

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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*Unless otherwise indicated, this Management's Discussion and Analysis ("MD&A") of our financial results for the interim period ended December 31, 2009 is as at February 4, 2010. In this MD&A, "we", "our", and "us" refer to Manitoba Telecom Services Inc. ("MTS"). This interim MD&A should be read in conjunction with our interim consolidated financial statements and the discussion and analysis that accompanies our audited consolidated financial statements for the year ended December 31, 2008. This interim MD&A for the three and twelve months ended December 31, 2009 updates the information contained in our interim MD&As for the first, second and third quarters of 2009, and our 2008 annual MD&A. Unless otherwise stated, all amounts are expressed in Canadian dollars.*

## **Regarding Forward-Looking Statements**

*This interim MD&A as well as the financial outlook contained herein includes forward-looking statements and information (collectively, the "statements") about our corporate direction, business opportunities, operating and dispute resolution activities, financial objectives and future*

*financial results and performance that are subject to risks, uncertainties and assumptions. As a consequence, actual results in the future may differ materially from any conclusion, forecast or projection in such forward-looking statements. Examples of statements that constitute forward-looking information may be identified by words such as "believe", "expect", "project", "should", "anticipate", "could", "target", "forecast", "intend", "plan", "outlook", "see", "set", "pending", and other similar terms.*

*Factors that could cause anticipated opportunities and actual results to differ materially include, but are not limited to, matters identified in the "Risks and Uncertainties" section and elsewhere in this interim MD&A, as well as our interim MD&As for the first, second and third quarters of 2009, our 2008 annual MD&A, and our Annual Information Form, all of which are available on SEDAR at [www.sedar.com](http://www.sedar.com).*

*Please note that forward-looking statements reflect our expectations as at the date hereof. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise except as required by law. This interim MD&A and the financial information contained herein have been reviewed by our Audit Committee and approved by our Board of Directors.*

## **NON-GAAP MEASURES OF PERFORMANCE**

In this MD&A, we provide information concerning continuing operations, EBITDA and free cash flow because we believe investors use them as measures of our financial performance. These measures do not have a standardized meaning as prescribed by Canadian generally accepted accounting principles ("GAAP"), and are not necessarily comparable to similarly titled measures used by other companies.

- **Continuing Operations** – We provide information that refers to our performance from continuing operations to assist investors in understanding the performance of our company.

Continuing operations in 2009 excludes our non-telecommunications information technology ("IT") consulting business, which has been classified as discontinued operations; restructuring costs; the costs to transition certain wireless service requirements away from Bell Mobility to new suppliers and to our wireless platform; costs related to our high-speed packet access ("HSPA") deployment and related billing implementation; costs related to certain regulatory proceedings; certain costs associated with our transition from Canadian GAAP to International Financial

Reporting Standards (“IFRS”); a rebate related to *Use of deferral account funds to improve access to telecommunications services for persons with disabilities and to expand broadband services to rural and remote communities*, Telecom Decision CRTC 2008-1 (“Decision 2008-1”); the impact of changes in statutory income tax rates and other rate adjustments on our tax asset; and solvency funding to our pension plans.

Continuing operations in 2008 excludes our non-telecommunications IT consulting business, which has been classified as discontinued operations; restructuring costs; the costs of transitioning certain wireless service requirements away from Bell Mobility to new suppliers and to our wireless platform, as well as costs associated with the advanced wireless services (“AWS”) spectrum auction; the impact of changes in statutory income tax rates and other rate adjustments on our tax asset; the refund of a directors’ and officers’ trust (the “directors’ and officers’ trust”) that was established in 2002 by Allstream Inc.; and solvency funding to our pension plans.

- **EBITDA** – We define EBITDA as earnings before interest, taxes, amortization and other income. EBITDA should not be construed as an alternative to operating income or to cash flows from operating activities (as determined in accordance with Canadian GAAP) as a measure of liquidity.
- **Free Cash Flow** – We define free cash flow as cash flow from operating activities, less capital expenditures, and excluding changes in working capital. Free cash flow is the amount of discretionary cash flow that we have for purchasing additional assets beyond our annual capital expenditure program, paying dividends, buying back shares and/or retiring debt.

## **OVERVIEW**

MTS is a leading national communications provider in Canada and the market leader in Manitoba. In 2009, we were organized into two reportable operating segments, the Consumer Markets division (“CMD”) and the Enterprise Solutions division (“ESD”). Our 2009 financial results and the discussion in this MD&A are reported on this basis.

Effective January 1, 2010, we aligned our business around segments and markets. We replaced our two divisions with two new business units – an MTS unit, and an Allstream unit. The enterprise account base in Manitoba, previously part of the Enterprise Solutions division, will be a part of the MTS unit, and the small business account base across Canada, previously part of the Consumer Markets division, will be a part of the Allstream unit. The organization

impacts only the operating divisions, all corporate groups will continue to be integrated on a company-wide basis.

Our previous structure achieved our goals for increased productivity and cost savings for our business, enabling a fully-integrated approach from our corporate support groups. Our new structure will enable us to better leverage our different geographic markets, and should allow for improved performance going forward. It is an evolution which will further enable our company to leverage our market presence, brand and efficiencies while bringing us closer to our customers so we can serve them better.

In 2010, our financial reporting will reflect the new business segmentation. For comparative purposes, we have provided our 2009 results for revenues and EBITDA on this new basis. Please refer to our fourth quarter 2009 supplementary package for this information.

### ***Consumer Markets division***

The Consumer Markets division leads every telecommunications market segment in Manitoba, delivering a full suite of wireless, high-speed Internet and data, digital television and wireline voice services under the MTS brand, as well as security and alarm monitoring services through AAA Alarm Systems Ltd. (“AAA Alarms”), a subsidiary of MTS. This complete range of products is unmatched by any other provider in Manitoba.

In 2009, the Consumer Markets division served the national small business telecommunications market, providing customers in targeted major Canadian centres with a range of innovative business Internet, data and voice services under the Allstream brand. Effective January 1, 2010, our small business account base across Canada, previously reported as part of the Consumer Markets division, will be a part of the Allstream unit and included with our Allstream unit’s 2010 financial results.

### ***Enterprise Solutions division***

The Enterprise Solutions division, which operates under the Allstream brand nationally and under the MTS Allstream brand in Manitoba, is a leading competitor in the national business and wholesale markets. This division’s main customer base is medium and large businesses and government organizations and its key products are Internet protocol (“IP”)-based communications, unified communications, voice and data connectivity, and security services. The Enterprise Solutions division operates an extensive national broadband fibre optic network that spans almost 30,000 kilometres, and provides international connections through strategic alliances and interconnection agreements with other international service providers. Effective January 1, 2010, the enterprise account base in Manitoba, previously reported as part of the Enterprise Solutions division, will be a part of the MTS unit and included with the MTS unit’s financial results.

Our common shares are listed on the Toronto Stock Exchange (trading symbol: MBT). Our website is [www.mtsallstream.com](http://www.mtsallstream.com).

## **SUBSEQUENT EVENTS**

### ***Court's Decision on Pension Lawsuit***

On January 19, 2010, the Manitoba Court of Queen's Bench (the "Court") ruled on a lawsuit regarding the 1997 initial funding, ongoing surplus and governance of the MTS Pension Plan, which is the primary pension plan for employees in Manitoba. In its decision, the Court upheld the governance of the pension plan and affirmed our position with respect to the issue of ongoing surplus. As a result, there will be no changes to our expected future ongoing funding requirements and administration of the MTS Pension Plan. The Court also ruled, however, that we are obligated to make a \$43 million one-time payment, retroactive to 1997, the year MTS was privatized and the MTS Pension Plan was implemented. We believe, based on legal advice received, that key aspects of this part of the decision are flawed and present strong grounds for appeal.

In order to reach the decision regarding the \$43 million one-time payment, the Court has set aside the critically important opinion of an independent actuary appointed by the Provincial Auditor of Manitoba and substituted its own opinion. We continue to believe that we have complied with all of the requirements of the *Pension Benefits Standards Act, 1985* (Canada) as well as the provincial legislation that privatized MTS and led to the creation of the MTS Pension Plan. Accordingly, we will appeal the Court's decision.

Pending the outcome of an appeal, the financial implications of the Court's decision could result in a one-time future payment of approximately \$100 million measured as of December 31, 2009. This would be comprised of \$43 million plus interest calculated at a rate equal to the pension plan's rate of return since 1997 until December 31, 2009. We expect that such a payment, if any, would not be required until all appeals have been determined. Importantly, however, there will be no increase to our ongoing pension funding requirements as a result of this decision.

### ***Sale of Non-Telecommunications IT Consulting Group***

On January 12, 2010, we announced that we had entered into an agreement to sell the majority of our non-telecommunications IT consulting group to PricewaterhouseCoopers Canada ("PwC"). In addition, we have created an alliance with PwC that we expect to contribute to our revenues. PwC will refer these customers, who require communications solutions services to us, and we will refer our customers who require the support of a non-telecommunications IT consulting group to PwC.

The portion of our business that is being sold has been classified as discontinued operations, as prescribed in the

Canadian Institute of Chartered Accountants' Handbook, with a loss from discontinued operations net of tax in the amount of \$2.2 million taken in 2009. For comparative purposes, we have restated our 2008 and 2009 financial results to exclude the portion of the business that we sold.

## **STRATEGIC PRIORITIES UPDATE**

In summary, in 2009, we made the following progress on five core priorities:

- 1. Focus on profitable growth*  
Our Consumer Markets division's growth services revenues increased by 7.5%, and our Enterprise Solutions division's growth services revenues increased by 2.0%. EBITDA from our growth services, across the company, was up 6.4%.
- 2. Improve the customer experience and gain market share*  
Our wireless services revenues climbed by 8.0% year-over-year on customer growth of 5.5%. Our consumer high-speed Internet revenues were up by 6.6%, with subscribers growing by 3.0%. Driven in part by the success of our new high definition television ("HDTV") product, MTS Ultimate TV Service, which was introduced late in the first quarter of 2009, our digital television services revenues were up by 8.2% on subscriber growth of 2.3%. Revenues from our converged IP enterprise data products delivered 10.6% growth. We have maintained our market share in most of our major product lines. In 2009, we met and exceeded our customer experience targets, as measured through independent surveys.
- 3. Align cost structure to new market realities*  
Our revised and increased target for 2009 was to generate \$50 million to \$60 million in annualized cost savings. We met this target, achieving \$58.4 million in annualized cost savings for the twelve months ended December 31, 2009.
- 4. Drive the transition from legacy to growth services*  
Growth services accounted for 45.4% of our total revenue from continuing operations in 2009, up from 42.4% a year earlier.
- 5. Determine HSPA deployment plan in Manitoba and Allstream wireless strategy*  
On July 28, 2009, we made a significant announcement regarding our wireless strategy going forward for both divisions of our company.

We entered into a strategic wireless arrangement with Rogers Wireless Partnership ("Rogers Wireless") that will see both companies share the cost to deploy an HSPA wireless network across Manitoba. The agreement also allows us to leverage Rogers Wireless's purchasing scope and scale to gain cost effective access

to the new network technology and leading-edge HSPA handsets. Our customers will have access to the best national and international roaming capabilities with Rogers Wireless as our roaming partner, and both companies will share roaming revenues from the HSPA network in Manitoba. The deployment of our regional wireless HSPA network is proceeding according to schedule, and we expect the network to be operational by the end of 2010.

Our strategic wireless agreement with Rogers Wireless also provides us with the opportunity to launch a business wireless offering under the Allstream brand through a competitive wholesale arrangement. Towards the end of 2010, we expect to launch Allstream wireless targeting the geographic markets where we are strongest. Our Allstream wireless offering will focus on a converged wireless/wireline product suite. This business-only wireless service will complement our existing enterprise portfolio and provide customers with unique functionality. Over the next three years, we would expect our cumulative investment in Allstream wireless to be a maximum of approximately \$25 million, including customer acquisition costs, as we already have significant customer relationships, wireless application development capabilities, distribution channels and billing systems and access to a national wireless network through our strategic arrangement with Rogers Wireless.

## **RESULTS OF OPERATIONS**

### ***2009 Results in Summary***

<i>(in millions \$, except EPS)</i>	<b>2009 actual</b>	<i>2009 revised financial outlook</i>
Revenue (continuing operations)*	1,823.4	1,805 to 1,850
EBITDA	625.1	625 to 645
EPS	2.64	2.60 to 2.90
Free cash flow	233.5	230 to 250
Capital expenditures	14%	13% to 15% of revenues

\* Actual results for our continuing operations and our 2009 financial outlook have been adjusted to exclude revenues from our non-telecommunications IT consulting business, which was subsequently sold and classified as discontinued operations. The amount of these revenues was approximately \$50 million.

In 2009, we delivered results that were in line with our financial outlook, which was updated on October 7, 2009. Through the year, our Consumer Markets division consistently achieved strong results and growth, driven by strong performance in wireless, high-speed Internet and digital television services. Our Consumer Markets division

benefitted from exposure to Manitoba's resilient economy. Converged IP services, our Enterprise Solutions division's largest and most profitable revenue line, also delivered continued strong growth. Beginning in the second quarter of 2009, however, we started to see the impact of the global recession and slow pace of economic recovery affect our financial results, primarily the performance of our Enterprise Solutions division. This resulted in a sharper than originally expected decline in our long distance and legacy data services portfolios, as well as lower revenues from our unified communications line of business.

Importantly, our key growth services, such as wireless, digital television, high-speed Internet and converged IP, performed well despite the economy. In 2009, we succeeded in making our internal processes more efficient and cost effective. We reached our cost reduction target, achieving \$58.4 million in annualized cost savings by the end of the year.

### ***Quarterly Metrics for the Most Recent Five Quarters***

<i>(in millions \$, except EPS)*</i>	<b>2009</b>				<b>2008</b>
	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>	<b>Q4</b>
Growth services revenues	<b>205.5</b>	206.4	203.8	212.5	200.0
Legacy services revenues	<b>247.2</b>	244.7	247.6	255.7	263.9
Revenue	<b>452.7</b>	451.1	451.4	468.2	463.9
EBITDA	<b>146.3</b>	157.1	159.0	162.7	158.3
Free cash flow	<b>43.4</b>	62.2	59.8	68.1	40.9
EPS	<b>0.59</b>	0.68	0.66	0.71	0.61
Capital expenditures/revenue	<b>16%</b>	15%	14%	12%	19%

\* All financial metrics in this table are from continuing operations.

Similar to the second and third quarters of 2009, we continued to experience the impacts of the recession and slow pace of economic recovery through the fourth quarter, which contributed to the year-over-year declines in the financial metrics listed in the above table.

## REVENUES

### Operating Revenues

<i>(in millions \$)</i>	<i>Q4/09</i>	<i>Q4/08</i>	<i>% change</i>
Revenue (continuing operations)	<b>452.7</b>	463.9	(2.4)
Revenue	<b>452.7</b>	463.9	(2.4)

  

<i>(in millions \$)</i>	<i>YTD/09</i>	<i>YTD/08</i>	<i>% change</i>
Revenue (continuing operations)	<b>1,823.4</b>	1,867.1	(2.3)
Deferral account rebate	<b>(13.5)</b>	--	n.m.
Revenue	<b>1,809.9</b>	1,867.1	(3.1)

Revenues from continuing operations decreased by \$11.2 million and by \$43.7 million, respectively, in the fourth quarter and for the full-year 2009 as compared to the same periods in 2008. These results reflect declines in our local, long distance, data and unified communications lines of business, which were partly offset by strong growth in wireless, consumer high-speed Internet, digital television and converged IP services. In the third quarter of 2009, we recorded a \$13.5 million charge for the deferral account rebate in relation to Decision 2008-1, which lowered our full-year revenues on a consolidated basis by 3.1% to \$1,809.9 million.

### By Segment (continuing operations)

<i>(in millions \$)</i>	<i>Q4/09</i>	<i>Q4/08</i>	<i>% change</i>
<b>Revenues</b>	<b>452.7</b>	463.9	(2.4)
CMD growth services revenues	<b>105.4</b>	100.0	5.4
ESD growth services revenues	<b>100.1</b>	100.0	0.1
<b>Total growth services revenues</b>	<b>205.5</b>	200.0	2.8
CMD legacy services revenues	<b>100.1</b>	105.2	(4.8)
ESD legacy services revenues	<b>147.1</b>	158.7	(7.3)
<b>Total legacy services revenues</b>	<b>247.2</b>	263.9	(6.3)

  

<i>(in millions \$)</i>	<i>YTD/09</i>	<i>YTD/08</i>	<i>% change</i>
<b>Revenues</b>	<b>1,823.4</b>	1,867.1	(2.3)
CMD growth services revenues	<b>418.7</b>	389.5	7.5
ESD growth services revenues	<b>409.5</b>	401.5	2.0
<b>Total growth services revenues</b>	<b>828.2</b>	791.0	4.7
CMD legacy services revenues	<b>407.3</b>	428.5	(4.9)
ESD legacy services revenues	<b>587.9</b>	647.6	(9.2)
<b>Total legacy services revenues</b>	<b>995.2</b>	1,076.1	(7.5)

### Growth Services Revenues

*Our growth services revenues include wireless, consumer high-speed Internet, digital television, converged IP, unified communications, and security services, as well as our alarm monitoring services business.*

Collectively, our growth services revenues rose by \$5.5 million and by \$37.2 million in the three and twelve months ended December 31, 2009, respectively, as compared to the same periods last year. Driving this performance is higher, often market-leading, year-over-year revenue growth from converged IP, consumer Internet, wireless and digital television services on a quarterly and full-year basis, which was partially offset by lower revenues from unified communications, and security services.

### Legacy Services Revenues

*Local, long distance and legacy data services are included in our legacy services revenues.*

Legacy services revenues totaled \$247.2 million in the fourth quarter as compared to \$263.9 million in the same period last year. In the twelve months ended December 31, 2009, our legacy services generated revenues of \$995.2 million as compared to \$1,076.1 million in 2008. These results reflect the impact of lower revenues from legacy services contracts with Rogers Communications Inc. ("Rogers") and AT&T Corp. ("AT&T"), re-pricing and

lower volumes in the enterprise legacy market and competitive losses in the consumer market. In addition, we are seeing a decline in legacy services revenues related to the slowing economy as some of our enterprise customers, who are based or have operations in the U.S., are reducing their business volumes.

As expected, Rogers and AT&T continued to migrate their communications traffic from our network to their own networks, resulting in year-over-year decreases in revenues from these customers of \$3.2 million to \$17.6 million and \$24.7 million to \$70.5 million for the fourth quarter and year to date, respectively.

#### **Operating Revenues (continuing operations)**

<i>(in millions \$)</i>	<b>Q4/09</b>	<b>Q4/08</b>	<b>% change</b>
Wireless	<b>78.5</b>	74.6	5.2
Data	<b>151.6</b>	155.9	(2.8)
Local	<b>127.3</b>	131.2	(3.0)
Long distance	<b>73.1</b>	80.2	(8.9)
Other	<b>22.2</b>	22.0	0.9
<b>Total</b>	<b>452.7</b>	463.9	(2.4)

<i>(in millions \$)</i>	<b>YTD/09</b>	<b>YTD/08</b>	<b>% change</b>
Wireless	<b>312.9</b>	289.7	8.0
Data	<b>620.3</b>	637.8	(2.7)
Local	<b>514.9</b>	527.5	(2.4)
Long distance	<b>288.4</b>	328.2	(12.1)
Other	<b>86.9</b>	83.9	3.6
<b>Total</b>	<b>1,823.4</b>	1,867.1	(2.3)

#### **Wireless Services**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4	<b>78.5</b>	74.6	5.2
YTD	<b>312.9</b>	289.7	8.0

*Our wireless portfolio consists of cellular, wireless data, paging and group communications services that we offer in the Manitoba market.*

Our wireless services revenues increased by \$3.9 million in the fourth quarter and by \$23.2 million in the twelve months ended December 31, 2009, driven by growth in our subscriber base and significantly higher wireless data usage. At year-end, we had 458,478 wireless subscribers, up by 5.5% from the prior year. Our wireless results in 2009 were also enhanced by a \$3.4 million one-time sale of FleetNet 800™ handsets to the City of Winnipeg, which occurred in the first quarter.

Our average revenue per user (“ARPU”) of \$57.03 decreased by 0.6% or \$0.37 for the twelve months ended December 31, 2009. Although we continued to see increased airtime usage along with strong growth in wireless

data services and calling-feature utilization, the presence of aggressively-priced plans from competitors in the fourth quarter of 2008 and first quarter of 2009 impacted our positive performance. We remained disciplined with our pricing strategy but were forced to partly respond to these plans for a limited time and withdrew our promotion in February 2009. In the fourth quarter of 2009, we saw more price stability in the marketplace as compared to the fourth quarter of 2008.

We continue to see strong growth potential for our wireless services in Manitoba. Our MTS Mobility services provide strong brand awareness, network reach and customer service. In addition, the high-value product bundles that we offer customers cannot be matched by our competitors. These factors, along with increasing consumer adoption of wireless products, provide an environment for further growth in Manitoba. For example, at the end of the fourth quarter of 2009, wireless penetration in Manitoba was approximately 65% as compared to our estimate of the Canadian penetration rate of approximately 67%.

#### **Data Services**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4	<b>151.6</b>	155.9	(2.8)
YTD	<b>620.3</b>	637.8	(2.7)

*Our data line of business includes revenues earned from providing converged IP, high-speed Internet, unified communications, legacy data and security services. Data services connect data, video and voice networks to establish private connections across office locations and to integrate traffic over highly secure networks. We provide a wide range of Internet connectivity services to meet the needs of residential customers in Manitoba and business customers across the country. We also offer hosting and security services to business customers across Canada.*

Our data services revenues decreased by \$4.3 million in the fourth quarter and by \$17.5 million for the full-year 2009, respectively, as compared to the same periods a year earlier. These results reflect continuing strong growth in converged IP and consumer Internet lines of business, which was offset by the effects of lower legacy data services revenues resulting from customer transition to IP-based growth services and the impact of the recession as many enterprise customers are experiencing lower business volumes and postponing purchases of unified communications and security services. In addition, the continuing migration of legacy data communications traffic by Rogers and AT&T to their respective networks has further impacted the year-over-year declines in our data services revenues. Excluding the impact of Rogers and AT&T, our data services revenues would have shown declines of 1.3% and 0.1% in the fourth quarter and year to date periods, respectively.

We continue to experience strong demand for our converged IP services, which delivered revenue growth of 6.6% and

10.6% for the fourth quarter and full-year 2009, respectively, over the same periods in the prior year. The capabilities of the suite of data products offered by our Enterprise Solutions division continued to be demonstrated by solid growth in our IP-virtual private network (“IP-VPN”) customer base. As at December 31, 2009, we were supporting 366 IP-VPN customers, a 17.7% increase over last year.

Our consumer Internet services revenue grew by 1.4% to \$21.4 million in the fourth quarter and 6.6% to \$87.5 million in the full-year 2009. These increases were driven by growth of 3.0% in our consumer high-speed Internet customer base, which totaled 181,913 customers at December 31, 2009, and a 5.7% year-over-year increase in ARPU. Similar to our national peers, increasing penetration in the high-speed Internet market is slowing our subscriber activations.

### **Local Services**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4	<b>127.3</b>	131.2	(3.0)
YTD	<b>514.9</b>	527.5	(2.4)

*Local services revenues include basic voice connections for residential customers, including enhanced calling features (such as Call Answer, Call Display, Call Waiting and 3-Way Calling), payphone revenue, wholesale revenues from services provided to third parties, as well as a full range of local services to business customers. These services allow customers to complete calls in their local calling areas and to access long distance, cellular networks and the Internet.*

Local services revenues decreased marginally by \$3.9 million in the fourth quarter and by \$12.6 million for the full-year 2009, respectively, as compared to the same periods in 2008. Year-over-year, reduced local services revenues reflect decreased residential network access lines due to local competition and substitution. Westman Communication Group launched digital phone service in the Brandon, Manitoba market late in 2008, which has contributed to the decline in our local services revenues in 2009. Our year-over-year residential line loss, however, is among the lowest in Canada at 5.7%, demonstrating the success of our service bundling and consumer strategies in this market. In the local business markets across Canada, our Enterprise Solutions division continues to perform well and achieve stable revenues in the markets where it competes.

We believe that we have positioned ourselves for long-term success in our markets by bundling our residential services in attractive offerings. Our popular residential service bundles, which can include wireless, Internet, digital television and alarm monitoring services, continue to provide a unique value proposition for our customers and cannot be matched by our competitors. Customers utilizing our bundled service offerings grew by 3.8% in the fourth quarter of 2009 as compared to the same period in 2008. Through the success of these programs we continued

to deliver “best in class” performance against cable company competitors, and are minimizing the reduction in our local services revenues. At December 31, 2009, our overall residential customer connections in Manitoba, which include residential network access services, consumer high-speed Internet, consumer wireless and digital television subscribers, were up by more than 8,000 connections year-over-year.

### **Long Distance Services**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4	<b>73.1</b>	80.2	(8.9)
YTD	<b>288.4</b>	328.2	(12.1)

*Long distance services enable residential customers in Manitoba and business customers across Canada to communicate with destinations outside the local exchange. Our long distance voice service portfolio includes basic, domestic, cross-border and international outbound long distance, basic and enhanced toll-free services, calling cards and audio conferencing, as well as a variety of enhanced long distance services and features.*

Long distance services revenues totaled \$73.1 million in the fourth quarter and \$288.4 million for the full-year 2009 as compared to \$80.2 million and \$328.2 million in the same periods in 2008, respectively. The effects of competitive pricing pressures, customer losses and a slowing economy contributed to lower long distance services revenues in all markets that we serve.

Long distance services revenues in our Consumer Markets division were lower mainly due to customer migration to lower-priced long distance plans, reduced volumes and customer losses. Our Enterprise Solutions division’s long distance services were primarily impacted by lower volumes in the cross-border and domestic markets along with lower domestic rates. Reduced business activity by our customers that are based or have operations in the U.S., as well as exiting customers, have resulted in lower domestic and cross-border volumes of long distance services. We have launched sales and marketing initiatives designed to identify new customers, retain our existing customer base and encourage higher long distance usage to counter these impacts upon our long distance business in the enterprise segment.

## Other Revenues

(in millions \$)	2009	2008	% change
Q4	22.2	22.0	0.9
YTD	86.9	83.9	3.6

Other revenues consist of revenues earned from our digital television and alarm monitoring services, and miscellaneous items. Our digital television service is offered across our broadband network platform and is targeted at residential customers in Winnipeg, Brandon and Portage la Prairie. Miscellaneous revenues primarily consist of the sale and maintenance of terminal equipment.

Other revenues grew by \$0.2 million in the fourth quarter and were ahead by \$3.0 million for the entire year. The increase in the fourth quarter is attributable to growth in digital television services revenues partly offset by lower revenues from alarm monitoring services. Our digital television services revenues grew by 8.8% or \$1.1 million in the fourth quarter, and by 8.2% or \$4.1 million for the full-year 2009. Year-over-year, our higher digital television services revenues reflect subscriber growth, together with a price increase to our basic television service implemented in January 2009, increased sales of our MTS Ultimate TV personal video recorder (“PVR”) as well as increased subscriber purchases of pay-per-view events and video-on-demand services. We had 86,520 digital television subscribers at year-end, representing an increase of 2.3% over 2008.

With respect to our television service, 2009 was highlighted by the introduction of our premium television offering, branded “MTS Ultimate TV”. The new service combines technology from Alcatel-Lucent Canada Inc. and the Microsoft Mediaroom Internet Protocol Television software platform, providing customers with the most-sophisticated, feature-rich television experience in Canada, as well as access to our fastest Internet speeds. In October, we enhanced MTS Ultimate TV with whole home PVR functionality, a new, more-advanced PVR capable of recording up to three programs at the same time and playing back programs to any connected television in a subscriber’s home. The service is exclusive to MTS Ultimate TV subscribers and is proving to be very popular.

The rollout of this product occurred gradually throughout 2009 and by the end of the third quarter of the year, we had launched this service in Brandon and reached the majority of households in Winnipeg. The opportunity offered by this recently expanded footprint was demonstrated by strong subscriber additions reaching the highest level in the fourth quarter as compared to previous quarters this year. At the end of December 2009, we had more than 14,000 MTS Ultimate TV subscribers with only three months of limited promotion of the new product. Of these subscribers, approximately half are new customers while the balance are upgrading to MTS Ultimate TV from our other television services. In addition, the newer service produces a higher average revenue per subscriber and

provides premium revenue potential for us. As at December 31, 2009, the new service was available to approximately 70% of Winnipeg households as well as to households in Portage la Prairie and Brandon. As the service is extended to more areas in Winnipeg and as we increase our promotional efforts, we expect it to drive growth in our overall television subscriber base.

## EBITDA

(in millions \$)	Q4/09	Q4/08	% change
EBITDA (continuing operations)	146.3	158.3	(7.6)
Restructuring and other costs	(5.8)	(13.7)	(57.7)
National wireless/wireless transition costs	(3.7)	(9.3)	(60.2)
EBITDA	136.8	135.3	1.1

(in millions \$)	YTD/09	YTD/08	% change
EBITDA (continuing operations)	625.1	666.4	(6.2)
Deferral account rebate	(13.5)	--	n.m.
Restructuring and other costs	(33.6)	(20.8)	61.5
National wireless/wireless transition costs	(18.1)	(27.1)	(33.2)
EBITDA	559.9	618.5	(9.5)

Our EBITDA from continuing operations for the fourth quarter, at \$146.3 million, was lower by \$12.0 million as compared to the fourth quarter of 2008. For all of 2009, EBITDA from continued operations declined by \$41.3 million to \$625.1 million. These results reflect solid growth in wireless, digital television and consumer Internet services, as well as double-digit growth in revenues from our converged IP services, which was offset by the impact of the recession on our long distance, legacy data, unified communications, and security services revenues as well as lower revenues from Rogers and AT&T.

We continue to progress with our long-term strategic objectives to increase our revenues from growth services and create efficiencies in all areas of our business. For the year ended December 31, 2009, revenues from our growth services comprised 45.4% of our revenues, which is up from 42.4% a year earlier. We are closely monitoring the effects the economy is having on our industry by focusing on our management of our cost structure, revenue retention and prudent capital spending. As an example, at the midpoint of the year, our cost reduction program was delivering more savings than originally forecasted and as a result, we

increased our initial cost savings target for 2009 of \$35 million to \$45 million to the range of \$50 million to \$60 million. By year-end, we achieved that revised target, generating \$58.4 million in annualized savings. We believe that there are further opportunities to streamline and gain additional efficiencies in our business in 2010.

Higher consolidated EBITDA in the fourth quarter was primarily driven by lower year-over-year restructuring costs as well as the costs associated with our transition away from Bell Mobility to new suppliers and our own wireless platform. For the twelve months ended December 31, 2009, consolidated EBITDA was also impacted by the deferral account rebate that we recorded in the third quarter of 2009.

### EPS

<i>(in \$)</i>	<i>Q4/09</i>	<i>Q4/08</i>	<i>% change</i>
EPS (continuing operations)	<b>0.59</b>	0.61	(3.3)
Future statutory tax rate and other tax rate adjustments	<b>(0.36)</b>	(0.14)	n.m.
Discontinued operations	<b>(0.03)</b>	(0.02)	50.0
Restructuring and other costs	<b>(0.06)</b>	(0.14)	(57.1)
National wireless/wireless transition costs	<b>(0.04)</b>	(0.10)	(60.0)
<b>Basic EPS</b>	<b>0.10</b>	0.21	(52.4)

<i>(in \$)</i>	<i>YTD/09</i>	<i>YTD/08</i>	<i>% change</i>
EPS (continuing operations)	<b>2.64</b>	3.03	(12.9)
Future statutory tax rate and other tax rate adjustments	<b>(0.36)</b>	(0.26)	(38.5)
Discontinued operations	<b>(0.03)</b>	(0.05)	(40.0)
Restructuring and other costs	<b>(0.35)</b>	(0.21)	66.7
National wireless/wireless transition costs	<b>(0.19)</b>	(0.28)	(32.1)
Deferral account rebate	<b>(0.14)</b>	--	n.m.
<b>Basic EPS</b>	<b>1.57</b>	2.23	(29.6)

Note: EPS for the three and twelve months ended December 31 is based on weighted average shares outstanding of 64.7 million for 2009, and 64.6 million for 2008.

On a year-over-year basis, EPS from continuing operations decreased by \$0.02 to \$0.59 in the fourth quarter and by \$0.39 to \$2.64 for the twelve months ended December 31, 2009 mainly as a result of lower EBITDA. In

both the second quarter and the fourth quarter of 2009, we issued long-term debt at attractive rates, which resulted in higher debt charges and impacted EPS. While these rates are higher than the short-term rates we incurred last year, they represent excellent financing rates for us relative to our historical long-term average.

In the fourth quarter, basic EPS was \$0.10 as compared to \$0.21 in the same period in the prior year. This decrease reflects a number of items that did not arise from continuing operations including higher non-cash charges associated with tax adjustments and a \$0.03 per share loss from discontinued operations we incurred in connection with the portion of our non-telecommunications IT consulting business that is being sold. For the twelve months ended December 31, 2009, basic EPS was \$1.57 as compared to \$2.23 in the prior year. In addition to the items listed above, lower EPS in 2009 also reflects higher restructuring costs as well as the rebate from the deferral account.

### OPERATING EXPENSES

#### *Operations Expense (continuing operations)*

<i>(in millions \$)</i>	<i>2009</i>	<i>2008</i>	<i>% change</i>
Q4	<b>306.4</b>	305.6	0.3
YTD	<b>1,198.3</b>	1,200.7	(0.2)

Operating expenses in the fourth quarter and for the full year were up by \$0.8 million and decreased by \$2.4 million, respectively, as compared to the same periods in the prior year. We continued to make excellent progress with our 2009 cost reduction program throughout the year, and by December 31, 2009, we exceeded our original target and met our increased target, achieving \$58.4 million in annualized savings. For the twelve months ended December 31, 2009, these savings were offset by a combination of factors including higher costs associated with certain growth services, higher direct costs and contractual wage rate increases. In addition, due to the timing of these cost saving actions which occurred throughout the year, we did not expect to realize the full benefit of these cost reductions in 2009.

In addition, we are seeing success with our cost reduction program focusing on areas of our business not impacted by the previous initiatives and expect to continue generating further savings in the future.

#### *Restructuring and Transition*

<i>(in millions \$)</i>	<i>2009</i>	<i>2008</i>	<i>% change</i>
Q4	<b>9.5</b>	23.0	(58.7)
YTD	<b>51.7</b>	47.9	7.9

We incurred restructuring costs in the amounts of \$5.8 million and \$33.6 million in the fourth quarter and year to date, respectively. These costs represent a

continuation of the cost reduction initiative we started in the fourth quarter of 2008 with the aim to achieve process improvements and further cost reductions, including facilities consolidation of certain real estate. Our restructuring costs totaled \$33.6 million for the full-year 2009, which is in line with our initial estimate of \$25 million to \$35 million. Please refer to Note 2 to our consolidated financial statements for further details on our restructuring and transition expenses.

Transition costs for the fourth quarter were \$3.7 million and \$18.1 million for the twelve months ended December 31, 2009, as compared to \$9.3 million and \$27.1 million for the same periods in the prior year. Our costs are lower in 2009 primarily as result of the completion of our transition from the services of Bell Mobility to our own platforms, which occurred mostly in 2008.

#### **Amortization Expense**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4	<b>77.9</b>	83.3	(6.5)
YTD	<b>322.7</b>	329.4	(2.0)

Amortization expense was \$5.4 million lower in the fourth quarter as compared to the same period last year due to a decrease in the composite rate. In the twelve months ended December 31, 2009, amortization expense was down by \$6.7 million as compared to the prior year, reflecting a decrease in the composite rate, partly offset by an increase in intangible assets and a charge taken in the first quarter of 2009 related to an accounting change in AAA Alarms.

#### **Other Income**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4	<b>3.3</b>	(0.5)	n.m.
YTD	<b>10.9</b>	7.1	53.5

Other income was higher in the fourth quarter of 2009 primarily due to interest income on a tax credit under the scientific research and experimental development ("SR&ED") program. In the twelve months ended December 31, 2009, other income was positively impacted by a gain of \$3.1 million related to the sale of our alarm monitoring services customers outside of Manitoba in exchange for Manitoba-based customers of SecurTek Monitoring Solutions Inc. ("SecurTek"), an adjustment in our favour resulting from a tax audit of our participation in the SR&ED program and interest income on a tax credit we received under the SR&ED program.

#### **Debt Charges**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4	<b>15.6</b>	12.2	27.9
YTD	<b>59.5</b>	48.9	21.7

Debt charges are higher by \$3.4 million in the fourth quarter and \$10.6 million for the entire year, respectively, as compared to the same periods in 2008. This increased interest expense is primarily associated with our higher levels of outstanding debt and higher average coupon rates, which resulted from a higher proportion of our debt being long-term in 2009.

#### **Income Tax Expense**

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>% change</b>
Q4			
Income tax on continuing operations	<b>17.8</b>	23.1	(22.9)
Tax impact of one-time items	<b>(3.6)</b>	(7.6)	(52.6)
Statutory tax rate and other tax rate adjustments	<b>23.4</b>	9.0	n.m.
Total income tax	<b>37.6</b>	24.5	53.5
YTD			
Income tax on continuing operations	<b>82.8</b>	99.4	(16.7)
Tax impact of one-time items	<b>(21.5)</b>	(16.0)	34.4
Statutory tax rate and other tax rate adjustments	<b>23.4</b>	16.5	41.8
Total income tax	<b>84.7</b>	99.9	(15.2)

Income tax expense increased by \$13.1 million to \$37.6 million in the fourth quarter and decreased by \$15.2 million to \$84.7 million in the twelve months ended December 31, 2009. The increase in income tax expense in the fourth quarter of 2009 as compared to the same period in the prior year is mainly attributable to the impact of changes in the statutory tax rate and other rate adjustments. For the full-year 2009, lower income tax expense reflects lower income before tax, which was partially offset by the impacts of the change in the statutory tax rates and other tax rate adjustments.

We continue to benefit from our substantial capital cost allowance (“CCA”) pools and available tax losses which have enabled us to fully-offset our taxable income. By utilizing our deferred CCA deductions, we project that we will not pay cash taxes before 2017 with the present value of our tax asset being approximately \$350 million.

## CONSOLIDATED QUARTERLY DATA

Unaudited quarterly financial data for our eight most recently completed quarters is presented below:

<i>(in millions \$, except EPS)</i>	<b>Q4 2009</b>	<b>Q3 2009</b>	<b>Q2 2009</b>	<b>Q1 2009</b>
Operating revenues	452.7	437.6	451.4	468.2
Operating income	58.9	51.9	59.0	67.4
Net income before discontinued operations	9.0	28.1	30.0	36.8
Net income and comprehensive income	6.7	27.9	30.1	37.0
EPS before discontinued operations	0.14	0.43	0.47	0.57
Diluted EPS before discontinued operations	0.14	0.43	0.47	0.57
EPS	0.10	0.43	0.47	0.57
Diluted EPS	0.10	0.43	0.47	0.57
<i>(in millions \$, except EPS)</i>	<b>Q4 2008</b>	<b>Q3 2008</b>	<b>Q2 2008</b>	<b>Q1 2008</b>
Operating revenues	463.9	467.3	472.1	463.8
Operating income	52.0	68.6	79.6	88.9
Net income before discontinued operations	14.8	39.4	38.5	54.7
Net income and comprehensive income	13.7	38.1	38.0	54.2
EPS before discontinued operations	0.23	0.61	0.60	0.85
Diluted EPS before discontinued operations	0.23	0.61	0.60	0.85
EPS	0.21	0.59	0.59	0.84
Diluted EPS	0.21	0.59	0.58	0.83

Our consolidated financial results for the eight most recently completed quarters reflect the ongoing performance of our business in the marketplace, as well as the recording of the following items:

- A loss in the amount of \$2.3 million in the fourth quarter of 2009 associated with discontinued operations of our non-telecommunications IT consulting business.
- Charges in the amount of \$13.5 million for the deferral account rebate in relation to Decision 2008-1 in the third quarter of 2009.
- Costs in relation to the transition of certain wireless service requirements away from Bell Mobility to new suppliers and to our wireless platform in the first, second, third and fourth quarters of 2009, in the amounts of \$7.4 million, \$6.3 million, \$0.7 million and \$3.7 million, respectively. We recorded costs in the amounts of \$10.3 million, \$7.5 million and \$9.3 million in the second, third and fourth quarters of 2008, respectively, for this transition and costs associated with the AWS spectrum auction.
- Restructuring costs for our ongoing cost reduction initiatives in each of the four quarters of 2009 in the amounts of \$5.4 million, \$12.3 million, \$8.6 million and \$5.3 million, listed chronologically, versus \$7.1 million and \$13.7 million in the third and fourth quarters of 2008, respectively.
- Charges to reflect decreases in the value of our income tax asset as a result of reductions in future income tax rates or rate differential on temporary differences, consisting of \$23.4 million in the fourth quarter of 2009; and \$7.5 million and \$9.0 million in the second and fourth quarters of 2008, respectively.

## **LIQUIDITY AND CAPITAL RESOURCES**

### ***Cash Flows from Operating Activities***

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>\$ change</b>
Q4	<b>39.4</b>	168.6	(129.2)
YTD	<b>263.8</b>	533.8	(270.0)

*Cash flows from operating activities refer to cash we generate from our normal business activities.*

In the fourth quarter of 2009, cash flows from operating activities were \$39.4 million as compared to \$168.6 million in the fourth quarter of 2008. The year-over-year decrease of \$129.2 million is mainly due to a reduction of \$88.5 million in our utilization of our accounts receivable securitization program. In addition, we paid \$14.5 million more in the fourth quarter of 2009 as compared to 2008 to pre-fund our total 2010 pension solvency obligation. The

decrease also reflects the fact that cash flows from our operating activities in the fourth quarter of 2008 included a refund of the directors' and officers' trust. The directors' and officers' trust was established in 2002 to provide additional coverage to directors and officers of Allstream Inc. in the event of any legal claim arising before December 31, 2008, at which time the trust terminated and the trust funds were returned to us.

Cash flows from operating activities for the full-year 2009 were \$263.8 million as compared to \$533.8 million in 2008. The decrease of \$270.0 million in 2009 is mainly due a reduction of \$211.0 million in our utilization of our accounts receivable securitization program this year, lower consolidated EBITDA, higher pension funding reflecting our prepayment in 2009 of our 2010 solvency obligation as well as higher debt charges. The decrease also reflects the cash refund of the directors' and officers' trust which was received in 2008.

### ***Cash Flows used in Investing Activities***

<i>(in millions \$)</i>	<b>2009</b>	<b>2008</b>	<b>\$ change</b>
Q4	<b>93.6</b>	94.3	(0.7)
YTD	<b>297.9</b>	343.2	(45.3)

*Investing activities represent cash used for acquiring, and cash received from disposing of, long-term assets and other long-term investments.*

Cash flows used in investing activities were \$93.6 million in the fourth quarter of 2009 as compared to \$94.3 million in the fourth quarter of 2008. For the twelve months ended December 31, 2009, we used \$297.9 million for investing activities, as compared to \$343.2 million in 2008. The decrease is mainly attributable to our purchase of wireless spectrum during the AWS spectrum auction in 2008, lower capital expenditures from continuing operations, partly offset by increased capital expenditures related to our HSPA network deployment and the expenditure for our acquisition of VisionIP Technologies Inc. in the third quarter of 2009.

### ***Capital Expenditures***

In 2009, capital was allocated principally to fund our higher growth segments. Our capital expenditures from continuing operations in the fourth quarter of 2009 were \$73.2 million as compared to \$88.6 million in the same quarter in 2008 and on an annual basis were \$259.8 million as compared to \$282.2 million last year.

### Free Cash Flow

<i>(in millions \$)</i>	<b>Q4/09</b>	<b>Q4/08</b>	<b>% change</b>
Free cash flow (continuing operations)	<b>43.4</b>	40.9	6.1
Pension solvency funding	<b>(23.2)</b>	(8.5)	n.m.
HSPA and related billing expenditures	<b>(18.6)</b>	--	n.m.
Restructuring and other costs	<b>(5.8)</b>	--	n.m.
Restructuring capital expenditures	<b>(1.2)</b>	(13.7)	(91.2)
National wireless/wireless transition costs	<b>(3.7)</b>	(9.3)	(60.2)
Wireless transition capital expenditures	--	(2.2)	n.m.
Directors' and officers' trust refund	--	14.8	n.m.
Consolidated free cash flow	<b>(9.1)</b>	22.0	n.m.

<i>(in millions \$)</i>	<b>YTD/09</b>	<b>YTD/08</b>	<b>% change</b>
Free cash flow (continuing operations)	<b>233.5</b>	266.2	(12.3)
Pension solvency funding	<b>(46.7)</b>	(30.6)	52.6
HSPA and related billing expenditures	<b>(32.6)</b>	--	n.m.
Restructuring and other costs	<b>(33.6)</b>	(20.8)	61.5
Restructuring capital expenditures	<b>(2.8)</b>	--	n.m.
National wireless/wireless transition costs	<b>(18.1)</b>	(27.1)	(33.2)
Deferral account rebate	<b>(13.5)</b>	--	n.m.
Wireless transition capital expenditures	--	(4.6)	n.m.
Directors' and officers' trust refund	--	14.8	n.m.
Spectrum license costs	--	(48.6)	n.m.
Consolidated free cash flow	<b>86.2</b>	149.3	(42.3)

*Free cash flow refers to cash flow from operating activities, less capital expenditures, and excluding changes in working capital.*

Free cash flow from continuing operations was \$43.4 million in the fourth quarter of 2009 as compared to \$40.9 million in the same period in 2008. The quarterly year-over-year increase in free cash flow from continuing operations primarily reflects lower capital expenditures, partly offset by lower EBITDA from continuing operations. For the twelve months ended December 31, 2009, free cash flow from continuing operations was \$233.5 million as compared to \$266.2 million in 2008. The decrease is mainly attributable to lower EBITDA from continuing operations, higher debt charges and deferred wireless costs, partly offset by lower capital expenditures.

Consolidated free cash flow was negative \$9.1 million in the fourth quarter this year and decreased to \$86.2 million for the full-year 2009 as compared to \$22.0 million and \$149.3 million in the comparable periods in 2008. Details of the items not included in continuing operations are included in the preceding tables.

### ***Cash Flows from (used in) Financing Activities***

<i>(in millions \$)</i>	<b>2009</b>	2008	<i>\$ change</i>
Q4	<b>155.2</b>	(62.1)	217.3
YTD	<b>137.8</b>	(165.9)	303.7

*Financing activities refer to actions we undertake to fund our operations through equity capital and borrowings.*

Cash flows from financing activities were \$155.2 million in the fourth quarter of 2009. The increase in cash flows in the fourth quarter of 2009 over the same period in the prior year is primarily due to the issuance of debt. In December 2009, we issued \$200.0 million in medium term notes and are using the proceeds to pre-fund our HSPA build, 2010 pension solvency obligations, deferral account rebate, and past restructuring accruals. For the twelve months ended December 31, 2009, cash flows from financing activities totaled \$137.8 million, versus cash used in financing activities in the amount of \$165.9 million in 2008. The increase in cash flows from financing activities in 2009 is primarily due to the proceeds from the issuance of debt being greater than the use of cash in the repayment of notes payable and maturing long-term debt.

### ***Credit Facilities***

<i>(in millions \$)</i>	<i>capacity</i>	<i>utilized at December 31, 2009</i>
Medium term note program	500.0	200.0
Accounts receivable securitization	150.0	--
Revolving credit facility	350.0	137.3
Total	1,050.0	337.3

We have arrangements in place that allow us to access the debt capital markets for funding when required. Borrowings under these facilities typically are used to fund new initiatives, refinance maturing debt, and manage cash flow fluctuations.

We renewed our medium term note program on October 16, 2009 for \$500.0 million and utilized \$200.0 million of this facility to issue debt in December 2009. We also have a \$350.0 million revolving credit facility, of which \$150.0 million is available to back-stop our commercial paper program. As at December 31, 2009, we utilized \$137.3 million of our revolving credit facility for undrawn letters of credit. Of this amount, \$110.2 million represents letters of credit issued under the *Solvency Funding Relief Regulations* enacted in 2006 under the *Pension Benefits Standards Act, 1985* (Canada), which permit the extension of pension solvency payments from a five-year amortization period to a 10-year amortization period for our defined benefit pension plans. In addition to these programs and facilities, we have an accounts receivable securitization program under which we had unutilized available liquidity of \$150.0 million at year-end.

### ***Capital Structure***

<i>(in millions \$)</i>	<b>December 31, 2009</b>	December 31, 2008
Cash and cash equivalents	<b>(110.2)</b>	(6.5)
Proceeds from accounts receivable securitization	--	127.0
Notes payable	--	95.0
Capital lease obligations, including current portion	<b>17.6</b>	18.8
Long-term debt, including current portion	<b>1,051.5</b>	650.2
Total debt	<b>958.9</b>	884.5
Shareholders' equity	<b>1,316.9</b>	1,382.0
Total capitalization	<b>2,275.8</b>	2,266.5
Debt to capitalization	<b>42.1%</b>	39.0%

Our capital structure illustrates the amount of our assets that are financed by debt versus equity. Our debt to total capitalization ratio of 42.1% at December 31, 2009 continues to represent financial strength and flexibility.

### ***Credit Ratings***

S&P – Senior debentures	BBB
S&P – Commercial paper	A-2
DBRS – Senior debentures	BBB
DBRS – Commercial paper	R-2 (high)

Two leading rating agencies, Standard & Poor's ("S&P") and DBRS Limited ("DBRS"), analyze us and assign ratings based on their assessments. We consistently have been assigned solid investment grade credit ratings. On December 7, 2009, S&P revised their credit ratings on our long-term corporate credit and senior unsecured debt to "BBB" from "BBB+", and confirmed our commercial paper rating of "A-2". S&P also changed its outlook to stable from negative. DBRS confirmed its ratings on January 18, 2010 for our senior debentures as "BBB" and our commercial paper "R-2 (high)". DBRS's outlook remained stable.

## ***Outstanding Share Data as at January 26, 2010***

### **Authorized:**

- Unlimited number of Preference Shares of two classes issuable in one or more series
- Unlimited number of Common Shares of a single class

<b>Issued:</b>		
<b>Shares</b>	<b>Number</b>	<b>Book Value (in millions \$)</b>
Common	64,667,817	1,266.9

<b>Stock options:</b>		
<b>Options</b>	<b>Number</b>	<b>Weighted Average Exercise Price Per Share</b>
Outstanding	2,321,835	\$40.70
Exercisable	1,272,040	\$41.36

### ***Contractual Obligations, Financial Instruments, Off-Balance Sheet Arrangements, and Other Financial Arrangements***

Our contractual obligations, financial instruments, off-balance sheet arrangements, and other financial arrangements remain substantially unchanged from those that were disclosed in our interim MD&As for the first, second and third quarters of 2009, and our 2008 annual MD&A. For additional details, please consult these documents, which are available on our Web site at [www.mtsallstream.com](http://www.mtsallstream.com).

### **CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS**

Our critical accounting estimates and assumptions remain substantially unchanged from those that were disclosed in our interim MD&As for the first, second and third quarters of 2009, and our 2008 annual MD&A. For additional details, please consult these documents, which are available on our Web site at [www.mtsallstream.com](http://www.mtsallstream.com).

### **CHANGES IN ACCOUNTING POLICIES, INCLUDING INITIAL ADOPTION**

Our accounting policies, including initial adoption, remain substantially unchanged from those that were disclosed in our interim MD&As for the first, second and third quarters of 2009, and our 2008 annual MD&A. For additional details, please consult these documents, which are available on our Web site at [www.mtsallstream.com](http://www.mtsallstream.com).

### ***IFRS***

In February 2008, the Canadian Accounting Standards Board confirmed January 1, 2011 as the date IFRS will replace Canadian GAAP for publicly accountable enterprises. Currently, there are a number of areas where accounting standards under IFRS are different from those under Canadian GAAP. Also, because IFRS continues to evolve, it is expected that IFRS at the changeover date will differ from current IFRS. Our first financial statements under IFRS will be for periods commencing January 1, 2011, and will include the comparative period of 2010.

We began our IFRS changeover project in 2008 and have developed a detailed IFRS changeover plan. A project governance structure has been established, which includes a steering committee, consisting of senior management from our finance, IT, network services, enterprise risk management and treasury departments. Our project team includes certain dedicated resources, employees who contribute as required by the project plan, as well as external consultants who have been engaged for project management and technical accounting expertise. The project team reports regularly to the Audit Committee of our Board of Directors regarding the status of the project and implications of the changeover to IFRS. Throughout the execution of our IFRS plan, there is ongoing training and communication to affected employees and other internal and external stakeholders. Our IFRS changeover plan consists of the following four phases.

#### ***Phase 1: Diagnostic Gap Assessment***

Phase 1 consists of a high-level diagnostic gap and impact analysis of the differences between Canadian GAAP and IFRS applicable to us. The key activities of Phase 1 include:

- Identification of significant technical accounting and disclosure differences;
- Identification of key IFRS accounting policy alternatives; and
- Identification of major operational and system impacts.

We completed Phase 1 of our IFRS changeover plan in June 2008.

#### ***Phase 2: Design and Planning***

Phase 2 entails a detailed analysis of relevant Canadian GAAP and IFRS differences, as well as an assessment of the implications of implementing new standards. The key activities of Phase 2 include:

- Detailed evaluation of accounting and disclosure options, including review of estimated impacts on our financial position and results of operations, key performance indicators, and business activities;
- Selection of IFRS-compliant accounting policies, including IFRS 1, *First-time Adoption of International Financial Reporting Standards* ("IFRS 1"), policy choices and ongoing accounting policies;

- Assessment of implications to systems, processes and controls in sufficient detail to support solution development in Phase 3; and
- Identification of a dual reporting solution to maintain parallel records during 2010.

We have completed Phase 2 activities to assess and select accounting policies on a preliminary basis. This assessment is based on our expectations of accounting standards that will be in place at the time of changeover, as well as the estimated impact of these standards. Consequently, the detailed evaluation of the impacts of certain accounting policy options is ongoing, along with the final selection of these accounting policies. As IFRS continues to evolve, further evaluation may be required. We have identified a dual reporting solution.

#### *Phase 3: Solution Development*

During Phase 3, we will design and test solutions that will be implemented as we changeover to IFRS. The key activities of Phase 3 include:

- Design, development and execution of testing strategies for changes to accounting and business processes and IT solutions;
- Design, development and execution of a testing strategy for our dual reporting solution; and
- Revision of internal controls, as required, resulting from changes to ongoing accounting policies and the one-time adjustments to our opening balance sheet on changeover to IFRS.

We have substantially completed Phase 3 activities, including the assessment of implications to systems, processes and internal controls resulting from the expected financial accounting policy differences. We have designed a solution for dual reporting in 2010, and testing of the solution is underway. We also have completed design and development activities related to IT system and process changes resulting from the changes in accounting standards for property, plant and equipment. Testing of this solution is also underway.

#### *Phase 4: Implementation*

During Phase 4, we will implement IFRS-compliant accounting policies and related systems, processes and controls. The key activities of Phase 4 include:

- Implementation of changes to accounting policies;
- Preparation of IFRS-compliant opening balance sheet as at January 1, 2010;
- Preparation of IFRS-compliant financial statements and related note disclosures; and
- Implementation of changes to systems, processes and controls.

Phase 4 of the IFRS changeover plan has commenced and is expected to continue until the end of the first quarter of 2011.

During our IFRS changeover project, we have identified differences between Canadian GAAP and IFRS that may impact our consolidated financial statements. The key differences we have identified are described below.

#### *Employee benefits*

IAS 19, *Employee Benefits*, provides accounting options for the treatment of actuarial gains and losses. We expect to adopt an accounting policy whereby actuarial gains and losses will be recognized immediately in equity rather than in net income. Under Canadian GAAP, we currently use the corridor approach to account for actuarial gains and losses and recognize the related expense in net income.

In addition, under IAS 19, we intend to measure the expected return on plan assets at fair value of pension fund assets. This is different from Canadian GAAP, where we measure the expected return on plan assets based on a market-related value of pension fund assets. As a result, we expect pension expense to be different under IFRS than under Canadian GAAP.

#### *Property, plant and equipment*

IAS 16, *Property, Plant and Equipment*, requires that each item of property, plant and equipment with a cost that is significant in relation to the total cost of the item must be depreciated separately. We expect that this requirement will result in differences in the classification of individual components of property, plant and equipment. Additionally, we expect to adopt a separate unit straight-line methodology for depreciating items of property, plant and equipment. This is different than our current methodology where depreciation expense is calculated based on the pooling of assets.

In addition, IAS 16 requires certain expenditures, which are appropriate to capitalize as property, plant and equipment under Canadian GAAP, to be expensed under IFRS.

It is expected that the retrospective implementation of these changes in accounting policies will result in a change in the net book value of property, plant and equipment and in depreciation expense going forward.

#### *Accounts receivable securitization*

IAS 27, *Consolidated and Separate Financial Statements*, requires financial assets to be derecognized based on an analysis of the transfer of risks and rewards of ownership, followed by a determination regarding transfer of control of the asset. Canadian GAAP looks only to the transfer of control to determine whether a financial asset qualifies for derecognition. As such, the accounting treatment of our accounts receivable securitization program may require the recognition of a liability under IFRS rather than the derecognition of accounts receivable.

#### *Leases*

IAS 17, *Leases*, requires that in a sale-leaseback transaction where the leaseback is classified as an operating lease, any

gain on sale is recognized immediately in income. This differs from our current policy, where, in accordance with Canadian GAAP, any gain on sale is deferred and recognized in income over the term of the operating lease.

#### *Impairment of long-lived assets*

IAS 36, *Impairment of Assets*, requires that a one-step approach be used to test for and to measure impairment of long-lived assets, and that the carrying value of assets be compared with the higher of fair value less costs to sell and value in use, which is measured using discounted cash flows. This is different than the two-step approach followed under Canadian GAAP. This approach first requires an entity to compare carrying values to undiscounted future cash flows to assess whether any impairment exists, and then to measure the impairment using discounted cash flows. This difference in methodologies could result in different conclusions regarding asset impairments under IFRS and Canadian GAAP.

#### *First-time adoption of IFRS*

On adoption of IFRS, entities are required to implement accounting policies that are in accordance with IFRS and to apply these policies retrospectively. IFRS 1 includes certain mandatory exceptions and certain optional exemptions to this retrospective application. The significant optional exemptions that we expect to apply are as follows:

- Employee benefits – We expect to recognize all cumulative actuarial gains and losses on pension and other non-pension future employee benefits in opening retained earnings at January 1, 2010.
- Business combinations – We expect to not restate any business combinations that occurred prior to January 1, 2010.

These key differences are described to allow investors to better understand the possible impacts of our transition to IFRS. It may not be appropriate to use such information for any other purpose. These differences have been identified based on the accounting standards we expect to be in place in the year of our changeover to IFRS. The International Accounting Standards Board, however, has projects underway which could have an impact on the differences we have currently identified. Changes in accounting standards and our assessments of the estimated impacts may affect our final accounting policy selection. The financial impacts of these differences cannot be reliably quantified at this time, and while they may be material, we expect the impacts to be similar to those of our competitors. Further information regarding the quantification of the impacts will be provided as we move closer to the changeover date.

## **REGULATORY ENVIRONMENT**

The telecommunications and broadcast industries in which we operate in are federally regulated. We operate as both an incumbent local exchange carrier (“ILEC”) in Manitoba and as a competitive local exchange carrier (“CLEC”) nationally.

In addition, pursuant to Broadcasting Decision CRTC 2002-235, the Canadian Radio-television and Telecommunications Commission (“CRTC”) granted us a Class 1 regional broadcasting distribution license to operate as a broadcasting distribution undertaking serving Winnipeg and the surrounding areas. The following describes developments relating to material regulatory and policy proceedings that occurred during the fourth quarter of 2009 and should be read in conjunction with the “Risks and Uncertainties” section in our 2008 annual MD&A, as well as our interim MD&As for the first, second and third quarters of 2009.

#### *Essential Facilities*

On December 11, 2009, the Cabinet dismissed the petition we had filed in March 2009. Our petition sought to have Ethernet and asymmetric digital subscriber line access and transport facilities controlled by the incumbents treated as essential and made available to competitors on a mandated basis, at cost-based rates. In addition, the Cabinet also referred back to the CRTC, the decision that was appealed by Bell Canada and TELUS Communications Inc. (“TELUS”) relating to the requirement for incumbent carriers to provide so-called matching speeds to wholesale customers as compared to incumbent retail services. In response to the Cabinet’s actions, the CRTC commenced a proceeding on December 23, 2009 to review high-speed access services and the appropriate regulatory framework to ensure investment in broadband infrastructure and competition sufficient to protect the interests of users. The proceeding will include a hearing at the end of May 2010 and a decision is expected by September 2010.

#### *Proposed Unbundled Local Loop Rate Increases*

On June 2, 2009, Bell Canada and Bell Aliant filed tariff notices with the CRTC that propose to increase monthly and one-time charges for unbundled local loops. We filed an intervention requesting that the CRTC either dismiss the applications or establish a proceeding to validate the cost study methodology utilized in support, and assess the implications of the applications on local exchange services, local competition, price caps, the forbearance framework and the contribution regime. In response, the CRTC has given notice of process with respect to its review of the tariff application that will involve a number of procedural steps, submissions and interrogatories with a decision expected by the end of the third quarter of 2010. In the meantime, unbundled loop rates have been made interim.

## **2010 OUTLOOK**

*This financial outlook and the information contained herein have been reviewed by our Audit Committee and should be read in conjunction with the disclaimer “Regarding Forward-Looking Statements” and the “Risks and Uncertainties” sections in this interim MD&A, as well as similar sections of our interim MD&As for the first, second and third quarters of 2009, our 2008 annual MD&A and our 2008 Annual Information Form.*

Our financial outlook for 2010 is as follows:

<b>2010 Financial Outlook - Continuing Operations</b>	
Revenues	\$1.780 billion to \$1.880 billion
EBITDA	\$585 million to \$635 million
EPS	\$2.00 to \$2.50
Free cash flow	\$175 million to \$225 million
Capital expenditures	14% to 16% of revenues
Annualized dividend*	\$2.60 per share

\* Subject to legal requirements, and if and as declared in the discretion of the Board of Directors.

Our financial outlook for 2010 continues to be based on a strategy focused on driving growth in our IP-based services, aggressive cost reductions and success-based capital spending. Excluding a non-cash increase in pension expense of approximately \$15 million, EBITDA in 2010 is anticipated to approximate 2009 levels. Our free cash flow from continuing operations in 2010 is expected to be slightly lower than 2009 due to higher debt charges associated with higher levels of outstanding long-term debt as well as higher capital spending, but in excess of the level of dividends paid in 2009. We expect our total capital spending in 2010, excluding our HSPA network build in Manitoba, to be within 14% to 16% of our revenue range.

Our business plan for 2010 contemplates strategic and focused investments including the expansion of our Allstream IP network, the launch of Allstream wireless towards the end of the year in the geographic markets where we are strongest, and the deployment of fibre to the home (“FTTH”) in certain areas of Manitoba. We have set aside approximately \$25 million of our capital program for these investments.

We are embarking on a program to extend fibre in markets where Allstream has a proven track record of success with the goal of increasing our on-net revenues and improving profitability. We plan to spend up to \$15 million to expand our Allstream IP network in 2010 in a very targeted manner selecting areas that will enable us to provide improved margin connectivity services to new and existing customers. The capital spending associated with this investment is

success-based as determined by new customer wins, and will help us leverage Allstream’s fundamental strengths, which include powerful products and high on-net customer satisfaction and loyalty.

Towards the end of 2010, we expect to launch Allstream wireless targeting geographic markets where we are strongest. Our Allstream wireless offering will focus on a converged wireless/wireline product suite. This business-only wireless service will complement our existing enterprise portfolio and provide customers with unique functionality. Over the next three years, we would expect our cumulative investment in Allstream wireless to be a maximum of approximately \$25 million, including customer acquisition costs, as we already have significant customer relationships, wireless application development capabilities, distribution channels and billing systems and access to a national wireless network through our strategic arrangement with Rogers Wireless.

Our FTTH initiative in Manitoba is expected to cover 500 homes in the province through 2010. The FTTH network is the next evolution in advanced communication networks providing us the ability to maintain our competitive edge against the cable networks. FTTH is also more effective in servicing new home developments as compared to existing hybrid fibre/copper technologies, which helps deliver both capital and operating efficiencies.

Building on the considerable progress we made in 2009 improving our cost structure, we are targeting an additional \$30 million to \$40 million in 2010 in annualized cost reductions through operational efficiency and restructuring. We estimate our restructuring costs associated with these initiatives to be between \$35 million and \$45 million.

We pre-funded our HSPA build, 2010 pension solvency obligations, deferral account rebates, and past restructuring accrual with the proceeds from our very successful \$200 million debt offering in December 2009. In 2010, additional borrowings are expected to be limited to approximately \$20 million. Even with this incremental borrowing, we continue to have one of the strongest balance sheets in our industry, with a debt to EBITDA ratio of 1.7x.

Our business plan for the year ahead contemplates a quarterly dividend payout of \$0.65 per share in 2010, assuming our business is performing to our expectations. Any actual declaration of our dividends, however, is reviewed on a quarterly basis and is subject to legal requirements and in the discretion of our Board of Directors.

Longer term, we forecast that we will not pay cash taxes any earlier than 2017. This is based on our longer-term EBITDA growth assumptions of 1% to 3% once the economy recovers.

### ***Material Assumptions***

We have made a number of assumptions in preparing our financial outlook for 2010 and making certain other forward-looking statements, which include, but are not limited to, the following assumptions:

#### *Market Assumptions*

We expect our consumer market services, such as wireless, Internet and digital television, to continue to grow in 2010 at levels similar to 2009. We are assuming that there will not be any material changes to the continued growth of wireless services in 2010, notwithstanding anticipated changes to relationships and market dynamics. In addition, we continue to anticipate there will be no meaningful new entrant in wireless services in Manitoba in 2010. We expect ongoing competitive pressures in our local and long distance services. Revenues generated by the residential voice telecommunications market will continue to decrease due to competition and substitution. Although we expect competition from an incumbent cable operator to continue in the Manitoba residential market, we are confident that we have prudently prepared our operations and strategies to counter these challenges. Through our broadband network initiative, our bundling leadership, and our residential service offerings, which include wireless, Internet, digital television, local, long distance and alarm monitoring services, we believe that we are well-positioned to compete successfully. In 2010, we plan to strengthen our competitive advantage and leadership position in Manitoba by making further improvements to our broadband services, extending the coverage of our MTS Ultimate TV service throughout Winnipeg, deploying FTTH in certain areas of Manitoba, and launching our province-wide wireless HSPA network.

We expect our national enterprise unit, which operates under the Allstream brand, to continue to face the challenges in the marketplace which emerged during the economic recession. Although we began to see long distance volumes return and some stabilization of our business in the second half of 2009, we remain cautious. Our outlook assumes that we will not see any significant impacts of a national economic recovery on our enterprise customers' purchasing decisions in 2010. The competitive pressures experienced in our legacy data connectivity and long distance services are anticipated to continue. Likewise, we anticipate that customers will continue to migrate from legacy services to IP-based services. We expect our national enterprise unit to continue to deliver strong growth in its IP-based services. We expect to launch a converged wireless/wireline product suite on a targeted geographic footprint towards the end of 2010. To face the continued competition in the enterprise markets through 2010, we have been refining our market focus, creating innovative IP solutions, reducing our cost structure, refocusing our sales efforts, and investing selectively in higher-margin opportunities.

#### *Economic Assumptions*

Consumer market services are expected to benefit from a Manitoba economy that is forecast to grow in real gross

domestic product ("GDP") by 2.3% in 2010, according to the Manitoba Department of Finance. The Bank of Canada is forecasting real GDP growth for Canada in 2010 to be 2.9% and we expect that the benefit of this return to growth to our enterprise markets will lag several quarters as business customers recover and consolidate from the economic recession before resuming spending to levels prior to the recession.

#### *Cost Reduction Assumptions*

For 2010, we expect to achieve \$30 million to \$40 million in annualized cost reductions through operational efficiency and restructuring efforts. Our restructuring costs for 2010 are anticipated to be between \$35 million and \$45 million.

#### *Capital Resource and Liquidity Assumptions*

We continue to invest in our core operations with a focus on our growth products and services to ensure success in the markets in which we operate. We have adopted a prudent expenditure and investment strategy that is scalable and provides flexibility to adjust the pace of investment according to economic conditions. For example, during 2009, we scaled back our capital expenditures in light of the impact the economy had upon our enterprise markets. In 2010, our capital program is expected to be 14% to 16% of our revenues from continuing operations, with the majority spent on wireless and IP-based services.

In December 2009, we issued \$200 million in medium term notes and are using the proceeds to pre-fund our HSPA build, 2010 pension solvency obligations, deferral account rebates, and past restructuring accruals. Our free cash flow from continuing operations is expected to be slightly lower in 2010 as compared to 2009 due to higher debt charges associated with the higher levels of outstanding long-term debt, but in excess of the level of dividends paid in 2009.

#### *Tax Assumptions*

We have been able to reduce our taxable income by utilizing our substantial CCA pools and available tax losses. By utilizing our deferred CCA deductions, we project that we will not pay cash taxes before 2017. The present value of our tax asset is approximately \$350 million.

## **RISKS AND UNCERTAINTIES**

Risk management practices are part of our normal business operations to help identify and manage our principal risks. Governance of principal risks forms part of the mandate and the charters of our Board of Directors and its committees, including monitoring of our risk management program by the Audit Committee of our Board of Directors.

Our risk management program is enterprise-wide with focus on identification, assessment and mitigation of risks associated with achievement of our strategic objectives. Principal risks are identified and evaluated relative to their potential impact and likelihood, including consideration of

mitigating activities. We perform an annual risk assessment that is linked to our yearly business plan process, and we conduct periodic updates to identify potential emerging risks arising from major business decisions, key initiatives and external factors.

Our risk management program is managed through an executive-level strategic risk committee in conjunction with our enterprise risk management and internal audit groups. Reports on principal risks are reviewed by our executive management, the Audit Committee and the Board of Directors. In addition, the scope of our internal audit plan is risk-based, taking into account the results of risk assessments as well as other factors such as internal control risks and operational risks.

The risks and uncertainties discussed below highlight the more important and relevant factors that could significantly affect our operations. They do not represent an exhaustive list of all potential issues that could affect our financial results.

### ***Market Conditions***

Our business is affected by general economic conditions including consumer confidence and spending, enterprise confidence and spending, and the demand for, and prices of, our products and services.

Our consumer business, which is based in Manitoba, is subject to variations based on economic conditions. We have observed that demand for telecommunication consumer products is in aggregate not very sensitive to economic fluctuations and changes in market conditions. In addition, we continue to benefit from the resilience of the Manitoba economy. Our enterprise business, which services customers across Canada including some who operate in the U.S., is in aggregate more sensitive to economic fluctuations and changes in market conditions. For enterprise customers, an extended economic downturn may cause postponed purchases and capital investments, reducing or discontinuing the usage of our services.

Economic conditions also affect the financial position of our customers and correspondingly, could affect our ability to collect receivables. Weak economic conditions could negatively affect our results of operations, including cash flows.

We continuously monitor market conditions and proactively take steps to adjust our business plans and marketing efforts in light of such conditions.

### ***Debt and Equity Market Fluctuations***

There are inherent risks associated with investing in the debt and equity markets. External factors over which we may not have any control could negatively impact the market price of our securities. Differences between our actual or anticipated financial results and the published expectations of financial analysts could contribute to volatility in our securities.

Further, a major decline in the capital markets in general or an adjustment in the market price or trading volumes of our securities may adversely affect our ability to raise capital, issue debt, retain employees, make strategic acquisitions or enter into joint ventures.

### ***Pension Funding***

We have legal funding requirements in respect of pension plans that we sponsor.

Valuations of our plans' assets and liabilities determine our funding requirements. These valuations depend on a number of factors including returns on pension plan assets, long-term interest rates, plan demographics and government pension regulations. Changes in these factors could cause actual future contributions to significantly differ from our current estimates and could require us to increase contributions to our pension plans in the future, and therefore, could have an adverse effect on our liquidity and results of operations. A material portion of our pension plans' assets are invested in equity and fixed income securities. As a result, the ability of our pension plans to earn our projected rates of return depends significantly on the performance of the capital markets. Accordingly, there is no assurance that our pension plans will be able to earn their projected rates of return. These same market conditions also impact the discount rate used to calculate our pension solvency obligations and thereby could significantly affect our pension solvency funding requirements.

Our pension solvency funding requirements are also affected by pension regulations. In 2009, the federal government outlined a reform proposal that is expected to affect our pension plans. Further clarification regarding the technical details of the new proposal is required before the magnitude of the impact, if any, can be determined. As a result of this proposal and other proposals that could be introduced in the future, our pension solvency funding requirements may be higher or lower than expected.

We carefully monitor our anticipated pension funding requirements as part of our business planning process and take steps, as reasonably required, to ensure that we continue to meet our obligations.

We also announced in early 2010 that we received a court decision relating to one of our Manitoba pension plans, obligating us to make a one-time payment in the amount of \$43 million plus interest retroactive to 1997, representing a total of approximately \$100 million measured as of December 31, 2009. Based on legal advice received, we believe that key aspects of this decision are flawed and present strong grounds for appeal. Our ultimate obligation to make such payment, or any obligations arising under such litigation, will depend upon our successes in such appeal.

### ***Changes in Regulation or Legislation***

The telecommunications and broadcast industries in which we operate are federally regulated. As a result, our business

is affected by decisions made by various regulatory agencies of the federal government, including the CRTC and Industry Canada. The outcome of regulatory reviews, proceedings, appeals and other regulatory and policy developments could have a material positive or negative impact on our business and results of operations. We are generally interveners in all such proceedings that could have a material impact on our business. While historically we have had successes at many of such proceedings, there can be no assurances that we will continue to do so.

For a description of the principal regulatory initiatives and proceedings affecting us, please see the “Regulatory Environment” section in this interim MD&A.

Changes in legislation can also change the ability of our customers to use the products and services we offer. As an example, like others in the telecommunications industry, our customers may become subject to stricter laws limiting the use of hand-held wireless devices while driving or in other situations. If this legislation were to become effective within Manitoba, we do not currently expect this would have an adverse effect on our results or demand for our services, although there can be no assurances that this would not happen. We promote responsible driving and recommend that driving safety should be every wireless customer’s first responsibility.

## ***Competition***

### *General*

Like all of our industry peers, we continue to operate in a competitive environment. There can be no assurance that our current or future competitors will not provide services comparable or superior to those that we provide, or at lower prices, adapt more quickly to evolving industry trends or changing market requirements, enter the markets we operate, or introduce competing services. Any of these factors could adversely affect our market share and results of operations.

### *Manitoba Operations*

In Manitoba, our operating environment is becoming increasingly competitive, which could potentially impact subscriber growth and put pressures on revenues and profitability.

Our primary competitors in the consumer and small business wireline market are incumbent cable providers. Cable competition and ongoing technology substitutions have contributed to the erosion of our residential network access lines. This erosion is expected to continue.

Our primary competitor in the wireless markets is Rogers, and to a lesser extent TELUS and some of Bell Canada’s non-core brands such as Virgin and PC Mobile. In 2008, Shaw Communications Inc. and Globalive Communications Corp., two “new entrant companies”, acquired spectrum within Manitoba. We expect these companies may launch wireless operations in Manitoba in

the future. Although Bell Canada does not own spectrum in Manitoba, they have announced an agreement to use the wireless footprint of a third party to offer Bell-branded services in Manitoba.

Our primary competitors in the broadband market are the incumbent cable providers. We do not expect the competitive landscape to change significantly in the short-term. It is possible, however, that in the future, technologies such as wireless broadband will evolve to a level in which it affects the competitive landscape.

Our primary competitors in the television market are the incumbent cable providers and satellite television providers. Our television offering is available in Winnipeg, Brandon, Portage la Prairie and several smaller centres within Manitoba, and we are increasing such footprint on a regular basis. While our television offering provides significant interactivity and customization advantages as compared to the services offered by our primary competitors, there are no assurances that our television offering will continue its past successes. We continue to expand our broadband infrastructure in both coverage and speed, and to enhance our ability to deliver services.

As the dominant full-service provider in Manitoba, we possess the unmatched ability to bundle up to five services: wireline, wireless, alarm monitoring, high-speed Internet, and television services. While other competitors are able to offer smaller bundles, we believe the wide scope of our offerings allows us to differentiate ourselves. We expect to continue to leverage this advantage to compete effectively in the future.

Within Manitoba, we also operate in the enterprise market as the ILEC and as a provider of wholesale services to other carriers and service providers. In this market, we face competition from certain CLECs who operate within Manitoba. As the incumbent carrier, we believe we are well-positioned to compete within this market.

### *National Operations*

Nationally, we operate as a competitive provider of telecommunications services to businesses and as a provider of wholesale services to other carriers and service providers. All participants in the enterprise market face competition and customers’ requirements are complex and continuously evolving. In areas in which we offer services using our own network, we believe we face significantly less risk in our ability to offer competitive services to our customers. In areas in which we offer our services outside of our footprint, we face greater risks because we are subject to the inferior service levels provided by the incumbent carriers. In such situations, we are also subject to the risks associated with any changes to the regulatory framework, which can alter our rights to access such networks at reasonable prices, if at all. We do take steps to attempt to manage this risk. By way of examples, we are continuously examining the benefits of expanding our network footprint in key locations

to allow more focused, on-net services, and we also explore the feasibility of new alliances with third parties (such as Radiant Communications Corp. and cable companies) to deliver the same services at lower costs, all while reducing our dependency on the incumbent carriers.

In response to the pressures in the enterprise markets, we have been refining our market focus, creating innovative IP solutions, reducing our cost structure and investing selectively in higher-margin opportunities. We also actively monitor and participate in all regulatory proceedings that could affect the profitability of our national operations.

#### *Legacy Services*

The industry-wide transition from a legacy voice and data infrastructure to an IP-based infrastructure continues at a vigorous pace. We, along with our peers, are experiencing accelerated pressures in our legacy lines of business, such as long distance, local, frame relay and private line data services, as technology changes are allowing our customers to have integrated telecommunications products that offer a wider range of functionalities. This affects both our Manitoba and national operations. As a result, the revenues and margins associated with legacy services, for the most part, are declining. To date, these financial pressures have only been partly offset by increased demand and migration of customers to wireless and IP-based platforms. Our experience within the Manitoba wireline market, however, has been that our rate of losses has been lower than the Canadian average, which has helped to mitigate such financial pressures.

Our risk from this exposure has become less pronounced in recent years as we have deliberately focused on transitioning our revenue base to IP-based services across both divisions. As an example of our success, by the end of 2009, our revenues from growth services on a consolidated basis represented 45% of our total revenues, as compared to 42% at the end of 2008 and 30% four years ago. While we expect that a substantial portion of our future revenue growth will be achieved from IP-based services and we have invested significant capital resources in the development of our networks, there is a risk that this growth will not offset the decline in our legacy services.

We also continue to face the migration of certain customers' traffic from our legacy services either to new services or to their own respective networks. We expect that this type of revenue loss, however, now has been largely stabilized and we believe that the risks of any future impact has been diminished. We are also acting on strategies to facilitate the migration of our customers to IP solutions in a manner that utilizes our existing capabilities and infrastructure to mitigate the impact on our financial performance.

#### ***Continuous Rapid Changes in Technology***

We operate in markets that are affected by constant and rapid technology change. Network technology continues to evolve at a pace that may enable competitors to enter our

markets with increased flexibility, provide more choice for customers, and speeds up the obsolescence of our core technologies. At the same time, this provides us with new opportunities to exploit markets that were previously more difficult or costly for us to enter. These changes, however, could result in the displacement of products and services with substitutes and create a need for accelerated investment in our network evolution. Accordingly, we need to anticipate technological change and invest in, or develop new technologies, products and services, sometimes utilizing partnerships or alliances to reduce our costs. By way of example, in Manitoba we are currently jointly deploying a new HSPA wireless network with Rogers Wireless. These investments are critical to drive growth, achieve our financial objectives and in some cases reduce our overall cost structure.

Like others in our industry, there can be no assurance that we will be successful in developing, implementing and marketing new technologies, products and services or that we will be able to fully-realize the expected sales, cost savings and efficiencies from these new technologies, or that we will be able to make these necessary investments. Nor can we be assured that we will be able to gain access to such technologies and other business inputs at reasonable terms or prices. New products or services that use new or evolving technologies could reduce demand for our existing offerings or cause prices for those services to decline.

One of the key priorities in our business planning process is to ensure that we prudently manage technological changes in a manner that benefits our company and our shareholders.

#### ***Litigation and Legal Matters***

##### *Litigation*

As is the case with any large operating company, investigations, claims and lawsuits seeking damages and other relief are often threatened or pending against us. In addition, plaintiffs within Canada are also able to launch class action claims on behalf of a large group of persons.

By way of indicative examples, MTS and other major telecommunication service providers are defendants in two large national class action claims. The first involves a claim relating to a class of subscribers for wireless or cellular services who are seeking recovery of fees that the carriers have categorized as system access fees or system licensing charges, and which the plaintiffs allege have been improperly characterized as government-related charges. The second major class action claim relates to allegations that customers for both land line and wireless services have paid extra fees and charges in association with 911 or emergency service access fees that now ought to be repaid to those customers. We believe we will be successful in defending these specific claims. The outcome of any of such actions, or new actions that may arise, however, is always uncertain and, until the particular matter is resolved, there can be no assurance that our financial position will not be

negatively impacted as the costs to us in losing such claims could be material. We work closely with expert outside counsel to vigorously defend all material litigation against us that we consider to be without merit or against which we have strong defences. In addition, we conduct our business with controls designed for compliance with legal obligations, thus reducing exposure to legal claims, or risk of loss of those claims, should they materialize.

#### *Civil Liability in the Secondary Market*

Securities laws impose potential liability for misrepresentations by public companies in written disclosure and oral statements or the failure to make timely disclosure of a material change. We have well-documented processes in place, including a corporate disclosure policy, that we believe provides reasonable procedures and controls for all of our public disclosure. We also have a strong internal control certification program that we believe is a strong safeguard for our officers and Board of Directors to limit any exposure we may have in this area. We actively monitor legal developments and are prepared to make changes that we consider appropriate and prudent. While there can be no assurance that all of our processes will be followed by employees, officers, third parties and directors at all times, having processes in place is expected to provide the necessary risk mitigation one would expect for a company of our size.

#### *Legal and Regulatory Compliance*

As is the case with all companies, we necessarily rely on our senior management, Board of Directors, employees and key third-party contractors to conduct themselves according to legal and ethical standards. Situations might occur where individuals do not adhere to our policies or where legal requirements are inadvertently breached. This includes the risk of ensuring that our customers' personal information is handled in a way compliant with all applicable privacy laws. Such events could expose us to damages, sanctions and fines, or negatively affect financial or operating results. Although we cannot predict outcomes with certainty, we believe we have reasonable policies, processes and awareness in place for proper compliance and that these programs reduce risks.

#### *Applicable Legislation and Corporate Articles*

We are subject to certain legislation and our own articles of incorporation that limit the ability of individuals to own and trade our securities. In particular, there are constraints in respect of foreign ownership and ownership by individuals owning more than a specified percentage of our common shares. These restrictions could theoretically serve to deter a change of control of our company, limit the market demand, market price or liquidity of our securities, or affect our ability to access capital. Although we support the liberalization of foreign ownership as being in the best interests of our shareholders, this change could result in new foreign competitors or our existing competitors benefiting from new foreign investments or partnerships, which could result in increased competition.

Our Board of Directors and senior management are subject to fiduciary duties, corporate and securities laws, and stock exchange requirements, all of which provide protection to our investors.

#### *Contractual Provisions*

Technology evolution also brings additional legal risks and uncertainties. The intellectual property and proprietary rights of owners and developers of hardware, software, business processes and other technologies may be protected under statute, such as trade-mark, patent, copyright and industrial design legislation, or under common law, such as trade secrets. Contractual provisions to which we are bound are generally becoming increasingly complicated and expose us to heightened risks, and we are not always able to fully limit our liability in respect of these matters. We also have exposure under contracts to our customers and vendors. We have reasonable processes and controls in place to ensure that contractual exposure is properly managed in consideration of the markets we operate.

#### *Radio Frequency*

It has been suggested that the radio frequency emissions from wireless devices could be associated with health concerns. We are not aware of any credible information of real health concerns. In addition, this issue is monitored and regulated by the federal government and we comply with all applicable legislation and regulatory requirements. Actual or perceived issues associated with such suggestions, however, could affect our results and operations or could result in litigation.

#### *Financing and Debt Requirements*

We periodically raise capital through debt and equity offerings in the capital markets. Our business plans and growth could be negatively affected if existing financing is not sufficient to cover funding requirements or if we are unable to refinance maturing debt at favourable rates.

Our ability to raise debt financing depends on our ability to continue to access the public capital markets, the bank credit market, and our accounts receivable securitization program. The cost and amount of funding depend largely on market conditions and the outlook for our business and credit ratings at the time funds are raised, which in turn, is dependent on a wide range of factors.

Although our past experience has been that our strong balance sheet has afforded us continued access to these programs at favourable terms and that we have been able to refinance our maturing debt at competitive rates, there are no assurances that this will continue.

#### *Dividend Payments*

We currently pay dividends in amounts approved on a quarterly basis by our Board of Directors. A more fulsome discussion of our current dividend policy is set forth in our most recent Annual Information Form. Payment of a

dividend is subject to the discretion of our Board of Directors, as well as legal requirements, and if as declared, which in turn, considers factors such as EPS, results of operations and financial condition, as well as our cash position and investment opportunities. Historically, our dividend has offered a stable cash flow for our shareholders and while we expect to have access to enough liquidity in 2010 to fund our dividend policy, there can be no assurances that we will continue dividend payments or dividend payments at the current level.

### ***Operational Execution***

We define and implement both short- and long-term strategies to manage our business within a competitive, regulated and fast-evolving telecommunications environment. We develop business plans for our operating units that are aligned with long-term strategies. The implementation of our strategies requires shifts in employee skills, products and services, capital spending, and targeted cost reductions. If our management, employees or processes are not able to adapt to these changes or if required capital is not available on favourable terms, we may not achieve our business objectives, which could have a negative effect on our business and financial results. There also can be no assurance that we will be successful in reducing costs. If we are unable to implement operating unit business plans that are aligned with our strategic objectives, our business and results of operations could be negatively affected.

We believe in the past we have been very effective in executing our objectives, and particularly effective on many metrics as compared to our industry peers. Additionally, our leaders are incented to achieve the business objectives set by our Board of Directors and are held accountable for their results. We feel that this fosters an environment in which our leaders are most likely to achieve our objectives.

### ***Security and Network Failures***

Like all others in our industry, our operations depend on how well we and our suppliers protect our networks, equipment, IT systems, software and the information stored in data centres against damage from a number of threats, including, but not limited to, natural disasters, fire, power loss, hacking, computer viruses, vandalism, theft and other events. Our operations also depend on the timely maintenance, upgrade and replacement of our and our suppliers' networks, equipment, IT systems and software. Any of these and other events could result in network failures, billing errors and delays in customer service. The failure of networks or a component of our networks would, in some circumstances, result in a loss of service for our customers and could adversely impact our results of operations. We rely on third parties to fulfill many of our customers' needs. Any of the above events affecting such third parties might also cause an interruption in service that would last until we could find alternative service delivery options and could also harm our customer relationships.

We have taken significant efforts to protect our networks against failure and interruption including implementing engineering designs with redundancy whenever commercially reasonable. We have also taken steps to protect us against the impact of network failures such as holding insurance policies and preparing and testing disaster recovery plans. In 2009, we were recognized for leadership in disaster recovery planning with the Award of Excellence from the Disaster Recovery Institute of Canada, recognizing excellence in planning and preparedness in the areas of continuity management, technology recovery and crisis management – the first such recognition for a telecommunications provider.

### ***Human Resources***

#### ***Collective Agreements***

A majority of our employees are covered by collective bargaining agreements. Historically, we have had a very positive and constructive working relationship with our unions. Although we have no reasons to expect significant issues to arise, renegotiating collective bargaining agreements always has the risk to result in higher labour costs and work disruptions including work stoppages or work slowdowns. While we have not had a labour disruption in over a decade, there can be no assurance that should a strike or work disruption occur, it would not adversely affect the services that we provide to our customers and our results of operation. A work disruption at a service provider who carries portions of our traffic could harm our businesses, including our customer relationships and results of operations.

#### ***Reliance on Key Personnel***

Our business depends on the efforts, abilities and expertise of our senior executives and employees. The loss of key individuals could impair our business and development until qualified replacements are found. There is no assurance that these individuals could quickly be replaced with persons of equal experience, skills and capabilities. To manage these risks, our management and Board of Directors regularly review the compensation structure, succession plans and career progression of such personnel to minimize the risks of any such potential disruption.

#### ***Tax Matters***

Our business activities are subject to tax legislation and regulations that frequently change. Changes in tax law or the adoption of new tax laws could result in higher tax rates or new taxes. Our tax filings are subject to government audits which could materially change the amount of current and future income tax assets and liabilities and could, in certain circumstances, result in an assessment of interest and penalties. We leverage internal and external expertise in order to manage this risk to the best of our ability. In addition, we have a substantial tax asset which is currently expected to enable us to offset the payment of cash income taxes until approximately 2017.

## FIRST QUARTER DIVIDEND

On February 4, 2010, the Board of Directors of MTS declared a quarterly cash dividend of \$0.65 per share. The first quarter dividend is payable on April 15, 2010 to shareholders of record at the close of business on March 15, 2010.

The first quarter dividend is designated as an “eligible” dividend under the *Income Tax Act* (Canada) and any corresponding provincial legislation. Under this legislation, individuals resident in Canada may be entitled to enhanced dividend tax credits which reduce income tax otherwise payable.

### Notes:

1. Supplementary financial information is available in the Investors section of the MTS Web site at [www.mtsallstream.com](http://www.mtsallstream.com).
2. MTS's fourth quarter 2009 conference call with the investment community is scheduled for 5:00 p.m. Eastern time on February 4, 2010. The dial-in number is 1-888-231-8191. A live audio Webcast of the investor conference call can be accessed by visiting the Investors section of the MTS Web site ([www.mtsallstream.com](http://www.mtsallstream.com)). A replay of the conference call will be available until midnight February 15, 2010 and can be accessed by dialing 1-800-642-1687 or 1-416-849-0833 (access code 49385346). The audio Webcast will be archived on MTS's Web site.

**MANITOBA TELECOM SERVICES INC.**  
**CONSOLIDATED STATEMENTS OF NET INCOME AND**  
**COMPREHENSIVE INCOME**

(unaudited)

For the periods ended December 31 (in millions, except earnings per share)	Three months ended		Twelve months ended	
	2009	2008	2009	2008
Operating revenues	\$ 452.7	\$ 463.9	\$ 1,809.9	\$ 1,867.1
Operating expenses				
Operations	306.4	305.6	1,198.3	1,200.7
Restructuring and transition (Note 2)	9.5	23.0	51.7	47.9
Amortization	77.9	83.3	322.7	329.4
	393.8	411.9	1,572.7	1,578.0
Operating income	58.9	52.0	237.2	289.1
Other income (expense)	3.3	(0.5)	10.9	7.1
Debt charges	(15.6)	(12.2)	(59.5)	(48.9)
Income before income taxes	46.6	39.3	188.6	247.3
Income tax expense (recovery) (Note 3)				
Current	0.8	-	(1.0)	0.3
Future	36.8	24.5	85.7	99.6
	37.6	24.5	84.7	99.9
Income before discontinued operations	9.0	14.8	103.9	147.4
Loss from discontinued operations, net of tax (Note 4)	(2.3)	(1.1)	(2.2)	(3.4)
Net income and comprehensive income for the period	\$ 6.7	\$ 13.7	\$ 101.7	\$ 144.0

**Basic and diluted earnings per share (Note 9)**

Income before discontinued operations	\$ 0.14	\$ 0.23	\$ 1.61	\$ 2.28
Net income	\$ 0.10	\$ 0.21	\$ 1.57	\$ 2.23

**MANITOBA TELECOM SERVICES INC.**  
**CONSOLIDATED STATEMENT OF RETAINED EARNINGS**

(unaudited)

For the periods ended December 31 (in millions)	Three months ended		Twelve months ended	
	2009	2008	2009	2008
Retained earnings, beginning of period	\$ 65.7	\$ 125.1	\$ 96.8	\$ 120.8
Net income for the period	6.7	13.7	101.7	144.0
Dividends declared	(42.0)	(42.0)	(168.1)	(168.0)
Retained earnings, end of period	\$ 30.4	\$ 96.8	\$ 30.4	\$ 96.8

**MANITOBA TELECOM SERVICES INC.**  
**CONSOLIDATED BALANCE SHEETS**

(unaudited)

December 31	2009	2008
(in millions)		
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 110.2	\$ 6.5
Accounts receivable (Note 5)	166.2	46.3
Future income taxes (Note 3)	79.0	90.5
Other current assets	58.0	64.0
Assets held for sale (Note 4)	18.6	17.7
	<b>432.0</b>	<b>225.0</b>
Capital assets (Note 6)	1,643.3	1,615.4
Other assets	417.2	334.6
Future income taxes (Note 3)	362.1	436.8
Goodwill	41.8	41.2
	<b>\$ 2,896.4</b>	<b>\$ 2,653.0</b>
<b>Liabilities and shareholders' equity</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 349.1	\$ 347.7
Advance billings and payments	52.5	49.9
Current portion of long-term debt (Note 8)	11.9	220.0
Notes payable (Note 7)	-	95.0
Current portion of capital lease obligations	4.2	3.8
Liabilities related to assets held for sale (Note 4)	9.0	5.4
	<b>426.7</b>	<b>721.8</b>
Long-term debt (Note 8)	1,039.6	430.2
Long-term portion of capital lease obligations	13.4	15.0
Deferred employee benefits	43.1	44.2
Other long-term liabilities	55.5	58.1
Future income taxes (Note 3)	1.2	1.7
	<b>1,579.5</b>	<b>1,271.0</b>
Shareholders' equity		
Share capital (Note 9)	1,266.9	1,265.8
Contributed surplus	19.6	19.4
	<b>30.4</b>	<b>96.8</b>
	<b>1,316.9</b>	<b>1,382.0</b>
	<b>\$ 2,896.4</b>	<b>\$ 2,653.0</b>

**MANITOBA TELECOM SERVICES INC.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

(unaudited)

For the periods ended December 31	Three months ended		Twelve months ended	
(in millions)	2009	2008	2009	2008
Cash flows from operating activities				
Income before discontinued operations	\$ 9.0	\$ 14.8	\$ 103.9	\$ 147.4
Add (deduct) items not affecting cash				
Amortization	77.9	83.3	322.7	329.4
Future income taxes (Note 3)	36.8	24.5	85.7	99.6
Gain on sale of intangible assets	-	-	(3.1)	-
Deferred wireless costs	(11.3)	(11.4)	(46.7)	(40.2)
Pension funding and net pension credit	(31.6)	(14.2)	(80.3)	(56.6)
Other, net	3.1	15.8	(0.8)	5.1
Changes in non-cash working capital	(44.5)	55.8	(117.6)	49.1
Cash flows from operating activities	39.4	168.6	263.8	533.8
Cash flows from investing activities				
Capital expenditures, net	(93.0)	(90.8)	(295.2)	(335.4)
Acquisition	-	(0.4)	(2.1)	(4.4)
Net proceeds from sale of intangible assets	-	-	1.4	-
Other, net	(0.6)	(3.1)	(2.0)	(3.4)
Cash flows used in investing activities	(93.6)	(94.3)	(297.9)	(343.2)
Cash flows from financing activities				
Dividends paid	(42.0)	(42.0)	(168.1)	(168.0)
Issuance of long-term debt	200.0	-	625.0	-
Repayment of long-term debt	-	-	(220.0)	(89.7)
(Repayment) issuance of notes payable, net	-	(20.0)	(95.0)	95.0
Issuance of share capital (Note 9)	-	-	0.9	0.2
Other, net	(2.8)	(0.1)	(5.0)	(3.4)
Cash flows from (used in) financing activities	155.2	(62.1)	137.8	(165.9)
Cash flows before discontinued operations	101.0	12.2	103.7	24.7
Cash flows from (used in) discontinued operations (Note 4)	0.2	(2.2)	-	(8.1)
Change in cash and cash equivalents	101.2	10.0	103.7	16.6
Cash and cash equivalents (bank indebtedness), beginning of period	9.0	(3.5)	6.5	(10.1)
Cash and cash equivalents, end of period	\$ 110.2	\$ 6.5	\$ 110.2	\$ 6.5

**MANITOBA TELECOM SERVICES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

For the years ended December 31, 2009 and 2008 (All financial amounts are in \$ millions, except where noted.)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The interim consolidated financial statements of Manitoba Telecom Services Inc. (the "Company") have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). These interim consolidated financial statements have been prepared using the same accounting policies and methods of their application as the Company's audited consolidated financial statements for the year ended December 31, 2008, except as described in Note 6.

These interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2008.

**2. RESTRUCTURING AND TRANSITION**

For the years ended December 31, 2009 and 2008, the Company recorded net restructuring and transition expenses as follows:

	<b>2009</b>	2008
Restructuring		
Workforce	<b>12.8</b>	11.2
Other	<b>20.8</b>	9.6
	<b>33.6</b>	20.8
Wireless transition	<b>18.1</b>	27.1
	<b>51.7</b>	47.9

The liability for restructuring costs as at December 31, 2009 is as follows:

Balance December 31, 2008	<b>11.3</b>
2009 restructuring costs, net of a \$1.5 million reversal of previously recorded costs	<b>33.6</b>
Less cash payments	<b>(31.0)</b>
Balance December 31, 2009	<b>13.9</b>

Restructuring activities in 2009 represent a continuation of the cost reduction initiative which commenced in the fourth quarter of 2008 aimed at achieving process improvements and further cost reductions. The costs recorded in 2009 include severance and other employee-related expenses that supported workforce reduction initiatives undertaken throughout the year, costs to review and improve efficiencies in current processes, real estate facility consolidation charges, as well as other non-recurring amounts associated with certain regulatory proceedings and the transition from Canadian GAAP to International Financial Reporting Standards.

Wireless transition includes costs of transitioning certain wireless service requirements away from Bell Mobility to new suppliers and to the Company's wireless platform and strategic planning costs related to a national wireless initiative. In 2008, this amount also included costs associated with the advanced wireless services spectrum auction.

**MANITOBA TELECOM SERVICES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

For the years ended December 31, 2009 and 2008 (All financial amounts are in \$ millions, except where noted.)

**3. INCOME TAXES**

A reconciliation of the statutory income tax rate to the effective income tax rate on income before discontinued operations is as follows:

	<b>2009</b>	2008
Combined basic federal and provincial statutory income tax rate	<b>32.0%</b>	32.9%
Change in substantively enacted tax rates	<b>9.2</b>	3.0
Rate differential on temporary differences	<b>5.0</b>	3.6
Other items	<b>(1.3)</b>	0.9
Effective tax rate on income before discontinued operations	<b>44.9%</b>	40.4%

The balances of future income taxes as at December 31, 2009 and December 31, 2008 represent the future benefit of unused tax losses, and temporary differences between the tax and accounting bases of assets and liabilities. The major items giving rise to future income tax assets and liabilities are presented below:

	<b>2009</b>	2008
Non-capital loss carryforwards	<b>142.7</b>	169.4
Property, plant and equipment	<b>383.9</b>	488.8
Employee Benefits	<b>(86.6)</b>	(69.7)
Reserves not currently deductible	<b>(0.1)</b>	1.1
Total future income tax asset	<b>439.9</b>	589.6
Valuation allowance	-	(64.0)
Net future income tax asset	<b>439.9</b>	525.6

Future income taxes are comprised of:

	<b>2009</b>	2008
Current future income tax asset	<b>79.0</b>	90.5
Long-term future income tax asset	<b>362.1</b>	436.8
Long-term future income tax liability	<b>(1.2)</b>	(1.7)
Net future income tax asset	<b>439.9</b>	525.6

During the year ended December 31, 2009, the Company recovered \$2.0 million in cash income taxes (2008 – \$0.5 million).

As at December 31, 2009, the Company had non-capital loss carryforwards available to reduce future years' taxable income, which expire as follows:

2014	<b>23.6</b>
2025 and beyond	<b>541.4</b>
	<b>565.0</b>

**MANITOBA TELECOM SERVICES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

For the years ended December 31, 2009 and 2008 (All financial amounts are in \$ millions, except where noted.)

**4. DISCONTINUED OPERATIONS**

On December 23, 2009, the Company committed to sell the majority of its non-telecommunications IT consulting group, which is a line of business within the Enterprise Solutions division, to PricewaterhouseCoopers Canada for a preliminary purchase price of \$12.5 million. The purchase price is subject to adjustments which will be finalized following the closing date of January 31, 2010. The decision to sell this line of business resulted in a goodwill impairment charge of \$0.5 million. The financial results attributable to this line of business have been presented as discontinued operations.

The following table provides further information on the composition of revenues and income (loss) related to discontinued operations:

	2009	2008
Revenue	51.2	54.4
Income (loss) from discontinued operations before income taxes	0.1	(5.2)
Costs related to sale	(2.8)	-
Future income tax recovery related to discontinued operations	0.5	1.8
Loss from discontinued operations, net of tax	(2.2)	(3.4)

The following table provides further information on the composition of assets and liabilities held for sale:

	2009	2008
Assets		
Current Assets	17.7	15.9
Property, plant and equipment, net	0.9	1.3
Goodwill	-	0.5
Assets held for sale	18.6	17.7
Liabilities		
Current liabilities	9.0	5.4
Liabilities related to assets held for sale	9.0	5.4

The following table provides further information on cash flows relating to discontinued operations:

	2009	2008
Cash flows from (used in) operating activities	0.1	(7.8)
Cash flows used in investing activities	(0.1)	(0.3)
Cash flows from (used in) discontinued operations	-	(8.1)

**5. ACCOUNTS RECEIVABLE SECURITIZATION**

Under the terms of the Company's accounts receivable securitization program, the Company has the ability to sell, on a revolving basis, an undivided ownership interest in its accounts receivable to a securitization trust, up to a maximum of \$150.0 million. The terms of the Company's accounts receivable securitization program also require the Company to maintain reserve accounts, the fair value of which approximates carrying value. As at December 31, 2009, the Company had no outstanding balances from its accounts receivable securitization program.

During the year ended December 31, 2009, the Company recognized a recovery of \$0.7 million on previously recorded losses on the sale of accounts receivable, which is recorded in other income. During the year ended December 31, 2008, the Company recognized a pre-tax loss of \$0.2 million on the sale of accounts receivable.

During the year ended December 31, 2009, cash flows received and paid to the trust in revolving period securitizations were \$2,221.7 million (2008 - \$2,775.5 million).

**MANITOBA TELECOM SERVICES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

For the years ended December 31, 2009 and 2008 (All financial amounts are in \$ millions, except where noted.)

**6. CAPITAL ASSETS**

Effective January 1, 2009, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants' ("CICA") Handbook section 3064 Goodwill and Intangible Assets and the updates to CICA Handbook section 1000 Financial Statement Concepts. This guidance establishes updated standards for the recognition, measurement, presentation and disclosure of intangible and deferred assets. Accordingly, for the 2008 comparatives, the Company has reclassified \$51.3 million of other long-term assets and \$9.5 million of other current assets relating to deferred wireless costs and installation costs to intangible assets. The Company also reclassified specific software costs within capital assets of \$129.9 million from property, plant and equipment to intangible assets.

The following table provides details of the Company's capital assets:

	2009			2008		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Property, plant and equipment						
Network equipment and outside plant	2,924.6	1,913.6	1,011.0	2,750.2	1,777.4	972.8
General equipment and other	435.1	319.7	115.4	414.3	271.2	143.1
Buildings	267.7	152.9	114.8	262.2	142.7	119.5
Equipment under capital lease	5.4	1.0	4.4	5.4	0.6	4.8
Plant under construction	93.3	-	93.3	91.4	-	91.4
Materials and supplies	17.0	-	17.0	21.3	-	21.3
Land	6.3	-	6.3	6.3	-	6.3
	<b>3,749.4</b>	<b>2,387.2</b>	<b>1,362.2</b>	3,551.1	2,191.9	1,359.2
Intangible assets						
Software	302.7	158.0	144.7	239.8	110.0	129.8
Deferred wireless costs	86.2	33.4	52.8	78.3	37.6	40.7
Other deferred installation costs	34.0	17.9	16.1	43.7	23.6	20.1
Customer contracts and relationships	29.5	14.0	15.5	27.1	13.8	13.3
Other contractual relationships	1.3	0.7	0.6	1.3	0.5	0.8
Spectrum licenses	48.5	-	48.5	48.6	-	48.6
Broadcasting certificate	2.9	-	2.9	2.9	-	2.9
	<b>505.1</b>	<b>224.0</b>	<b>281.1</b>	441.7	185.5	256.2
<b>Total</b>	<b>4,254.5</b>	<b>2,611.2</b>	<b>1,643.3</b>	3,992.8	2,377.4	1,615.4

**7. NOTES PAYABLE**

As at December 31, 2009, the Company has a \$350 million bank credit facility with a syndicate of financial institutions which is used for cash management purposes, the issuance of letters of credit and to support the Company's \$150 million commercial paper program. As at December 31, 2009, the Company had \$137.3 million in undrawn letters of credit outstanding under this facility. The Company paid short-term interest costs of \$2.5 million (2008 - \$2.5 million) for the year ended December 31, 2009.

**MANITOBA TELECOM SERVICES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

For the years ended December 31, 2009 and 2008 (All financial amounts are in \$ millions, except where noted.)

**8. LONG-TERM DEBT**

	2009	2008
Medium Term Note, 5.85%, due February 23, 2009	-	70.0
Medium Term Note, 5.25%, due June 10, 2009	-	150.0
Medium Term Note, 8.625%, due September 8, 2010	11.9	11.9
Medium Term Note, 5.20%, due September 27, 2011	220.0	220.0
Medium Term Note, 5.05%, due May 11, 2012	100.0	-
Loan payable, 6.59%, due May 14, 2014	75.0	-
Medium Term Note, 6.15%, due June 10, 2014	200.0	200.0
Medium Term Note, 6.65%, due May 11, 2016	250.0	-
Medium Term Note, 5.625%, due December 16, 2019	200.0	-
	<b>1,056.9</b>	651.9
Less: deferred costs associated with the issuance of long-term debt	<b>(5.4)</b>	(1.7)
	<b>1,051.5</b>	650.2
Less: current portion of long-term debt	<b>(11.9)</b>	(220.0)
	<b>1,039.6</b>	430.2

Interest expense on long-term debt, including amortization of debt issue costs, amounts to \$47.6 million in 2009 (2008 – \$39.4 million). During the year ended December 31, 2009, the Company paid interest on long-term debt of \$43.5 million (2008 – \$39.8 million).

**9. SHARE CAPITAL**

As at December 31, 2009, share capital consists of 64,667,817 issued and outstanding Common Shares (December 31, 2008 – 64,637,917).

During the year ended December 31, 2009, 29,900 stock options were exercised (2008 – 6,250 stock options) for cash consideration of \$0.9 million (2008 – \$0.2 million), of which \$1.1 million was credited to share capital (2008 – \$0.3 million) and \$0.2 million was charged to contributed surplus (2008 – \$0.1 million).

**Earnings per share reconciliation**

The following table provides a reconciliation of the information used to calculate basic and diluted earnings per share:

	2009	2008
<b>Net income – basic and diluted</b>		
Income before discontinued operations	103.9	147.4
Loss from discontinued operations, net of tax	(2.2)	(3.4)
Net income	101.7	144.0
<b>Weighted average shares outstanding (in millions)</b>		
Weighted average number of shares outstanding – basic and diluted	64.7	64.6
<b>Earnings per share – basic and diluted (\$)</b>		
Income before discontinued operations	1.61	2.28
Loss from discontinued operations, net of tax	(0.04)	(0.05)
Net income	1.57	2.23

**MANITOBA TELECOM SERVICES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

For the years ended December 31, 2009 and 2008 (All financial amounts are in \$ millions, except where noted.)

**10. STOCK-BASED COMPENSATION**

The following tables provide further information on outstanding stock options:

	2009		2008	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Outstanding, beginning of year	2,173,940	42.00	1,876,090	42.12
Granted	381,695	34.24	508,000	42.24
Exercised	(29,900)	30.67	(6,250)	29.91
Terminated	(203,900)	43.41	(203,900)	44.05
Outstanding, end of year	2,321,835	40.70	2,173,940	42.00
Exercisable, end of year	1,246,940	41.21	1,039,460	40.54

Year granted	Options outstanding	Options exercisable	Weighted average exercise price per share	Range of exercise price per share	Expiry date
2009	367,195	-	34.20	32.93 – 35.19	2019
2008	418,800	90,000	42.24	42.24	2018
2007	314,000	135,200	47.30	44.00 – 49.37	2017
2006	224,100	139,100	39.76	38.78 – 47.76	2016
2005	579,900	464,800	42.36	40.44 – 49.03	2015
2004	131,080	131,080	45.61	45.61	2014
2003	95,160	95,160	34.84	34.75 – 35.81	2013
2002	97,100	97,100	34.18	33.58 – 34.71	2012
2001	56,500	56,500	37.07	36.42 – 38.81	2011
2000	38,000	38,000	32.16	23.81 – 35.60	2010

**11. SEGMENTED INFORMATION**

As at December 31, 2009, the Company had two reportable operating segments: the Consumer Markets division and the Enterprise Solutions division. The Consumer Markets division provides a full range of wireless, high-speed Internet and data, digital television, wireline voice services, and alarm monitoring services to residential and small business customers in Manitoba. The Consumer Markets division also provides Internet, data and voice services to small business customers in Canada. The Enterprise Solutions division provides Internet protocol-based communications, unified communications, voice, and data connectivity services to medium and large business customers in Canada.

The Company evaluates performance based on EBITDA (earnings before interest, taxes, amortization, and other income). EBITDA, as reported below, includes intersegment revenues and expenses. The Company accounts for intersegment revenues and expenses at either prices that approximate current market prices or cost, depending on the type of service.

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**11. SEGMENTED INFORMATION (continued)**

The following tables provide further segmented information:

	Consumer Markets		Enterprise Solutions		Other		Total	
	2009	2008	2009	2008	2009	2008	2009	2008
Operating revenue								
External	<b>812.5</b>	818.0	<b>997.4</b>	1,049.1	–	–	<b>1,809.9</b>	1,867.1
Internal	<b>0.5</b>	0.4	<b>0.1</b>	0.1	<b>36.0</b>	39.4	<b>36.6</b>	39.9
EBITDA	<b>395.1</b>	389.2	<b>172.0</b>	231.8	<b>(7.2)</b>	(2.5)	<b>559.9</b>	618.5
Restructuring & transition	<b>14.1</b>	25.7	<b>30.9</b>	19.9	<b>6.7</b>	2.3	<b>51.7</b>	47.9
Amortization	<b>223.1</b>	235.8	<b>99.1</b>	93.3	<b>0.5</b>	0.3	<b>322.7</b>	329.4
Goodwill	<b>10.4</b>	11.8	<b>31.4</b>	29.4	–	–	<b>41.8</b>	41.2
Assets	<b>1,788.2</b>	1,758.0	<b>1,772.1</b>	1,701.8	<b>236.5</b>	59.3	<b>3,796.8</b>	3,519.1
Capital expenditures, net	<b>182.4</b>	216.2	<b>111.0</b>	118.7	<b>1.8</b>	0.5	<b>295.2</b>	335.4

Reconciliations of net income and assets are as follows:

	2009	2008
<b>Consolidated net income</b>		
Total EBITDA	<b>559.9</b>	618.5
Amortization	<b>(322.7)</b>	(329.4)
Other income	<b>10.9</b>	7.1
Debt charges	<b>(59.5)</b>	(48.9)
Income tax expense	<b>(84.7)</b>	(99.9)
Income before discontinued operations	<b>103.9</b>	147.4
Loss from discontinued operations, net of tax	<b>(2.2)</b>	(3.4)
	<b>101.7</b>	144.0
<b>Consolidated assets</b>		
Assets for operating segments	<b>3,796.8</b>	3,519.1
Eliminations	<b>(1,360.1)</b>	(1,411.1)
Future income taxes	<b>441.1</b>	527.3
Assets held for sale	<b>18.6</b>	17.7
	<b>2,896.4</b>	2,653.0

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## **12. COMMITMENTS AND CONTINGENCIES**

### **Commitments**

On May 30, 2002, the Canadian Radio-television and Telecommunications Commission ("CRTC") issued *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, which provided the regulatory framework for local rates charged to residential and business customers and the rates that incumbent telephone companies charged their competitors. As part of this framework, the CRTC established a regulatory deferral account. On January 17, 2008, the CRTC issued *Disposition of funds in the deferral accounts*, Telecom Decision CRTC 2008-1, which required the funds that were accumulated in the Company's deferral account to be used for the expansion of broadband services, for initiatives to improve accessibility to telecommunications services for persons with disabilities, and for certain rate reductions or credits. Aspects of Decision 2008-1, including the requirement for rate reductions or credits, were appealed to the Federal Court and then the Supreme Court of Canada by Bell Canada, TELUS Communications Inc. and the Public Interest Advocacy Centre with a decision by the Supreme Court ultimately upholding the CRTC's decision on September 18, 2009. The estimated balance of the Company's deferral account is approximately \$25 million as at December 31, 2009. During the year, the Company recorded a liability in its financial statements in the amount of \$13.5 million for the estimated amount applicable to rate reductions or credits. The Company filed its intended plan and costs for the approved extension of broadband services with the CRTC on January 15, 2010 and its intended plan for the administration of the rate reductions or credits on January 29, 2010.

### **Contingencies**

In September 1999, three of the Company's unions and a retiree suing on behalf of other retirees and their surviving spouses filed a claim in the Court of Queen's Bench of Manitoba against the Company in respect of the Manitoba Telecom Services Inc. and Participating Subsidiaries Employee Pension Plan (the "Pension Plan"). This claim sought various declarations to the effect that the Company was not entitled to use any portion of the surplus in the Pension Plan to reduce contributions, and that such utilization by the Company was a breach of the Company's obligations to its employees and former employees. The claim also sought, among other things, a mandatory order directing the Company to reimburse the Pension Plan for all amounts of the surplus that the Company has used to reduce its contributions, as well as an injunction prohibiting the Company from utilizing any future surplus in the Pension Plan.

The Company filed a statement of defence in this action in December 1999. This matter proceeded to trial in the fall of 2008, and the Company received a decision from the Court on January 19, 2010. In its decision, the Court upheld the governance of the pension plan and affirmed the position of the Company with respect to the issue of ongoing surplus. As a result, there will be no changes to the Company's expected future ongoing funding requirements and administration of the Pension Plan. The Court also ruled that the Company was obligated to make a \$43 million one-time payment, retroactive to 1997, the year the Company was privatized and the Pension Plan was implemented, plus interest from that date at the effective rate of return earned by the Pension Plan during this period. The potential financial implications of the Court's decision could result in a one-time future payment of up to \$100 million as at December 31, 2009. The Company believes, based on legal advice received, that the decision presents strong grounds for appeal, and accordingly the Company will appeal the Court's decision.

## **13. COMPARATIVE FIGURES**

The prior year figures have been reclassified when necessary to conform to the current year's presentation.