUSINESS SALES

Following their record-setting year of revenue growth in 1985, NBTEL's mobile group and NBTEL DATA, the company's computer sales and service division, both again surpassed their annual sales objectives. Mobile's introduction of visual-display pagers and the expansion of paging and autotel (direct-dial mobile service) services into virtually all areas of New Brunswick were prime contributors to the group's \$10.5 million in sales, 14.5 per cent above its 1986 objective.

Increased sales and expansions of data services — such as Datapac, the national switched-data network, and Envoy 100, an electronic mail service — generated

revenues of \$9.4 million for NBTEL DATA this year, exceeding its objective by 13.2 per cent. Once again demonstrating that it is an innovative leader in the telecommunications industry, NBTEL was the first telephone company in Canada to introduce Trade Route service, the computer-to-computer exchange of business documents between two or more companies.

NBTEL's Phone Power and Telemarketing group also made a significant contribution to revenues this year, with annual sales reaching \$6.3 million, 29 per cent above its 1986 objective.

COMPANY RECOGNIZED AS ONE OF THE COUNTRY'S BEST

NBTEL was named one of the 100 best companies to work for in Canada by *The Financial Post* this year. Described as "... a superior workplace, where learning opportunities and career progression are excellent",

in a book published in early 1986 by *The Financial Post*, NBTEL was one of only four companies in Atlantic Canada to be included in this select group of employers.

COMMITMENT TO SERVICE KEY TO SUCCESS

In the late 1970s, NBTel undertook a public-awareness campaign to convey to its customers that "it takes a lot more than phones to make a phone company". Now, almost a decade later and with NBTel about to enter a new era in the provisioning of telecommunications services in New Brunswick, this message is even more relevant. It is NBTel's capable and committed personnel — employees who can develop products, find new markets and provide support of their services — who will enable the company to succeed in the interconnect environment, just as they have been instrumental in its success this year.

Providing quality service to the customer is not a new concept for NBTel — service has always been the company's priority. To reinforce its importance and to recognize those employees who provide exceptional service — service beyond the requirements of the job, beyond the expectations of the customer — the company introduced the *Excellent Service Program (ESP)* in June. ESP awards are presented to employees who, as identified by external customers or from within the company, have provided outstanding service to either NBTel or its customers.

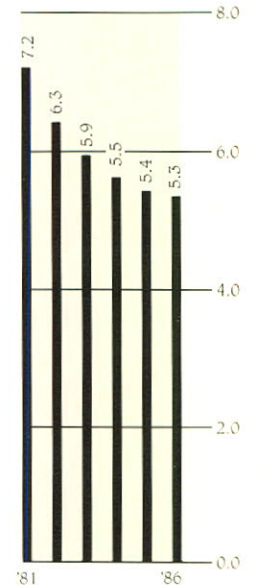
DATA-PROCESSING COMPANY UP AND RUNNING

The creation of Datacor Atlantic Inc. and its coincident installation of Canada's first IBM 3090-180 computer processor unit were major steps in the provisioning of data-processing services in Atlantic Canada. The Moncton-based company is jointly owned by NBTel (51 per cent) and Blue Cross of Atlantic Canada (49 per cent).

Datacor was created to provide high-quality, responsive and cost-effective data and office-related processing services to its two principals and to obtain leading technologies not viable for either company if they acted independently. Upon its formation, Datacor

purchased the data-processing facilities operated by Blue Cross in Moncton and NBTel in Saint John, which are integrated through a high-speed data link.

The \$6.5-million investment in the new processor unit and associated equipment doubled the capacity of the combined former NBTel and Blue Cross data centres, enabling Datacor to expand its services to other users in the Atlantic region. Following the successful implementation of services to its owners, Datacor has been given the mandate to pursue additional business opportunities with other clients.



Employees per 1000 Phones

A PROMISING FUTURE

Datacor's computer resources and technical skills will enable the company to provide a "total" service, far beyond the traditional time-sharing business, and the company is actively seeking new marketing prospects.

Under the direction of its president, Peter Blackman, Datacor has fulfilled the expectations of its owners and is rapidly positioning itself to be a provider of cost-effective, quality data-processing services to customers throughout Atlantic Canada.

Datacor has begun to provide payroll and other enhanced financial services to a municipality and anticipates it will soon perform similar functions for the majority of hospitals in New Brunswick. The health-services industry represents a prime source of business, with a notable potential for growth. Other markets which Datacor is pursuing include the financial-services

sector, government services and the wholesale/retail industry.

Upon the successful roll-out of business in new markets, which Datacor is anticipating in 1987, the company will be adding another major computer to its operations. Datacor intends to package hardware and software to meet any unique customer requirements, both main-frame and off-site, including office-services applications.

To accommodate the rapid growth of its operations, Datacor expects to increase its facilities and its number of employees within the next one to two years and will be actively recruiting senior professional staff to provide the necessary data-processing and marketing skills.

OFFICER AND DIRECTOR CHANGES

Lino J. Celeste was appointed president and chief operating officer of NBTel in February 1986. Mr. Celeste, who began his career with the company in 1960, had been vice-president (planning) since 1983. He succeeded Kenneth V. Cox, who remains chairman and chief executive officer.

In June, Peter G. Jollymore was appointed to succeed

Mr. Celeste as vice-president (planning). Mr. Jollymore joined NBTel in 1967 and, immediately prior to his appointment, had served as NBTel's chief engineer.

Long-serving director, John G. Burchill, who joined NBTel's board in 1965, retired in September. He was succeeded by Mr. Celeste. The board thanks Mr. Burchill for his many years of valuable service to NBTel.

The New Brunswick Telephone Company, Limited

CONSOLIDATED INCOME STATEMENT *(in thousands)*

Year ended December 31

1986

1985

OPERATING REVENUES

Local service	\$ 91 828	\$ 88 045
Long-distance service	145 344	136 844
Other operating revenues	20 548	20 015
Less: Uncollectible operating revenues	1 167	956
	<u>256 553</u>	<u>243 948</u>

OPERATING EXPENSES

Depreciation	48 404	44 395
Maintenance	32 736	30 468
Other operating expenses	91 580	86 525
Pensions and other employee benefits	8 575	8 810
	<u>181 295</u>	<u>170 198</u>

Operating income 75 258 73 750

OTHER INCOME

Allowance for funds used during construction	1 501	1 198
Other	4 570	1 117
	<u>6 071</u>	<u>2 315</u>

Income before underlisted items 81 329 76 065

OTHER CHARGES

Interest on long-term debt	21 127	17 435
Amortization of unrealized foreign exchange loss	497	450
Other	1 112	1 219
	<u>22 736</u>	<u>19 104</u>

Income before income taxes 58 593 56 961

Income taxes 28 767 29 456

Net income 29 826 27 505

Dividends on preferred shares 1 027 1 112

Net income applicable to common shares \$ 28 799 \$ 26 393

Earnings per common share \$ 1.78 \$ 1.65

The New Brunswick Telephone Company, Limited

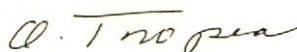
CONSOLIDATED BALANCE SHEET *(in thousands)*

<i>December 31</i>	1986	1985
ASSETS		
TELECOMMUNICATIONS PROPERTY <i>(at cost)</i>		
Buildings, plant and equipment	\$702 484	\$669 440
Less: Accumulated depreciation	282 665	256 480
	<u>419 819</u>	<u>412 960</u>
Land, and plant under construction	19 015	13 492
Construction materials	9 386	8 115
	<u>448 220</u>	<u>434 567</u>
INVESTMENTS <i>(note 2)</i>	31 930	30 802
CURRENT		
Accounts receivable	34 832	34 423
Income tax recoverable	6 287	—
Prepayments	2 933	2 604
	<u>44 052</u>	<u>37 027</u>
DEFERRED CHARGES		
Long-term debt expense	1 488	1 103
Unrealized loss on foreign currency	3 541	4 249
Other	437	759
	<u>5 466</u>	<u>6 111</u>
TOTAL ASSETS	\$529 668	\$508 507

Signed on behalf of the Board of Directors:



Marks H. Lockhart, Director



O. Tropea, Director

MANAGEMENT REPORT

The accompanying consolidated financial statements of The New Brunswick Telephone Company, Limited and all information in this annual report were prepared by management, who is responsible for their integrity and objectivity. The statements were prepared in accordance with generally accepted accounting principles and include amounts that are based on management's best judgements and estimates. Financial information presented elsewhere in this annual report is consistent with that in the financial statements.

The company maintains a system of internal control which provides management with 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. This system includes a comprehensive program of periodic audits by its internal auditors. The company also has in place policies and guidelines to ensure high ethical standards among employees.

The board of directors has reviewed and approved these financial statements. To assist the board in meeting its responsibility, it has appointed an audit committee which is composed entirely of outside directors. The audit committee meets quarterly to review the financial statements of the company, as well as accounting policies and audit and control procedures to ensure that management is properly discharging its financial reporting responsibilities. Its meetings are conducted with representatives of management, internal audit staff and the shareholders' auditors, the latter having full access to the committee with and without the presence of management.

These financial statements have been examined by the shareholders' auditors, Clarkson Gordon, chartered accountants, and their report is presented opposite.



W.H.R. Smith
Vice-President (finance)

LIABILITIES AND SHAREHOLDERS' EQUITY**SHAREHOLDERS' EQUITY**

Capital stock (note 3)	\$100 418	\$101 530
Contributed surplus	19 790	19 785
Retained earnings	87 353	79 446
	<u>207 561</u>	<u>200 761</u>
LONG-TERM DEBT (note 4)	204 774	183 553
CURRENT LIABILITIES		
Short-term obligations (note 5)	3 711	7 232
Accounts payable and accrued charges	23 749	23 258
Income tax payable	—	2 602
Interest accrued on long-term debt	4 861	4 207
Long-term debt due within one year (note 4)	8 503	9 609
	<u>40 824</u>	<u>46 908</u>
DEFERRED INCOME TAX	76 509	77 285
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$529 668</u>	<u>\$508 507</u>

AUDITORS' REPORT

To the Shareholders of The New Brunswick Telephone Company, Limited:

We have examined the consolidated balance sheet of The New Brunswick Telephone Company, Limited as at December 31, 1986 and the consolidated statements of income, retained earnings, contributed surplus and cash flows 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 consolidated 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.

Clarkson Gordon

Chartered Accountants
Saint John, Canada
January 28, 1987

The New Brunswick Telephone Company, Limited

CONSOLIDATED STATEMENT OF CASH FLOWS *(in thousands)*

<i>Year ended December 31</i>	1986	1985
INTERNAL CASH		
From operations:		
Net income	\$29 826	\$27 505
Items not requiring cash:		
Depreciation	48 404	44 395
Deferred income tax	(776)	698
Miscellaneous	538	(2 271)
Allowance for funds used during construction	(1 501)	(1 198)
	<u>76 491</u>	<u>69 129</u>
Cash used by changes in working capital	(8 482)	(872)
Internal cash generated	68 009	68 257
Less: Dividends	21 919	20 598
Net internal cash generated	<u>46 090</u>	<u>47 659</u>
INVESTMENT OF CASH		
Capital expenditures (net)	60 556	58 226
Investment in affiliated companies	1 021	34 758
Total investment	<u>61 577</u>	<u>92 984</u>
Excess of investment over net internal cash generated	(15 487)	(45 325)
EXTERNAL FINANCING		
Issue of common shares	—	6 394
Increase in long-term debt	20 115	28 617
Preferred shares purchased for cancellation	(1 107)	(228)
Net external financing	<u>19 008</u>	<u>34 783</u>
Increase (decrease) in cash	3 521	(10 542)
Cash (short-term obligations) at beginning of year	(7232)	3 310
Short-term obligations at end of year	<u>\$ (3 711)</u>	<u>\$ (7 232)</u>

CONSOLIDATED STATEMENT OF CONTRIBUTED SURPLUS *(in thousands)*

<i>Year ended December 31</i>	1986	1985
Balance at beginning of year	\$19 785	\$19 750
Discount on preferred shares purchased for cancellation	5	35
Balance at end of year	<u>\$19 790</u>	<u>\$19 785</u>

CONSOLIDATED STATEMENT OF RETAINED EARNINGS *(in thousands)*

<i>Year ended December 31</i>	1986	1985
Balance at beginning of year	\$ 79 446	\$ 83 311
Add: Net income	29 826	27 505
	<u>109 272</u>	<u>110 816</u>
Less:		
Dividends on preferred shares	1 027	1 112
Dividends on common shares	20 892	19 486
Dividend-in-kind	—	10 772
	<u>21 919</u>	<u>31 370</u>
Balance at end of year	<u>\$ 87 353</u>	<u>\$ 79 446</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATED FINANCIAL STATEMENTS include the accounts of the wholly owned subsidiary, Teldata Limited.

DEPRECIATION is calculated on a straight-line basis over the estimated useful life of telecommunications property by applying rates to the company's investment by class of property. The annualized composite rate for the year ended December 31, 1986, was 7.08 per cent (6.83 per cent for the year ended December 31, 1985).

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION is included in income and added to the cost of property to provide for a return on capital invested in new telecommunications property while under construction. The rate of 12.6 per cent being applied for 1986 reflects the company's rate of return on total invested capital for the previous year (13.2 per cent for 1985).

PENSION FUND OBLIGATIONS are computed by annual actuarial reviews and studies, using the aggregate funding method. Under this method, pension costs, including prior service costs, and all changes in cost due to experience or other factors

are paid and accounted for over the estimated remaining working lifetime of employees. The provision for pension cost, for the year ended December 31, 1986, computed at 9.0 per cent of salaries and wages, was \$6 434 000 including the portion capitalized (10.0 percent and \$6 746 000 for the year ended December 31, 1985).

LONG-TERM DEBT PAYABLE IN FOREIGN CURRENCY is stated in Canadian dollars at the exchange rate prevailing at the balance sheet date and the resulting unrealized loss is amortized over the remaining life of the debt.

LEASES are classified as either capital or operating leases. Assets recorded under capital leases, which substantially transfer the benefits and risks of ownership to the lessee, are amortized on a straight-line basis over the term of the lease. Obligations recorded under capital leases are reduced by rental payments net of imputed interest.

COMPARATIVE FINANCIAL STATEMENTS have been reclassified from statements previously presented to conform to the presentation of the 1986 financial statements.

2. INVESTMENTS

Investments represent mainly the company's investment in Brunswick Square Ltd., consisting of 30 000 cumulative, redeemable, convertible Class C Preferred

Shares at a cost of \$30 000 000, and its joint-venture investment in Dacor Atlantic Inc., consisting of a 51-per cent interest totaling \$1 128 000.

3. CAPITAL STOCK

Description	Number of Shares			Stated Capital	
	Authorized	Outstanding		December 31 1986	December 31 1985
	December 31 1986	December 31 1986	December 31 1985		
Common shares	Unlimited	16 195 583	16 195 583	\$ 88 164 568	\$ 88 164 568
Preferred shares					
Par value of \$20					
\$1.37	272 096	272 096	275 236	5 441 920	5 504 720
\$1.85	340 564	340 564	393 064	6 811 280	7 861 280
				12 253 200	13 366 000
				\$100 417 768	\$101 530 568

Preferred shares (cumulative redeemable — par value \$20 each).

\$1.37 The provisions of the \$1.37 preferred shares require the company to make all reasonable efforts to purchase for cancellation, in the open market, up to 10 000 shares in each calendar year, on a noncumulative basis, at a price not exceeding par value. In addition, the company may redeem, at its option, these shares at par value plus a premium of \$.60 if redeemed on or before March 15, 1987; the premium thereafter decreasing to \$.40 if redeemed

on or before March 15, 1990 and at par value plus a premium of \$.20 if redeemed thereafter.

During the year ended December 31, 1986, the company purchased 3 140 \$1.37 preferred shares in the open market.

\$1.85 The company has an obligation under the provisions of the \$1.85 preferred shares to redeem, for sinking fund purposes, 30 000 shares on March 15 of each year. The company may also redeem, at its option, an additional 22 500 shares on the same date. Sinking fund redemptions are at par.

The company may redeem these shares at its option, other than for sinking fund purposes, at par value plus a premium of \$1.00 if redeemed on or before March 15, 1989; the premium thereafter decreasing \$.20 every three years to March 15, 1998 and at par value plus a premium of \$.20 if redeemed thereafter. In addition, the terms of the issue enable the company to purchase these preferred shares in the open market at a price not exceeding this redemption price. Shares acquired during a calendar year, other than through the operation of the mandatory sinking fund, may be applied against the mandatory sinking fund requirement on March 15 of the following year.

On March 15, 1986, the company applied 30 000 \$1.85 preferred shares redeemed in 1986 to meet the mandatory sinking fund requirement on that date.

During the year ended December 31, 1986, the company redeemed 52 500 \$1.85 preferred shares.

Serial preferred shares

The company is authorized to issue an unlimited number of serial preferred shares without nominal or par value.

4. LONG-TERM DEBT (in thousands)

			December 31 1986	December 31 1985
Debentures				
<i>Series</i>	<i>Rate</i>	<i>Date Due</i>		
Q	9-3/8%	September 15, 1986-2001	\$ 17 601	\$ 19 006
		(1986 — \$12.75 million U.S. Funds)		
		(1985 — \$13.60 million U.S. Funds)		
N	8-3/20%	March 2, 1986-1997	11 000	12 000
J	6-1/2%	September 1, 1986	—	7 000
S	15-1/2%	June 15, 1987	30 000	30 000
		(extended maturity option) (a)		
K	7-1/4%	November 15, 1987	6 000	6 000
L	7-3/4%	December 1, 1988	5 000	5 000
M	9-1/4%	June 1, 1990	1 310	1 310
O	9-1/2%	April 15, 1996	20 000	20 000
P	10-7/8%	July 2, 1997	25 000	25 000
R	10%	July 15, 2003	25 000	25 000
T	10%	September 16, 2006	30 000	—
			<u>170 911</u>	<u>150 316</u>
		Promissory note (b)	30 000	30 000
		Obligations under capital leases	12 366	12 846
			<u>213 277</u>	<u>193 162</u>
		Less: Due within one year	8 503	9 609
			<u>\$204 774</u>	<u>\$183 553</u>

(a) The maturity date of the Series S Debentures may be extended to June 15, 1992, at the holders' option between September 15, 1986 and March 15, 1987. The company may increase the rate of interest payable on the Series S Debentures prior to February 15, 1987, effective June 15, 1987.

(b) The Promissory note was issued at the Bank of Nova Scotia's prime interest rate, which averaged 10.6 per cent for the year ended December 31, 1986. It is due March 30, 1988. Annual repayment of long-term debt for each of the next five years is as follows:

Twelve Months Ending December 31	Notes and Debentures	Capital Leases	Total
1987	\$ 8 174	\$329	\$ 8 503
1988	37 174	206	37 380
1989	2 174	214	2 388
1990	3 484	259	3 723
1991	2 174	268	2 442

5. SHORT-TERM OBLIGATIONS (in thousands)

Short-term obligations consist of cash, temporary cash investments, bank overdrafts and notes due to affiliated companies.

	December 31 1986	December 31 1985
(Cash) bank overdraft	\$(1 158)	\$1 282
Temporary cash investments	(2 976)	—
Notes due to affiliated companies	7 845	5 950
Short-term obligations	<u>\$ 3 711</u>	<u>\$7 232</u>

6. INCOME TAXES

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

Year ended December 31	1986	1985
Combined basic federal and provincial income tax rate	52.8%	51.9%
Dividend income and capital gains not subject to tax	(3.6%)	(0.5%)
Allowance for funds used during construction, net of applicable depreciation adjustment	(0.6%)	(0.4%)
Other permanent differences	0.5%	0.7%
Effective income tax rate	49.1%	51.7%

7. LEASES (in thousands)

"Buildings, Plant and Equipment" includes office space and leasehold improvements recorded under capital leases as follows:

	December 31 1986	December 31 1985
Cost	\$14 040	\$14 791
Less: Accumulated depreciation	4 437	4 489
	<u>\$ 9 603</u>	<u>\$10 302</u>

The future minimum lease payments under capital leases and operating leases that have initial non-cancellable lease terms in excess of one year as of December 31, 1986 are as follows:

Twelve Months Ending December 31	Capital Leases	Operating Leases
1987	\$ 1 709	\$ 894
1988	1 558	378
1989	1 543	97
1990	1 543	43
1991	1 543	18
Thereafter, to year-end 2006	23 139	20
Total future minimum lease payments	31 035	\$1 450
Less: Imputed interest, at 9.0% - 11.75%	18 669	
Present value of minimum lease payments	<u>\$12 366</u>	

8. RELATED PARTY TRANSACTIONS

At December 31, 1986, Bell Canada Enterprises Inc. owned 31.1 per cent of the common shares of Bruncor Inc., the parent company of The New Brunswick Telephone Company, Limited (30.7 per cent at December 31, 1985). During the year ended December 31, 1986, the company purchased from Northern Telecom Canada Limited, a subsidiary of Bell Canada Enterprises Inc., equipment and related supplies in the amount of \$29 644 000 (\$26 673 000 for the year ended December 31, 1985). The amount due that company at December 31, 1986 was \$1 481 000 (\$2 409 000 at December 31, 1985).

In July 1986, the company sold its main-frame computer and related equipment to Datacor Atlantic Inc. (Datacor) for \$4 660 000. The company has entered into an agreement with Datacor for the provision of electronic data-processing services. During the year ended December 31, 1986, the company paid \$4 126 000 to Datacor for those services.

Bruntel Holdings Ltd., an affiliate of the company, has a 50.0-per-cent interest in Brunswick Square Ltd. which, under a long-term lease arrangement, provides office accommodations for the company in Saint John, New Brunswick. During the year ended December 31, 1986, the company paid \$3 380 000

to Brunswick Square Ltd. for those accommodations (\$3 081 000 for the year ended December 31, 1985). Included in other income for the year ended December 31, 1986 is \$1 916 000 in dividend income from the company's investment in Brunswick Square Ltd. (\$166 000 for the year ended December 31, 1985).

Bruncor Inc. has guaranteed the company's \$30 000 000 promissory note payable to the Bank of Nova Scotia. In return for this guarantee, the company is required to pay to Bruncor a monthly fee equal to one-twelfth of 1¼ per cent times the average principal amount of the loan outstanding for the month. During the year ended December 31, 1986, the company paid \$375 000 in guarantee fees to Bruncor (\$42 000 for the year ended December 31, 1985).

The company has entered into an agreement with Bruncor Inc. granting Bruncor exclusive rights of access to the company's white-page directory listings for the purpose of soliciting advertising and publishing telephone directories. In return, Bruncor is required to pay a fee to the company which, during the year ended December 31, 1986, amounted to \$2 258 000.

OFFICERS

Name	Principal Occupation
Kenneth V. Cox	Chairman of the Board and Chief Executive Officer
Lino J. Celeste	President and Chief Operating Officer
Berton W. Cosman	Secretary-Treasurer
G. Edwin Graham	Vice-President
Peter G. Jollymore	Vice-President (planning)
William H. R. Smith	Vice-President (finance)

DIRECTORS

Simon L. Bujold †	President, S and N Consultants
Alfons Buzas	Manager of Business and Development Elmtree Resources Ltd.
Lino J. Celeste	President and Chief Operating Officer The New Brunswick Telephone Company, Limited
George L. Colter	President, Diamond Group
Kenneth V. Cox	Chairman and Chief Executive Officer The New Brunswick Telephone Company, Limited
Dr. Ginette Gagné-Koch	Medical Director, The Moncton Hospital
W. Brian Hewat	Executive Vice-President-Marketing Bell Canada
Gerald B. Lawson	Senior Partner Lawson and Lawson
Marks H. Lockhart †	President Lockharts Limited
James A. MacMurray †	Company Director
Raymond Michaud	President and General Manager Kasner's Ltd.
Edward Reevey	President Battery and Electric Service Limited
J. T. Richard Savoie	Chief Executive Officer La Fédération des Caisses Populaires Acadiennes Ltée
John E. Sinclair †	Executive Vice-President, Corporate Bell Canada Enterprises Inc.
Orland Tropea †	Company director

† *Member of audit committee*

