MTS

Manitoba Telecom Services Inc. and Participating Subsidiaries Employee Pension Plan

2012 ANNUAL REPORT

For More Information

If you have any questions about the information contained in this Annual Report, if you would like to receive a copy of the MTS Pension Plan's Statement of Investment Policies and Goals, or if you would like to provide any comments concerning this Annual Report, please contact:

MTS Pension Plan
Benefits Administration
P.O. Box 6666
19th Floor, 333 Main Street
Winnipeg, Manitoba R3C 3V6

Phone No.: (204) 941-7347 or 1-800-635-4973
Fax No.: (204) 774-3163
e-mail: mtspensionplan@mtsallstream.com

If you would like more information on your personal retirement or termination benefits, please contact the MTS Pension Plan's administrative services provider:

The Civil Service Superannuation Board
1200 - 444 St. Mary Avenue
Winnipeg, Manitoba R3C 3T1

Phone No.: (204) 946-3200 or 1-800-432-5134
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Cover photo: Peter Cohoe (retiree) and Joanne Cohoe (spouse)

TABLE OF CONTENTS

MESSAGE FROM
THE CHIEF EXECUTIVE OFFICER

I am pleased to provide you with the MTS Pension Plan Annual Report for the year ending December 31, 2012.

2012 proved to be a robust year for global stock markets and an exceptional year for the performance of the MTS Pension Plan's investments. The MTS Pension Plan generated a strong one-year return of 10.6%, exceeding the Plan's benchmark return and performance objective by a significant margin. This accomplishment was achieved while maintaining the Plan's long term diversified asset mix, which balances risk and reward in the pursuit of solid returns and the preservation of capital. The MTS Pension Plan ranked in the top quartile of pension plans in Canada, outperforming the average Canadian pension plan's return of 9.5% based on independent measurement. Strong performance from the majority of the MTS Pension Plan's investment managers in a wide variety of asset classes contributed to the successful year. In addition, as detailed on page 16 of this report the Plan has outperformed over the longer four-year and since inception time periods.

As a result of the strong investment performance and substantial employer funding in 2012, the MTS Pension Plan's assets exceeded $1.4 billion. In addition, the MTS Pension Plan has a going-concern surplus position of 101% as at January 1, 2013, and is well positioned for the long-term. In 2012, MTS provided $26.6 million in cash funding to the MTS Pension Plan and employees contributed a further $10.1 million. The MTS Pension Plan's assets are also supplemented by $196.1 million in letters of credit arranged by MTS and held in trust for the Plan. Since inception of the MTS Pension Plan in 1997, MTS has contributed over $429 million in cash and $196 million in letters of credit while employees have contributed over $160 million. MTS expects to continue making substantial contributions to the MTS Pension Plan in 2013 to ensure the security of your retirement.

Looking ahead to 2013, most financial opinions support cautious optimism. This is a sentiment that I share and I am optimistic for the future of our Company. We delivered solid financial performance in 2012 despite intense competition from our rivals, generating strong revenue growth across all of our strategic product lines. We maintain a strong balance sheet and generate significant free cash flow. We remain the leading telecommunications provider in Manitoba and our national Allstream business has achieved 9 consecutive quarters of growth in profitability. It is our competiveness and financial strength that ensures continued support for the MTS Pension Plan.

Pierre Blouin
CHIEF EXECUTIVE OFFICER

ABOUT YOUR PLAN

HIGHLIGHTS

The MTS Pension Plan (the "Plan") is a contributory defined benefit plan that provides pension benefits to certain employees and retirees of Manitoba Telecom Services Inc. and its participating subsidiary, MTS Inc. (collectively the "Company").

Here are some highlights of the Plan:

- Eligible employees contribute to the Plan by payroll deduction each pay period. These contributions are fully tax deductible. The Company contributes the amounts necessary to ensure that the Plan can meet its obligations. The Company contributed approximately $85.5 million in cash and letters of credit to the Plan in 2012.
- Plan benefit payments to retirees and beneficiaries were $62.2 million in 2012.
- At retirement, members are eligible for a pension based on a formula using their average earnings during the five years of employment when their earnings were the highest and their years of credited service as a member of the Plan.
- Members may retire with an unreduced pension at or after age 55 if their age plus years of continuous service total at least 80. Members also may retire with an unreduced pension at age 60 if they have at least 10 years of continuous service. Members may retire with a reduced pension at or after age 55 if they have completed at least two years of continuous service, or as early as age 45 if their age plus years of continuous service equals at least 70.
- The Plan provides for a guaranteed cost of living adjustment ("COLA") equal to two-thirds of the increase in the Canadian Consumer Price Index ("CPI") to a maximum CPI increase of 4%.
- Members who leave the Company before they are eligible to retire are entitled to a deferred pension (which is a pension that is payable when they are eligible to retire). They also may choose to transfer the value of the pension to a locked-in RRSP.

For more details on the Plan, please refer to the MTS Pension Plan Web site at www.mtspensionplan.ca.

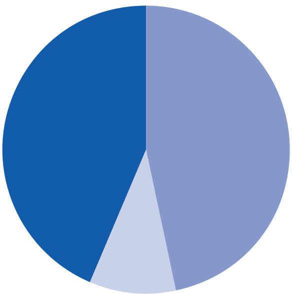
PRIVACY

The Company is dedicated to protecting your privacy and safeguarding your personal information. The Company collects, uses or discloses personal information for the purpose of administering the Plan. Access to your personal information is limited to certain Company staff, The Civil Service Superannuation Board which provides administrative services in respect of the Plan, the Plan's Actuary, persons to whom you have authorized access, and persons authorized by law.

MEMBERSHIP

The Plan's membership falls into three categories: active, deferred, and retirees and their beneficiaries. Active members are those employees who currently contribute to the Plan. Deferred members are former employees who have left their pension benefits in the Plan to be paid at a later date. Retirees and beneficiaries are those individuals who currently receive a pension from the Plan.

The membership in the Plan at December 31, 2012 was as follows:



Active Members	2,761
Deferred Members	566
Retirees and Beneficiaries	2,843
Total Members	**6,170**

The total number of Plan members decreased by 112 from the end of 2011. There was a decrease in the number of active members (170) and deferred members (17), and an increase in the number of retirees (75).

YOUR PENSION BENEFIT

Your pension benefit is calculated using a defined benefit formula, which includes the average of your best five years of earnings ("Best Average Earnings"), multiplied by the number of years or partial years you have contributed to the Plan (referred to as "Credited Service"). The formula is as follows:

2.0% of your Best Average Earnings

Multiplied by

Your years of Credited Service

Less

0.6% of the average YMPE (for the same five years of earnings)

Multiplied by

Your years of Credited Service

(YMPE, or Year's Maximum Pensionable Earnings, is the limit set by the federal government each year to determine the maximum Canada Pension Plan contributions and benefits.)

- Kathy Hatzipanayis (retiree)

BENEFIT CALCULATION EXAMPLE

Consider an employee who retires from the Plan at age 55 on December 31, 2012. The employee has Best Average Earnings of $60,000 and 30 years of Credited Service. The average YMPE in this example is $47,360.

2.0% x $60,000 (Best Average Earnings)	$ 1,200
Multiplied by	
30 years Credited Service	X 30
	$ 36,000
Less	
0.6% x $47,360 (average YMPE)	$ 284
Multiplied by	
30 years Credited Service	X 30
	$ 8,520
Annual Benefit*	$ 27,480

*The actual benefit you receive will be affected by a number of factors, including your earnings, your age at retirement, your years of Credited Service, future COLA increases to pension payments and the survivor benefit option that you choose.

COST OF LIVING ADJUSTMENTS

The Plan provides for a guaranteed COLA increase to pension payments each year. This guaranteed COLA is equal to two-thirds of the increase in CPI to a maximum CPI increase of 4%. COLA increases are granted each July. In 2012, retirees received a COLA increase of 1.53%, which was two-thirds of the 2011 CPI increase of 2.3%. Past COLA increases account for approximately 18% of the pension benefits paid to retirees in 2012. In 2013, retirees will receive a COLA increase of 0.55% which is two-thirds of the 2012 CPI increase of 0.83%. The guaranteed annual COLA increase is a valuable benefit that many other pension plans in Canada do not have.

IT'S A DEFINED BENEFIT PLAN

The Plan is a defined benefit pension plan. This means that your benefit is a predictable amount determined by a formula based on your earnings during the five years when they were the highest and your years of participation in the Plan. Your benefit does not depend on the rate of return earned by the Plan's investments. Employees contribute to the Plan based on a set formula, and the Company contributes the additional amounts necessary to pay the benefits that you earn. A predictable retirement income is the most desirable feature of a defined benefit pension plan.

SOURCES OF FUNDING

The money necessary to pay the benefits promised by the Plan comes from three sources:

- Company contributions;
- Employee contributions; and
- Investment earnings.

In 2012, investment earnings were the largest source of funding for the Plan. Of the $168.2 million in total inflows in 2012, investment earnings (comprised of investment income and current period change in fair value of investments) accounted for $131.5 million or 78%, the Company's cash contributions accounted for $26.6 million or 16%, and employee contributions accounted for $10.1 million or 6%.

COMPANY CONTRIBUTIONS

The Company contributes the amount necessary to ensure that benefits earned can be paid when they are due. This does not mean that the Company contributes $1 at the same time you contribute $1. The timing of the Company's contribution is determined by an actuarial valuation completed in accordance with pension legislation. In 2012, the Company contributed $26.6 million in cash funding, consisting of $19.8 million in normal cost funding and $6.8 million in additional contributions, as well as $58.8 million in letters of credit. This equates to an $8.45 contribution for every $1 contributed by employees. Since the inception of the Plan in 1997, the Company has contributed $429.6 million in cash funding and $196.1 million in letters of credit to the Plan. This level of funding demonstrates the Company's commitment to your secure retirement.

The actuarial funding valuation completed as at January 1, 2013, showed that the Plan was fully funded with an $18 million surplus on a going concern basis, and in a deficit position of $514 million on a solvency basis. The solvency valuation assumes that the Plan terminated on the date the valuation was done, while the going concern valuation assumes that the Plan will continue operating indefinitely. The Plan's going concern liabilities were $1,392 million as at January 1, 2013. On a solvency basis the liabilities were $2,123 million. The Plan's going concern funded ratio was 101%, while the Plan's solvency funded ratio was 76% as at January 1, 2013. The ratios have improved from the January 1, 2012 valuation due to continued funding and strong investment returns. Until the Plan is fully funded on a solvency basis, the Company will continue to make additional contributions either in cash or by letters of credit. The next actuarial funding valuation will be completed as at January 1, 2014.

LETTERS OF CREDIT

PBSA regulations were amended effective April 1, 2011 to permit letters of credit to be used, up to a maximum of 15% of plan assets, to meet solvency funding requirements for federally regulated pension plans. A letter of credit is essentially a guarantee issued by a financial institution. It provides security to the pension plan up to its face value in the event the plan sponsor defaults in their obligations to the pension plan. The letters of credit held by the trustee, RBC Investor Services

Trust, on behalf of the MTS Pension Plan automatically renew each year and cannot be withdrawn or reduced by the Company unless they are either replaced with cash funding or it is determined in an actuarial valuation that the letters of credit, or a portion thereof, are no longer required. In addition, PBSA regulations require that the letters of credit be issued by a financial institution which has a credit rating of A or higher. The letters of credit held by the Plan, totaling $196.1 million as at December 31, 2012, have been issued by the Canadian Imperial Bank of Commerce, Royal Bank of Canada, Bank of Montreal and Bank of Nova Scotia. These letters of credit, in combination with the Plan's investments in short-term investments, bonds, mortgages, equities and real estate, provide security for the benefit obligations to Plan members.

EMPLOYEE CONTRIBUTIONS

Employee contributions to the Plan are based on the employee's earnings as follows:

- 5.1% of earnings up to the YMPE, and
- 7.0% of earnings over the YMPE

Employee contributions totaled $10.1 million in 2012, and since the inception of the Plan in 1997, employees have contributed $164.5 million.

INVESTMENT EARNINGS

The third source of funds for the Plan is earnings on the investments held in the Plan's trust fund. Further information on the Plan's investment earnings is available beginning on page 16 of this Annual Report.

PAYMENTS FROM THE PLAN

In 2012, payments made from the Plan were as follows:

Pension payments to retirees and beneficiaries	$	62.2 million
Termination and lump-sum death benefit payments	$	17.9 million
Reciprocal transfers	$	0.3 million
Investment expenses	$	5.5 million
Administrative expenses	$	1.3 million
Total	**$**	**87.2 million**

Pension payments to retirees increased by $3.1 million or 5%, termination and lump-sum death benefit payments increased by $9.9 million or 124%, and administrative expenses increased by 0.1 million or 8% from 2011. Investment expenses remained unchanged from 2011.

BUYER BEWARE

When employees retire or terminate their employment, they are faced with the decision of whether to keep their pension funds in the Plan or to transfer the funds to a locked-in RRSP. This is always a difficult decision to make, and one that should not be made without receiving some sound advice.

It may or may not be in your best interests to transfer your money out of the Plan once you are no longer an active employee. Everyone's situation is different. However, before making this decision, we strongly suggest that you seek professional advice, not only from your financial advisor, but from someone knowledgeable about income taxes. You also may want to speak to family and former co-workers who may have been through a similar situation.

If you decide to transfer your pension funds out of the Plan, it is important that you be absolutely sure of your decision. Once the funds have been transferred out of the Plan, the Company and the Plan no longer guarantee, or remain in any way responsible for, your pension. Any financial losses that you may incur due to your investment decisions or those of your financial advisor are entirely your responsibility.

PENSION COMMITTEE

The Pension Committee reports to the Audit Committee of the Board of Directors. The Pension Committee met twice in 2012. In accordance with its mandate, the Committee reviewed the results of the funding actuarial valuation and the COLA actuarial valuation, and reviewed the Plan's investment performance and other administrative aspects of the Plan.

The current members of the Pension Committee are as follows:

Rod Pennycook (Chair)	Retired (formerly with The Great-West Life Assurance Company)
Paul Beauregard	Chief Legal Officer & Corporate Secretary
Bob Linsdell	TEAM Representative
Debbie Marantz	CEP Representative
Brenda McInnes	Vice-President & Treasurer
Don Rooney	Director Labour Relations
Don Senkow	IBEW Representative
Laurie Stewart	Director Operations – Consumer
Larry Trach	Retiree Representative

LEGAL PROCEEDING

An update on the lawsuit is provided in note 12 to the Financial Statements on page 27 of this Annual Report.

PLAN WEB SITE

The Plan Web site gives Plan members the opportunity to learn more about their Plan, keep up-to-date on what's new, and to even view this Annual Report. This Web site can be found at www.mtspensionplan.ca.

- Susan Stutski (retiree)

ABOUT THE INVESTMENTS

INVESTMENT COMMITTEE

The Investment Committee oversees and directs the investment of the Plan's funds by establishing investment principles and guidelines, recommending investment managers and monitoring the performance of the Plan's investments. The Investment Committee reports on the performance of the Plan's investments to the Audit Committee of the Board of Directors each year.

The current members of the Investment Committee are as follows:

Wayne Demkey (Chair)	Chief Financial Officer
Brenda McInnes	Vice-President & Treasurer
Pat Solman	Vice-President Regional Operations, MTS Inc.
John Smith	Managing Director, Granite Financial Group Inc.
Neil Benditt	Retired (formerly Assistant Deputy Minister of Finance, Province of Manitoba)
Rod Pennycook	Retired (formerly with the Great-West Life Assurance Company)

During 2012, the Investment Committee held four regular quarterly meetings to discuss the performance of the Plan's managers.

ASSET MIX

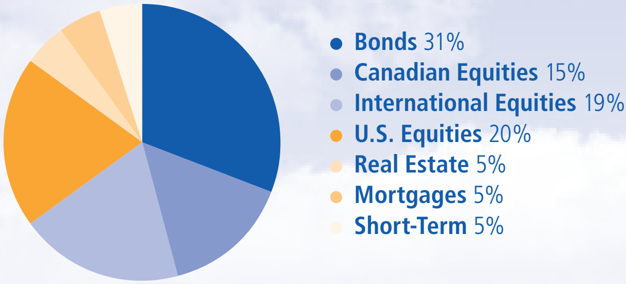
Strong investment returns are important to growing the Plan's assets. To achieve this in volatile financial markets, it also is important that the Plan has a diversified asset mix that is designed to achieve long-term growth, while preserving capital during years of negative performance in financial markets. The policies that govern the Plan are designed to ensure a disciplined and balanced approach to investing, which helps achieve both growth and capital preservation.

The Plan's asset mix is the combination of the different types of assets in which the Plan is invested, such as bonds, equities, mortgages and real estate. The Plan's funds are invested in a diversified portfolio of different types of assets because diversification – not putting all your eggs in one basket – is a fundamental principle of investing. If one type of asset results in a loss, a gain in another may offset the loss. For example, if Canadian equities perform poorly during the year, this may be offset by positive gains in bonds and real estate assets. Investing in a diversified asset mix is a strategy that minimizes risk and provides more stability in investment returns over time.

The Investment Committee is responsible for determining the asset mix guidelines for the Plan's investments. This is done in conjunction with an actuarial consultant during a process called a risk management study. The purpose of this study is to determine the most appropriate asset mix for the Plan's funds for the long-term. These studies are typically conducted every four to six years. A risk management study was completed for the Plan in 2012 which confirmed the Plan's current asset mix and led to the creation of a long-term plan to adjust the assets in relation to changing economic conditions, with the ultimate goal of reducing future return fluctuations.

INVESTMENTS AT DECEMBER 31, 2012

At the end of 2012, the Plan's investments (excluding cash and accrued income) totaled $1,400.0 million. The following chart and table show how the Plan's assets were invested.



INVESTMENT	MARKET VALUE ($ MILLIONS)
Bonds	$ 432.8
Canadian Equities	$ 203.0
International Equities	$ 267.5
U.S. Equities	$ 280.7
Real Estate	$ 76.3
Mortgages	$ 70.9
Short-term Investments	$ 68.8
Total Funds	**$ 1,400.0**

The following table shows the ten largest investment holdings held directly by the Plan and their percentage of the total portfolio market value:

MTS PENSION PLAN
TOP 10 DIRECT HOLDINGS

Government of Canada [1]	$ 87,161,529	6.2%
Canada Housing Trust [1]	$ 69,819,069	5.0%
Province of Ontario [1]	$ 49,034,070	3.5%
Bank of Nova Scotia [1,2]	$ 22,432,818	1.6%
Royal Bank of Canada [1,2]	$ 22,241,719	1.6%
CIBC [1,2]	$ 18,597,808	1.3%
Apple Inc [2]	$ 18,439,871	1.3%
Province of Quebec [1]	$ 16,378,822	1.2%
TD Bank [1,2]	$ 14,435,386	1.0%
Google Inc. [1]	$ 10,494,577	0.7%

[1] Bond investment [2] Equity investment

ASSET TYPES

Short-term Investments: primarily cash and securities that mature within days, weeks or months (such as Government of Canada treasury bills). These investments generate income by receiving interest payments or by their purchase at a discount to mature at par. Income is based on the market's short-term interest rates.

Bonds: primarily investments in Canadian-issued federal, provincial and corporate bonds having semi-annual interest payments and terms to maturity over one year. Bonds generate income through interest payments and increases in value. Over the long-term, bonds historically have produced lower rates of return with more stability (smaller differences from year-to-year) relative to equities.

Equities: primarily investments in common shares of Canadian, U.S. and international companies. Equities generate income through dividends and increases in share value. Over the long term, equity investments historically have produced higher rates of return with more volatility (larger differences from year-to-year) relative to other asset types.

Mortgages: primarily investments in high quality mortgages on Canadian residential and commercial properties. Mortgage investments generate income through interest payments.

Real Estate: primarily investments in buildings and property. Real estate investments generate income from rental income and increases in asset value.

INVESTMENT MANAGERS

The responsibility for investing the Plan's assets rests with external investment managers under the direction of the Investment Committee and the Audit Committee of the Board of Directors. The investment managers and the types of assets that they manage are as follows:

- **Beutel, Goodman & Company Ltd.** (Canadian equities and Canadian bonds)
- **BonaVista Asset Management Ltd.** (Canadian equities)
- **Fiera Capital Corporation** (small capitalization Canadian equities)
- **The Great-West Life Assurance Company** (real estate and mortgages)
- **Mawer Investment Management Ltd.** (international equities)
- **MFS Institutional Advisors, Inc.** (international equities)
- **Phillips, Hager & North Investment Management Ltd.** (Canadian bonds)
- **Sprucegrove Investment Management Ltd.** (U.S. and international equities)
- **T. Rowe Price Associates, Inc.** (U.S. equities)

The Plan's investment managers were chosen for the following reasons:

- the quality and experience of their investment management teams;
- their investment approach and style;
- their investment performance track record over several market cycles; and
- the level of fees that they charge.

Where more than one investment manager directs the investment of a single asset type, such as Canadian equities, the investment managers were chosen for their complementary investment styles. In 2012, following a comprehensive search process, Mawer Investment Management was hired as a new international equities manager for the Plan replacing Alliance Bernstein.

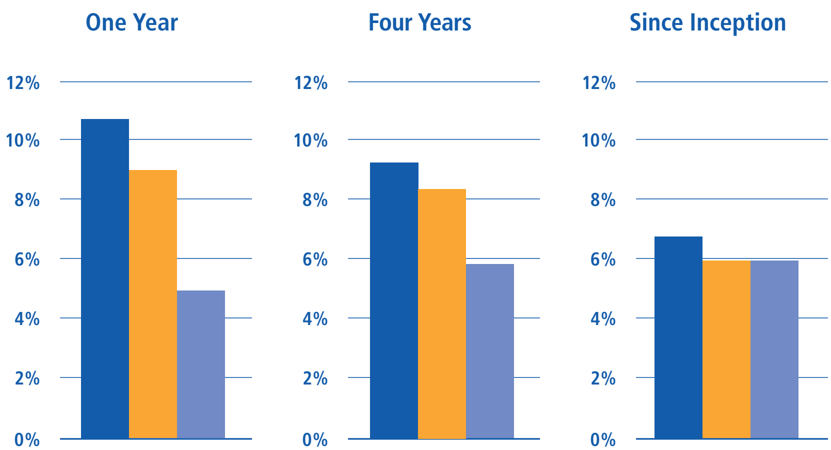
CUSTODIAN/TRUSTEE

The custodian/trustee for the Plan is RBC Investor Services Trust. RBC Investor Services is responsible for the custody of the investment assets and letters of credit held in the Plan's trust fund.

PLAN PERFORMANCE

The Investment Committee measures the Plan's rate of return against its long-term performance objective of the annual rate of inflation (which is the annual change in the CPI for Canada) plus 4%. In order to measure the success of the Plan's active investment managers, the Investment Committee compares the Plan's rate of return against the weighted average of the markets' returns for the Plan's normal policy mix (the "benchmark").

Although annual returns are reviewed carefully, it is the Plan's performance over longer periods that best indicate how well the Plan's funds are invested.



	One Year (2012)	Four Years (Annualized) (2009–2012)	Since Inception (Annualized) (January 1997)
● MTS Pension Plan Return	10.6%	9.2%	6.7%
● Customized Benchmark	8.9%	8.3%	5.9%
● Performance Objective (CPI + 4%)	4.9%	5.8%	5.9%

10.6% INVESTMENT RETURN IN 2012

The Plan invests in a diversified portfolio of assets, including Canadian equities, U.S. equities, international equities, bonds, real estate, mortgages and short-term investments.

2012 proved to be a strong year for investing, with both stock and bond markets generating positive overall returns. International equities (as measured by the MSCI EAFE Index) returned 15.3% during the year, while U.S. equities returned 13.4% (as measured by the S&P 500 Index). Canadian equities (as measured by the S&P/TSX Composite Index) returned 7.2% and Canadian bonds (as measured by the DEX Universe Bond Index) returned 3.6%. These positive returns were in spite of an economically challenging and politically uncertain year, which included lackluster economic growth, European sovereign debt concerns, the U.S. fiscal cliff, slowing economic growth in China and dysfunctional governments around the globe. The Plan benefitted from its exposure to international equities, real estate, U.S. equities, Canadian equities and global equities with returns of 20.5%, 19.7%, 16.2%, 14.4% and 11.7% respectively. This was partially offset by allocations to mortgages and bonds, which returned 3.5% and 3.7% and underperformed equities as a whole. Although more volatile over the short-term, the investment of a portion of the Plan's investments in equity assets provides the Plan with the greatest opportunity to achieve its performance objective over the long-term. Because of its diversified nature and strong performance from the investment managers, the Plan returned 10.6% in 2012 and ranked in the top quartile of pension plans in Canada.

The performance of the Plan's investments is compared to a customized benchmark, which is based on the market returns of the Plan's target asset mix. This comparison measures the active management of the investments versus a passive or indexed approach. In 2012, the Plan's investments outperformed the customized benchmark return by 1.7%. The Plan has also outperformed over longer periods, with the Plan's active managers adding 0.9% in value over the four-year time period and 0.8% since inception of the Plan.

The Plan's investment return outperformed the performance objective of the annual change in the CPI plus 4% over the one-year and four-year time periods, benefitting from strong equity and real estate returns. This performance objective is not a short-term goal; instead, it is an objective meant to be achieved over the long-term. The Plan has outperformed on an annualized basis since inception of the Plan.

SECURING YOUR FUTURE

It is the Company's responsibility to ensure that your pension benefits are secure, and this is a responsibility that the Company takes very seriously. Manitoba Telecom Services Inc. is a profitable, leading edge company with a solid capital structure and strong cash flow. It is this strength that ensures the Company's continued support for the Plan.

The Plan has a conservative approach and is more defensive in nature than many pension plans in Canada. Well-developed risk management and governance policies are in place, which has guided us through the financial turmoil and has helped us to avoid speculative investment strategies.

SUMMARY FINANCIAL STATEMENTS

The following financial information is a summarized version of the financial information included in the Plan's audited financial statements. The Plan's audited financial statements have been audited by Deloitte LLP.

STATEMENT OF FINANCIAL POSITION

AS AT DECEMBER 31

(in thousands)	2012	2011
Assets		
Cash	$ 3,964	$ 3,091
Investments (Note 4)	1,400,017	1,321,074
Receivables		
Investment income	3,545	3,691
Employee contributions	933	927
Employer contributions	2,505	1,982
	1,410,964	1,330,765
Liabilities		
Benefits payable	-	876
Accounts payable & accrued liabilities	1,103	1,016
	1,103	1,892
Net Assets Available for Benefits	1,409,861	1,328,873
Pension Obligations	1,696,672	1,554,703
Deficit	$ (286,811)	$ (225,830)

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

FOR THE YEAR ENDED DECEMBER 31

(in thousands)	2012	2011
Increase in Net Assets		
Contributions (Note 5)		
Employee	$ 10,069	$ 10,199
Employer	26,649	26,528
Investment income (Note 6)	39,114	36,368
Current period change in fair value of investments (Note 7)	92,422	(24,295)
	168,254	48,800
Decrease in Net Assets		
Benefit payments (Note 8)	80,090	67,054
Reciprocal transfers	329	30
Administrative expenses (Note 9)	6,847	6,705
	87,266	73,789
Change in Net Assets	80,988	(24,989)
Net Assets Available for Benefits, Beginning of Year	1,328,873	1,353,862
Net Assets Available for Benefits, End of Year	$ 1,409,861	$ 1,328,873

STATEMENT OF CHANGES IN PENSION OBLIGATIONS

FOR THE YEAR ENDED DECEMBER 31

(in thousands)	2012	2011
Increase (Decrease) in Pension Obligations:		
Change in assumptions	$ 103,097	$ 65,631
Experience losses (gains)	13,641	(14,421)
Interest on accrued benefits	72,086	74,819
Benefits accrued	34,441	32,339
Benefits paid in year	(81,296)	(67,028)
Change in Pension Obligations	141,969	91,340
Pension Obligations, Beginning of Year	1,554,703	1,463,363
Pension Obligations, End of Year	$ 1,696,672	$ 1,554,703

NOTES TO FINANCIAL STATEMENTS

1. DESCRIPTION OF PLAN

The following description of the Manitoba Telecom Services Inc. and Participating Subsidiaries Employee Pension Plan (the "Plan") is a summary only. For more complete information, reference should be made to the Plan document.

a) General

The Plan is a contributory defined benefit pension plan covering certain current and former Manitoba employees of Manitoba Telecom Services Inc. ("MTS") and its participating subsidiary (collectively the "Company"). The Plan came into effect on January 1, 1997 in accordance with *The Manitoba Telephone System Reorganization and Consequential Amendments Act*. On January 1, 1997, all employees and former employees of The Manitoba Telephone System and its subsidiaries who were members of The Civil Service Superannuation Fund became members of the Plan. Effective January 1, 2010, MTS adopted a new registered pension plan to provide retirement benefits on a defined contribution basis (the "DC Plan") for Manitoba employees hired by MTS and its participating subsidiary after December 31, 2009 and Plan members who elect to participate in the DC Plan for future service. At December 31, 2012, the participating subsidiary was MTS Inc. The Plan is registered under the *Pension Benefits Standards Act, 1985* (Canada) ("PBSA").

b) Funding Policy

The Plan document sets out the arrangements for the Company to fund the benefits determined under the Plan together with the employees. The amount of funding by employees is based on a defined formula. The determination of funding by the Plan sponsors is made on the basis of an actuarial valuation performed on at least a triennial basis. As required by the PBSA, the Company is responsible for making special payments to finance any unfunded liabilities of the Plan over a period not exceeding 15 years in the case of a going concern deficiency, and if there is a solvency deficiency, by annual solvency special payments equal to the amount by which the three-year average solvency deficiency divided by five exceeds the amount of going concern special payments that are payable during the plan year.

The most recent actuarial valuation for funding purposes was prepared by Towers Watson Canada Inc. as at January 1, 2013, and a copy of this valuation will be filed with the Office of the Superintendent of Financial Institutions and the Canada Revenue Agency. This valuation disclosed an unfunded solvency liability as at January 1, 2013. In accordance with the PBSA, unless the Plan has a solvency ratio of 120% or greater, completion of an annual actuarial funding valuation is required, and as a result, the amount of the special annual payment is subject to change.

Effective April 1, 2011, new regulations under the PBSA provided that letters of credit may be used to meet solvency special payment requirements. The total face value of the letters of credit cannot exceed 15% of the market value of the assets as determined on the valuation date. To facilitate solvency special payments, MTS has arranged for $196.1 million (2011 - $137.3 million) in letters of credit to be held by RBC Investor Services Trust, the trustee for the Plan. The letters of credit are not reflected in the net assets available for benefits of the Plan.

c) Investments

The Plan's capital is its net assets available for benefits. The Plan's objective when managing assets is to safeguard the Plan's ability to continue to provide pension and related payments to its members. The administrator manages the net assets of the Plan in accordance with the Statement of Investment Policies and Goals which specifies allocation limits for each asset class. There has been no change to the Statement of Investment Policies and Goals during the year (2011 – No change). In addition, as a federally regulated pension plan, the investments must be in accordance with the PBSA regulations.

d) Retirement Pensions

A retirement pension is based on the number of years of pensionable service and the highest five-year average earnings. A retirement pension is payable to members who retire after completion of at least one year of membership in the Plan and who have attained age 65. Unreduced pensions are payable to members who have reached at least age 55 and the sum of their age plus continuous service equals 80, or have reached age 60 with 10 years of service. With certain restrictions, members can retire with reduced pension benefits as early as age 45.

e) Disability Benefits

Members who are on long term disability after January 1, 1997 may be credited with pensionable service while disabled without making contributions to the Plan. Members also may be able to retire immediately and receive a disability pension from the Plan.

f) Termination Benefits

Subject to lock-in provisions, refunds and commuted value transfers are available when an active member ceases employment.

g) Death Benefits

Death benefits are available upon the death of an active member or deferred member and may be available upon the death of a retired member depending on the pension option chosen. The benefit may take the form of a lump-sum payment or a survivor pension.

h) Cost-of-Living Adjustments

The Plan provides for a guaranteed cost of living increase each year equal to 2/3 of the increase in the Consumer Price Index ("CPI") for Canada to a maximum CPI increase of 4.0%.

i) Income Taxes

The Plan is a Registered Pension Plan as defined in the *Income Tax Act* (Canada). The Plan is not subject to income taxes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian accounting standards for pension plans and include the following significant accounting policies:

a) Basis of Presentation

These financial statements are prepared on a going concern basis and present the aggregate financial position of the Plan as a separate financial reporting entity independent of the Plan sponsor and Plan members.

Accounting Standards for Private Enterprises as set out in Part II of the Canadian Institute of Chartered Accountants Handbook (the "Handbook") has been chosen for accounting policies that do not relate to the Plan's investment portfolio or pension obligations, to the extent that those standards do not conflict with the requirements of Section 4600.

b) Investments and Investment-Related Receivables and Liabilities

Investments and investment-related receivables and liabilities are measured at fair value. Fair value is the amount of consideration that would be agreed on between knowledgeable, willing parties in an arm's length transaction. Bonds and debentures and equities are valued at the year-end market price where quoted prices are readily available. Pooled fund investments are valued at the unit value supplied by the pooled fund administrator, which represents the Plan's proportionate share of underlying net assets at fair value determined using closing market prices. Investment transactions are recorded as of the trade date (the date upon which the substantial risks and rewards of ownership have been transferred).

c) Foreign Exchange

Foreign currency transactions are translated into Canadian dollars at rates of exchange prevailing at the dates of the transactions. At year-end, the market values of investments denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of investment income or current period change in fair value of investments.

d) Investment Income

Income from investments is recorded on an accrual basis and includes interest income, dividends, securities lending revenue and other income.

e) Investment Transaction Costs

Investment transaction costs in the form of brokerage commissions are reflected in the statement of changes in net assets available for benefits as administrative expenses.

f) Current Period Change in Fair Value of Investments

The change in the difference between the fair value and cost of investments, at the beginning and end of each fiscal year, adjusted for realized gains and losses in the year, is reflected in the statement of changes in net assets available for benefits as a current period change in fair value of investments.

g) Use of Estimates

In preparing these financial statements, management must make certain estimates and assumptions, such as the discount rate to measure pension obligations and expected future salary increases, that affect the reported amount of pension obligations at the date of the financial statements. A change in an estimate or assumption could affect the present value of the pension obligation.

h) Future Accounting Change

The Plan is required to adopt International Financial Reporting Standard ("IFRS") 13, Fair Value Measurement, for fiscal years beginning on or after January 1, 2013 for the measurement of its investment assets. IFRS 13 replaces the fair value measurement guidance currently dispersed across different IFRSs with a single definition of fair value and a comprehensive framework for measuring fair value. It also establishes disclosure requirements about fair value measurements. This new standard will have minimal impact on these financial statements.

3. FINANCIAL RISKS

The Plan actively manages the risks that arise from its use of financial instruments, including liquidity, credit and market risk. The Plan adheres to an investment policy that outlines the objectives, constraints, and parameters related to its investing activities. This policy prescribes limits around the quality and concentration of investments held by the Plan. Management regularly reviews the Plan's investments to ensure all activities adhere to the investment policy. The Plan's exposure to and management of these risks has not changed materially since December 31, 2011.

4. INVESTMENTS

(in thousands)	**2012**	**2011**
Short-term investments		
Notes and securities	$ 57,255	$ 57,916
Cash equivalent pooled funds	11,129	6,645
Pending trades	442	7
Total short-term investments	68,826	64,568
Bonds and debentures		
Government guaranteed	253,003	250,270
Corporate	179,809	177,841
Total bonds and debentures	432,812	428,111
Mortgages		
Pooled funds	70,921	72,459
Total mortgages	70,921	72,459
Equities		
Investment corporations	57,801	46,873
Real estate corporations	6,231	3,527
Resource corporations	53,916	53,512
Other Canadian and Foreign corporations	432,459	450,143
Pooled funds	200,777	129,061
Total equities	751,184	683,116
Real Estate		
Pooled funds	76,274	72,820
Total real estate	76,274	72,820
	$ 1,400,017	$ 1,321,074

5. CONTRIBUTIONS

(in thousands)	2012	2011
Employee		
Current service	$ 10,019	$ 10,134
Past service	50	65
	$ 10,069	$ 10,199
Employer		
Current service	$ 19,611	$ 18,089
Special contributions	7,038	8,439
	$ 26,649	$ 26,528

6. INVESTMENT INCOME

(in thousands)	2012	2011
Interest		
Bonds	$ 15,481	$ 17,280
Mortgages	3,403	3,578
Deposits and short-term notes	730	480
Dividends		
Canadian equities	8,577	4,484
Foreign equities	10,658	10,367
Securities lending	231	160
Other	34	19
	$ 39,114	$ 36,368

7. CURRENT PERIOD CHANGE IN FAIR VALUE OF INVESTMENTS

(in thousands)	2012	2011
Net realized gains on sale of investments	$ 23,513	$ 25,798
Net unrealized market gains (losses)	68,909	(50,093)
	$ 92,422	$ (24,295)

8. BENEFIT PAYMENTS

(in thousands)	2012	2011
Retirement benefits	$ 62,067	$ 58,975
Disability benefits	98	146
Termination benefits	16,204	7,151
Death benefits	1,721	782
	$ 80,090	$ 67,054

9. ADMINISTRATIVE EXPENSES

(in thousands)	2012	2011
Administrative expenses		
Administrative expenses – Manitoba Telecom Services Inc.	$ 462	$ 452
External administration fees	424	432
Actuarial	316	228
Audit	17	16
Other	93	119
	1,312	1,247
Investment expenses		
Investment management	4,684	4,600
Custodial	388	396
Transactions costs	463	462
	5,535	5,458
	$ 6,847	$ 6,705

10. PENSION OBLIGATIONS

The Plan's pension obligations were determined in an actuarial valuation as at December 31, 2012 by Towers Watson Canada Inc. The next actuarial valuation is required to be completed as at December 31, 2013. The valuation of the pension obligations was determined using the projected unit credit method as prescribed by International Accounting Standard 19. The assumptions used in the valuation were based on the Plan Administrator's best estimate of future events with the exception of the discount rate which was determined by reference to market interest rates of high quality corporate bonds at the measurement date. Future experience will differ from those assumptions. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations.

The major long-term economic assumptions used in the actuarial valuation are:

	2012	2011
Discount rate	4.30%	4.75%
Future salary increases	3.25%	3.25%

11. IRREVOCABLE LETTERS OF CREDIT

Irrevocable letters of credit in the amount of $196.1 million (2011 - $137.3 million) are held by the Plan's trustee, RBC Investor Services Trust, on behalf of the Plan. The letters of credit, issued by major Canadian banks, have been arranged by the Plan sponsor to satisfy solvency funding requirements under the PBSA. The trustee can make a demand for payment on the letters of credit in the event the Plan sponsor does not meet its solvency funding obligations under the PBSA or the Trust Agreement. The letters of credit are not included in the net assets available for benefits of the Plan.

12. CONTINGENCIES

In 1999, three of the Company's unions and a retiree suing on behalf of other retirees and their surviving spouses filed a claim against the Company in respect of the Manitoba Telecom Services Inc. and Participating Subsidiaries Employee Pension Plan ("the Pension Plan"). This claim was based on events that had occurred at the time of privatization of the Company in 1997. This matter proceeded to trial in 2008, and in 2010 the trial court ruled that the Company was obligated to make a one-time payment to the Pension Plan. The Company believed the decision was legally incorrect and appealed. In 2012, a panel of the Manitoba Court of Appeal agreed unanimously with the Company, dismissed the claim in its entirety, and concluded that the Company had complied with its obligations and that no changes to the future funding requirements or any other aspects of the Pension Plan were required as a result of this past litigation. The plaintiffs subsequently sought leave to appeal the decision to the Supreme Court of Canada.

On October 25, 2012 it was announced that the Supreme Court of Canada has decided to hear the plaintiffs' appeal. The Company does not believe that the pending hearing will change the unanimous decision of the Manitoba Court of Appeal. A decision from the Supreme Court is expected within the next 8 to 12 months. There will be no changes to the Company's expected future funding requirements or any other aspects of the Pension Plan until the appeal process is completed.

13. AUDITORS' REPORT

The financial information presented in these statements is an excerpt of the financial information included in the Plan's audited financial statements. The Plan's audited financial statements have been audited by Deloitte LLP.

NOTES

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