

2012 ANNUAL REPORT

OUR PATH FORWARD



MANITOBA TELECOM SERVICES INC.

AT A GLANCE

30,000+

5,500

2012

12

\$300M

route km
world-class
national IP
fibre network

employees
strong across
Canada

top-ranking telecom
provider on the
Corporate Knights
2012 Diversity
Index rankings

consecutive
years on the
Jantzi Social Index
for leadership in
social responsibility

value of unique
tax asset

OUR PATH FORWARD:

Deliver strong shareholder returns through strategies that strengthen our business and deliver customer value

MTS Allstream, one of Canada's leading national communications providers, supplies innovative services and solutions for the way Canadians live and work. With more than 100 years of industry experience and success, our business is driven by two main operating divisions, each with a strong brand: MTS is the market leader in Manitoba and Allstream is an innovative competitor in business markets across Canada. Our common shares are listed on Toronto Stock Exchange (trading symbol: MBT).



"We met our financial goals in 2012 and delivered an attractive 15.1% total shareholder return by executing on our strategies with operational improvements in both divisions. In 2013, we will benefit from our continued investments in our networks and along with our strong focus on cost management, improve our market strengths and deliver cash flow growth."

PIERRE BLOUIN CEO, MTS ALLSTREAM

2012 HIGHLIGHTS

15.1% total shareholder return

Achieved 2012 financial guidance

EBITDA up 2.5%

\$33.6 million in annualized cost savings

Earnings per share up 3.1%

2013 PRIORITIES

Expand MTS market leadership position in Manitoba

Pursue IP growth at Allstream

Grow free cash flow

Continue delivery of leading customer experience

Deliver improved cost structure



AT A GLANCE

100,000+ 90+ 497,367 50TH FIVE

television subscribers

retail locations across the province

wireless customers in Manitoba

anniversary of AAA Alarms subsidiary

service bundle unique to MTS in Manitoba
• Wireless
• High-speed Internet
• IPTV
• Home phone
• Home security

OUR PATH FORWARD:

Continue to deliver market-leading performance by leveraging our network, our products and services, and our deep brand strengths in Manitoba

MTS is the leading full-service communications provider for residential and business customers across Manitoba. MTS operates advanced wireline and wireless networks, offering the widest service coverage and richest bundling capabilities in Manitoba. MTS benefits from exceptional brand recognition, excellent distribution channels, robust infrastructure, innovative products, and from a skilled and experienced workforce with a long track record of success in serving Manitobans.



“Year after year, MTS keeps proving its resilience in Manitoba by leveraging our strong and unique presence throughout the province. We remain focused on continuing to lead the Manitoba market through great products and services, the investments in our network, and improving our customers’ experience.”

KELVIN SHEPHERD PRESIDENT, MTS

2012 HIGHLIGHTS

First provider to offer LTE wireless technology in Manitoba

Highest EBITDA margin in Canadian telecom at 50.5%

Average revenue per user growth in all strategic product lines

Wireless data revenues up 29.7%

High-speed Internet revenues up 8.4%

IPTV revenues up 11.2%

Customers with bundled services up 8.5%

2013 PRIORITIES

Build on MTS market leadership in Manitoba

Increase MTS growth product revenues

Grow our base of high value bundled and multi-service customers

Expand broadband coverage and capabilities for TV and high-speed Internet

Expand 4G LTE coverage



AT A GLANCE

42%

335

2,723

IP SOLUTIONS

ALLSTREAM SERVICE GUARANTEE

of total revenues from strategic and supporting services

buildings added to national IP fibre network in 2012

total number of Allstream fibre-fed buildings

- IP communications
- Managed IP network services
- Unified communications
- Cloud enablement
- Data and security management

an industry-first customer service commitment

OUR PATH FORWARD:

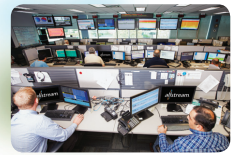
Continue to drive IP growth in Canada’s business market through a strategy focused on providing the best customer experience in our industry

Allstream is the only national communications provider that works exclusively with business customers. A Canadian leader in innovative IP-based communications solutions, Allstream leverages its nationwide high-performance fibre network to help businesses of all sizes unify and improve the many ways in which they connect with their employees, customers and partners. As a trusted advisor, Allstream helps customers get ready for the future by improving their network performance and workforce productivity while managing costs better.



“We have good momentum in our business, building on strong IP sales wins in the latter half of 2012 and adding more buildings to our national network footprint. We expect to be cash flow positive in 2013 by continuing to focus on improvements in our profitability, margins and cost structure.”

DEAN PREVOST PRESIDENT, ALLSTREAM



2012 HIGHLIGHTS

Nine consecutive quarters of year-over-year EBITDA growth

Increased EBITDA margin to 15.2%

IP sales up 15.8%

Awarded \$55-million contract to provide IP services to Shared Services Canada

14% increase in buildings added to IP fibre network

61% of IP revenues were on-net or near-net

Achieved customer satisfaction targets at world-class level

2013 PRIORITIES

Focus on IP growth

Leverage suite of IP/cloud services

Connect another 300+ buildings to our national IP network

Maintain leadership in customer experience

Continue to improve economics



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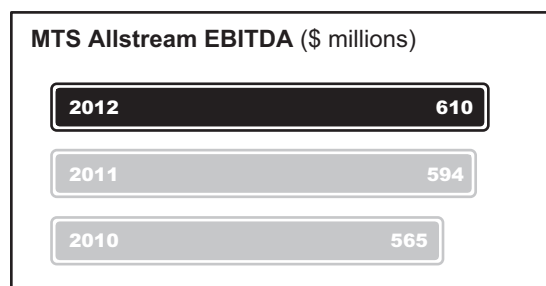
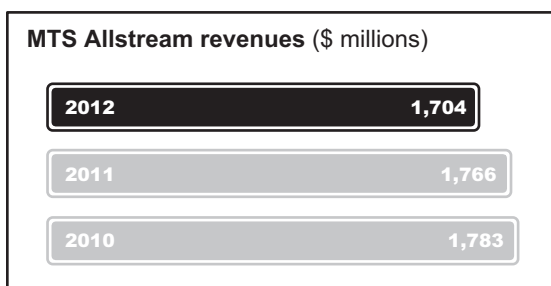
FINANCIAL HIGHLIGHTS

<i>(in millions \$, except EPS and capital expenditures)</i>	2012	2011	% change
Revenues	1,704.1	1,765.6	(3.5%)
EBITDA ¹	609.5	594.4	2.5%
EPS ²	\$2.63	\$2.55	3.1%
Free cash flow ³	117.6	129.8	(9.4%)
Capital expenditures/revenues	19.8%	16.3%	—

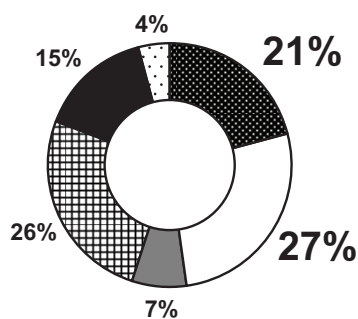
1 EBITDA (earnings before interest, taxes, depreciation and amortization, and other income (expense)) is a non-IFRS measure of performance. See the Glossary term titled "Non-IFRS measures of performance" in the Management's Discussion and Analysis section for further information.







2 Earnings per share ("EPS") is based on weighted average shares outstanding of 66.6 million and 65.5 million for the twelve months ended December 31, 2012 and December 31, 2011, respectively. The increase in the number of weighted shares outstanding is mainly due to participation in our dividend reinvestment program.

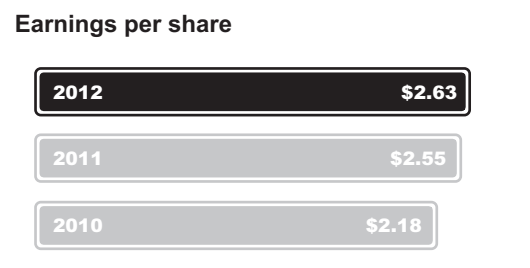
3 We define free cash flow as cash flows from operating activities, less capital expenditures, and excluding changes in working capital. See the Glossary term titled "Non-IFRS measures of performance" in the Management's Discussion and Analysis section for further information.



2012 MTS Allstream revenue mix

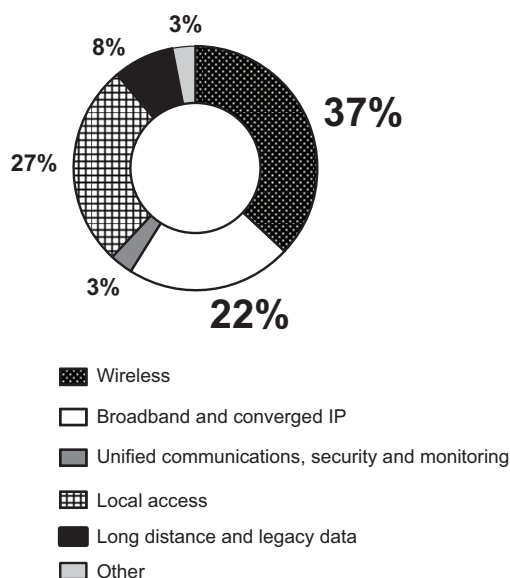


-  Wireless
-  Broadband and converged IP
-  Unified communications, hosting, security and monitoring
-  Local access
-  Long distance and legacy data
-  Other



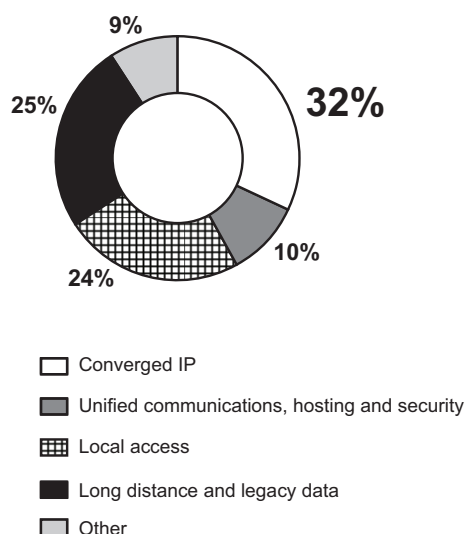
Revenues from strategic lines of business – wireless, broadband and converged IP – accounted for **48%** of MTS Allstream's revenues in 2012

2012 MTS revenue mix



57% of post-paid wireless subscribers now have data plans

2012 Allstream revenue mix



2012 MTS operating highlights

(revenues in millions \$)	2012	2011	% change
Revenues			
Wireless revenues	362.1	356.3	1.6%
Wireless data revenues	116.3	89.7	29.7%
Broadband & converged IP revenues	212.9	195.3	9.0%
IPTV revenues	78.5	70.6	11.2%
Internet revenues	110.1	101.6	8.4%
Subscribers (#)			
Total wireless subscribers	497,367	496,432	0.2%
Total post-paid subscribers	402,824	390,889	3.1%
Post-paid data plans	229,478	173,837	32.0%
Total television customers	101,550	99,865	1.7%
IPTV subscribers	97,232	95,476	1.8%
High-speed Internet subscribers	193,690	189,366	2.3%
ARPU (\$)			
Wireless ARPU	\$60.35	\$59.66	1.2%
Wireless data ARPU	\$19.69	\$15.28	28.9%
IPTV ARPU	\$66.92	\$62.38	7.3%
High-speed Internet ARPU	\$41.65	\$38.56	8.0%

2012 Allstream operating highlights

(in millions \$, except gross margin and buildings)	2012	2011	% change
EBITDA	115.3	108.5	6.3%
Direct costs	306.9	369.3	(16.9%)
Converged IP revenues	243.6	239.8	1.6%
Converged IP gross margin	73.5%	71.3%	2.2 pts
Fibre-fed buildings	2,723	2,388	14.0%

Allstream achieved nine consecutive quarters of year-over-year EBITDA growth in Q4 2012

2012 annual report

This document discusses the financial results and business operations of Manitoba Telecom Services Inc. (TSX: MBT). Within this document we may also refer to ourselves as "the Company", or "MTS Allstream".

Non-IFRS measures of performance

In this annual report, we provide information concerning 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 International Financial Reporting Standards ("IFRS") and are not necessarily comparable to similarly titled measures used by other companies.

Regarding forward-looking statements

Our 2012 annual report includes forward-looking statements and information (collectively, the "statements") about our corporate direction, business opportunities, operations, financial objectives, future financial results and performance, future cash flows and distributions to shareholders 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. Please note that forward-looking statements reflect our expectations as at February 13, 2013. 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. Additional information relating to our company, including our Annual Information Form, is available on SEDAR at www.sedar.com. Unless otherwise stated, all amounts expressed in this report are in Canadian dollars.

CHAIR'S MESSAGE TO SHAREHOLDERS



David Leith
Chair

Dear fellow shareholders,

The telecommunications industry in Canada continued to evolve in 2012 as a result of technological innovation, a shift to more progressive policies governing the competitive environment, and the increasing expectation from Canadians for value and functionality from the communications services they rely on at home, at work and on the move.

These developments open up new business opportunities for your Company but also impose new challenges on our management team and employees. On behalf of the Board and the Company, I would like to express my appreciation to the management team led by Pierre Blouin and to all our dedicated employees for their achievements in 2012 and indeed for their resiliency in the face of the dynamic changes they confront daily in our business.

In 2012, MTS Allstream delivered another good year of business performance and solid financial results. Your Company provided an attractive level of total shareholder return last year, building on our strong competitive positioning in our markets and our firm commitment to the disciplined, cost-optimized operation of our business.

In Manitoba, MTS continues to demonstrate why it remains the undisputed market leader across its residential and business markets. MTS keeps rolling out new and better products, optimizing its network, innovating across the business and actively participating in the community it serves, all with the aim of continuing to strengthen the business and the brand. Key to the enduring success of the MTS brand has been a sustained marketing strategy based in part on a campaign featuring "Morty", the animated bison character, which won several national advertising awards in 2012.

Nationally, Allstream made more progress in its business markets across Canada during the year, evident in the continued expansion of its network, consistently improving financials, strong customer satisfaction levels that we believe lead the industry, and growth in selling IP network solutions. These developments, among others, have guided Allstream's turnaround in recent years and will play a key role in its strategies going forward.

A continuing subject of interest from our shareholders is the strategic review process that the Company announced in September 2012 to evaluate alternatives for the future of Allstream. Our objective in this regard continues to be that we will do what's right for Allstream and our shareholders, leveraging the momentum developed in that division in recent years.

Looking ahead, we are optimistic about our business. As well, we expect that the sector will keep rapidly transforming itself, adapting to strong forces all converging at once, it seems, including trends in areas such as social networking, mobile applications and – not insignificantly – content production and media distribution.

Our outlook is also informed, in part, by key decisions and directions pursued by the CRTC and the federal government in the past several years to respond to what Canadian consumers and businesses want by way of more choice and competition in the industry. In addition to new rules for foreign investment, policymakers and the regulator have demonstrated a reasoned approach to issues based on principles of competition and the rights of customers to receive choices. We welcome this approach and we will continue to advocate for changes we believe are vital to the health of the industry and to the customers we serve across Canada.

I would emphasize in closing that the Board views the pace of change in our industry to be a permanent feature. For the first time, thanks to changes in regulations, we have produced our annual report mainly for digital distribution. We are now only required to produce print copies for those who request it. In whatever form you're receiving this report, I hope you will take the time to review it carefully to understand how MTS Allstream is moving forward confidently and with accountability to our shareholders.

Sincerely,

A handwritten signature in dark ink, appearing to read "David Leith". The signature is fluid and cursive, with the first name "David" and last name "Leith" clearly distinguishable.

David Leith
Chair
March 20, 2013

CEO'S MESSAGE TO SHAREHOLDERS



Pierre Blouin
Chief Executive Officer

Dear fellow shareholders,

2012 was another year of progress in delivering on our strategic areas of focus for MTS Allstream. MTS solidified its position as the undisputed leader in the Manitoba market and Allstream accelerated its transition towards being a pure IP provider for Canadian businesses. We met all our financial targets, reached our cost reduction objective for the eighth consecutive year and generated a strong 15.1% total shareholder return – all solid proof that we are disciplined operators.

Over the past years we have been making strategic capital investments to expand and modernize our networks. We expect to harvest the financial benefits from those strategic investments starting in 2013. As we look ahead, our path forward is to continue to execute on our plans to deliver strong shareholder returns through strategies that strengthen our business and deliver customer value.

MTS – Our path forward is to leverage past strategic investments

In Manitoba, MTS delivered some of the best operating results in the industry including the highest EBITDA margin in Canada at 50.5%. MTS's unique ability to bundle up to five services remains an important advantage that competitors cannot offer so that close to 100,000 MTS customers have bundled services (up 8.5%) with a majority of them subscribing to our three and four product bundles. Combined with the largest network footprint in Manitoba, our extensive retail presence, the latest in wireless, high-speed Internet and IPTV technology, MTS is the clear leader in the Manitoba market. By leveraging these strengths we are seeing very low churn rates and growing average revenue per user in all our strategic product lines.

Allstream – Our path forward is to create top line growth focusing on IP and cash flow growth

This year Allstream achieved its ninth consecutive quarter of EBITDA improvement which demonstrates that our strategy to focus on IP is working. We achieved strong IP sales momentum with a 15.8% increase in sales. In fact, Q4 2012 was our best IP sales quarter ever including one of our largest IP contract wins, making Allstream the number one data supplier for the federal government. Excluding the impact of the one large customer we have discussed in 2011 – eHealth Ontario – IP revenues would have grown 6.5% for the year. In 2012, we also announced a wide-ranging strategic review of Allstream to consider alternatives to further enhance its competitiveness. The review is focused on getting to the right outcome for Allstream and our shareholders and we will update you when the process has concluded.

Investing in our networks for the future

This year, we built and launched Manitoba's first LTE wireless network. Since the launch, MTS has expanded its smartphone line-up and now offers the latest wireless devices and services, including the Samsung Galaxy and the iPhone 5. These technology investments are helping us to drive growth in the wireless portfolio; one example was the 29.7% growth in wireless data revenues we achieved in 2012. With respect to our rollout of fibre-to-the-home (FTTH) technology across Manitoba, we've now expanded to 11 communities with three more planned for 2013. FTTH enables MTS to provide IPTV service, download capabilities of up to 250 Mbps and lays the groundwork for more broadband services in the future.

We also continued to invest in Allstream's national IP fibre network. In 2012, we connected 335 office buildings to its fibre-optic network enabling more IP growth and improving our margins. Allstream expects to surpass the 3,000 building threshold in 2013.

Keeping the customer experience at the forefront of everything we do

In an industry not known for exceptional customer service, MTS Allstream is standing out from the rest and being recognized for excellence in customer experience nationally. The SQM Group (a leading North American call centre research firm) recognized MTS's customer care team for its First Call Resolution improvement while MTS employees were also honoured by the Manitoba Customer Contact Association, earning awards for training and development, performance management and customer service excellence. In June, we successfully launched the "Allstream Service Guarantee", a first in our industry. This guarantee to business customers on five service fronts is simple for us to provide, as our customer experience levels are now at world class customer satisfaction levels, leading the industry for the second year in a row.

Advocating for a competitive regulatory environment

Along with our success in advocating for the lifting of foreign investment restrictions as they relate to Allstream, the CRTC has heard our voice for a more competitive telecom environment with more choice for Canadians and intervened with decisions that helped lower our costs and facilitated improved customer experience. MTS supported the new consumer protection legislation for wireless customers in Manitoba, and fully complied with the legislation once it came into effect. We were also proponents of the CRTC's effort to establish a national wireless code of conduct, appearing before the Commission and advocating for a consumer friendly result.

Strengthening our business through corporate citizenship and employee engagement

The way MTS Allstream operates and gives back to our communities says a great deal about who we are and what we value. Through our employee volunteerism programs, MTS Allstream employees, retirees and their families contributed more than 50,000 volunteer hours to community causes and events across Canada. Nationally, employees once again participated in the Company's United Way annual fundraising campaign, increasing our donation by five per cent. The Company also supported more than 200 community organizations across Canada through value-in-kind services or monetary donations which included a robust community festival sponsorship program in Manitoba.

MTS and Allstream continued to strengthen their brand recognition and reputation through sponsorships. We are proud of our involvement with the Winnipeg Jets through our sponsorship of the MTS Centre and are excited to have become the exclusive telecommunications provider for the Investors Group Field, the new home of the Winnipeg Blue Bombers. Allstream supported the return of the internationally attended Global Relay Gastown Grand Prix in Vancouver which helped revitalize this community.

We upheld our track record of good governance and environmental responsibility throughout 2012. In June, we signed the Catalyst Accord, joining Catalyst in their call to action for Canadian corporations to increase the overall proportion of board seats held by women. As a constituent of the Jantzi Social Index, our company ranks among the top socially responsible and environmentally progressive companies in Canada. We continue to make progress toward our goal of reducing our impact on the environment and helping our customers and employees do the same through a range of initiatives including offering public transportation incentives and telework solutions. We are also proud to be among the first companies in Canada providing this annual report and our 2013 circular to our shareholders electronically using the new "Notice and Access" mechanism.

Employee engagement is a fundamental ingredient to a high performance company and a best-in-class workplace. Our 2012 employee engagement survey had a 90% participation rate, which is a world class level. This survey gauges how strongly employees feel connected to MTS Allstream, and our results exceeded the global telecommunications benchmark by 8%. We are very proud of these results!

Our path forward is to deliver on our plans and create shareholder value

With the majority of our strategic investments now in place, we can start to benefit from them with a high focus on generating improved free cash flow. We will heighten our focus on enhancing customer experience, driving growth in our strategic product lines and lowering our capital expenditures.

I would like to thank all of our employees for their dedication and hard work and our Board of Directors for their support and guidance in these challenging times. I would also like to thank you, our shareholders, for your continued confidence in our company. We met with many of you last year, as we pursued open dialogue with all of our stakeholders, and expect to continue this in 2013.

All of us at MTS Allstream look forward to continuing the work of creating shareholder value and strengthening our Company as we continue on our path forward.

Sincerely,



Pierre Blouin
Chief Executive Officer
March 20, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of our financial results comments on our operations, performance and financial condition for the years ended December 31, 2012 and 2011. This MD&A is based on financial statements prepared under International Financial Reporting Standards ("IFRS"). All financial amounts, unless otherwise indicated, are in Canadian dollars and in accordance with IFRS. MTS Allstream implemented changes to its organizational structure on January 1, 2012. Accordingly, segmented information for 2011 has been restated.

Unless otherwise indicated, this MD&A for the year ended December 31, 2012 is as at February 13, 2013. In preparing this MD&A, we have taken into account information available to us up to February 13, 2013. In this MD&A, "we", "our", and "us" refer to Manitoba Telecom Services Inc. ("the Company" or "MTS Allstream"). This MD&A should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2012.

About us

For more information about our company, including our Annual Information Form for the year ended December 31, 2012, dated February 13, 2013, please visit our website at www.mtsallstream.com or visit SEDAR at www.sedar.com.

Risks and uncertainties

In conjunction with our financial statements and this MD&A, we urge you to read the important risks and uncertainties that are detailed in this MD&A.

Glossary

A glossary of financial and telecommunications terms is included in this MD&A.

Regarding forward-looking statements

This MD&A includes forward-looking statements and information (collectively, "the statements"), about our corporate direction, business opportunities, operations, financial objectives, future financial results and performance, future cash flows and distributions to shareholders, which 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. Therefore, forward-looking statements should be considered carefully and undue reliance should not be placed on them. 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.

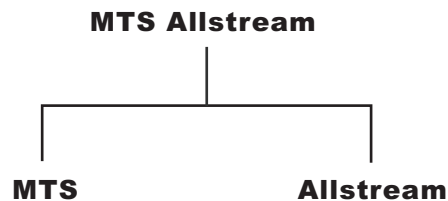
Factors that could cause anticipated opportunities and actual results to differ materially include, but are not limited to, matters identified throughout this 2012 annual MD&A.

Please note that forward-looking statements reflect our expectations as at February 13, 2013. 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 annual MD&A and the financial information contained herein have been reviewed by our Audit Committee and approved by our Board of Directors.

EXECUTIVE SUMMARY – CORPORATE PROFILE

THE COMPANY

Manitoba Telecom Services Inc. (“the Company” or “MTS Allstream”) is a leading national communications provider in Canada and the market leader in Manitoba. We provide innovative communications solutions for the way Canadians live and work today, serving all market segments in Manitoba through our MTS subsidiary (“MTS”) and business customers across Canada through our Allstream subsidiary (“Allstream”). Our common shares are listed on the TSX (trading symbol: MBT). The Company’s office is headquartered in Winnipeg, with eight other corporate offices across Canada. Our website is www.mtsallstream.com.



LEADERSHIP

The MTS Allstream leadership team, consisting of key senior executives, is accountable for the Company’s operations, financial results and strategic focus. The team sets the direction for driving us to be the best telecommunications provider in Canada. By leveraging the strength of all of our employees’ entrepreneurial spirit and skills, and maintaining our close customer relationships, the Company as a whole is building on a strong foundation and network, now and for the future. To view more information on our leadership team, please visit www.mts.ca/leadershipteam.

A STRONG FOUNDATION FOR THE FUTURE

MTS Allstream is focused on continually producing solid revenue and customer growth in strategic areas, along with planning to maintain reliable cash flows and improve our customer experience. We are a leading socially responsible corporate citizen with a reputation as a great place to work.

CORPORATE GOVERNANCE – BOARD OF DIRECTORS

MTS Allstream is governed by a Board of Directors (“the Board”) that consists of 10 members who are business and community leaders. The Board has been carefully chosen for nomination in order to maintain its independence and also to ensure that it has a solid base of experience and expertise. The Board is the highest governing authority within the MTS Allstream management structure. The Board’s responsibilities include the following items:

- Review and approval of the Company’s strategic direction, financial objectives and major policy decisions;
- Selection, evaluation, compensation and succession for key management roles;
- Monitoring financial and operational performance, risks, business conduct and ethics and internal auditing controls;
- Effective Board governance and director education and
- Timely and accurate disclosure of shareholder information.

Key awards and recognitions

<p>2012 April ISS Proxy Advisory Services published a positive report, stating “the Board has demonstrated good stewardship of investors’ interests”</p>	<p>November Cited in CCGG’s 2012 Best Practices Guide for Proxy Circular Disclosure</p>	<p>November Manitoba Chambers of Commerce award <i>Lieutenant-Governor’s Award for outstanding contribution by an individual to the community, presented to Board member Gregg Hanson</i></p>
<p>November Board member Carol Stephenson inducted into the London and District Business Hall of Fame</p>	<p>November Board ranked in the top 10 percent in The Globe and Mail’s <i>Board Games 2012</i> and the best Telecom company in the report: Canadian Corporate Governance rankings</p>	<p>Financial Post Manitoba Telecom Services ranked 32nd in total shareholder return for Canadian companies</p>

The Globe and Mail’s corporate ranking reviews publicly-traded companies by board composition, shareholding and compensation, shareholder rights and disclosure. Our high ranking highlights MTS Allstream’s top-performing Board – one which follows and observes some of the best corporate practices and policies. It also emphasizes the consistent performance of our Board, as recognized by the Canadian Coalition for Good Governance in 2011 for having “Best Disclosure of Governance Practices and Approach to Executive Compensation by Small or Mid-Sized Issuer”. For more information on our Board, please visit www.mts.ca/bod or review our annual management proxy and information circular.

Highly-skilled workforce – across Canada

A key factor in our success is our highly-skilled and dedicated workforce of 5,500 fully-engaged employees across Canada. In 2012, 90% of employees demonstrated their commitment to the long-term success of the Company by responding to our employee engagement survey. The survey identified areas of strength, which include:

- Our customer focus
- Communications to staff about strategy and direction
- Keeping our employees engaged and informed about our business

Our 2012 employee engagement Index is above the Canadian National and Global Telecommunications average.

In 2012, 4,495 unique employees took part in nearly 40,000 learning activities, using “My Learning Campus”, which is part of our web-based talent management system. The learning activities included e-learning, instructor-led learning delivered by internal learning professionals, webinars, live and in-person seminars/workshops and outside training.

EXECUTIVE SUMMARY – MTS

MTS – THE UNDISPUTED MARKET LEADER IN MANITOBA

MTS is the leading full-service telecommunications provider for residential and business customers. MTS has the strongest in region distribution and the richest bundling capabilities among its peers, and these are supported by pervasive infrastructure and exceptional brand recognition.

<p>Services</p> <ul style="list-style-type: none"> • Wireless (4G HSPA+/4G LTE, CDMA and Wi-Fi) • High-speed Internet • IPTV • Wireline voice • Home security • Business Services (Data/converged IP/unified communications) 	<p>497,367 Wireless subscribers in Manitoba</p>	<p>193,690 High-speed Internet subscribers in Manitoba</p>	<p>101,550 MTS television subscribers in Manitoba</p>
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We offer a full suite of wireless, high-speed Internet, Internet Protocol television (“IPTV”), wireline voice and home security services together with a complete package of business telecommunication services. Our Manitoba operations rank among the most profitable in Canada, with a 2012 EBITDA margin of 50.5%.

MTS STRATEGIC OBJECTIVE

At MTS, we intend to strengthen our market-leader position by:

- Continuing to invest substantial resources to bring the latest technology to Manitoba;
- Expanding our reach to further communities across the province;
- Improving the way that services can be purchased cost-effectively within a bundle and
- Strengthening our brand recognition through active participation in many important community initiatives.

MTS COMPETITIVE ADVANTAGES

Only 4G LTE network

MTS is the first and only provider of 4G Long Term Evolution (“LTE”) high-speed mobile data in Manitoba.

Network and data reach

Broad and fast wireless networks: Our combined 4G LTE, 4G HSPA+, CDMA and Wi-Fi network coverage to 97% of Manitoba gives us the best wireless network reach in Manitoba. We also have arrangements with other national and international wireless service providers allowing our customers to access cellular and data services outside of Manitoba. We are the only service provider to offer unlimited wireless and data plans in Manitoba.

IPTV provides exceptional quality and varied choices

As at December 31, 2012, 77% of our IPTV customer base is now subscribing to our premium IPTV service, MTS Ultimate TV, which is available to 95% of Winnipeg households, to 98% of Brandon households, to 94% of Portage la Prairie households and to a growing number of homes in nine other communities.

Strength in bundles

MTS owns the home in Manitoba: We offer unique, unmatched bundles, including wireless, television, Internet, home phone and security services. Bundling brings our most attractive offers to our best customers.

Brand recognition, commitment to Manitoba

For more than 100 years, MTS has been at the heart of Manitoba’s economic growth and community life – supported by our exceptional brand recognition in Manitoba. Across Manitoba, we assist nearly 200 community organizations and events by providing value-in-kind services or monetary funding including the MTS sponsored Winnipeg Art Gallery centennial celebrations and the inaugural MTS Digital Media Camp at the Gimli Film Festival, among many other initiatives. MTS also continued its ongoing sponsorship of educational institutions across the province, including the Canadian Museum for Human Rights. We continue to be proud sponsors of the MTS Centre in Winnipeg, home to the Winnipeg Jets. In 2012 we became the exclusive telecommunications provider for the new Investors Group Field in Winnipeg, where the Winnipeg Blue Bombers will play in 2013.

MTS DEVELOPMENTS IN 2012

4G LTE wireless network – launched on August 28, 2012

We were the first to launch a 4G LTE wireless network in Manitoba. LTE is currently offered only by MTS in Manitoba, with the fastest network download speeds – up to 75 Mbps – and upload speeds of up to 25 Mbps, ensuring our customers can use their smartphones to the fullest. We plan to expand this network – presently available in Winnipeg and Brandon – to more communities across the province, in 2013.

More advanced services in more homes

Expanding the MTS Fibre-to-the-home (“FTTH”) network into additional communities allows us to provide more customers with the most advanced telecommunications services MTS currently offers, including our innovative MTS Ultimate TV service. The MTS Ultimate TV service is currently available to 95% of Winnipeg households, to 98% of Brandon households, to 94% of Portage la Prairie households and to a growing number of homes in nine other communities served by FTTH technology. In 2012, we expanded FTTH into Neepawa, Minnedosa, Carberry and Killarney.

MyBundle – sets us apart from our peers

MTS customers are able to mix and match the services they want. We bundle their choices into packages which save them the most money. With our industry-leading five-service bundling option, our customers receive the best value. This is the current marketplace standard and remains unmatched by our competition. At December 31, 2012, we had a total of 96,503 bundled customers, which is an 8.5% increase over 2011.

iPhone 5 launch and handset lineup expansion

2012	September 28 iPhone 5	November 23 Sony Xperia™ T	December 13 Samsung Galaxy S III	March 2013 (expected) BlackBerry® Z10
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Financial strength – the numbers tell the story

Strong cost management at MTS with a focus on increasing revenue, resulted in gains in our key metrics. 2012 highlights are shown in the table below.

2012	Revenues \$980.6 million, up 0.4%	EBITDA \$495.5 million, up 1.1%	EBITDA margin 50.5%, up 0.3 points
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Key awards and achievements

2012	November 16 SQM Group Customer Care award <i>First Call Resolution improvement award</i>	November 19 Manitoba Customer Contact Association (“MCCA”) awards <i>Eleven Manitoba Excellence in Customer Contact Achievement (“MECCA”) People Awards</i> <i>Two MECCA Organizational Awards, for Training & Development and Performance Management</i>
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EXECUTIVE SUMMARY – ALLSTREAM**ALLSTREAM – THE LEADING COMPETITOR IN THE CANADIAN BUSINESS SECTOR**

Allstream is the largest national communications provider that works exclusively with business customers. A Canadian industry leader in innovative IP-based solutions, Allstream leverages its nationwide high-performance Internet Protocol (“IP”) network to help businesses of all sizes unify the many ways they connect – to better serve their customers, to improve efficiency and productivity and to maximize their payback.

IP-based solutions	1 of only 3	2,723	30,000 km+
<ul style="list-style-type: none"> • IP connectivity • Unified communications • Security and hosting services 	Truly national providers in business markets	IP fibre connected buildings	National IP fibre network with 8 U.S. network access points

At Allstream, we are a strong competitor in the Canadian telecommunications market with IP revenues of \$243.6 million in 2012. We connect businesses across our nation with our extensive national IP network that spans over 30,000 kilometres and that has a presence in a total of 2,723 buildings (up 335 buildings over last year).

ALLSTREAM STRATEGIC OBJECTIVES

Our key strategic objectives at Allstream are to:

- Improve our profitability and margins by exiting low-margin legacy business and shifting to high-margin businesses such as IP-based products that are delivered on our network;
- Expand our on-net footprint through the targeted build of our national network to key buildings in major cities across Canada and
- Improve cost efficiencies across all areas of the business.

STRATEGIC REVIEW

The strategic review process announced on September 13, 2012 is ongoing. The Company does not intend to disclose any developments with respect to this strategic review process until such time as the Board of Directors approves a particular course of action or otherwise determines that further disclosure is appropriate or required. There is no assurance or expectation that any changes will be made as a result of this process.

ALLSTREAM COMPETITIVE ADVANTAGES**Allstream Service Guarantee**

What our customers get from Allstream is a commitment for predictable and personalized service, with a guarantee that we will stand behind this promise. To support this claim Allstream recently introduced the Allstream Service Guarantee,

a unique proposal in the industry. If we falter in this assurance to our clients, we will give the client a month of free service – proof that we keep our promises and are accountable. In 2012, an independent market research company surveyed both Allstream customers and non-customers/prospects located in or near Allstream's network. As a result, the year-end 2012 national Relative Customer Value score of 113% (World Class) is 5 points higher than both the target and the 2011 score of 108%.

Network structure and reach

Allstream is the only national communications provider focused exclusively on serving Canadian business. We are able to leverage our multi-billion-dollar investment in our extensive IP network, along with the popularity of IP-based products in the Canadian business marketplace.

ALLSTREAM DEVELOPMENTS IN 2012

National fibre footprint growth – 335 new buildings connected in 2012

Allstream's targeted expansion approach maximizes momentum created by the popularity and growth of IP-based products in the Canadian business marketplace. We have 2,723 buildings now connected to our fibre network. This focused smart-growth approach has supported our drive to deliver value to all business markets, while growing our target market.

Year-over-year EBITDA increase

We have worked hard to keep Allstream's financial performance in line with our strategic objectives. As a key measure of operating success, our ninth consecutive quarter of year-over-year EBITDA growth is pushing the company's financials in the right direction. In 2012, EBITDA grew 6.3% over 2011.

Cost structure

Growth can sometimes spur higher-than-expected costs. At Allstream, our mandate is to keep those costs in check. Our operating approach – to optimize and grow the business while having a strong handle on our cost structure – saw us realize annualized savings of \$24 million in 2012.

Key awards and achievements

<p>2012 and 2013</p>	<p>May 3 Allstream achieves Cisco Master Managed Services Certification</p>	<p>May 24 Allstream wins Cisco® Collaboration Partner Award for Canada</p>	<p>July 19 Allstream earns Mitel's 2012 Canadian Channel Partner of the Year Award</p>	<p>November 15 Supplier Recognition Award of Excellence from NAV CANADA <i>This award acknowledges Allstream's outstanding support to NAV CANADA's Operations and Air Traffic Management System in 2011.</i></p>	<p>January 24, 2013 Allstream achieves Cisco Cloud certification</p>
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EXECUTIVE SUMMARY – 2012 IN REVIEW

2012 IN REVIEW***First quarter***

- MTS begins offering a comprehensive wireless protection program.
- MTS Allstream announces a favourable Court of Appeal ruling regarding pension lawsuit.
- MTS Allstream opens trading session on the TSX.
- MTS and True North launch mobile Winnipeg Jets app.

Second quarter

- Allstream introduces Allstream Service Guarantee.
- Allstream wins Cisco® Collaboration Partner Award for Canada.
- MTS becomes the exclusive provider of telecommunications services at the new Winnipeg Blue Bombers stadium.
- Allstream achieves Cisco Master Managed Services Certification.
- AAA Alarms celebrates 50 years of providing full-service residential and business security.
- MTS Ultimate TV Personal Video Recorder (“PVR”) set-top boxes earn Energy Star rating.
- MTS employee receives Canadian Women in Communications Leadership Excellence Award.
- MTS Allstream welcomes the Government’s decision to increase investment and innovation in Canadian telecommunications.
- 100,000th customer signs-up for MTS TV.

Third quarter

- MTS is first to offer 4G LTE in Manitoba.
- MTS offers the iPhone 5.
- The Company announces a strategic review of Allstream in response to changes in foreign investment rules.
- Allstream earns Mitel’s 2012 Canadian Channel Partner of the Year Award.
- MTS employee receives National Award for Achievement in Business Continuity Management.

Fourth quarter

- Shared Services Canada selects MTS Allstream to deliver and manage its MPLS network: a \$55-million contract.
- MTS adds Sony Xperia™ T and Samsung Galaxy S III to its handset lineup.
- MTS FTTH network now available in the Manitoba communities of Neepawa, Carberry, Minnedosa and Killarney.
- MTS completes final partnership payment to Norway House Cree Nation.
- MTS Customer Service Team receives an SQM Group Customer Care award and 13 MCCA awards.
- Allstream wins NAV CANADA’s Supplier Recognition Award of Excellence.
- Supreme Court announces it will hear appeal regarding pension lawsuit.
- MTS publicizes agreement to offer mobile commerce to Manitobans in 2013.

January 2013

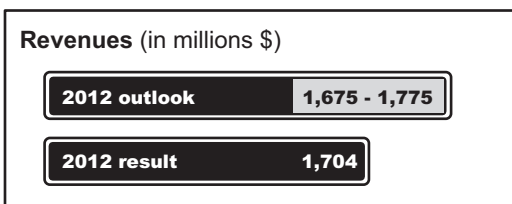
- MTS and its advertising agency DARE win two Canadian Advertising Success Stories silver medals recognizing the Morty the Bison advertising campaign.
- MTS announces it will make BlackBerry Z10 smartphones available to customers in March 2013.
- MTS volunteer liaison presented with the Queen Elizabeth II Diamond Jubilee medal.
- Allstream achieves Cisco Cloud certification.

February 2013

- MTS makes \$70-million prefunded pension solvency payment.

EXECUTIVE SUMMARY – 2012 FINANCIAL SCORECARD

2012 FINANCIAL SCORECARD – MET ALL KEY PERFORMANCE INDICATORS



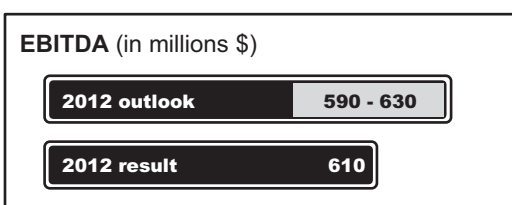
2012 Outlook \$1,675 to \$1,775 million

2012 Result \$1,704 million

2012 Score Met

2011 Result \$1,766 million

- Wireless data revenues up by 29.7%
- IPTV revenues up by 11.2%
- Allstream converged IP revenues up by 1.6%
- Internet revenues up by 8.4%



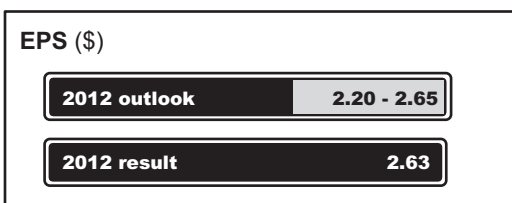
2012 Outlook \$590 to \$630 million

2012 Result \$610 million

2012 Score Met

2011 Result \$594 million

- MTS Allstream EBITDA up by 2.5%
- MTS EBITDA up by 1.1%
- Allstream EBITDA up by 6.3%



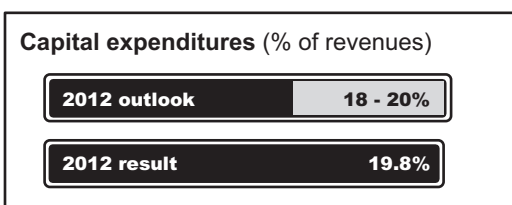
2012 Outlook \$2.20 to \$2.65

2012 Result \$2.63

2012 Score Met

2011 Result \$2.55

- EPS up by 3.1%
- Diligent cost management lowered operating expenses
- Decrease in income tax expense



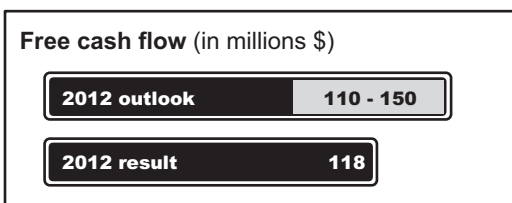
2012 Outlook 18% to 20% of revenues

2012 Result 19.8% of revenues

2012 Score Met

2011 Result 16.3% of revenues

- Capital expenditures up by 17.4% to \$338.0 million
- Increase due to wireless billing system upgrades, MTS FTTH and 4G LTE network builds, Allstream IP fibre network expansion and a lower Scientific Research & Experimental Development ("SR&ED") investment tax credit ("ITC") in 2012 over 2011



2012 Outlook \$110 to \$150 million

2012 Result \$118 million

2012 Score Met

2011 Result \$130 million

- Free cash flow down by 9.4%
- Decrease mainly due to capital investment
- Partly offset by EBITDA growth, lower pension funding

DISCUSSIONS OF OPERATIONS – CONSOLIDATED RESULTS

CONSOLIDATED STATEMENTS OF INCOME

<i>(in millions \$, except EPS and weighted average shares outstanding)</i>	2012	2011	% change
Operating revenues	1,704.1	1,765.6	(3.5%)
Operations expense	1,094.6	1,171.2	(6.5%)
EBITDA	609.5	594.4	2.5%
Depreciation and amortization	322.8	298.9	8.0%
Other (expense) income	(1.1)	2.5	n.a.*
Finance costs	(60.2)	(65.5)	(8.1%)
Income before income taxes	225.4	232.5	(3.1%)
Income tax expense	50.0	65.4	(23.5%)
Net income for the year	175.4	167.1	5.0%
Other comprehensive loss for the year, net of tax	(76.9)	(143.1)	(46.3%)
Total comprehensive income for the year	98.5	24.0	n.a.
Weighted average shares outstanding ¹ (in millions)	66.6	65.5	1.7%
EPS	\$2.63	\$2.55	3.1%

¹ Increases in the number of weighted average shares outstanding are mainly due to participation in our dividend re-investment program.

* Not applicable

Operating revenues

<i>(in millions \$)</i>	2012	2011	% change
MTS	980.6	976.3	0.4%
Allstream	758.2	825.7	(8.2%)
Intersegment eliminations	(34.7)	(36.4)	(4.7%)
Total operating revenues	1,704.1	1,765.6	(3.5%)

Total operating revenues were down by 3.5% in 2012 due to legacy revenue declines, including \$33.3 million in planned legacy reductions at Allstream. This decrease was partly offset by growth in IP revenues at Allstream and revenues from strategic lines of business at MTS.

Operations expense

Operations expense decreased by \$76.6 million in 2012 compared to 2011, due to a 16.9% decrease in direct costs, operational efficiency initiatives completed in previous periods and cost structure improvements at Allstream.

As of December 31, 2012, we achieved annualized cost savings of \$33.6 million as a result of operational efficiency programs mainly associated with legacy product lines.

EBITDA

<i>(in millions \$)</i>	2012	2011	% change
MTS	495.5	490.1	1.1%
Allstream	115.3	108.5	6.3%
Other	(1.3)	(4.2)	(69.0%)
Total EBITDA	609.5	594.4	2.5%

MTS Allstream's 2012 EBITDA increased to \$609.5 million, largely attributed to a decrease in direct costs and less operating expense.

At MTS, EBITDA was up \$5.4 million due to higher revenues from the wireless, IPTV and high-speed Internet lines of business, partly offset by a decrease in revenues from legacy lines of business. MTS achieved an EBITDA margin of 50.5% in 2012, up from 50.2% in 2011.

Allstream's EBITDA in 2012 was up \$6.8 million year over year, mainly due to IP revenue growth, lower direct costs and lower operations expense, compared to the prior year. Allstream's 2012 gross margin increased to 59.5%, up from 55.3% in 2011. Direct costs decreased by 16.9%, while revenues were lower by 8.2%.

Depreciation and amortization expense

Depreciation and amortization expense in 2012 increased by \$23.9 million in comparison to 2011. This increase was mainly due to a \$10.3-million adjustment to SR&ED ITC recoveries recorded in 2011, a greater count of assets in service and higher amortization of wireless costs of acquisition, related to increased demand for smartphones.

Other (expense) income

Other expense was \$1.1 million in 2012, compared to other income of \$2.5 million in 2011. This decrease was mainly due to the one-time recovery of the previous year's expenditures in the first quarter of 2011.

Finance costs

Finance costs decreased by \$5.3 million in 2012, due to lower debt levels and rates during the year.

Income tax expense

In 2012, our income tax expense decreased by \$15.4 million. The decrease was due to a favourable \$10.2-million impact resulting from a change in the expected tax rate applicable to deferred tax assets recorded in the first quarter of 2012 and a \$1.5-million favourable impact on deferred tax assets resulting from provincial statutory tax rate changes in 2012.

The Company continues to have substantial capital cost allowance pools, tax losses and investment tax credits, which we expect will fully offset our taxable income and eliminate cash income taxes until at least 2019. The present value of our tax asset is approximately \$300 million.

Net income and EPS

In 2012, our net income and EPS increased by \$8.3 million and \$0.08, respectively, when compared to 2011. The increases were mainly due to EBITDA growth and decreased finance and income tax costs, partially offset by higher depreciation and amortization expense and increased other expenses.

Other comprehensive loss

Other comprehensive loss represents net actuarial losses arising from changes in the present value of our defined-benefit plans' obligations and in the fair value of our defined-benefit plans' assets. These items are recognized in other comprehensive income net of tax, and therefore do not have an impact on net income or EPS.

DISCUSSION OF OPERATIONS – MTS

MTS LINES OF BUSINESS

MTS has six lines of business, each of which is described below. The following pages then provide an analysis of the results for each line of business on a year-over-year basis.

Wireless services

Steady, constant demand for high-speed wireless data should push strong growth in wireless revenues

MTS's wireless portfolio for residential and business customers consists of cellular, wireless data, paging and group communications. Our market share and combined 4G LTE, 4G HSPA+, CDMA-EVDO and Wi-Fi hotspot network demonstrates that we are the market leader, with the best wireless network reach in the province. Our network coverage is available to 97% of Manitobans. We are the first and only 4G LTE provider – this advanced network is capable of delivering download speeds of up to 75 Mbps and upload speeds of 25 Mbps, ensuring our customers can use their smartphones to the fullest. To view the map of our wireless network coverage, visit www.mts.ca/mts/personal/wireless/coverage+and+roaming.

Broadband and converged IP services

Broadband network reach continues to expand

Broadband and converged IP services include revenues earned from providing high-speed Internet and IPTV services to residential customers, as well as IP-based connectivity to business customers.

Broadband network reach	84% of Manitoba homes have access to MTS high-speed Internet services
VDSL/FTTH network reach	Over 95% of Winnipeg and Brandon homes, available in ten other Manitoba communities
2012 FTTH market expansion	Launched in four additional communities
2013 FTTH market schedule	Three more communities planned
FTTH coverage	21,937 homes were passed by FTTH (as of December 31, 2012)

Unified communications, security and monitoring services

Consistent growth achieved

Revenues for this line of business are earned from the sale of IP telephony products and services to business customers in Manitoba and nationally, along with our IP-based security offerings to national business customers. For certain customers, the ability to offer integrated security and equipment services is important for winning their business. This business line also includes revenues earned from the installation and monitoring of alarm services to residential, business and industrial customers.

Local access services

Quality sets us apart

Our local access services include revenues earned from the sale of residential and business voice connectivity including calling features (such as Call Answer, Call Display, Call Waiting and 3-Way Calling), payphone revenue, wholesale revenues from services provided to third parties and contribution revenues. The quality of our local wireline connection remains a competitive differentiator in the success of our voice services operations. It is a strategic entry point into customer premises for high-growth services, including high-speed Internet and IPTV.

Long distance and legacy data services

Enhanced long distance services and features

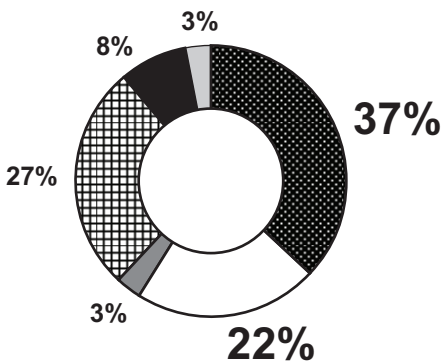
Long distance and legacy data services include revenues earned from long distance calling charges along with the marketing of networking and related products and services to our business customers. At MTS, long distance services enable residential customers in Manitoba and business customers across Canada to communicate with destinations outside their 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, a dial-around service and audio conferencing, as well as a variety of enhanced long distance services and features.

Other

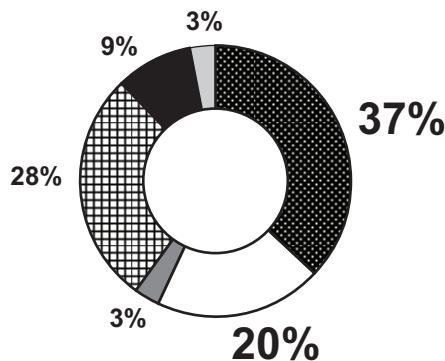
Other services include revenues earned from intersegment transactions, customer late payment charges, facilities rental and other miscellaneous items.

MTS FINANCIALS

2012 MTS revenue mix



2011 MTS revenue mix

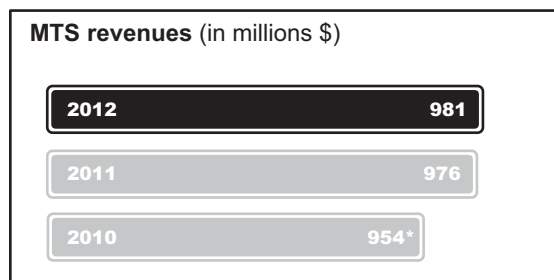


In challenging economic conditions and increased competitive pressure, MTS generated an increase in revenues from growth services (wireless and broadband) in 2012.

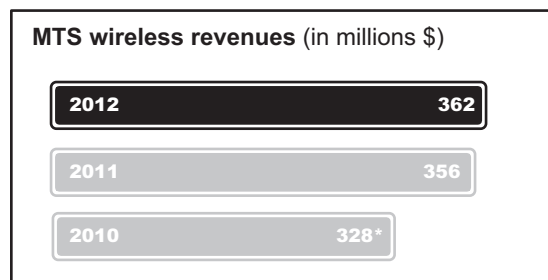


MTS OPERATING REVENUES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Wireless services	362.1	356.3	1.6%
Broadband and converged IP services	212.9	195.3	9.0%
Unified communications, security and monitoring services	36.2	35.0	3.4%
Local access services	266.5	277.3	(3.9%)
Long distance and legacy data services	76.1	84.1	(9.5%)
Other services	26.8	28.3	(5.3%)
Total MTS operating revenues	980.6	976.3	0.4%



* Estimated

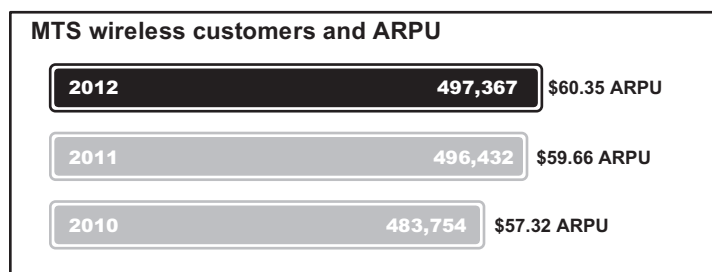


* Estimated

MTS OPERATING REVENUES – DESCRIPTION**WIRELESS SERVICES**

<i>(Revenues in millions \$)</i>	2012	2011	% change
Wireless revenues	362.1	356.3	1.6%
Wireless data revenues	116.3	89.7	29.7%
Wireless ARPU	\$60.35	\$59.66	1.2%
Wireless data ARPU	\$19.69	\$15.28	28.9%
Post-paid subscribers with data plans (as at December 31, 2012)	229,478	173,837	32.0%
Total post-paid subscribers	402,824	390,889	3.1%
Total wireless subscribers	497,367	496,432	0.2%

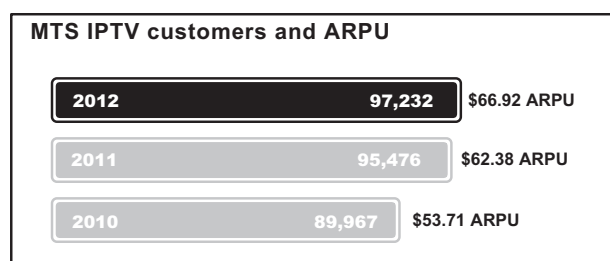
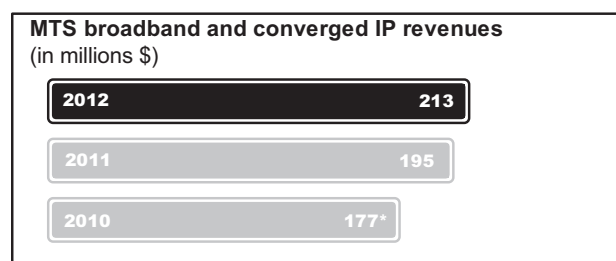
Wireless revenues increased, driven by a 29.7% increase in wireless data revenues. The increase in year-to-date wireless average revenue per user (“ARPU”) was due to higher wireless data ARPU, which was up 28.9% over the same period in 2011. The increase of 11,935 post-paid customers partly offset a decrease in pre-paid and wholesale customers. Wireless costs of acquisition for 2012 were \$2.3 million lower when compared to 2011, reflecting pent-up demand for smartphones as a result of the 4G HSPA+ wireless network launch and the introduction of the iPhone 5 earlier that year.



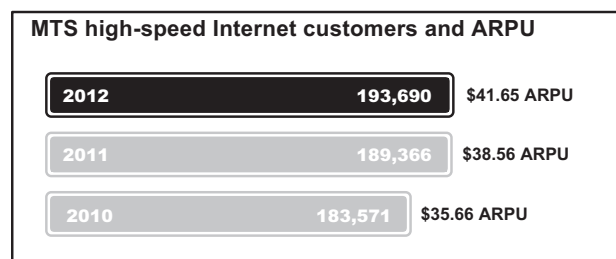
BROADBAND AND CONVERGED IP SERVICES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Broadband and converged IP revenues	212.9	195.3	9.0%
IPTV revenues	78.5	70.6	11.2%
Internet revenues	110.1	101.6	8.4%
IPTV services ARPU	\$66.92	\$62.38	7.3%
Total television customers (as at December 31, 2012)	101,550	99,865	1.7%
Television customers with IPTV service (as at December 31, 2012)	97,232	95,476	1.8%
High-speed Internet subscribers (as at December 31, 2012)	193,690	189,366	2.3%

Strong growth from IPTV, high-speed Internet and converged IP drove the increases in broadband and converged IP revenue.



* Estimated

**IPTV services revenues**

The increase in revenues from IPTV services was due to year-over-year ARPU and subscriber growth. ARPU for IPTV services increased when compared to 2011, mainly due to fewer subscribers on promotional plans, more premium television service subscribers and price increases. At December 31, 2012, MTS had a total of 101,550 television customers, of which 97,232 are higher-ARPU IPTV subscribers, representing a year-over-year increase of 1.8% in IPTV customers. Despite aggressive peer promotions, our television subscriber base continues to grow. Of MTS's IPTV customers, 77% subscribe to our premium IPTV service – Ultimate TV, which generates higher ARPU when compared to our Classic TV service.

High-speed Internet revenues

Revenues from high-speed Internet were higher due to fewer subscribers on promotional plans and to price increases. At December 31, 2012, our high-speed Internet subscriber base was 193,690, an increase of 2.3% over 2011. This increase was reached despite intensified peer promotional plans.

UNIFIED COMMUNICATIONS, SECURITY AND MONITORING SERVICES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Unified communications revenues	23.9	22.7	5.3%
Security and monitoring	12.3	12.3	—

Unified communications, security and monitoring services revenues

The increase in unified communications revenues reflects rising demand for these services.

LOCAL ACCESS SERVICES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Local access revenues	266.5	277.3	(3.9%)

Local access services revenues

Local access revenues were \$266.5 million, down 3.9% in 2012, mainly due to price changes on features and to line losses from wireless substitution and some local competition.

LONG DISTANCE AND LEGACY DATA SERVICES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Long distance revenues	44.4	50.1	(11.4%)
Legacy data revenues	31.7	34.0	(6.8%)

LD and legacy data services revenues

Long distance revenues were down due to customer migration to lower-priced long distance plans and reduced volumes, as customers continue to replace long distance calling with alternative methods of communication, such as email, text messaging and social networking.

Legacy data services revenues decreased as customers continue to migrate towards converged IP services.

OTHER SERVICES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Other revenues	26.8	28.3	(5.3%)

Other services revenues

Other services revenues were down \$1.5 million in 2012, mostly due to a one-time retroactive rate increase in facilities rental resulting from CRTC Ruling 2010-900, which affected the first quarter of 2011.

DISCUSSION OF OPERATIONS – ALLSTREAM**ALLSTREAM LINES OF BUSINESS**

Allstream has five lines of business, each of which is described below. The following pages then provide an analysis of the results for each line of business on a year-over-year basis.

Converged IP services***Demand for on-net IP network services continues to drive sales***

Allstream's Business IP virtual private network ("VPN") service provides business organizations with a connectivity solution that enables growth and expansion to any location, while reducing costs and increasing productivity. Converged IP services include revenues earned from the provision of IP-based networking and related products and services to business customers nationally. To read more about our national IP fibre network, visit www.allstream.com/about-us/ipnetwork.

Unified communications, hosting and security services***Helping customers share vital data and expertise***

Unified communications, hosting and security services include revenues earned from the provision of IP-related telephony products and services, along with revenues from IP-based security offerings to national business customers.

Local access services***Keeping your business properly connected***

Local access services include revenues earned for the provision of business voice connectivity, including calling features, to national business and wholesale customers.

Long distance and legacy data services***Providing telecommunications links to the people you need to stay in touch with – wherever they are***

Long distance and legacy data services include revenues earned from the provision of long distance calling, along with legacy data services such as private line networks, to business customers nationally.

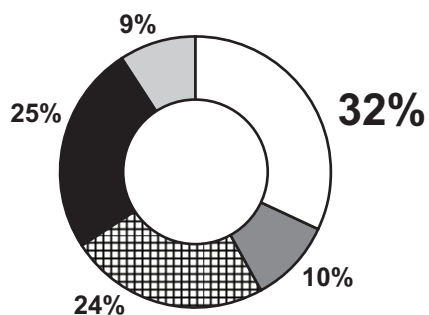
Other

Offering easy access and reliable service

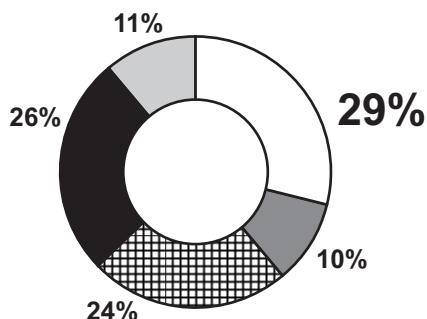
Other services include revenues earned from intersegment transactions, the routing and exchange of long distance network traffic, customer late payment charges and other miscellaneous items.

ALLSTREAM FINANCIALS

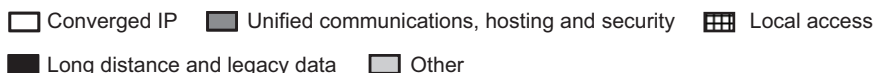
2012 Allstream revenue mix



2011 Allstream revenue mix

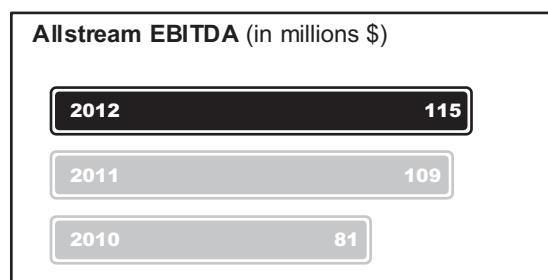
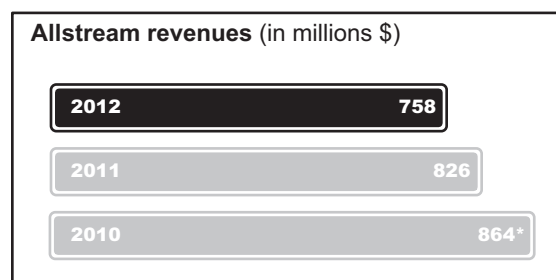


Revenues from converged IP now account for 32% of Allstream's operating revenues in 2012.



ALLSTREAM OPERATING REVENUES

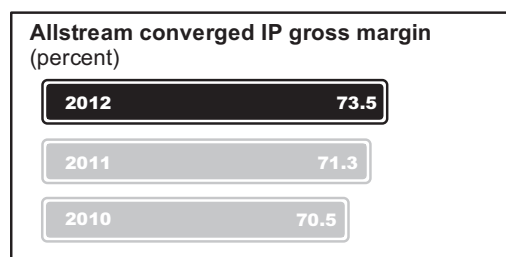
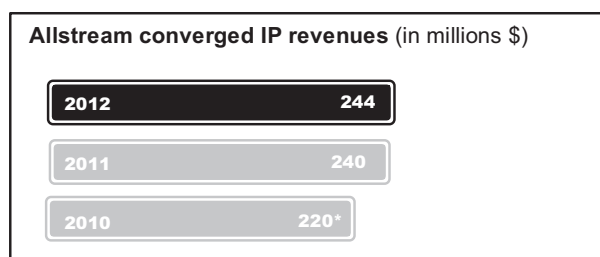
(Revenues in millions \$)	2012	2011	% change
Converged IP services	243.6	239.8	1.6%
Unified communications, hosting and security services	78.3	86.7	(9.7%)
Local access services	179.7	196.6	(8.6%)
Long distance and legacy data services	186.0	210.9	(11.8%)
Other services	70.6	91.7	(23.0%)
Total Allstream operating revenues	758.2	825.7	(8.2%)



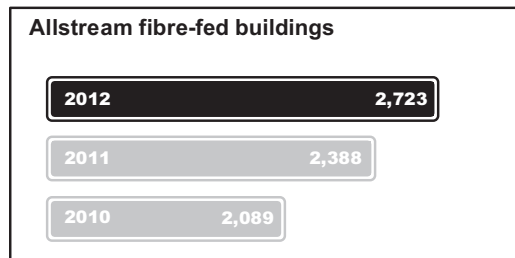
* Estimated

ALLSTREAM OPERATING REVENUES DESCRIPTION**CONVERGED IP SERVICES**

<i>(Revenues in millions \$)</i>	2012	2011	% change
Converged IP revenues	243.6	239.8	1.6%
Converged IP gross margin	73.5%	71.3%	2.2 pts
Fibre-fed buildings	2,723	2,388	14.0%



* Estimated



Allstream's converged IP revenue growth continues to be partly offset by an increase in disconnects related to a Government of Ontario department's decision to change its policy on the procurement of telecommunications services for individual doctors' offices and clinics. Adjusting for the impact of this contract, converged IP revenues would have grown 6.5% in 2012. IP revenues will continue to be affected by this contract reduction in 2013. However, the multi-year contract signed with Shared Services Canada ("SSC"), at the end of 2013 is one of the largest ever for the company and over time will contribute significant IP revenues.

Converged IP gross margins also continued to grow – 73.5% in 2012 compared to 71.3% in 2011. Allstream is extending and connecting more multi-tenant office buildings to its fibre network. In 2012, the number of Allstream fibre-fed buildings grew to 2,723, up by 335 over 2011.

UNIFIED COMMUNICATIONS, HOSTING AND SECURITY

<i>(Revenues in millions \$)</i>	2012	2011	% change
Unified communications, hosting and security	78.3	86.7	(9.7%)

Unified communications, hosting and security services revenues declined due to a decrease in one-time product sales and management's shift away from stand-alone low-margin security product sales, partly offset by an increase in hosting revenue.

LOCAL ACCESS SERVICES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Local access revenues	179.7	196.6	(8.6%)

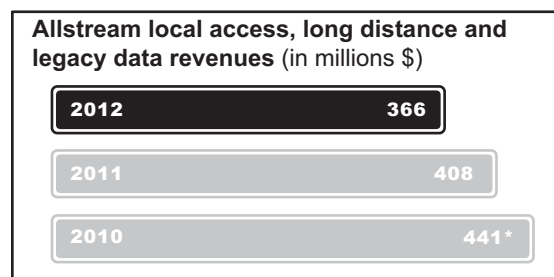
Local access revenues declined, primarily due to decreases in resold wholesale voice lines, as per Allstream's strategy of focusing on services delivered on its network and exiting low-margin lines of business. These decreases were partly offset by price increases.

LONG DISTANCE AND LEGACY DATA SERVICES

<i>(Revenues in millions \$)</i>	2012	2011	% change
Long distance revenues	91.8	106.7	(14.0%)
Legacy data revenues	94.2	104.2	(9.6%)

Revenues from long distance services decreased, mainly due to reduced volumes in the domestic, cross-border and international markets, along with lower domestic, cross-border and international rates.

The legacy data revenue decrease was mainly due to Allstream customers' continued transition to broadband and other IP-based services. Allstream continues to implement its strategy of improving profitability by reducing costs and transitioning customers to IP-based service.



* Estimated

SELECTED ANNUAL AND QUARTERLY FINANCIAL INFORMATION**SELECTED ANNUAL INFORMATION**

<i>(in millions \$, except EPS and cash dividends declared per share)</i>	2012	2011	2010
Operating revenues	1,704.1	1,765.6	1,782.6
Net income	175.4	167.1	141.3
Total assets	2,732.3	2,681.5	2,630.6
Total long-term debt, including current portion	921.9	1,020.8	1,040.6
Basic and diluted EPS	\$2.63	\$2.55	\$2.18
Cash dividends declared per share	\$1.70	\$1.70	\$2.15

Over the past three years, operating revenues have reflected improvements in our strategic growth areas, which include MTS's wireless, high-speed Internet and IPTV services, as well as Allstream's converged IP services, offset by declines in legacy telecommunications services. Since 2010, our revenue mix has changed favourably through our focus on generating revenues from high-margin lines of business and on deliberately exiting low-margin lines of business.

From 2011 to 2012, net income and EPS increased mainly due to EBITDA growth, decreased finance and income tax costs, partially offset by higher depreciation and amortization expense and increased other expenses. The increases in net income and EPS from 2010 to 2011 were mainly due to EBITDA growth and an increase in other income, partially offset by higher depreciation and amortization expense, increased income taxes, and higher finance costs.

Total assets have increased slightly over the past three years, due to an increase in fibre-to-the-home network assets in 2011 and an increase in intangible software capital in 2012. Long-term debt decreased from 2010 to 2011 due to the repayment of a \$220-million medium-term note being partially offset by the issuance of a \$200-million medium-term note. Long-term debt declined from 2011 to 2012 due to the repayment of a \$100-million medium-term note.

In the first two quarters of 2010, the Company's quarterly dividend as approved by the Board was \$0.65 per outstanding common share. On August 6, 2010, the Board approved an update to the Company's 2010 financial outlook, and set a new dividend payout ratio target of 70% to 80% of free cash flows from its Manitoba operations. As a result, the Board of Directors declared the quarterly dividends of \$0.425 per outstanding common share for the third and fourth quarters of 2010, which continued for all four quarters in 2011 and 2012.

CONSOLIDATED FINANCIAL RESULTS*(in millions \$, except EPS and weighted average shares outstanding)*

	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Operating revenues	413.1	424.3	431.6	435.1	439.4	443.2	443.7	439.3
EBITDA	150.3	151.7	153.5	154.0	146.9	146.9	150.8	149.8
Net income	37.0	40.8	44.5	53.1	36.9	37.0	49.8	43.4
Weighted average shares outstanding ¹	67.0	66.7	66.4	66.2	65.9	65.7	65.4	65.2
EPS	\$0.55	\$0.61	\$0.67	\$0.80	\$0.56	\$0.56	\$0.76	\$0.67

¹ The increase in the number of weighted average shares outstanding is mainly due to participation in our dividend re-investment program.

SELECTED QUARTERLY FINANCIAL RESULTS

Our consolidated financial results for the last eight quarters (Q1 2011 to Q4 2012) reflected the following significant transactions and trends:

- Over the last eight quarters, operating revenues reflected strong growth in strategic services and declines in total legacy services revenues. We have seen an increase in demand for IP-based telecommunications services.
- Over the past several years, we have continued to improve our cost structure through operational efficiencies and restructuring initiatives. Since 2005, we have achieved nearly \$400 million in total cost savings. Restructuring costs related to these ongoing cost reduction initiatives resulted in decreases in EBITDA, offset by the savings from these initiatives. In 2011, restructuring expenses were \$1.4 million in the third quarter and \$5.3 million in the fourth quarter. In 2012, restructuring expenses were \$2.0 million in the fourth quarter.
- In the first quarter of 2012, a change in the expected tax rate applicable to deferred tax assets resulted in a one-time \$10.2-million decrease in income tax expense.
- In the second quarter of 2011, we recognized \$20.7 million of additional SR&ED recovery due to completion of the Canada Revenue Agency's ("CRA") audit for the 2005 to 2008 taxation years. The impact of the SR&ED recovery reduced depreciation expense by \$10.3 million in the second quarter of 2011, which was partially offset by an income tax expense of \$2.7 million, resulting in an increase to net income of \$7.6 million, or \$0.12 per share.

FOURTH QUARTER IN REVIEW**FOURTH-QUARTER CONSOLIDATED FINANCIAL RESULTS***(in millions \$, except EPS)*

	Q4 2012	Q4 2011	% change
Revenues	413.1	439.4	(6.0%)
EBITDA	150.3	146.9	2.3%
Earnings per share ¹	\$0.55	\$0.56	(1.8%)
Capital expenditures/revenues	17.8%	19.3%	1.5 pts
Free cash flow	37.1	18.3	102.7%

¹ EPS is based on weighted average shares outstanding of 67.0 million and 65.9 million for the three months ended December 31, 2012 and December 31, 2011, respectively. The increase in the number of weighted shares outstanding is mainly due to participation in the Company's dividend re-investment program.

FOURTH-QUARTER CONSOLIDATED FINANCIAL RESULTS DESCRIPTION**Revenues**

Fourth-quarter consolidated revenues were in line with expectations, down \$26.3 million or 6.0% when compared to the fourth quarter of 2011.

EBITDA

MTS Allstream's fourth-quarter EBITDA of \$150.3 million increased \$3.4 million year over year primarily due to improving margins at Allstream, improvements to our cost structure, as well as lower restructuring expenses and other costs.

At MTS, the \$1.9-million decrease in EBITDA was mainly due to lower revenues. At Allstream, the \$5.2-million, or 21.5% increase in EBITDA was mostly due to improved margins and lower operating costs. At Allstream, we continued to direct our efforts toward increasing mid-market on-net IP revenues instead of low-margin, off-net and legacy revenues.

Net income and EPS

At MTS Allstream, net income was in line with the fourth quarter of 2011, having increased by \$0.1 million. EPS decreased by \$0.01 in the fourth quarter of 2012 compared to the same period of 2011. The increase in net income is mostly attributable to EBITDA growth, partially offset by higher depreciation and amortization expense. The fourth-quarter EPS decrease was due to an increase in the weighted average shares outstanding.

Capital expenditures

Capital expenditures decreased \$11.0 million in the fourth quarter of 2012 over the prior year, mainly due to the majority of capital investments having been made earlier in 2012, such as upgrades to the wireless billing system and the 4G LTE wireless network build at MTS, and IP fibre network expansion at Allstream.

Free cash flow

At MTS Allstream the \$18.8-million rise in free cash flow in the fourth quarter of 2012 reflects an increase in EBITDA, a decrease in capital expenditures and a decrease in deferred wireless cost of acquisition in the fourth quarter of 2012.

MTS FOURTH-QUARTER OPERATING REVENUES

<i>(Revenues in millions \$)</i>	Q4 2012	Q4 2011	% change
Wireless services	89.9	92.8	(3.1%)
Broadband and converged IP services	53.3	50.7	5.1%
Unified communications, security and monitoring services	9.2	9.5	(3.2%)
Local access services	65.4	68.6	(4.7%)
Long distance and legacy data services	18.9	20.5	(7.8%)
Other services	6.8	7.1	(4.2%)
Total MTS operating revenues	243.5	249.2	(2.3%)

MTS FOURTH-QUARTER FINANCIAL HIGHLIGHTS

Wireless services

Wireless revenues at MTS decreased by \$2.9 million in the fourth quarter, mostly due to a decline in wholesale wireless revenues. This decrease was partly offset by strong wireless data revenue growth. Roaming and resale revenues decreased due to competitors migrating their own wireless customers away from CDMA service provided on MTS's network onto their own 4G HSPA+ network in Manitoba.

Broadband and converged IP services

Revenues for broadband and converged IP were up \$2.6 million over the same quarter last year. The increase was largely due to fewer subscribers on promotional plans and a price increase. In 2012, MTS's year-to-date ARPU for high-speed Internet and IPTV services increased by 8.0% and 7.3% to \$41.65 and \$66.92, respectively.

ALLSTREAM FOURTH-QUARTER OPERATING REVENUES

<i>(Revenues in millions \$)</i>	Q4 2012	Q4 2011	% change
Converged IP services	61.0	61.1	(0.2%)
Unified communications, hosting and security services	18.9	20.7	(8.7%)
Local access services	41.6	48.7	(14.6%)
Long distance and legacy data services	44.3	48.8	(9.2%)
Other services	12.5	19.5	(35.9%)
Total Allstream operating revenues	178.3	198.8	(10.3%)

ALLSTREAM FOURTH-QUARTER FINANCIAL HIGHLIGHTS

Converged IP services

Converged IP services revenues decreased by \$0.1 million or 0.2% in the fourth quarter of 2012. This revenue decrease was due in part to disconnections related to a decision by a Government of Ontario department to change its telecommunications services procurement policy for individual doctors' offices and clinics. Adjusting for the impact of this contract, converged IP revenues would have grown 4.9% in the fourth quarter of 2012 when compared to the same period of 2011. Allstream experienced very strong sales in the fourth quarter, including the multi-year contract signed with SSC, the Government of Canada department responsible for providing telecommunication services, email and data centres to its partners. This bodes well for the future.

LIQUIDITY AND CAPITAL RESOURCES

SUMMARY OF CASH FLOWS

<i>(in millions \$)</i>	2012	2011	% change
Cash flows from (used in):			
Operating activities	439.4	386.6	13.7%
Investing activities	(342.5)	(315.0)	8.7%
Financing activities	(126.3)	(104.8)	20.5%
Change in cash and cash equivalents for the year	(29.4)	(33.2)	(11.5%)

Operating activities

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

The increase of \$52.8 million in cash flows from operating activities was mainly due to a reduction in solvency funding resulting from the use of letters of credit, a \$15.0-million decrease in cash flows used in working capital and EBITDA growth of \$15.1 million. The decrease in cash flows used in working capital was mainly due to higher payments on account and higher inventory levels in 2011, both related to the launch of our 4G HSPA+ wireless network earlier that year.

Investing activities

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 increased by \$27.5 million in 2012. This increase was primarily due to various capital projects in 2012, such as our investments in our 4G LTE network, upgrades to our wireless billing system, FTTH deployment and IP fibre network expansion.

Financing activities

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

Cash flows used in financing activities increased by \$21.5 million in 2012. The increase was mainly due to our \$100-million repayment of long-term debt in 2012, offset by the issuance of \$54.5 million in notes payable in 2012, as compared to the increased use of cash in 2011 when we repaid \$220 million of long-term debt while issuing \$200 million of long-term debt in parallel.

In each quarter of 2012, cash dividends of \$0.425 per common outstanding share were paid to shareholders, as approved by the Board. In the second quarter of 2010, we established a dividend re-investment program ("DRIP") with a 3% discount, which enables eligible holders of the Company's common shares to automatically re-invest their regular quarterly dividends in additional common shares of the Company without incurring brokerage fees. Participation in our DRIP remained over 25% throughout 2012, which resulted in \$33.5 million additional cash available for operations.

FREE CASH FLOW

<i>(in millions \$)</i>	2012	2011	% change
Cash flows from operating activities	439.4	386.6	13.7%
Changes in non-cash working capital	16.2	31.2	(48.1%)
Capital expenditures	(338.0)	(288.0)	17.4%
Free cash flow for the year	117.6	129.8	(9.4%)

Free cash flow

Free cash flow decreased \$12.2 million in 2012, mainly due to investments in certain capital projects and to a \$16.2-million net adjustment to the Company's SR&ED recovery recorded in 2011, partly offset by lower required pension solvency funding and EBITDA growth.

CAPITAL MANAGEMENT

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.

CREDIT FACILITIES

<i>(in millions \$)</i>	Utilized at December 31, 2012	Capacity
Medium-term note program	200.0	500.0
Revolving credit facility	119.6	400.0
Additional credit facility	149.3	150.0
Accounts receivable securitization	54.5	110.0
Total	523.4	1,160.0

We renewed our medium-term note program on August 23, 2011 for \$500.0 million and we utilized \$200.0 million of this facility to issue debt in September 2011. We also have a \$400.0-million revolving credit facility, of which we had utilized \$119.6 million at December 31, 2012 for undrawn letters of credit. We also have a \$150.0-million credit facility, which is used solely for the issuance of letters of credit. As at December 31, 2012, we utilized \$149.3 million of this facility for undrawn letters of credit. In addition to these programs and facilities, we have a \$110.0-million accounts receivable securitization program, of which we had utilized \$54.5 million as at December 31, 2012.

Pension solvency funding – letters of credit

Of the \$268.9 million in total letters of credit outstanding, \$235.9 million represent letters of credit issued in accordance with the Pension Benefits Standards Act, 1985 (Canada), which permits the use of letters of credit in lieu of cash funding for solvency special payments to our defined-benefit pension plans, up to 15% of pension plan assets. For 2013, Allstream pension plans will be funded using letters of credit with the Company prefunding \$70 million into the MTS pension plan utilizing existing credit facilities. We plan to replace this short-term borrowing with equity unless there is additional liquidity as a result of the strategic review.

CAPITAL STRUCTURE

<i>(in millions \$)</i>	December 31, 2012	December 31, 2011
Bank indebtedness (cash and cash equivalents)	12.6	(16.8)
Notes payable	54.5	—
Finance lease obligations, including current portion	14.0	15.0
Long-term debt, including current portion	921.9	1,020.8
Total debt	1,003.0	1,019.0
Shareholders' equity	809.1	789.7
Total capitalization	1,812.1	1,808.7
Debt to capitalization	55.4%	56.3%

Our capital structure illustrates the amount of our assets that is financed by debt versus equity. Our debt-to-total-capitalization ratio of 55.4% at December 31, 2012 continues to represent financial strength and flexibility.

CREDIT RATINGS

S&P – Senior debentures	BBB (stable)	DBRS – Senior debentures	BBB (stable)
S&P – Commercial paper	A-2	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 February 6, 2013, S&P confirmed their credit ratings on our long-term corporate credit and senior unsecured debt at "BBB", and also confirmed our commercial paper rating of "A 2". S&P also confirmed its outlook as stable. DBRS confirmed its ratings on December 21, 2012, with our senior debentures at "BBB" and our commercial paper rating of "R 2 (high)". DBRS's outlook remained stable.

OUTSTANDING SHARE DATA

	As at January 25, 2013	As at December 31, 2012
Common shares outstanding	67,269,231	66,994,852
Stock options outstanding	2,950,672	2,950,672
Stock options exercisable	1,838,525	1,838,525

CONTRACTUAL OBLIGATIONS

<i>(in millions \$)</i>	Less than 1 year	1-2 years	2-3 years	3+ years	Total
Long-term debt	—	275.0	—	650.0	925.0
Finance leases	6.5	2.8	2.8	2.9	15.0
Operating leases	57.6	53.1	49.9	271.8	432.4
Purchase obligations	114.4	51.3	16.4	21.5	203.6
Total	178.5	382.2	69.1	946.2	1,576.0

Our long-term debt consists of medium-term notes and a loan payable. We issue medium-term notes and obtain loans payable for general corporate and working-capital purposes, and for financing investments and additions to property, plant and equipment. We have equipment under capital leases. We rent buildings, operating facilities, construction and other equipment under operating leases. Purchase obligations include contractual commitments for services required in the normal course of operations, as well as capital purchase commitments under supply contracts and customer contracts.

FINANCIAL INSTRUMENTS, OFF-BALANCE SHEET ARRANGEMENTS AND OTHER FINANCIAL ARRANGEMENTS**Foreign currency forward contracts**

We use foreign currency forward contracts to manage the foreign currency exposure. These instruments hedge anticipated transactions and are not recorded on our balance sheet. As at December 31, 2012, we had outstanding foreign currency forward contracts to purchase \$26.8 million U.S. On January 2, 2013, we entered into an additional foreign currency forward contract to purchase \$4.5 million U.S. During the year ended December 31, 2012, we recorded a \$0.1-million expense in other income, relating to our accounting policy of adjusting outstanding foreign currency forward contracts from book value to fair value.

Accounts receivable securitization

Under the terms of our accounts receivable securitization program, we have the ability to sell, on a revolving basis, an undivided interest in our accounts receivable to a securitization trust, to a maximum of \$110.0 million. We are required to maintain reserve accounts, in the form of additional accounts receivable over and above the cash proceeds received, to absorb any credit losses on the receivables sold. We are required to maintain certain financial ratios with respect to our accounts receivable, or the cash proceeds must be repaid. We also are subject to certain risks of default which, should they occur, could cause the agreement to be terminated early. As at December 31, 2012, the Company had \$54.5 million outstanding under its accounts receivable securitization program.

2013 OUTLOOK

MTS Allstream's 2013 financial guidance reflects continued improvement on its strategic objectives. MTS Allstream's financial guidance for 2013 is as follows:

2013 FINANCIAL OUTLOOK

<i>(in millions \$, except earnings per share and capital expenditures)</i>	2013 outlook	2012 adjusted results ¹	2012 results	2012 outlook
Revenues	1,630 to 1,730	1,704.1	1,704.1	1,675 to 1,775
EBITDA	590 to 630	585.1	609.5	590 to 630
EPS	\$1.75 to \$2.15	\$2.19	\$2.63	\$2.20 to \$2.65
Capital expenditures/revenues	17% to 19%	19.8%	19.8%	18% to 20%
Free cash flow ²	160 to 200	117.6	117.6	110 to 150

¹ The non-cash impact of International Accounting Standard ("IAS") 19 on reporting of defined benefit pension plans is described earlier in this MD&A, in note 4 of our 2012 consolidated financial statements, and with quarterly adjustments our supplementary information package.

² Free cash flow does not include the \$70 million prefunded MTS pension solvency payment.

MTS Allstream expects consolidated revenues in 2013 to be slightly lower than 2012, as revenue growth from strategic services such as wireless, broadband and converged IP will not fully offset the expected and planned reductions in legacy services.

EBITDA growth in 2013 will come from a combination of cost savings achieved during the prior year and gross margin improvement. The Company plans additional cost reductions in 2013 in the range of \$30 million to \$40 million, having achieved \$33.6 million in cost savings in 2012.

MTS Allstream is anticipating 2013 EPS to be lower than that in 2012 as the favourable impact of EBITDA improvements will be more than offset by higher fixed asset amortization. For comparison purposes, 2012 EPS included \$0.15 for a non-cash tax rate adjustment. When normalized for this tax impact and the effect of IAS 19 changes, 2012 EPS would have been \$2.04.

Total capital spending is expected to be lower in 2013 compared to 2012, due to the completion of several significant capital projects, such as the 4G LTE wireless network launch and improvements to billing systems. The Company's 2013 capital program includes FTTH deployment to three more Manitoba communities and Allstream's success-based IP fibre expansion nationally.

The expected significant increase in 2013 free cash flow over the prior year can be attributed to planned EBITDA increases and lower capital expenditures as noted above.

MATERIAL ASSUMPTIONS

The Company has made a number of material assumptions in preparing its 2013 financial outlook and when making certain forward-looking statements, which include, but are not limited to, the following:

Economic assumptions

- MTS's services are expected to benefit from a Manitoba economy that is forecast to grow in real gross domestic product ("GDP") by 2.1% in 2013, according to Manitoba Finance.
- Allstream assumes that Canadian businesses will remain cautious regarding investments in new telecommunications services, similar to 2012.

Market assumptions

Both MTS and Allstream expect competition in 2013 to be similar to 2012 across all lines of business.

MTS

- MTS expects it will remain the only telecommunications provider in Manitoba that can bundle the full spectrum of consumer telecommunications services such as wireless, IPTV, Internet, home phone, and security. As a result, it expects to be able to maintain market share and churn, as well as grow high-ARPU customers.
- MTS's wireless business will be affected by a decline in wholesale revenues as national providers move their CDMA customers to their own HSPA networks. MTS also anticipates an increase in wireless costs of acquisition in line with wireless revenue growth. A more important presence by Bell Canada in Manitoba, supported by a network footprint covering about 60% of the Manitoba population, is also expected. Other new entrants will not have established a significant presence in Manitoba in 2013.
- Residential local line losses and related revenues will continue to decline at prior years' pace, largely due to wireless substitution.

Allstream

- Allstream expects to benefit from the IP sales contracts won in 2012, with growth in IP revenues expected to be in line with the overall IP market. We will continue to be impacted by the decline associated with the Government of Ontario contract reduction.
- Declines in legacy lines of business are expected to continue at rates similar to those in prior years. We will continue to implement the largely completed planned exits from certain low-margin legacy services in the course of 2013.

Financial assumptions

- We expect to achieve \$30 million to \$40 million in annualized cost reductions through operational efficiency and restructuring efforts.
- Planned reductions to our capital expenditures and operating costs will allow us to continue to successfully grow our businesses.
- The Company assumes that cash debt financing costs will be similar to those in 2012, although IAS 19 will increase the interest expense by approximately \$10 million.

- We will continue to maintain our investment-grade credit rating.
- We have assumed that the Company will not pay cash taxes by utilizing MTS Allstream's substantial CCA pools and available tax losses. The Company is not expected to pay cash taxes before 2019. The Company's effective tax rate is expected to be approximately 27%.
- There will be no material changes to today's regulatory framework.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The preparation of our consolidated financial statements in accordance with IFRS requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. We make these estimates and assumptions based on reasonable methodologies, established processes and comparisons to industry standards. We continuously evaluate these estimates and assumptions, which rely on the use of professional judgment. Because professional judgment involves inherent uncertainty, actual results could differ from our estimates. Each of the accounting estimates and assumptions identified below affects both of our operating segments, except for the estimates relating to our deferred tax assets, which affect our company on a consolidated basis only. Our estimates, assumptions and methods have been applied consistently.

Valuation of accounts receivable

As we expect that a certain portion of receivables from customers will not be collected, we maintain an allowance for doubtful accounts. If circumstances related to specific customers change, economic conditions change or actual results differ from expectations, our estimate of the recoverability of receivables could fluctuate from that provided for in the consolidated financial statements. A change in our estimate could impact bad debt expense and accounts receivable.

Property, plant and equipment

Property, plant and equipment are amortized on a straight-line basis over their estimated period of future benefit. We review these estimates on an annual basis, or more frequently if events during the year indicate that a change may be required. Consideration is given to technological obsolescence, competitive pressures and other relevant business factors. A change in our estimate could impact depreciation expense and the carrying value of property, plant and equipment.

Useful lives of definite-life intangible assets

Intangible assets with a definite useful life are depreciated on a straight-line basis over their estimated period of future benefit. We review these estimates on an annual basis, or more frequently, if events during the year indicate that a change may be required. Consideration is given to customer churn, industry standards and other relevant business factors. A change in estimate could impact amortization expense and the carrying value of definite-life intangible assets.

Goodwill and indefinite-life intangible assets

Goodwill and indefinite-life intangible assets are tested for recoverability on an annual basis or earlier when events or changes in circumstance indicate that the carrying value might not be recoverable. The recoverable amount of each cash-generating unit is determined based on value in use calculations. These calculations require the use of estimates, including our expectations of revenues and operating costs and assumptions of growth rates. A change in our estimates could impact the carrying value of goodwill and indefinite-life intangible assets.

Deferred tax assets

We have deferred tax assets resulting from net operating loss carry-forwards and deductible temporary differences, which, to the extent utilized, will reduce future taxable income. Realization of these deferred tax assets is dependent on our ability to utilize the underlying future deductions against future taxable income. In assessing the carrying value of the deferred tax assets, we make estimates and assumptions of future taxable income using internal management projections, the carry-forward period associated with the deferred tax assets, the nature of income that may be used to realize the deferred tax assets, future tax rates, and ongoing audits by CRA. A change in our assessment of any of these factors could affect the value of our deferred tax asset and related income tax expense. CRA audits are currently underway for the years 2001 to 2008. These audits include a review of loss carry-forwards accumulated by Allstream prior to its acquisition by the Company in 2004.

Decommissioning provisions

When recognizing decommissioning provisions, we are required to make estimates of the probability of retiring assets, the timing and amount of retirement costs and the discount factor applied to determine fair value. Our estimates of probability and the timing and amount of costs are subject to change, and are reviewed annually or more frequently if events during the year indicate that a change may be required.

Employee benefits

We provide pension, supplemental pension and other non-pension employee future benefits to our employees. The determination of benefit expense and benefit obligation associated with employee future benefits requires the use of certain actuarial and economic assumptions, such as the discount rate to measure benefit obligations, the expected rate of return on plan assets, expected future salary increases and future mortality rates. A change in estimate or assumptions could affect benefit expense and the present value of the defined-benefit obligation.

CHANGES IN ACCOUNTING POLICIES

Our consolidated financial statements have been prepared using the same accounting policies as in the previous year except for the following amendment adopted in 2012:

Amendments to IAS 1, *Presentation of Financial Statements*

Effective January 1, 2012, we adopted the amendments to IAS 1, *Presentation of Financial Statements*, issued by the International Accounting Standards Board ("IASB") in June 2011. This amendment requires companies preparing financial statements to group together items within "Other comprehensive income" on the basis of whether they may be reclassified to the "Profit or loss" section of the income statement. These amendments have been adopted and applied in the financial statements used to prepare this MD&A. The application of this amended IFRS has not had any impact on the amounts reported for the current or prior year.

Accounting standards issued but not yet effective

We have not yet adopted certain standards, interpretations to existing standards and amendments which have been issued but are not yet effective. The following is an overview of accounting standard changes that we will be required to adopt in future years:

IFRS 9, *Financial Instruments*

IFRS 9, *Financial Instruments*, issued by the IASB in November 2009 and amended in October 2010, introduces new requirements for the classification and measurement of financial assets and liabilities. IFRS 9 requires all financial assets within the scope of IAS 39, *Financial Instruments – Recognition and Measurement*, to be subsequently measured at amortized cost or fair value, replacing the multiple classification options in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2015, with earlier application permitted.

IFRS 10, *Consolidated Financial Statements*

IFRS 10, *Consolidated Financial Statements*, issued by the IASB in May 2011, provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. IFRS 10 replaces IAS 27, *Consolidated and Separate Financial Statements*, and Standing Interpretations Committee ("SIC") 12, *Consolidation – Special Purpose Entities*. IFRS 10 is to be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

IFRS 11, *Joint Arrangements*

IFRS 11, *Joint Arrangements*, issued by the IASB in May 2011, describes the accounting for arrangements in which there is joint control by focusing on the rights and obligations of the arrangement, rather than on its legal form. IFRS 11 also removes the ability to use proportionate consolidation for joint ventures. IFRS 11 replaces IAS 31, *Interests in Joint Ventures*, and SIC 13, *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*, and is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. When adoption of IFRS 11 requires a change in accounting, the impact of the change is calculated at the beginning of the earliest period presented and the comparative periods are restated.

IFRS 12, *Disclosure of Interests in Other Entities*

IFRS 12, *Disclosure of Interests in Other Entities*, issued by the IASB in May 2011, is a new standard that addresses the disclosure requirements for all interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

IFRS 13, *Fair Value Measurement*

IFRS 13, *Fair Value Measurement*, issued by the IASB in May 2011, replaces the fair value measurement guidance currently dispersed across different IFRS standards with a single definition of fair value and a comprehensive framework for measuring for fair value when such measurement is required under other IFRSs. It also establishes disclosure

requirements about fair value measurements. IFRS 13 is to be applied prospectively and is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

The adoptions of the standards described above are not expected to have a material impact on our results and financial position.

Amendments to IAS 19, *Employee Benefits*

The amended version of IAS 19, *Employee Benefits*, issued by the IASB in June 2011, amends the accounting for pension and other post-employment benefits. Coming into effect on January 1, 2013, IAS 19 changes the method of calculating the net interest component of pension expense and also expands disclosure requirements for defined-benefit pension plans, providing additional information about the characteristics and associated risks of defined-benefit plans.

Had the amended version of IAS 19 been implemented effective January 1, 2012, EPS would have decreased by \$0.44 for the year ended December 31, 2012. The amended standard is not expected to affect our statement of financial position or the statement of cash flows.

REGULATORY DEVELOPMENTS

Regulatory

The telecommunications and broadcast industries in which we operate are federally regulated, pursuant to both the *Telecommunications Act* and the *Broadcasting Act*. The primary regulatory agency we are subject to is the CRTC. The Government, through the Departments of Industry and Canadian Heritage, exercises legislative oversight of the CRTC. We are subject to policy decisions taken by the Government from time to time, as well as any amendments to applicable legislation or regulatory instruments. We operate as both an incumbent local exchange carrier ("ILEC") in Manitoba and a competitive local exchange carrier ("CLEC") nationally. In addition, we operate as a licensed broadcasting distribution undertaking ("BDU") in parts of Manitoba, including Winnipeg and its surrounding areas. Decisions made by the CRTC may affect our operations and performance.

The following describes significant developments relating to regulatory and policy proceedings:

Telecommunications policy

Unbundled local loops

Beginning in the latter half of 2009 and continuing throughout 2010, the CRTC performed a detailed review of how to set prices for competitors who use an ILEC's copper facilities, known as "unbundled local loops", to provide local telephone service to customers. The review was triggered by an application submitted by Bell Canada and Bell Aliant Regional Communications, Limited Partnership in June 2009, and considered the issue of obsolescence of copper facilities in light of greatly expanded deployment of fibre in the applicants' access networks.

The CRTC's initial review led to Telecom Decision CRTC 2011-24, issued on January 12, 2011, which approved new rates that were on average 6% higher than the previous rates, based on recovery of the applicants' net book values of copper facilities over the assumed remaining useful life. In March 2011, MTS Allstream identified certain issues with the CRTC calculations and filed an application to have the consequent rates modified. In May 2011, the Bell companies filed an appeal of different aspects of Decision 2011-24, thus initiating a further review. On November 15, 2012, the CRTC issued Telecom Decision CRTC 2012-628, ruling on the appeals and establishing new rates that are, on average, 14% lower than the rates approved in Decision 2011-24. The rates approved in Decision 2012-628 were made effective December 2009.

Phase-out of essential services

On March 3, 2013, pursuant to the CRTC's 2008 Essential Services Decision, certain competitor digital network ("CDN") access and transport services will be forborne. Given the lack of alternative supply, particularly in Bell Canada and Bell Aliant territory, on January 8, 2013, Allstream filed a Part 1 application requesting that the CRTC direct Bell to make all wholesale facilities and services they lease to competitors including CDN available for resale irrespective of whether the service in question is forborne or continues to be regulated. The Allstream application also asks that certain in-service CDN access circuits be exempt from the essential phase-out and that the regulated pricing for these be grandfathered. This process closed on January 24, 2013 and we expect a decision shortly.

Usage-based billing

On November 15, 2011, the CRTC issued a decision rejecting Bell Canada's proposed usage-based billing ("UBB") model for wholesale residential and business high-speed Internet services and adopted instead the MTS Allstream model allowing incumbent and competitor ISPs to choose between a capacity-based ("CBB") or a flat-rate model for residential broadband accesses. The decision allows ISPs to manage network capacity and gives competitors flexibility in the market.

While there was general agreement on the CRTC's proposed model, there remains disagreement on approved rates and how they will be implemented. In January 2012, the Canadian Network Operators Consortium, Bell Canada, Rogers Communications Partnership, Quebecor Media Inc. and Shaw Cablesystems were among many who filed Part I Applications asking for further changes to their wholesale tariffs. MTS Allstream continues to participate in the CRTC proceedings relating to the implementation of CBB tariffs ensuring the MTS Allstream wholesale service and those of others are priced and implemented in a fair and effective manner. The proceeding closed on October 5, 2012 and a decision is expected in the first half of 2013.

Deferral account

The CRTC has approved our plan to use the funds remaining in our deferral account to improve accessibility of telecommunications services for persons with disabilities, rollout broadband to 16 rural Manitoba communities by the end of August 2014 and rebate the remaining deferral amount to residential urban customers in Manitoba. The customer rebate was completed in early 2011. As of the end of 2012, broadband service had been rolled out to 11 of the 16 communities, with the rest scheduled for completion prior to the August 2014 deadline. MTS Allstream is awaiting CRTC approval of our proposals to invest the remainder of the deferral account funds in specific accessibility initiatives.

Industry Canada radio spectrum consultations

On March 14, 2012, following on a series of consultations in 2011, the Government announced the policy and technical framework that will govern the wireless spectrum auctions for the 700-MHz and 2500-MHz spectrum bands.

The 700-MHz auction is expected to proceed in the latter half of 2013. The 2500-MHz auction will proceed in 2014, with bidders being capped at 40 MHz per licensee. For the auction the Government has allocated four "prime" blocks of paired spectrum and set limits on their ownership. "Large" wireless service providers, which include MTS Allstream within Manitoba, are limited to one prime-spectrum block. All wireless service providers, large or small, are limited to two spectrum blocks in total. Further, those providers who obtain two spectrum blocks within a region, directly or through partnerships or association, will be subject to rural deployment obligations. The rules for the 700-MHz auction are anticipated in the first quarter of 2013.

CRTC Proceeding to Consider a National Code for Wireless Services

In October 2012, after an initial public consultation in April examining whether there was a need for a national code for wireless services, the CRTC initiated a consultation seeking proposals to improve the clarity and transparency of information available to consumers, and whether and how the national code should coexist with existing provincial wireless consumer protection legislation. There is such provincial legislation in force in Manitoba with which MTS is compliant. In addition to written comments, a hearing on the matter will be held in Gatineau the week of February 11, 2013. MTS Allstream is participating in this process, which is expected to run until March 1, 2013 with a decision sometime in late 2013 or shortly thereafter.

CRTC Inquiry into 9-1-1 services

On December 17, 2012, the CRTC launched an inquiry into 9-1-1 services to investigate three broad areas:

1. the performance and adequacy of the technology currently employed by 9-1-1 services;
2. the issues related to the provision of 9-1-1 services on next-generation networks and
3. the policy considerations on 9-1-1 matters.

The CRTC initiated the proceeding to explore how the evolution to Internet Protocol standards will impact the system architecture and arrangements currently used to provide 9-1-1 service to Canadians. The inquiry will also examine how much money is currently collected and spent on 9-1-1 services by the industry, governments and others. We are participating in the inquiry.

The CRTC is expected to issue a report on the inquiry by the end of the second quarter 2013. This report is expected to be used to set the priorities and focus for subsequent CRTC proceedings on this issue.

RISKS AND UNCERTAINTIES

Risk evaluation processes

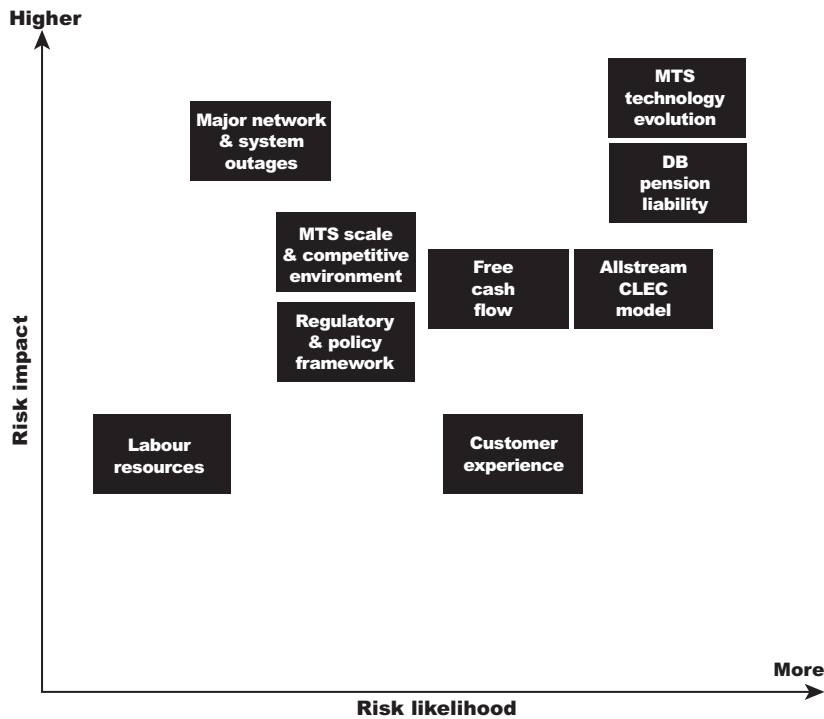
Risk management practices are part of our standard operations, across all of our businesses. Identifying and managing our principal risks forms part of our management's regular business planning process because risks, as well as associated opportunities, form the basis of many aspects of the Company's future business model and opportunities.

Once we set our strategic objectives, our risk management program undertakes to identify and assess the associated principal risks, and considers the activities being taken to mitigate them. The program is managed through an executive-level strategic risk committee, in conjunction with our enterprise risk management (ERM) team.

Annual risk assessment

We annually conduct a formal “risk assessment” process that is directly linked to our business plan. Regular updates are performed throughout the year to identify potential emerging or previously unidentified risks. Our ERM team plays a key role in ensuring management follows appropriate processes in completing these risk assessment reviews. The outcomes are formalized into reports, which are reviewed by executive management. Executive management provides its input, the reports are finalized and the results are presented to the Board. Certain categories of similar risks are often grouped together, forming the basis of what we refer to as “principal risks”.

While the formal reports contain considerably more detail and analysis on these principal risks, the table below is an indicative representation of how these principal risks are organized and ranked. It illustrates how management and the Board perceive our risks.



The constituent elements of these principal risks, as well as other risks we face, are explained in greater detail below and are not necessarily always grouped in the same, aggregating format.

Role of the Board and the Audit Committee

The Audit Committee charter requires an annual review of our risk management program for the identification and management of our principal risks and respective mitigation strategies. The Audit Committee must be satisfied with two procedural matters. First, they assess whether our risk management program is appropriate. Second, with the support of the ERM team, they ensure that each of the key risks and associated mitigations identified by management is delegated for more detailed review, oversight and monitoring by either the full Board or one of the Board’s standing committees.

In addition, the Board charter requires all directors be involved in the monitoring of all of the Company’s key risks and their respective mitigation plans. Our directors must have a solid and substantive understanding of the principal risks facing the Company. Consequently a majority of Board and committee meetings have agenda items devoted to risk discussions. Our Board believes that risks and opportunities are related and need to be considered together. When the Board or a committee is asked to approve key strategic matters (such as budgets, outlook or decisions), a discussion surrounding the associated risks and opportunities also occurs. In that sense, risks and the associated mitigations are an integral and necessary part of normal business planning.

Risk factors

The risks and uncertainties summarized below highlight the more important and relevant factors that could significantly affect our financial results and operations. Our executive management has reviewed these risk factors. They believe these factors are a fair and comprehensive summary of principal risks facing the Company and the mitigation plans in place to manage them. Sometimes however, risks manifest themselves in ways that are not expected. As such, the following is not intended to represent an exhaustive list of all potential issues that could significantly affect our financial results.

COMPETITION

General

Our primary risks come from our competitors. Like all of our industry peers, both MTS and Allstream operate in highly competitive environments. We have many competitors, and technology changes are making it easier for others to enter our markets. Although MTS and Allstream operate in different competitive markets, they face the same primary risk. This risk is that current or future competitors will provide services comparable or superior to those we provide, or at lower prices, adapt more quickly to evolving industry trends or changing market requirements; introduce competing services or execute better on their business plans. The products and services we sell have increasingly short "lifecycles", meaning that even when we successfully introduce and compete with a particular product or service, its replacement or the next-generation product or service is either in development or just about to be rolled out.

We have always been exposed to strong competition because many of our competitors are significantly larger than us. They possess a scale advantage, have greater access to financial resources and are better able to enter into exclusive or preferred arrangements with suppliers. All of these factors could adversely affect our market share and results.

We spend considerable time strategizing about how we can best mitigate competitive risks. All of our detailed business plans and go-to-market strategies are created with the primary objective of sustaining and growing our businesses, notwithstanding these intense competitive pressures.

MTS

Wireless competition

Our primary competitors in the Manitoba wireless market are Rogers Wireless and to a lesser extent, TELUS and Bell Mobility, including Bell's Virgin Mobile and PC Mobile brands. In recent months, we have seen significant and aggressive promotional discounts offered by Bell Mobility in the Manitoba market, specifically aimed at taking market share away from MTS. In 2008, Shaw and Globalive, two "new entrant" companies, acquired spectrum within Manitoba. Shaw has since announced it does not currently intend to deploy mobile wireless services. In January 2013, Shaw announced that Rogers had purchased an option to buy Shaw's spectrum. The spectrum option will be exercisable from the date on which Industry Canada and Competition Bureau approvals permit such exercise and the transfer of the spectrum licenses until expiry in March 2015, subject to extension in certain circumstances. Globalive has not disclosed plans to launch wireless operations in Manitoba soon. Shaw is in the process of deploying a series of wireless "hot spots" in Manitoba using unlicensed Wi-Fi spectrum. In addition, TELUS continues to expand its network footprint in Manitoba, which it shares with Bell Canada. It now covers approximately 70% of the Manitoba population, compared to our coverage of approximately 97%. Recently, we successfully deployed a joint 4G HSPA+ network with Rogers Wireless, which remains the most comprehensive mobile wireless network in Manitoba. MTS was the first wireless carrier to deploy 4G LTE in Manitoba, providing coverage in Winnipeg and Brandon. 4G LTE offers faster mobile data speeds than those of our existing 4G HSPA+ network and over time is expected to further evolve to offer even higher data speeds and support for voice (VoLTE) services. Many of our current or potential future mobile wireless competitors have announced their intention to deploy or have started the deployment of 4G LTE networks in major Canadian urban centres, which we anticipate would include Winnipeg over time. The ultimate scope of deployment of 4G LTE within Manitoba (by ourselves or our competitors) is currently unknown, and may depend on the rules set by Industry Canada in respect of the 700-MHz spectrum auction (refer to the *Regulatory developments section* in our MD&A for further details). The speed and scope of the 4G LTE deployment, as well as the general rapid evolution of mobile wireless technologies, creates substantial risks and opportunities for MTS's wireless business, which is material to our consolidated results. Deployment of new wireless networks is capital-intensive. Expanding the scope of our wireless services contains risks associated with technological issues and with access to cost-effective wireless roaming outside Manitoba and to new advanced wireless devices. In addition, the growing number of substitutes for wireless services, with more smartphones operating on Wi-Fi, could have a negative impact on our wireless business.

Demand for wireless data continues to increase at an exponential rate. Our ability to meet this demand in the future is not certain, and even if we can, we cannot predict the cost to do so. The inability to keep up with the demand for wireless data capacity could have an adverse effect on our business and financial results.

Spectrum is a finite and scarce resource that can be expensive to obtain, if it is available at all. The failure to acquire or maintain spectrum could affect our ability to deploy new mobile wireless technologies or to service existing customers with existing technologies. All of this could materially affect our operations and consolidated profitability. Specifically, the

upcoming 700-MHz auction creates a new series of risks for MTS. If we are successful in obtaining this spectrum, it could require us to make a material one-time payment for spectrum that was not contemplated in our financial plans. If we are unsuccessful in obtaining this spectrum, this could force us to spend considerable new capital to build more towers in order to deploy 4G LTE using other spectrum due to inferior propagation characteristics. Finally, there is also a risk that 700-MHz spectrum is acquired by a wireless service provider that is not currently in our market, or is in our market with limited spectrum resources. The acquisition of this spectrum by such party(parties) could cause overall competition in the Manitoba wireless market to intensify.

Ensuring our Manitoba wireless consumers have access to wireless devices (such as smartphones) and roaming partners can be challenging. Our roaming partners need to be technologically-compatible with our network, the spectrums we use and our wireless devices. In the past, we have been successful in securing such devices and roaming partners. However if we cannot continue this trend, our wireless business could be negatively affected. Existing or future revenue and profitability could be reduced.

Finally, we have seen a growing trend of governments passing "consumer protection" legislation that could impact our flexibility in marketing our services or requiring longer-term contractual commitments from consumers. In 2012, such legislation was introduced in Manitoba. We have successfully adapted our plans accordingly. This legislation can always be amended to further limit our flexibility. It remains a possibility that new, national legislation or codes will be imposed on MTS and could create a further set of obligations and limitations.

We have the most comprehensive wireless network in Manitoba (including CDMA, 4G HSPA+, 4G LTE and Wi-Fi hotspots) and the largest market share. We are also able to leverage other services in our consumer bundle offers (home phone, Internet, television and home alarm monitoring) as part of our strategy to continue our successes in the wireless market.

Wireline competition

Our primary competitors in the consumer and small business wireline market are the incumbent cable providers in Manitoba – Shaw and Westman Communications Group. Cable competition and ongoing technology substitutions (including increasingly viable wireless solutions as wireless providers are also competitors here) have contributed to the erosion of our residential network access line. This erosion is expected to continue over time. It creates significant financial pressure that needs to be offset with cost-reduction strategies and from other lines of business capable of producing profitable growth. There is no guarantee we will have the ability to continue to successfully implement these strategies in the future.

Broadband competition

Our primary competitors in urban broadband markets are the incumbent cable providers (Shaw and Westman Communications Group) and wireless Internet service providers in smaller communities and rural areas. Shaw now offers some of its customers Internet speeds that are faster than what we currently offer most of our customers. This development could adversely affect our ability to retain our market share. In addition, new wireless technologies, such as 4G LTE, are expected to be increasingly viable substitutions for our wireline broadband offerings, putting further pressure on our business results. Our broadband business continues to perform well, despite these competitive pressures. Our broadband services form an important part of MTS's "bundle" strategy. We are also continuing to deploy more fibre (fibre to the home" and "fibre to the node") to help maintain the competitiveness of our speeds and service offerings. These deployments however, are very capital-intensive.

Television competition

Our primary competitors in the television market are the incumbent cable providers (Shaw and Westman Communications Group) and satellite television providers (Shaw and Bell TV). There is also a growing base of other new content providers, such as Netflix, that offer substitute products. Streaming of "over-the-top" content via the Internet has now extended to wireless TV distribution platforms over smartphones. It is offered by some of our competitors such as Bell Mobility. Our IPTV is currently available in Winnipeg and Brandon, as well as in several other urban centres. Through our FTTH deployment, we will be increasingly able to provide residents in the largest rural Manitoba communities with our digital television service. While we have an advanced television offering, there are no assurances that our past successes will continue. Shaw recently deployed a whole home PVR offering that, in time, may become highly competitive with our own IPTV services. In addition, our acquisition costs for programming particularly sports programming, continue to increase. We generally have a limited ability to pass these increasing costs onto our consumers, which could affect our overall profitability. Much of this content is created and/or owned by our competitors (Bell, Rogers and Shaw), who could have conflicting interests when we negotiate for their content. To date, the CRTC has offered broadcasting distributors such as MTS very limited protection against attempts by our competitors who own this content (for use in both traditional television and mobile applications) to charge us unfair rates, or deny us access to this content altogether.

Competitive carriers and service providers

Within Manitoba, we operate as the incumbent carrier and as a provider of wholesale services to other competitive carriers and service providers. In this market, we face competition from competitors operating within Manitoba. Some of these competitors, such as Bell and TELUS, while not incumbent network providers within Manitoba, have a national scope and larger incumbent operations in other geographies. These competitors have always been much larger than us, with significantly more scale and financial resources. Most, but not necessarily all, of these national competitive carriers target our business customers. Sometimes these national/larger competitors are better positioned to acquire business customers such as banks and other national customers that have some locations in Manitoba but make national purchasing decisions. In addition, there are an increasing number of smaller competitors and competitive network alternatives, ranging from larger competitors such as Westman Communications Group and Manitoba Hydro Telecom to wireless Internet service providers ("ISPs"), VoIP service providers, and municipal/public dark fibre and wireless networks. Several of these smaller competitors are non-profit cooperatives, crown agencies or publicly funded agencies, or are subsidized by government broadband programs. These smaller competitors primarily compete with MTS in the small, mid-business and public service organization markets. We also face loss of customers and business revenues when our larger customers (such as public agencies or school boards) seek to acquire dark fibre and build their own networks. As the incumbent carrier within Manitoba, we have the network infrastructure that ensures we are well-positioned to compete against both larger national carriers and smaller regional competitors.

Certain dependency on key customers

We have several large business customers (such as the Province of Manitoba and the City of Winnipeg) that account for a noticeable percentage of our revenues. The loss of one or more of these key customers could adversely impact our financial results.

ALLSTREAM***Highly competitive markets***

Allstream serves business customers nationally. This market is highly competitive, with both revenues and margins for some of the services we offer declining across the industry. Our largest competitors are the incumbent Canadian telecommunications companies that operate in the major urban centres: Bell and TELUS. We also compete with non-incumbent telecommunications companies, such as various cable and hydro companies, that are resellers and/or have a more limited network.

Few non-incumbent telecommunications companies serving business customers have been successful in generating a sustained record of profitability and taking meaningful market share from the incumbent carriers. Our current strategy aims to mitigate this by focusing on high-growth products such as IP and more on the "mid-market" segment. This segment is subject to strong competitive pressures, but we believe it is less competitive than the large business customer market.

Reliance on third parties

Business customers require services in a broad range of geographic locations. Allstream has a national wireline network across Canada and in most large urban centres. There are many locations where we rely on third parties (often the incumbent phone company) for "last mile" access. In areas where we offer services using our own network, we believe we face significantly less risk in our ability to offer competitive services to our customers. As a result, we adopted our on-net strategy where we focus on selling higher-margin services to customers that are served utilizing our own network. This reduces the need to rely on the services of other providers. In areas where we offer our services outside of our footprint, we face greater risks because we have limited control over the service levels provided to us by the incumbent carriers, who are also our direct competitors. We are also subject to the risks associated with changes to the regulatory framework, which can alter our rights to access such networks at reasonable prices, if at all. There is also a risk that, where we operate outside of our network footprint, the incumbent carriers will increase the prices they charge us for forborne services or impose other non-price conditions of use that could materially impact our ability to service our customers and affect our profitability. A recent CRTC decision allowed incumbent carriers to do this for some services commencing in 2011, which resulted in price increases. In 2013, a number of additional services will be forborne which we expect to lead to further increases in the rates we pay to other carriers, or even potentially prevent us from acquiring services on terms that meet our customers' requirements. Many of our contracts also include a clause enabling us to pass on third-party network price increased to our customers, thus providing some protection to Allstream. Our recent network expansion and on-net strategy are expected to reduce our dependency on these carriers and make us less vulnerable to price increases. A large percentage of our services are delivered to our customers using aspects of other carriers' networks. Our profitability is highly sensitive to such charges. In addition to being vulnerable to price increases by incumbents, we could be entirely denied access to third-party facilities. Although we are advocating for such changes and re-regulation of these access services, the CRTC today does not require the incumbent carriers to provide us with access to all of the services we may require to serve our customers or to provide these services to us at reasonable rates. To reduce this risk, we have expanded our network over the past years and are continuing efforts to sign multi-year agreements with certain incumbent providers.

Significant exposure to legacy services

Allstream has financial exposure related to its legacy services, which are operated on our older voice and data infrastructure. These legacy lines of business, such as long distance and private line data services, are in decline as our customers migrate to integrated telecommunications products, such as converged IP, that offer a wider range of functionalities. As a result, the revenues for legacy services are generally declining. We work to offset this by focusing on growing the sales of our IP services, which can be sold at attractive margins. Managing the transition away from legacy services can be a complicated and, at times, a capital-intensive process. To manage this decline we need to reduce internal resources devoted to operating and maintaining such services. However, we continue to have customers actively using these services and we need to continue to maintain these systems and platforms with fewer resources. Managing this transition is complicated, and if not managed well, could adversely affect our financial position.

Demand generation and market growth

In order to manage the decline in our legacy services, we need to create significant off-setting growth in our IP suite of services. This is a significant challenge with material operational risk. We have had to change how we focus, motivate our sales force and become more deliberate about what we sell, where we sell it and to whom. We have been successful recently in driving growth. These growth rates may become harder to sustain as the market for IP services becomes more mature and competitive.

Dependency on key customers

We have several large customers that account for a significant percentage of our revenues. This is true for both our IP and legacy services. The loss of one or more of these key customers could adversely impact our financial results. Our recent efforts to focus on sales into the business mid-market will, over time, help to reduce this exposure to one or more larger customers.

Recent history of negative cash flow

Allstream has had negative free cash flow in recent years, which hinders our ability to make necessary re-investments into our business and infrastructure without using new capital. While our current business plan expects Allstream to be in a positive cash-flow position, there can be no assurances that management will be able to deliver on this plan.

CHANGES IN REGULATION OF TELECOMMUNICATIONS AND BROADCAST INDUSTRIES

The telecommunications and broadcast industries in which we operate are federally regulated. Our business is directly affected by decisions made by various regulatory agencies of the Government, including the CRTC and Industry Canada. The outcome of regulatory reviews, proceedings, appeals and other regulatory and policy developments could have a material impact (positive or negative) on our financial position.

For MTS, changes in the regulatory environment could affect the terms and conditions under which we are able to continue to use our licensed wireless spectrum, obtain new spectrum, alter the terms under which we are required to allow others to interconnect with our network, or change how we are permitted to sell our services to consumers or at what prices. Our television offering is also subject to broadcasting regulations. Changes to these regulations could impose new operating or capital costs or change the competitive dynamic of this market.

For Allstream, changes in the regulatory environment could affect the terms and conditions under which we are permitted to interconnect with others' networks, if at all. This has a significant impact on our profitability, as the amounts we pay to other (often incumbent) carriers are one of the most significant expenses in our business.

For a description of the principal regulatory initiatives and proceedings currently affecting our company, please see the section entitled *Regulatory developments* in which they are incorporated by reference as they form a significant element of the risks we face. We monitor changes in these regulations carefully and are frequent interveners in the regulatory process to ensure our perspective is understood by the regulators prior to their making decisions that will affect us.

MARKET CONDITIONS

Both MTS and Allstream are affected by general economic conditions including consumer and business confidence as well as spending and demand for, and prices of products and services. During adverse economic conditions, customers and businesses may delay buying our products and services, reduce purchases, seek greater discounts or even discontinue purchases altogether. Our ability to collect receivables could also be affected and our churn rates could increase. It has been our past experience that Allstream's business customers are more sensitive to changes in market conditions than MTS's Manitoba-based consumers. While we cannot control general economic conditions, we continuously monitor markets and proactively take steps to adjust our business plans and marketing efforts in light of such conditions.

FINANCING AND DEBT REQUIREMENTS

We periodically raise capital through debt and equity offerings in the capital markets, as well as through our DRIP. 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. We do not believe that our existing debt levels are excessive, given the profitability of our operations. However, as is the case with many of our peers, our debt levels increase our vulnerability to general adverse economic and industry conditions, limit our flexibility to plan for or react to changes in our business and industry and could place us at a disadvantage compared to our competitors with less financial leverage.

The cost and availability of any new required capital depends largely on market conditions, the outlook for our business and credit ratings at the time funds are raised. Our credit ratings are not only subject to our operational results, but also depend upon how third parties view us and the industry in which we operate. Changes to our credit ratings could adversely affect our ability to raise new debt or equity. If we were to cease to maintain our "investment grade" credit rating, this could have a material adverse effect on our ability to access the credit markets in the manner in which we have done so in the past and increase the cost of our debt.

FUTURE CASH FLOW REQUIREMENTS

Over the coming years, both the MTS and Allstream subsidiaries (as well as their respective industry peers) could be faced with some significant one-time cash flow requirements to fund investments such as new spectrum, network expansion or enhanced back-office systems. Even though these investments may be associated with positive business cases, the up-front expenses may not be covered by our in-year free cash flow. We may also need to make significant one-time payments as a result of unexpected and unfavourable decisions arising from litigation against us, as well as other payments to fund our pension solvency deficits. Any of these payments could require additional cash not previously planned for and do not form part of our outlook or business plans.

DEBT AND EQUITY MARKETS

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. Also, a major decline or lack of liquidity in the capital markets, 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.

Changes in interest rates could, over time, significantly increase our borrowing costs if we were forced to renew maturing debt at higher rates. In addition, some of our revenues and expenses are in U.S. dollars. While we can sometimes hedge some of these obligations, changes in the value of the Canadian dollar relative to the U.S. dollar could adversely affect our cash flow.

PENSION FUNDING

General

Pension funding associated with maintaining our defined-benefit pension plans in which some of our employees and retirees participate. The MTS subsidiary has a greater exposure to defined-benefit pension plan costs than has the Allstream subsidiary. The costs we face as a result of such plans are driven by various factors, many of which are largely outside of our control. These factors include:

- **Actuarial standards and applicable legislation**

Changes in actuarial standards and government pension regulations can directly increase or decrease the contributions we are required to make to our pension plans. In the past, we had some success in discussions with the Government, which led to changes in federal pension funding requirements, though any future changes could be either positive or negative. We have no meaningful ability to influence any future changes to actuarial standards.

- **Return on plan assets**

A material portion of our plans' assets is 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 financial markets. While we are thoughtful and conservative in choosing the types of investments made by our pension plans and we believe we have effectively managed our pension plans' assets in the past, ultimately we cannot control the financial markets.

- **Other variables affecting pension valuations**

Our funding obligations depend in part on the value of the liabilities in our pension plans. These valuations depend on actuarial standards and applicable legislation, long-term interest/discount rates and plan member demographics. We cannot control or influence these variables, yet they can significantly affect valuation. For example, the existing solvency deficits under our defined-benefit pension plans as of early 2013 would be turned into solvency surpluses if the applicable discount rate were to increase by a few percentage points.

- **Existing solvency deficits**

As measured on a solvency basis, our defined-benefit pension plans have material deficits. These deficits have been largely caused by recent historically low discount rates. Under new federal pension legislation, we are currently allowed to utilize letters of credit to satisfy a portion of our solvency funding obligations. However, we expect that there will soon be a need for significant further cash contributions into our pension plans, as we will have maximized the amounts of letters of credit we are entitled to utilize. Such cash contributions could adversely affect our free cash flow and would also increase the possibility of “stranded capital” in our pension plans should they subsequently move into a “surplus” position.

Pension litigation

We announced, in early 2010 that we had received a court decision relating to one of our Manitoba pension plans, obligating us to make a material one-time payment retroactive to 1997. Our appeal on this ruling was heard in December 2010. On February 11, 2012, the unanimous panel of the Manitoba Court of Appeal had ruled in our favour on the lawsuit. The Court of Appeal has ruled against the plaintiffs and for the Company, and has dismissed all cross-appeals raised by the plaintiffs. In dismissing all of the plaintiffs' claims, Manitoba's highest court confirmed that the Company complied with all of its legal obligations and has no liability to the plaintiffs. The Supreme Court of Canada is expected to hear the appeal of this decision this year. The Company and its external counsel believe that the Supreme Court will simply affirm the decision of the Manitoba Court of Appeal, though any decision would not be expected until the end of 2013 or the first half of 2014. There will be no expected cash or accounting impact on the Company during such period, though this remains the most material outstanding litigation facing the company.

OTHER

Operational execution/process risks

The businesses, technologies, processes and systems of both our MTS and Allstream subsidiaries are complex. Failure to properly execute on our plans may lead to negative customer experience, network outages and an inability to achieve necessary cost savings, or otherwise impede our ability to effectively carry on our business. We often rely on third parties to help us execute on objectives associated with our business plans. We cannot be assured such third parties will perform their obligations appropriately. In particular, as both MTS and Allstream operate in very competitive environments and are constantly required to find new efficiencies and cost savings, there is an increasing amount of operational risk as both subsidiaries are, in effect, forced to do more with significantly less resources.

Continuous rapid changes in technology

Both our MTS and Allstream subsidiaries operate in markets that are affected by constant and rapid technological 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 speed up the obsolescence of our core technologies. Some elements of our network and technologies are aging. We periodically face situations in which manufacturers are no longer supporting their technologies. These systems become more prone to failure, which can result in more widespread network failures or operational disruption. At the same time, this provides us with new opportunities to exploit markets that were previously too difficult or costly for us to enter. These changes could result in the displacement of products and services by substitutes and create a need for accelerated investment in our network evolution. We need to anticipate technological change and continue to invest in, or develop new technologies, products and services. We have deployed a joint wireless network with Rogers Wireless. The aspects of this network that are shared introduce new technological complexities as we deploy new services and standards.

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 fully realize the expected sales, cost savings and efficiencies, or 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.

Similarly, the deployment of new internal IT and network technologies (such as expanded networks, billing systems, back-office tools) often entails expensive and complicated projects, particularly as they need to be designed to work with both legacy and next-generation systems. These technologies are critical for us to collect our revenue, serve customers and remain competitive in the market. There are no assurances that such technologies can be deployed on time or on budget, or without causing significant business interruption.

Scale of our operations

Our MTS subsidiary has always been significantly smaller than most other incumbent telecommunications companies in Canada (for example, Bell, TELUS and Bell Aliant). It is smaller than some of its direct competitors within Manitoba (for example Rogers Wireless). Similarly, our Allstream subsidiary is smaller than many of its direct competitors. It is much smaller than the two large incumbent telecommunications companies serving business customers (Bell and TELUS). In turn, these Canadian-based competitors are significantly smaller than many of their global peers.

This means that both of our subsidiaries operate with considerably lower economies of scale and much less purchasing power, ability to impose custom technological standards on manufacturers and bargaining power with our larger customers. While MTS continues to benefit from its incumbent position in Manitoba, and both MTS and Allstream can leverage their positions as smaller players to be more effective and closer to their customers, it does place operational and financial pressures on us that may not be experienced by some of our larger competitors.

We mitigate this type of risk by partnering with others where appropriate and advantageous (for example, we participate in a joint mobile wireless network with Rogers Wireless) by leveraging our ability to be more agile or offer our customers a more personalized and customer-focused experience.

Security and network failures/cyber-risks

Like all others in our industry, the operations of both our MTS and Allstream subsidiaries depend on how well we and our suppliers protect our networks, equipment, IT systems, software and customer information (including personal information) against damage from a number of threats, including, but not limited to, cable cuts, damage to our physical plant, natural disasters, terrorism, fire, power loss, hacking, computer viruses, vandalism and theft. Our operations also depend on the timely maintenance, upgrade and replacement of our network and our suppliers' networks, equipment, IT systems and software, as well as pre-emptive expenses to mitigate the risks of failures (such as expenses we incur as a result of the periodic flooding in Manitoba). Any of these and other events could result in network failures, billing errors, delays in customer service and/or increase in capital expenses. The failure of networks or a component of our networks might, in some circumstances, result in a loss of service for our customers and could adversely impact our reputation, goodwill and results of operations. Any of the above events affecting third parties on which we rely may also result in an interruption in service that would last until the outage is fixed or alternative service delivery options are found and could also harm our customer relationships.

We understand the importance of network integrity. Both our MTS and Allstream subsidiaries spend a significant amount of time and resources to manage this risk, as many of these risks can be migrated through proper network and system design, maintenance and alternate sources of supply. We regularly consider the probability of cyber-incidents and the quantitative and qualitative magnitude of these risks, including the potential costs and other consequences arising from the misappropriation of assets or sensitive information, corruption of data or operational disruption.

To date, our pro-active and ongoing mitigation and planning efforts have been successful, as we have not experienced any significant network failures or "cyber security" incidents. However, these types of events are becoming increasingly common and are experienced by many companies, across all types of industries. There are no assurances that our ongoing controls will continue to be effective.

LITIGATION AND LEGAL MATTERS

Litigation

As is the case with any large company, investigations, claims and lawsuits seeking damages and other relief are 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 with increasing ease. By the nature of its consumer-facing businesses, our MTS subsidiary is more vulnerable to class-action litigation than our Allstream subsidiary.

By way of indicative examples, we 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 in association with 911 or emergency service access fees that now ought to be repaid, which is now also subject to an industry-wide regulatory review. We believe we will be successful in defending against these specific claims. The outcome of any such actions, or of new actions that may arise, however, is uncertain. Judges or juries can, at times, deliver unpredictable decisions. Until any particular matter is resolved, there can be no assurance that our financial position will not be negatively impacted as the costs associated with losing or defending against such claims could be material. We work hard to mitigate these risks by vigorously defending ourselves when appropriate. Negative financial outcomes associated with certain operational and/or legal risks are mitigated through the purchase of appropriate insurance coverage. We also take steps to minimize the risk of being sued or being subject to such proceedings at first instance, such as by implementing appropriate compliance programs and trying, whenever possible, to negotiate favourable contractual terms that limit our liability.

Civil liability in the secondary market

Securities laws impose potential liability for misrepresentations by public companies in written disclosure and oral statements or for 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 trust that our directors and officers possess significant integrity, and believe we have purchased appropriate

insurance coverage in respect of these risks. However, there can be no assurance that all of our processes will be followed by employees, officers, third parties and directors at all times.

Legal and regulatory compliance

We necessarily rely on our employees, senior management, the Board 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. Such events could expose us to damages, sanctions and fines, or negatively affect our financial operating results. We are required to handle our employees' and customers' personal information in a way that is compliant with all applicable privacy laws, which is becoming increasingly more onerous. We believe we have reasonable policies, processes and awareness in place for proper compliance, and that these programs reduce the risks associated with some of these complex obligations.

Applicable legislation and corporate articles

Despite the recent liberalization of foreign ownership requirements applicable to telecommunications companies with less than a 10% market share, we remain subject to foreign ownership requirements that apply to MTS's television business. In addition, our own articles of incorporation 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 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 interest of our shareholders, this change could result in new foreign competitors or existing competitors benefiting from new foreign investments or partnerships, which could result in increased competition.

Contractual provisions

Technology evolution 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 law, and significant damages may be awarded in property infringement claims advanced by right-holders. In addition, contractual provisions to which we are bound are becoming increasingly complicated and expose us to heightened risks vis-à-vis our customers and vendors, and we are not always able to fully limit our liability in respect of these matters.

Changes to legislation affecting our services

Changes in legislation can affect the ability of customers of both our MTS and Allstream subsidiaries to use the products and services we offer. As an example, in 2010 our Manitoba-based wireless customers became subject to stricter laws limiting the use of hand-held wireless devices while driving. Although we supported this change, and did not see any adverse effect on our results or on demand for our services, there can be no assurances that this will be the case with future changes in legislation. Similarly, changes to legislation can require us to build new systems or provide functionality that we would not otherwise establish, which could increase our costs. As an example, we may be required to incur unexpected network capital expenses to comply with potential new legislation mandating all telecommunications carriers to provide new methods of "lawful access" to law enforcement agencies.

Radio frequency

It is suggested that the radio frequency emissions from wireless devices (such as the ones sold by our MTS subsidiary) could be associated with health concerns. We are not aware of any credible basis to substantiate such risks. In fact, there is significant government-backed research concluding that there is no basis for such concerns. 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.

Dividend payments

On a quarterly basis, the Board considers whether to declare a dividend. A more comprehensive discussion of our current dividend policy is set forth in our most recent Annual Information Form ("AIF"), which is available on our website at www.mtsallstream.com or on SEDAR at www.sedar.com. Payment of a dividend is subject to the discretion of the Board, as well as legal requirements. There are no assurances that, in the future we will continue dividend payments at the current level, or at all.

HUMAN RESOURCES

Collective agreements

A majority of our employees are covered by collective bargaining agreements. Proportionately, a higher percentage of employees in our MTS subsidiary are unionized compared to employees of our Allstream subsidiary.

Renegotiating collective bargaining agreements carries the risk of resulting in higher labour costs and work disruptions including work stoppages or slowdowns. While we have not had a labour disruption in over a decade and have had recent successes in concluding a series of collective agreements with several of our unions, there can be no assurance that should

a labour disruption occur, it would not adversely affect the services that we provide to our customers and our operating results. We periodically develop, review and update contingency plans for labour disruption. Similarly, a labour disruption at one of our suppliers (for example, a service provider who carries portions of our traffic, a roaming partner or a content provider) could also harm our businesses, damage customer relationships and impact our operational results. Further information about our collective agreements is contained in our most recent AIF, which is available on our website at www.mtsallstream.com or on SEDAR at www.sedar.com.

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. We are smaller than many of our industry peers and, as a result, we sometimes face greater risks associated with employee retention. To manage this risk, our Board and its Human Resources and Compensation Committee take an active role in reviewing compensation levels to ensure we remain competitive within our peer group, and have a strong succession planning program in place. More details of these plans and mitigations are contained in our latest *Management Proxy Circular*.

TAX MATTERS

Our business activities are subject to tax legislation and regulations that frequently change. Changes in tax laws or the adoption of new tax laws could result in higher tax rates or new taxes. The calculation of collectable or payable taxes, in many cases, requires significant judgment in interpreting tax rules and regulations. Our tax filings are subject to government audits which could materially change the amount of current and deferred income tax assets and liabilities and could, in certain circumstances result in an assessment of interest and penalties. At present, we have a substantial tax asset and believe that this asset will enable us to offset the payment of cash income taxes until at least 2019.

CONTROLS AND PROCEDURES

MTS Allstream management is responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting. These terms are defined in National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, as adopted by the Canadian securities regulatory authorities.

Disclosure controls and procedures

Under the direction of our Audit Committee, our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), we evaluated the design and operation of our disclosure controls and procedures as at December 31, 2012. Based on this evaluation, our CEO and CFO have concluded that, as of the evaluation date, our disclosure controls and procedures were effective to provide reasonable assurance that information that is required to be disclosed in prescribed filings and reports that are filed with the Canadian securities regulatory authorities is recorded, processed, summarized and reported on a timely basis. It is also accumulated and communicated to management, including the CEO and the CFO, as appropriate, to allow timely decisions regarding required disclosure.

Internal control over financial reporting

Internal control over financial reporting is a process designed by, or under the supervision of, the CEO and CFO to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Our process includes those policies and procedures that:

- i) pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions relating to our assets;
- ii) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are made only in accordance with authorizations of management and our directors and
- iii) provide reasonable assurance regarding the prevention or timely detection of any unauthorized acquisition, use or disposition of our assets that could have a material effect on our annual financial statements.

Due to its inherent limitations, internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. As well, projections of an evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Under the direction of our Audit Committee and our CEO and CFO, we have evaluated the design and operation of our internal control over financial reporting as at December 31, 2012 based on the criteria set forth in the Internal Control –

Integrated Framework issued by the Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission. Based on this evaluation, our CEO and CFO have concluded that, as of the evaluation date, our internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. No material weaknesses in our internal control over financial reporting were identified.

There have been no changes in our internal control over financial reporting during the three-month period ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

SOCIAL AND ENVIRONMENTAL RESPONSIBILITY

At MTS Allstream we believe that companies have a responsibility to contribute to the welfare of the communities in which they operate. Corporate citizenship is very important to us. We strive to have a positive impact on the lives of our employees, on our customers, on other stakeholders and in the community. Year after year, we achieve this goal by engaging with our employees, leading by example in our communities and having a positive environmental impact.

Investing in our people

In today’s fast-paced and ever-changing world, we believe people make the difference. Recognizing that strong employee engagement is a critical success factor for the company and employees, we are committed to an Employee Engagement Improvement Strategy (“Strategy”). The strategy is used to measure employee opinions about the work environment. It includes processes to work with employees to develop action plans, sets measurable goals to implement programs for engagement and ensures continuous improvement.

Employee engagement

MTS Allstream has made the strategic connection that higher employee engagement is directly correlated with higher company performance. The 2012 survey results show the growth and commitment to employee engagement:

- Best-in-class participation rate of 90% – 2012 employee engagement survey
- Strong results with significant improvements (comparing 2008, 2010 and 2012 results):
 - Employee Engagement Index is strong at 84%, an increase of 7% over 2008 and 3% over 2010 results – above the Canadian national and global telecommunications norms
 - Results for Values improved by 6 points from 2010
 - Learning and Development Index improved by 5% from 2010 and 9% from 2008.

Our strategy also demonstrates the company’s commitment to:

- Gaining a better understanding of the views of our employees;
- Listening to what employees have to say about their experiences at MTS Allstream and their understanding of our business goals and objectives;
- Putting in place actions that will address areas that employees tell us are important;
- Comparing our results against world-class standards;
- Enabling employees to help shape the type of company MTS Allstream is and can become and
- Influencing how the company grows into an organization that is known for having a workplace that is best-in-class and where our employees are engaged and committed.

For example, we offer our employees potential for growth, development and advancement through education and career development programs. As well, we recognize and value the contributions our employees make through employee engagement and recognition programs. Our appreciation program rewards employees for displaying our values, meeting our corporate strategies and for demonstrating leadership, customer service, community service, innovation, and environmental leadership. Further, Allstream is a leader in providing options to enhance work-life balance with its remote-worker telework program. We are committed to equity and diversity in the workplace, and to the community as a whole.

Equity and diversity

Our commitment to equity and diversity in the workplace is shown by the highlights below:

- Based on an analysis of our employment equity data by the Canadian Human Rights Commission in 2012, our employment equity results are above the average for our industry and our performance is contributing to improved representation of designated groups within our industry.
- The Corporate Knights 2012 Diversity Index included our Board as one of the top gender-diverse boards and top minority/aboriginal diverse boards.
- MTS Allstream signed the “Catalyst Accord” and supported Catalyst in its call to action for Canadian corporations to increase the overall proportion of board seats held by women.
- We are an active supporter and sponsor of Canadian Women in Communications (CWC). In the last four years, four of our female leaders have received awards from CWC that recognize leadership excellence in the communications field.

Employee health and safety

Our company has an unwavering commitment to protecting our employees from workplace risks.

- MTS Allstream has a series of corporate policies to protect employees, ranging from a broad health and safety policy covering Employee Well-Being to Working Alone, Violence in the Workplace and Accident Prevention to Personal Protective Equipment. It is everyone's responsibility to know and follow these policies.

Our values

Our values define acceptable standards that govern the behaviour of all individuals' within the company.

- Courage, empathy, commitment and passion. These four words not only describe what MTS Allstream stands for as a company, they also highlight the specific values that the company holds up as both goals and performance measuring criteria.
- These values are integrated into MTS Allstream's processes and communications – from the promotion and hiring of new employees to our performance management process.

People-related governance

As with other areas of our operations, we apply significant rigour to governance policy and processes for our human resources/assets. This includes:

1. *Guide for business conduct*
Outlines the essential rules and guidelines necessary to retain our tradition of honest and ethical business conduct, which apply to all employees, directors, officers and agents of the company.
2. *Whistleblower program*
The company offers Business Conduct and Ethics Reporting as a venue for stakeholders to safely and confidentially report potential ethics and compliance violations on an anonymous basis.
3. *Privacy/Fair information practices*
A formal statement of principles and guidelines concerning the minimum requirements for the protection of personal information provided by the Company to its customers and employees. The practices ensure responsible and transparent practices in managing personal information in accordance with national standards and federal legislation.
4. *Respectful workplace*
MTS Allstream is committed to providing a workplace in which all customers and employees and everyone with whom employees interact at work or for business purposes are treated with dignity and respect at all times. Our respectful workplace policy ensures that all employees understand that harassment, discrimination and bullying will not be tolerated within the MTS Allstream workplace and outlines the remedial steps available to all employees.
5. *Accommodation in the workplace*
This policy provides for the accommodation of employees and applicants who require assistance in the workplace in order to perform their roles or apply for positions – developed in accordance with Human Rights and Employment Equity legislation.

Investing in our environment

We remained committed to reducing our impact on the environment and to helping our customers and employees do the same. Our overall plan is to reduce our absolute GHG emissions (at 17,236 tonnes in 2008, our current baseline year) by twenty percent by the end of 2020. We remain committed to effectively managing the environmental impact of our business operations. We encourage employees to reduce paper consumption and practice recycling through a corporate standard

for recycled office paper and a uniform recycling program. Our employees are also encouraged to use public transportation through such incentives as discounted monthly bus passes. We also enable telework which allows employees the opportunity to choose "greener" commuting options and reduce their personal impact on the environment.

We leverage technology and innovation to reduce our impact on the environment. The majority of our employees work in or out of Leadership in Energy and Environmental Design or Builder Owners and Managers Association-certified locations, which demonstrates our commitment to sustainable workplaces. Lighting, HVAC and alternate energy sources have been implemented at office locations and network sites to improve energy efficiency and increase the use of renewable energy. We have "greened our fleet" by installing GPS devices in order to minimize idling time and fuel consumption and by investing in electric and hybrid vehicles when replacing our fleet vehicles. By recycling all automotive materials possible, we are reducing and reusing what otherwise would be waste.

In addition to our efforts to minimize the impact of our operations on the environment, we continued to engage our customers in the "green" potential of innovative communications solutions and provide our employees with information and resources to reduce their personal impact on the environment outside of work. For our customers, we offer cell phone recycling, as well as e-billing options in order to minimize waste. We participated in the nation-wide mobile device recycling "Recycle My Cell" program which donates net proceeds from the program to Manitoba-based non-profit environmental organizations. We also offer virtual workplace communication solutions for our business customers in order to promote telecommuting and alternative work arrangements. At MTS Allstream, we recognize employees who demonstrate environmental leadership. We encourage employees to participate in external environmental events and we sponsor "green" initiatives in the community. New "Green" initiatives include:

- MTS Ultimate TV Energy Star set-top box leads in energy efficiency – the TV PVR set-top boxes have an Energy Star rating, a designation that recognizes products as the most energy-efficient in their categories. While we have used Energy Star-rated set-top boxes since the launch of MTS Ultimate TV in 2009, the newest set-top box places MTS at the forefront of energy efficiency and innovation using about half the power of an average PVR.
- In response to employees and as part of our efforts to reduce our impact on the environment, we launched electronic T4 and *Relevé 1* tax forms building on electronic pay statements launched several years ago.
- We have provided business customers with 24/7 secure access to a searchable database with seven years of electronic invoices through Allstream's self-service portal, TouchPoint, which reduces the need for printing, making it a true "green" solution.

Additional information and quantified results on our key priorities and initiatives can be found in our Green Report, which is produced annually and is available on our website at www.mtsallstream.com/greenreport.

GLOSSARY

A**Asymmetric digital subscriber line (ADSL)**

The technology used to move data quickly on existing copper phone lines.

ARPU

Average return per user, expressed as a dollar amount for a given period of measurement. It is used to demonstrate in part a telecom service providers operating performance.

B**Blended**

Refers to a combination of both pre-paid and post-paid wireless customers. This term is used when a metric counts all wireless customers (e.g. blended churn).

Blog

A website on which an individual or a group of users record opinions, information, etc. usually on a regular basis.

Broadband

High-speed transmission. The term is commonly used to refer to communications lines or services at T1 rates (1.544 Mbps) and above. Broadband facilities – fibre optic and coaxial cable, for example – may carry numerous voice, data and video channels at the same time.

Bundling

Refers to grouping two or more telecom services together.

C**CRA**

Canada Revenue Agency

Canadian Radio-television and Telecommunications Commission (CRTC)

The agency responsible for regulation of the Canadian telecommunications and broadcasting services.

Capital expenditures (CAPEX)

Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. This type of outlay is made by companies to maintain or increase the scope of their operations.

Cash flow

The movement of cash in and out of a business from day-to-day direct trading and other non-trading or indirect effects, such as capital expenditure, tax and dividend payments.

Churn

The rate at which existing subscribers cancel their services is called “churn”. Churn is calculated as the number of subscribers disconnected in a given period divided by the average subscriber base for that period.

Code Division Multiple Access (CDMA)

A method for transmitting multiple digital signals simultaneously over the same carrier frequency (the same channel). Although used in various radio communications systems, the most widely known application of CDMA is for cellphones.

Compound annual growth rate (CAGR)

The year-over-year growth rate of an investment over a specified period of time.

Committee on Uniform Securities Identification Procedures (CUSIP)

A CUSIP number is used to identify most securities and to facilitate clearing and settling of securities transactions.

Common share

A type of security which represents ownership in a company and entitles the holder to voting rights.

Canadian Securities Administrators (CSA)

A forum in which the 13 securities regulators of Canada's provinces and territories are able to coordinate and harmonize regulation of the Canadian capital markets.

D**Digital subscriber line (DSL)**

A technology for bringing high – bandwidth information to homes and small businesses over ordinary copper telephone lines.

Dividend

A distribution of a company's profits to its shareholders paid in proportion to the number of shares that an individual shareholder owns. The amount and frequency of the dividend payment is approved by the Board. Dividends are normally in the form of cash but can also be in other forms such as shares in the issuing company or shares in a subsidiary.

Dividend record date

The date the Board sets as the date of record to determine shareholders who are eligible to receive a declared dividend. To be eligible to receive a declared dividend, the shareholder must own or have purchased the security at least three market trading days prior to the record date (Trade date + 3).

Dividend reinvestment plan (DRIP)

A plan in which shareholders of a company can reinvest cash dividend payments in additional shares.

Dividend yield

The return earned on a security, calculated by expressing its dividend on an annualized basis as a percentage of the security's market price.

E**Earnings before interest, taxes, depreciation and amortization (EBITDA)**

EBITDA is a non-IFRS measure of performance. MTS Allstream defines EBITDA as "earnings before interest, taxes, depreciation and amortization, and other income (expense)". EBITDA should not be construed as an alternative to operating income or to cash flows from operating activities (as determined in accordance with IFRS), as a measure of liquidity.

Earnings per share (EPS)

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability.

Employee Share Ownership Plan (ESOP)

MTS Allstream employees have the opportunity to share in the success of the Company by investing in shares through the ESOP plan.

Evolution data optimized (EVDO)

A high-speed network protocol used for wireless data communications, primarily Internet access. EVDO is considered a broadband technology like DSL or cable modem Internet services.

Ex-dividend date

The first date on which a security trades when a purchaser of that security is not entitled to its dividend. The ex-dividend date falls two market trading days prior to the record date.

F**Free cash flow**

Free cash flow is a non-IFRS measure of performance. MTS Allstream defines free cash flow as "cash flows from operating activities, less capital expenditures and excluding changes in working capital". Free cash flow is the amount of discretionary cash flow that the Company has for purchasing additional assets beyond its annual capital expenditure program, paying dividends, buying back shares and/or retiring debt. The term "free cash flow", as it relates to 2012 and 2011 results prepared using IFRS, does not have any standardized meaning according to IFRS. It is therefore unlikely to be comparable to similar measures presented by other companies.

Fibre optic network

The method of transmitting information from one place to another by sending pulses of light through an optical fiber.

Fibre-to-the-home (FTTH)

When fibre cable runs all the way into a customer's home, instead of just to a box on the street corner. Because the fibre goes all the way into the house, it can carry more bandwidth which allows us to offer hi-tech integrated services like MTS Ultimate TV.

G**GAAP**

Generally accepted accounting principles.

Goodwill

Any surplus money paid to acquire a company that exceeds its net tangible assets value.

H**HSPA+ (High-speed packet access)**

A mobile telephony technology that allows for data transmission speeds of up to 21 Mbps. HSPA+ (also called Evolved HSPA or 4G) is a further evolution of HSPA that offers data speeds of up to 42 Mbps.

I**IFRS**

International financial reporting standards.

Internet Protocol (IP)

IP is the method by which data are transmitted between computers connected to the Internet. Each computer on the Internet has at least one IP address that uniquely identifies it out of all other computers on

the Internet, making it possible for data to be transmitted to a particular destination.

IP connectivity

The access network that provides Internet Protocol (IP) connections.

L**LTE**

The MTS LTE (Long Term Evolution) wireless network is the next step in wireless technology. LTE is capable of delivering download speeds up to 75 Mbps and upload speeds of 25 Mbps.

M**MBT**

The TSX trading symbol for Manitoba Telecom Services Inc.

MD&A

Management's discussion and analysis

Market value

The most recent price for a security at which a transaction has occurred.

MPLS network

A multiprotocol label switching (MPLS) network allows telecommunications companies the ability to provide Internet Protocol (IP) and switched Ethernet services.

N**Non-IFRS measures of performance**

In this MD&A, we provide information concerning 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 IFRS, and are not necessarily comparable to similarly titled measures used by other companies.

O**On-net IP**

By promoting on-net (services on Allstream's existing network) IP-based services, we are able to improve profitability.

P**Pre-paid wireless customers**

Refers to wireless customers who pay before they use the service. They are not on contract – they buy minutes as part of pay-as-you-go plans. Typically they spend less money and are more likely to switch to a competitor.

Post-paid wireless customers

Refers to wireless customers who pay after they use the minutes – they get a monthly bill and are on contract.

S**System for Electronic Document Analysis and Retrieval (SEDAR)**

The SEDAR website provides access to public securities documents and information filed by public companies and investment funds with the Canadian Securities Administrators (CSA).

Share

A unit of ownership in the equity of a company.

Share transfer agent

See "Transfer agent".

SR&ED

Scientific Research & Experimental Development investment tax credit

Spectrum

The specific part of the electromagnetic spectrum that can be licensed for use by telecommunications service providers. Telecoms can purchase, usually through an auction, a spectrum license that grants them the sole right to use a portion of the radio frequency spectrum in a given geographical area for communication purposes. A Canadian spectrum auction is expected to take place in 2013.

Stock exchange

An organization which facilitates the exchange of securities through the matching of buy and sell orders.

Stock symbol

A letter-only symbol used to individually identify each company that trades on an exchange or market.

Strategic growth services

MTS strategic growth services are wireless and broadband. Allstream strategic growth services are on-net IP.

T**Total shareholder return**

The total return of a stock to an investor (capital gain plus dividends).

Transfer agent

A company acting on behalf of a publicly traded company which maintains a record of its shareholder names, addresses and the quantities of shares each shareholder holds.

TSX

Toronto Stock Exchange

U**Unified communications (UC)**

The integration of real-time communication services which can include such services as instant messaging, video conferencing, data sharing, call control and speech recognition with non-real-time communication services such as unified messaging (integrated voicemail, email, SMS and fax). UC is not necessarily a single product, but a set of products that provides a consistent unified user interface and experience across multiple devices and media types.

V**Very high speed digital subscriber line (VDSL)**

VDSL transmits data in the 13-Mbps to 55-Mbps range over short distances, usually between 300 and 1500 meters, of twisted pair copper wire. The shorter the distance, the faster the data are transmitted.

Voice over Internet protocol (VOIP)

Transmitting voice signals in digital form over the Internet using the Internet Protocol (IP) method.

W**Wireless fidelity (Wi-Fi)**

A term used for a high-frequency wireless local area network (WLAN).

Wireless local area network (WLAN)

A local area network to which a mobile user can connect to through a wireless (radio) connection.

Y**Yield**

The return that an investment provides to an investor. It is a combination of income received and capital appreciation/depreciation.

CONSOLIDATED FINANCIAL STATEMENTS AND NOTES

RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of Manitoba Telecom Services Inc. (“MTS”) and the information in Management’s Discussion and Analysis are the responsibility of management. The information presented in Management’s Discussion and Analysis, and elsewhere in the annual report, is consistent with the information contained in the consolidated financial statements.

The consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards, and necessarily include some amounts that are based on management’s best estimates and judgments. In management’s opinion, these consolidated financial statements fairly present, in all material respects, MTS’s consolidated financial condition, financial performance and cash flows.

In fulfilling its responsibilities, management, under the direction of the Chief Executive Officer and the Chief Financial Officer, is responsible for developing and maintaining a system of internal controls, including systems and processes, policies and procedures, and segregation of duties and responsibilities. The system of internal controls is supported by an internal audit function that reports to the Audit Committee. This system is designed to provide reasonable assurance that the financial statements are accurate and complete in all material respects, that assets are adequately accounted for and safeguarded, transactions are properly authorized and recorded, and that the financial records are reliable for preparing the financial information included in Management’s Discussion and Analysis.

MTS also maintains a *Guide for Business Conduct & Ethics*, which requires adherence to high ethical business standards, and *Corporate Disclosure Policy & Practices*, which requires the public disclosure of all material information in accordance with securities regulations.

The Board of Directors is responsible for overseeing management’s responsibility for financial reporting and for reviewing and approving the consolidated financial statements. It carries out its responsibility for the consolidated financial statements and Management’s Discussion and Analysis principally through its Audit Committee.

The Audit Committee, which is comprised of independent directors, monitors MTS’s financial reporting functions and related internal control and management information systems. The Audit Committee has responsibility for establishing a governance process over the engagement of the external auditors; including the establishment of an *Auditor Independence Policy* and the requirement for pre-approval of all audit and non-audit services to be provided by the external auditors. The text of the Audit Committee’s Charter and a summary of the *Auditor Independence Policy* are disclosed in MTS’s Annual Information Form.

The Audit Committee meets periodically with management, and with the internal and external auditors, to discuss the results of audit examinations with respect to the adequacy of internal controls and to review and discuss the consolidated financial statements and other filings. The Audit Committee has recommended the consolidated financial statements and Management’s Discussion and Analysis to the Board for approval, and the Board has approved these documents.

The consolidated financial statements have been audited by Deloitte LLP, Chartered Accountants, who have full access to the Audit Committee, with and without the presence of management. The accompanying auditors’ report outlines the scope of their examination and their opinion.



Pierre Blouin
Chief Executive Officer



Wayne Demkey, CA
Chief Financial Officer



Kishore Kapoor, CA
Chair of the Audit Committee

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Manitoba Telecom Services Inc.

We have audited the accompanying consolidated financial statements of Manitoba Telecom Services Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, and the consolidated statements of net income and other comprehensive loss, statements of changes in equity and statements of cash flows for the years ended December 31, 2012 and December 31, 2011, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Manitoba Telecom Services Inc. as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.



Chartered Accountants
February 13, 2013
Winnipeg, Manitoba

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

Years ended December 31

(in millions of Canadian dollars, except earnings per share)

	Note	2012	2011
Operating revenues	5	\$ 1,704.1	\$ 1,765.6
Operating expenses			
Operations	6	1,094.6	1,171.2
Depreciation and amortization	6	322.8	298.9
		1,417.4	1,470.1
Operating income		286.7	295.5
Other (expense) income		(1.1)	2.5
Finance costs	7	(60.2)	(65.5)
Income before income taxes		225.4	232.5
Income tax expense	8	50.0	65.4
Net income for the year		\$ 175.4	\$ 167.1
Other comprehensive income			
Items never subsequently reclassified to net income			
Net actuarial losses from defined benefit plans and other employee benefits	16	\$ (108.2)	\$ (193.9)
Deferred taxes on items in other comprehensive income		31.3	50.8
Other comprehensive loss for the year, net of tax		(76.9)	(143.1)
Total comprehensive income for the year		\$ 98.5	\$ 24.0
Basic and diluted earnings per share	9	\$ 2.63	\$ 2.55

MANITOBA TELECOM SERVICES INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

<i>(in millions of Canadian dollars)</i>	Note	Share capital	Contributed surplus	Deficit	Total
Balance at December 31, 2011		\$ 1,303.7	\$ 20.6	\$ (534.6)	\$ 789.7
Net income for the year		—	—	175.4	175.4
Other comprehensive loss for the year		—	—	(76.9)	(76.9)
Total comprehensive income for the year		—	—	98.5	98.5
Share-based compensation		—	0.6	—	0.6
Issuance of shares	18	33.5	—	—	33.5
Dividends declared	18	—	—	(113.2)	(113.2)
Balance at December 31, 2012		\$ 1,337.2	\$ 21.2	\$ (549.3)	\$ 809.1
Balance at December 31, 2010		\$ 1,275.0	\$ 20.1	\$ (447.1)	\$ 848.0
Net income for the year		—	—	167.1	167.1
Other comprehensive loss for the year		—	—	(143.1)	(143.1)
Total comprehensive income for the year		—	—	24.0	24.0
Share-based compensation		—	0.5	—	0.5
Issuance of shares	18	28.7	—	—	28.7
Dividends declared	18	—	—	(111.5)	(111.5)
Balance at December 31, 2011		\$ 1,303.7	\$ 20.6	\$ (534.6)	\$ 789.7

**MANITOBA TELECOM SERVICES INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

<i>(in millions of Canadian dollars)</i>	Note	December 31 2012	December 31 2011
Assets			
<i>Current assets</i>			
Cash and cash equivalents	15	\$ —	\$ 16.8
Accounts receivable	15	165.7	156.6
Prepaid expenses		30.1	25.5
Inventories	10	20.1	29.3
		215.9	228.2
Property, plant and equipment	11	1,560.0	1,543.3
Intangible assets	12	368.7	307.2
Other assets	13	71.9	67.8
Deferred tax assets	8	515.8	535.0
Total assets		\$ 2,732.3	\$ 2,681.5
Liabilities and shareholders' equity			
<i>Current liabilities</i>			
Bank indebtedness	15	\$ 12.6	\$ —
Accounts payable and accrued liabilities	15	307.6	311.9
Advance billings and payments		58.2	55.8
Current provisions	14	23.9	33.1
Current portion of long-term debt	15	—	100.0
Notes payable	15	54.5	—
Current portion of finance lease obligations	23	6.5	5.4
		463.3	506.2
Long-term debt	15	921.9	920.8
Long-term portion of finance lease obligations	23	7.5	9.6
Long-term provisions	14	5.5	5.7
Employee benefits	16	477.1	398.6
Other long-term liabilities	15 & 17	47.0	49.9
Deferred tax liabilities	8	0.9	1.0
Total liabilities		1,923.2	1,891.8
<i>Shareholders' equity</i>			
Share capital	18	1,337.2	1,303.7
Contributed surplus	19	21.2	20.6
Deficit		(549.3)	(534.6)
		809.1	789.7
Total liabilities and shareholders' equity		\$ 2,732.3	\$ 2,681.5

Approved on behalf of the Board



David Leith
Chair



Kishore Kapoor, CA
Director

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

Years ended December 31

(in millions of Canadian dollars)

	Note	2012	2011
Cash flows from operating activities			
Net income		\$ 175.4	\$ 167.1
Add items not affecting cash			
Depreciation and amortization		322.8	298.9
Deferred income tax expense	8	50.4	65.4
Loss on disposal of assets		1.6	2.4
Deferred wireless costs		(64.7)	(67.0)
Pension funding and net pension expense		(30.0)	(54.6)
Other, net		0.1	5.6
Changes in non-cash working capital		(16.2)	(31.2)
Cash flows from operating activities		439.4	386.6
Cash flows from investing activities			
Capital expenditures		(338.0)	(288.0)
Other, net		(4.5)	(27.0)
Cash flows used in investing activities		(342.5)	(315.0)
Cash flows from financing activities			
Dividends paid		(112.7)	(111.1)
Issuance of notes payable	15	54.5	—
Issuance of long-term debt	15	—	200.0
Repayment of long-term debt	15	(100.0)	(220.0)
Issuance of share capital	18	33.5	28.7
Other, net		(1.6)	(2.4)
Cash flows used in financing activities		(126.3)	(104.8)
Change in cash and cash equivalents		(29.4)	(33.2)
Cash and cash equivalents, beginning of year		16.8	50.0
(Bank indebtedness) cash and cash equivalents, end of year		\$ (12.6)	\$ 16.8

**MANITOBA TELECOM SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2012
AND 2011**

All amounts are in millions of Canadian dollars, unless otherwise indicated

1. CORPORATE INFORMATION

Manitoba Telecom Services Inc. (the "Company") is incorporated in Manitoba, Canada, and its Common Shares are listed on the Toronto Stock Exchange ("TSX"). The Company's head and registered office is located at 333 Main Street, P.O. Box 6666, Winnipeg, Manitoba, Canada, R3C 3V6. The principal activities of the Company are described in note 21.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

These consolidated financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS") and the accounting policies described below. The policies used are based on the standards as issued by the International Accounting Standards Board ("IASB") applicable as at December 31, 2012, and which have been incorporated by the Canadian Accounting Standards Board into current generally accepted accounting principles for publicly accountable enterprises.

The consolidated financial statements were approved by the Board of Directors on February 13, 2013.

(b) Basis of presentation

The consolidated financial statements have been prepared on a historical cost basis, which is generally based on the fair value of the consideration at the time of the transaction. The consolidated financial statements are presented in Canadian dollars and all values are rounded to the nearest million unless otherwise indicated.

(c) Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, which includes its principal operating subsidiaries MTS Inc. and Allstream Inc. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. The Company has a joint arrangement, which is accounted for as a jointly-controlled asset. The Company recognizes its share of assets, liabilities, revenues and expenses related to this arrangement in its consolidated financial statements. All intercompany transactions and balances are eliminated on consolidation.

(d) Revenue recognition

Revenue is recognized when it is probable that the associated economic benefits of the transaction will flow to the Company and the amount of revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable from customers for the provision of telecommunications services and sale of equipment, net of discounts and sales taxes collected. More specifically, the Company applies the following revenue recognition policies:

- Revenues from the provision of local voice, wireless, data connectivity, Internet, Internet protocol television ("IPTV"), security and alarm monitoring services are recognized in the period in which services are provided.
- Monthly network access fees, which are billed in advance, are deferred and recognized on a straight-line basis over the contracted period.
- Revenues from long distance, wireless airtime and other pay-per-use services are recognized in the period in which services are delivered.
- Revenues related to interconnection of voice and data traffic between telecommunication operators are recognized in the period in which network usage occurs. These revenues are reported gross of any amounts charged by other telecommunications carriers for interconnection services. The costs of interconnection services received from other carriers are expensed in the period in which services are received.
- Revenues from the provision of maintenance services are recognized on a straight-line basis over the period of the customer contract.
- Revenues from the sale of equipment are recognized when the significant risks and rewards of ownership are transferred to the buyer, which is normally at the time the equipment is delivered to and available for use by the customer, in accordance with contractual arrangements.
- Advance payments received from customers are deferred and recognized in the period in which the services are provided or the goods are delivered.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

- Revenues related to contributions from customers for the construction of assets are deferred and recognized as revenue as the related service is provided.
- The Company enters into arrangements with customers in which services and products may be sold together. When the components of these multiple element arrangements have stand-alone value to the customer, the components are accounted for separately, based on the relative selling prices, using the appropriate revenue recognition criteria as described above.
- Revenues are disclosed net of discounts and rebates, as the Company does not receive an identifiable benefit in exchange for the discount given to the customer.

(e) Bank indebtedness

Bank indebtedness includes bank overdrafts, net of cash on hand, and money market instruments, which are readily converted into known amounts of cash and have a maturity of three months or less.

(f) Inventories

The Company's inventory balance consists of wireless handsets, parts and accessories, and communications equipment held for resale. The Company values its inventory at the lower of cost or net realizable value, with cost being determined on an average cost basis.

(g) Property, plant and equipment

Property, plant and equipment is recorded at historical cost, net of accumulated depreciation and accumulated impairment losses, if any. For construction projects, historical cost includes materials, direct labour, other directly attributable expenditures, and borrowing costs associated with construction projects that take a substantial period of time to get ready for their intended use. Historical cost is presented net of any related investment tax credits, which are recognized when the Company has reasonable assurance that they will be realized. The present value of estimated costs for decommissioning an asset after its intended use, representing a provision, is also included in the historical cost of property, plant and equipment.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset. When significant parts of property, plant and equipment are required to be replaced in intervals, the Company recognizes such parts as individual assets and depreciates them over their estimated useful lives. The estimated useful lives are reviewed annually, with any changes in estimate accounted for prospectively. Land is not depreciated. The estimated useful lives of property, plant and equipment are as follows:

	Estimated useful life
Network assets	
Plant assets	4 to 40 years
Wireless site equipment	4 to 12 years
General equipment and other	2 to 20 years
Buildings and leasehold improvements	9 to 40 years
Assets under finance lease	10 years

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset, which is calculated as the difference between the net disposal proceeds and the carrying amount of the asset, is included in the consolidated statement of net income in the period in which the asset is derecognized.

(h) Intangible assets

Intangible assets are recognized when the Company controls the asset, it is probable that future economic benefits attributable to the asset flow to the Company, and the cost of the asset can be reliably measured. Intangible assets are initially recognized at cost and subsequently measured at cost less accumulated amortization and impairment. Intangible assets, other than goodwill and indefinite life intangible assets, are amortized on a straight-line basis over their estimated periods of future benefit. The estimated periods of future benefit and amortization methods are reviewed annually, with any changes in estimate accounted for prospectively. The Company's intangible assets include the following:

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Computer software

Computer software, which is purchased from third parties, is amortized over the estimated period of benefit ranging from five to 10 years. Internal use software is recorded at historical cost and includes materials, direct labour and other directly attributable costs and is amortized over the estimated period of benefit ranging from five to 10 years.

(ii) Subscriber acquisition costs

Subscriber acquisition costs are capitalized and amortized over the average contractual life of the customer, which is normally 31 months for wireless costs and 36 months for alarm costs.

(iii) Spectrum licences and broadcast certificate

The wireless spectrum licences and broadcast certificate are indefinite life intangible assets and are therefore not amortized. The wireless spectrum licences were issued by Industry Canada on December 15, 2008, for an initial 10 year term expiring December 14, 2018. The broadcast certificate was issued by the Canadian Radio-television Telecommunications Commission for a seven year term expiring on August 31, 2015. The Company has determined that there are no legal, regulatory, contractual, economic or other factors which would prevent the renewals or limit the useful lives of its spectrum licences or broadcast certificate.

(iv) Customer contracts and relationships

Customer contracts and relationships acquired in business combinations are initially recognized at their fair value at the date of acquisition and are amortized on a straight-line basis over the estimated periods of benefit ranging from two to 10 years.

(v) Other

Other intangible assets, which include non-competition agreements and other service contracts, were acquired in business combinations. These items are initially recognized at their fair value at the date of acquisition and are amortized on a straight-line basis over the estimated periods of benefit ranging from two to 10 years. Other intangible assets are subsequently measured at cost less accumulated amortization.

(vi) Goodwill

Goodwill represents the excess of the aggregate purchase price over the fair value of the identifiable net tangible assets and intangible assets acquired in business combinations at the dates of acquisition. Goodwill is initially recognized as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

(i) Impairment of property, plant and equipment, and intangible assets

At each reporting date, the Company reviews the carrying amounts of its property, plant and equipment, and intangible assets to determine whether there is any indication that their carrying amount may not be recoverable. If such an indication of impairment exists, the recoverable amount of the asset is estimated and compared to its carrying amount to determine if the asset is impaired. If the recoverable amount of the individual asset cannot be determined, recoverability is tested on the basis of the cash-generating unit to which the asset is allocated.

The recoverable amount of an asset is the higher of its fair value less costs to sell or its value in use. Value in use is determined using discounted cash flow calculations. Estimated future cash flows of the asset or cash-generating unit are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset.

If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset is considered impaired and is reduced to its recoverable amount. An impairment loss is recognized immediately in income. Impairment losses, other than those related to goodwill, are reversed if the reasons for recognizing the original impairment loss no longer apply, and the asset is recognized at a value that would have been applied if no impairment losses had been recognized in prior periods.

Intangible assets with indefinite useful lives are tested for impairment annually and whenever there is an indication that the asset may be impaired.

Goodwill is tested for impairment annually and whenever there is an indication that the asset may be impaired. If the carrying amount of the cash-generating unit to which goodwill is allocated exceeds its recoverable amount, an impairment loss is recognized. Goodwill impairment losses cannot be reversed in future periods.

(j) Income taxes

The Company uses the liability method of accounting for income taxes. Under this method, current income taxes reflect the estimated income taxes payable for the current year. Deferred tax assets and liabilities are measured using substantively enacted tax rates, and are based on:

- the differences between the tax base of an asset, or liability and its carrying amount for accounting purposes; and
- the benefit of unused tax losses available to be carried forward to future years for tax purposes.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred tax assets and liabilities are determined using the tax rates that are expected to apply when the temporary difference is reversed. Deferred tax assets are recognized only to the extent that it is probable that taxable income will be available against which the deductible temporary differences or loss carryforwards can be utilized. Deferred tax assets and liabilities are not discounted.

Current and deferred taxes are recognized in the consolidated statement of income except when the tax relates to items charged or credited to other comprehensive income or equity, in which case the tax is recognized in other comprehensive income or equity, respectively. The Company establishes provisions for uncertain tax positions for possible consequences of audits and differing interpretations by the taxation authorities. These provisions are based upon the likelihood and then best estimate of amounts expected to be paid.

The Company recognizes investment tax credits on its research and development activities using the cost reduction method, under which credits are deducted from the assets or expenses to which they relate. Credits are only recorded when it is probable that they will be realized.

(k) Provisions

The Company recognizes a provision when it has a present legal or constructive obligation that is the result of a past event, it is probable that the Company will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Provisions are measured based on the best estimate of the amount required to settle the obligation. If the effect of the time value of money is material, the amount of the provision is determined using a pre-tax discount rate that reflects the risks specific to the obligation. The Company reviews its provisions at the end of each reporting period and, if required, an adjustment to reflect the current best estimate is made. In instances where it is no longer probable that an outflow of resources will be required to settle the obligation, the provision is reversed.

The Company recognizes restructuring provisions related to efficiency programs aimed at achieving process improvements and cost reductions. Restructuring provisions are recognized when we have announced or implemented a detailed formal plan that changes either the scope of our business or the manner in which the business is conducted. Facility exit costs are recognized as a liability and expensed when the Company exits a lease prior to the lease expiration date. The liabilities recognized are based on the remaining lease rentals reduced by the actual or estimated sublease rentals at the cease-use date. Decommissioning provisions are initially recognized at the best estimate of the amount required to settle the obligation, the resulting costs are added to the carrying amount of the related asset and the cost is amortized over the economic life of the asset. The carrying amount of the provision is adjusted for the passage of time and any changes in the market-based discount rate, amount or timing of the underlying future cash flows required to settle the obligation.

(l) Financial instruments

(i) Recognition and derecognition of financial assets and liabilities

Financial assets and liabilities are recognized on the Company's statement of financial position when the Company becomes a party to the contractual provisions of the instrument. The Company's financial assets and liabilities are recorded initially at fair value. Financial assets are derecognized when the Company no longer has rights to cash flows, the risks and rewards of ownership or control of the asset. Financial liabilities are derecognized when the obligation under the liability is discharged or cancelled or it expires.

(ii) Financial assets

Accounts receivable

Accounts receivable are classified as loans and receivables, and are measured at amortized cost less any allowance for doubtful accounts. The Company maintains an allowance for doubtful accounts for potential credit losses. This allowance is based on management's best estimates and assumptions regarding current market conditions, customer analysis and historical payment trends. These factors are considered when determining whether past due accounts are allowed for or written-off.

(iii) Financial liabilities

Bank indebtedness

Bank indebtedness includes bank overdrafts, net of cash on hand, and money market instruments, which are readily convertible into known amounts of cash. Bank indebtedness is classified as fair value through profit and loss ("FVTPL"), and represents a financial liability measured at fair value, with changes in fair value recognized in net income.

Long-term debt

Long-term debt is classified as other financial liabilities and is measured at amortized cost. The Company accounts for debt issue costs associated with the issuance of long-term debt as a reduction in the carrying value of long-term debt. These costs, which are amortized over the life of long-term debt using the effective interest rate method, are included in debt charges.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Other financial liabilities

Accounts payable, notes payable, securitization borrowings and other long-term liabilities are classified as other financial liabilities and are measured at amortized cost.

(iv) Fair value

The fair value of financial liabilities designated as FVTPL is determined based on quoted prices in active markets for identical assets, per Level 1 of the fair value hierarchy.

The fair value of long-term debt, which has fixed interest rates, is estimated by discounting the expected future cash flows using the relevant risk-free interest rate adjusted for an appropriate risk premium for the Company's credit profile.

(v) Accounts receivable securitization

The Company accounts for the transfer of receivables to a securitization trust as a collateralized borrowing. When the receivables are transferred, the Company continues to recognize the receivables on its statement of financial position because the associated risks and rewards, in particular credit risk, have not been transferred. A corresponding financial liability is recognized for the cash consideration received from the trust. All trade receivables transferred have a maturity of less than 90 days. Under this arrangement, the Company continues to manage and service the receivables transferred.

(vi) Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that the carrying value of a financial asset is impaired. If impairment occurs, the loss is recognized in the statement of net income and the carrying value is reduced to its fair value. With the exception of long-term debt, the carrying value of the Company's financial assets and liabilities, which are subject to normal trade terms, approximates the fair value due to the short duration to maturity.

(vii) Derivative financial instruments

The Company purchases foreign currency forward contracts in United States of America ("U.S.") dollars to manage foreign currency exchange exposure, which arises in the normal course of business operations. The Company has elected not to designate any of its foreign currency forward contracts as accounting hedges. Foreign exchange gains and losses on these foreign currency forward contracts are recorded in the consolidated statement of financial position as an asset or a liability, with changes in fair value recognized in the consolidated statement of net income. The resulting asset or liability is designated as FVTPL and is valued using observable market data as per Level 2 of the fair value hierarchy.

(m) Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement, and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets, and whether the arrangement conveys the right to use that asset.

Assets held under finance leases are recognized as assets of the Company at the lower of the present value of the minimum lease payments or the fair value of the leased assets. Assets held under finance leases are depreciated over the shorter of the lease term or their useful economic life. The corresponding liability of the Company is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation using the effective interest method. Finance charges are expensed in the reporting period.

Leases that do not transfer the risks and rewards of ownership are classified as operating leases. Payments are recorded in the statement of net income on a straight-line basis over the lease term.

(n) Employee benefits

The Company's cost of providing benefits under its defined benefit pension plans and other non-pension employee future benefits is determined annually by independent actuaries, using the projected unit credit method. These actuarial valuations require the use of assumptions, including the discount rate to measure obligations, the expected long-term rate of return on plan assets and expected future salary increases. The discount rate used to calculate the present values of the defined benefit obligation is determined by reference to market interest rates of high quality Canadian corporate bonds as at the measurement date. The expected return on plan assets is calculated using the fair value of pension fund assets. Past service costs arising from plan amendments are recognized immediately in income.

The defined benefit asset or liability recognized in the Company's consolidated statement of financial position comprises the present value of the defined benefit obligations less the fair value of plan assets. All actuarial gains and losses are recognized immediately in other comprehensive income. At each interim reporting period, the Company estimates actuarial gains and losses resulting from changes in the discount rate used to calculate the present value of the defined benefit pension obligations and from differences between the expected long-term rate of return on plan assets and the actual return

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

on plan assets. At year-end, all actuarial gains and losses arising from changes in the present value of the defined benefit obligations and the fair value of plan assets are determined in an accounting valuation prepared by an independent actuary. For funded defined benefit plans, when an asset is recognized, it is limited to the present value of the economic benefit in the form of reductions in future contributions to the plan. Any minimum funding requirements are considered in the calculation of the economic benefit. For plans recognized by a defined benefit liability, minimum funding requirements can also result in an increase in the liability. An economic benefit is available to the Company if it is realizable during the life of the plan or on settlement of the plan liabilities. The Company recognizes any decrease in an asset or increase in a liability as a result of the above in other comprehensive income ("OCI"). The Company recognizes its payments to the defined contribution plans as an expense in the period in which the employee service is incurred.

(o) Share-based compensation

The Company has a number of share-based compensation plans, whereby the Company receives services from employees or its Board of Directors in exchange for equity-settled or cash-settled share-based compensation. Equity-settled plans include the Company's stock option program. Cash-settled plans include the Company's employee share ownership plan, performance share unit plan, restricted share unit plan and share appreciation plan.

The cost of equity-settled share-based transactions is measured at the fair value of the stock option at the grant date, using the Black-Scholes option pricing model. The fair value of the stock options, which have graded vesting, is expensed over the respective vesting period of each tranche based on the Company's estimate of stock options expected to vest.

The Company uses a fair value-based methodology to measure the cost of cash-settled share-based transactions. Compensation expense is based on the expected payout amounts net of estimated forfeitures and is recorded over the term of the vesting period. Cash-settled awards are classified as liabilities, which are remeasured at each reporting date. The impact of any changes in the liability as a result of subsequent changes to the estimated payout values for the units expected to vest is recognized in income in the period of change.

(p) Translation of foreign currencies

The Company's consolidated financial statements are presented in Canadian dollars, which is also its functional currency. Foreign currencies have been translated into Canadian dollars at rates of exchange on the following bases:

- monetary assets and liabilities at rates in effect on the date of the statement of financial position;
- non-monetary assets and liabilities at historical exchange rates; and
- revenues and expenses at rates prevailing at the respective transaction dates.

(q) Adoption of new accounting standards

Effective January 1, 2012, the Company early adopted the amendments to International Accounting Standard ("IAS") 1, *Presentation of Financial Statements*, issued by the IASB in June 2011. This amendment requires companies preparing financial statements to group together items within other comprehensive income on the basis of whether they may be reclassified to the profit or loss section of the income statement. These amendments have been adopted and applied in these consolidated financial statements. The application of this amended IFRS has not had any impact on the amounts reported for the current or prior year.

3. CRITICAL ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGEMENTS

The preparation of our consolidated financial statements in accordance with IFRS requires management to make estimates, assumptions and judgements that affect the reported amounts of assets and liabilities as at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period.

(a) Critical accounting estimates and assumptions

Estimates and assumptions are based on reasonable methodologies, established processes and comparisons to industry standards. The Company continuously evaluates these estimates and assumptions, which rely on the use of professional judgement. Because professional judgement involves inherent uncertainty, actual results could differ from our estimates. Areas involving critical estimates and assumptions are described below:

(i) Valuation of accounts receivable

The Company estimates that a certain portion of receivables from customers will not be collected, and maintains an allowance for doubtful accounts. If circumstances related to specific customers change, economic conditions change or actual results differ from expectations, the Company's estimate of the recoverability of receivables could fluctuate from that provided for in the consolidated financial statements. A change in estimate could impact bad debt expense and accounts receivable.

3. CRITICAL ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGEMENTS (continued)***(ii) Property, plant and equipment***

Property, plant and equipment are amortized on a straight-line basis over their estimated useful life. The Company reviews these estimates on an annual basis, or more frequently if events during the year indicate that a change may be required, with consideration given to technological obsolescence, competitive pressures and other relevant business factors. A change in management's estimate could impact depreciation expense and the carrying value of property, plant and equipment.

(iii) Useful lives of definite life intangible assets

Intangible assets with a definite useful life are amortized on a straight-line basis over their estimated period of future benefit. The estimated periods of future benefit and amortization methods are reviewed on an annual basis, or more frequently, if events during the year indicate that a change may be required, with consideration given to customer churn, industry standards and other relevant business factors. A change in estimate could impact amortization expense and the carrying value of intangible assets.

(iv) Goodwill and indefinite life intangible assets

The Company tests the recoverability of goodwill and indefinite life intangible assets on an annual basis or earlier when events or changes in circumstance indicate that the carrying value might not be recoverable. The recoverable amount of each cash-generating unit to which the asset is allocated is determined based on value in use calculations. These calculations require the use of estimates, including management's expectations of revenues and operating costs, and assumptions on discount and growth rates. A change in estimates could impact the carrying value of goodwill and indefinite life intangible assets.

(v) Deferred tax assets

The Company has deferred tax assets resulting from net operating loss carryforwards and deductible temporary differences, which, to the extent utilized, will reduce future taxable income. Realization of these deferred tax assets is dependent on the Company's ability to utilize the underlying future deductions against future taxable income. In assessing the carrying value of the deferred tax assets, the Company makes estimates and assumptions of future taxable income using internal management projections, the carry forward period associated with the deferred tax assets, the nature of income that may be used to realize the deferred tax assets, future tax rates and ongoing audits by Canada Revenue Agency ("CRA"). A change in the Company's estimates or assumptions of any of these factors could affect the value of the deferred tax asset and related income tax expense. CRA audits currently are underway for the years 2001 to 2006. These audits include a review of loss carryforwards accumulated by Allstream Inc. prior to its acquisition by the Company in 2004.

(vi) Decommissioning provisions

When recognizing decommissioning provisions, the Company makes estimates of the probability of retiring assets, the timing and amount of retirement costs, and the discount factor applied to determine fair value. Management's estimates of probability and the timing and amount of costs, are subject to change and are reviewed annually or more frequently if events during the year indicate that a change may be required.

(vii) Employee benefits

The Company provides pension, supplemental pension and other non-pension employee future benefits to its employees. The determination of benefit expense and benefit obligation associated with employee future benefits requires the use of certain actuarial and economic assumptions, such as the discount rate to measure benefit obligations, the expected rate of return on plan assets, expected future salary increases and future mortality rates. A change in estimate or assumptions could affect benefit expense and the present value of the defined benefit obligation.

(b) Critical accounting judgement

In the normal course of operations, the Company enters into arrangements in which services and products are sold together. In the process of applying the Company's accounting policies for this type of revenue recognition, judgement is often necessary to determine when components can be accounted for separately.

4. ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

The Company has not yet adopted certain standards, interpretations to existing standards and amendments which have been issued but have an effective date of later than December 31, 2012. Many of these updates are not relevant to the Company and are therefore not discussed. The following is an overview of accounting standard changes that the Company will be required to adopt in future years:

IFRS 9, *Financial Instruments*

IFRS 9, *Financial Instruments*, issued by the IASB in November 2009 and amended in October 2010, introduces new requirements for the classification and measurement of financial assets and liabilities. IFRS 9 requires all financial assets within the scope of IAS 39, *Financial Instruments – Recognition and Measurement*, to be subsequently measured at amortized cost or fair value, replacing the multiple classification options in IAS 39. IFRS 9 also requires an entity choosing to measure a financial liability at fair value to present the portion of the change in its fair value due to changes in the entity's own credit risk in the other comprehensive income section of the income statement, rather than within the statement of net income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015, with earlier application permitted.

IFRS 10, *Consolidated Financial Statements*

IFRS 10, *Consolidated Financial Statements*, issued by the IASB in May 2011, provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. IFRS 10 replaces IAS 27, *Consolidated and Separate Financial Statements*, and Standing Interpretations Committee (“SIC”) 12, *Consolidation – Special Purpose Entities*. IFRS 10 is to be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

IFRS 11, *Joint Arrangements*

IFRS 11, *Joint Arrangements*, issued by the IASB in May 2011, describes the accounting for arrangements in which there is joint control by focusing on the rights and obligations of the arrangement, rather than its legal form. IFRS 11 also removes the ability to use proportionate consolidation for joint ventures. IFRS 11 replaces IAS 31, *Interests in Joint Ventures*, and SIC 13, *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*, and is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. When adoption of IFRS 11 requires a change in accounting, the impact of the change is calculated at the beginning of the earliest period presented and the comparative periods are restated.

IFRS 12, *Disclosure of Interests in Other Entities*

IFRS 12, *Disclosure of Interests in Other Entities*, issued by the IASB in May 2011, is a new standard that addresses the disclosure requirements for all interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

IFRS 13, *Fair Value Measurement*

IFRS 13, *Fair Value Measurement*, issued by the IASB in May 2011, replaces the fair value measurement guidance currently dispersed across different IFRS standards with a single definition of fair value and a comprehensive framework for measuring fair value when such measurement is required under other IFRSs. It also establishes disclosure requirements about fair value measurements. IFRS 13 is to be applied prospectively and is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

The adoptions of the standards described above are not expected to have a material impact on the Company's results and financial position.

Amended IAS 19, *Employee Benefits*

The amended version of IAS 19, *Employee Benefits*, issued by the IASB in June 2011 amends the accounting for pensions and other post-employment benefits. It changes the method of calculating the net interest component of pension expense and also expands disclosure requirements for defined benefit plans, providing additional information about the characteristics and associated risks of defined benefit plans. The accounting treatment for termination benefits has also been modified, specifically the point in time when an entity would recognize a liability for termination benefits. The amended standard is effective for annual periods beginning on or after January 1, 2013 and is to be applied retrospectively.

In comparison to the Company's current accounting policies and basis of presentation, the primary difference in the amended version of IAS 19 is that the current defined benefit plan expense components of “interest cost” and “expected return on plan assets” will be replaced by the component “net interest”. Net interest is determined for each defined benefit

4. ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE (continued)

plan by taking the plan's net surplus or deficit and multiplying it by the liability discount rate. Upon application of the amended standard the Company expects to recognize the net interest of its defined benefit plans as part of finance costs.

The Company expects that over the long term the rate of return on plan assets for its defined benefit plans will exceed the liability discount rate because a significant component of the defined benefit plan's assets are invested in equities and real estate. The difference between the actual rate of return on plan assets and the liability discount rate will be recognized in other comprehensive income. As a result, net income is expected to decrease, with a corresponding decrease in other comprehensive loss.

The amended standard is not expected to affect the Company's statement of financial position or the statement of cash flows. Had the amended version of IAS 19 been implemented effective January 1, 2012, the Company's consolidated statement of net income and other comprehensive loss would have been impacted as follows:

	Year ended December 31, 2012
Operating expense increase	(24.4)
Finance cost increase	(16.4)
Income tax expense decrease	11.0
Net income decrease	(29.8)
Other comprehensive income increase	29.8
Basic and diluted earnings per share decrease (\$)	(0.44)

The Company will apply the amended standard for periods beginning on January 1, 2013.

5. OPERATING REVENUES

	2012	2011
Operating revenues from the provision of services	1,641.5	1,696.4
Operating revenues from the sale of goods	62.6	69.2
Operating revenues	1,704.1	1,765.6

6. OPERATING EXPENSES

	2012	2011
Operations:		
Salaries and benefits expense	404.0	404.5
Bad debt expense	8.8	6.0
Other operations expenses	681.8	760.7
	1,094.6	1,171.2
Depreciation and amortization:		
Depreciation of property, plant and equipment	214.3	197.1
Amortization of intangible assets	108.5	101.8
Operating expenses	1,417.4	1,470.1

7. FINANCE COSTS

	2012	2011
Interest expense on long-term indebtedness	56.1	61.8
Interest expense on short-term indebtedness	5.3	4.5
Other finance expense	5.4	6.5
Capitalized borrowing costs	(6.6)	(7.2)
Interest income	—	(0.1)
Finance costs	60.2	65.5

During the year ended December 31, 2012, the Company paid short-term interest costs of \$5.1 million (2011 – \$4.5 million) and interest on long-term debt of \$56.9 million (2011 – \$61.6 million).

Borrowing costs associated with qualifying projects were capitalized at an average rate of 5.62% (2011 – 5.79%).

8. INCOME TAXES

The major components of income tax expense for the years ended December 31, 2012 and December 31, 2011 are:

	2012	2011
<i>Current income tax:</i>		
Current income tax expense	0.1	—
Adjustments in respect of current income tax expense of previous years	(0.5)	—
	(0.4)	—
<i>Deferred income tax:</i>		
Relating to origination and reversal of temporary differences	50.4	65.4
Income tax expense	50.0	65.4

Income tax recovery on actuarial gains and losses from defined benefit plans and other post employment benefits recognized in other comprehensive loss in 2012 is \$31.3 million (2011 – \$50.8 million).

Reconciliations between income tax expense recognized and the accounting income multiplied by the applicable tax rate for the years ended December 31, 2012 and December 31, 2011 are as follows:

	2012		2011	
	%	\$	%	\$
Net income before income taxes		225.4		232.5
Income tax at combined federal and provincial statutory tax rate	27.0	60.9	28.3	65.8
Effect of:				
Change in the expected tax rate applicable to deferred tax assets	(4.5)	(10.2)	—	—
Provincial statutory tax rate increase	(0.7)	(1.5)	—	—
Rate differential on temporary differences	—	—	(0.7)	(1.5)
Other items	0.4	0.8	0.5	1.1
Income tax reported in the consolidated statements of net income	22.2	50.0	28.1	65.4

The tax rate used represents the combined federal and provincial statutory tax rate applicable to the Company's major operating entity.

8. INCOME TAXES (continued)

The major items giving rise to deferred tax assets and liabilities are presented below:

	December 31, 2012	December 31, 2011
Tax loss carryforwards	258.3	229.3
Property, plant and equipment	130.5	196.1
Employee benefits	133.5	110.5
Other	(7.4)	(1.9)
Deferred tax assets, net	514.9	534.0

Reflected in the consolidated statements of financial position as follows:

	December 31, 2012	December 31, 2011
Deferred tax assets	515.8	535.0
Deferred tax liabilities	(0.9)	(1.0)
Deferred tax assets, net	514.9	534.0

Deferred tax assets of \$258.3 million (December 31, 2011 – \$229.3 million) on tax loss carryforwards, which arose in certain subsidiaries, were recognized in situations where their utilization is dependent on future taxable profits in excess of the reversal of existing temporary differences of the entities and where there is a history of current and prior year losses, since it is probable that the losses will be utilized through various other tax planning opportunities.

During the year ended December 31, 2012, the Company paid no cash income taxes (2011 – nil).

As at December 31, 2012, the Company, along with its subsidiaries, had non-capital tax loss carryforwards of \$958.3 million (December 31, 2011 – \$874.3 million) available to reduce future years' taxable income, which expire as follows:

2014	19.2
2025 and beyond	939.1
	958.3

9. EARNINGS PER SHARE

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

	2012	2011
Net income for the year		
Basic and diluted	175.4	167.1
Weighted average shares outstanding (in millions)		
Weighted average number of shares outstanding – basic and diluted	66.6	65.5
Earnings per share (\$)		
Basic and diluted earnings per share	2.63	2.55

As at December 31, 2012, 437,425 stock options had a dilutive effect (2011 – nil).

10. INVENTORIES

The Company performs periodic reviews of inventory for obsolescence and, during the year ended December 31, 2012, recorded a recovery of obsolete inventory expense of \$0.2 million (2011 – expense \$1.0 million). During the year ended December 31, 2012, the Company expensed \$36.7 million of inventory relating to cost of goods sold (2011 – \$38.5 million).

11. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are comprised of the following:

	Network assets	General equipment and other	Buildings and leasehold improvements	Assets under finance lease	Assets under construction	Land	Total
Cost							
December 31, 2010	2,924.0	586.3	279.8	1.7	154.4	6.4	3,952.6
Additions	151.6	59.4	11.3	—	21.4	—	243.7
Transfers	3.0	(3.0)	(0.2)	—	—	0.2	—
Disposals	(36.6)	(98.9)	(3.6)	—	—	—	(139.1)
Other changes	1.2	—	—	—	—	—	1.2
December 31, 2011	3,043.2	543.8	287.3	1.7	175.8	6.6	4,058.4
Additions	233.1	77.0	10.8	—	(88.7)	—	232.2
Disposals	(8.2)	(9.7)	(0.8)	—	—	—	(18.7)
December 31, 2012	3,268.1	611.1	297.3	1.7	87.1	6.6	4,271.9
Accumulated depreciation and impairment							
December 31, 2010	1,873.2	452.3	128.6	0.9	—	—	2,455.0
Depreciation expense	139.2	48.0	9.4	0.2	—	—	196.8
Disposals	(34.3)	(99.6)	(2.8)	—	—	—	(136.7)
December 31, 2011	1,978.1	400.7	135.2	1.1	—	—	2,515.1
Depreciation expense	153.0	52.2	8.8	0.2	—	—	214.2
Disposals	(7.3)	(9.6)	(0.5)	—	—	—	(17.4)
December 31, 2012	2,123.8	443.3	143.5	1.3	—	—	2,711.9
Net book value							
December 31, 2011	1,065.1	143.1	152.1	0.6	175.8	6.6	1,543.3
December 31, 2012	1,144.3	167.8	153.8	0.4	87.1	6.6	1,560.0

12. INTANGIBLE ASSETS

Intangible assets are comprised of the following:

	Computer software	Subscriber acquisition costs	Spectrum licences and broadcast certificate	Customer contracts and relationships	Other	Goodwill	Total
Cost							
December 31, 2010	334.9	117.3	51.4	10.7	42.7	27.7	584.7
Additions	44.3	68.1	—	—	28.2	—	140.6
Disposals	(3.3)	(46.8)	—	—	(26.0)	—	(76.1)
December 31, 2011	375.9	138.6	51.4	10.7	44.9	27.7	649.2
Additions	105.8	65.7	—	—	8.4	—	179.9
Disposals	(2.3)	(46.4)	—	—	(11.7)	—	(60.4)
December 31, 2012	479.4	157.9	51.4	10.7	41.6	27.7	768.7
Accumulated amortization and impairment							
December 31, 2010	217.1	55.9	—	3.6	28.6	—	305.2
Amortization expense	49.4	50.2	—	1.0	1.2	—	101.8
Amortization recorded in operations expense	—	—	—	—	11.1	—	11.1
Disposals	(3.3)	(46.8)	—	—	(26.0)	—	(76.1)
December 31, 2011	263.2	59.3	—	4.6	14.9	—	342.0
Amortization expense	47.1	58.5	—	1.0	1.9	—	108.5
Amortization recorded in operations expense	—	—	—	—	9.6	—	9.6
Disposals	(2.0)	(46.4)	—	—	(11.7)	—	(60.1)
December 31, 2012	308.3	71.4	—	5.6	14.7	—	400.0
Net book value							
December 31, 2011	112.7	79.3	51.4	6.1	30.0	27.7	307.2
December 31, 2012	171.1	86.5	51.4	5.1	26.9	27.7	368.7

Allocation of goodwill to cash-generating units for impairment testing

For the purposes of its annual goodwill impairment test, the Company allocates its goodwill to the cash-generating units, which are the smallest identifiable groups of assets that generate cash inflows that have goodwill and are largely independent of the cash inflows from other groups of assets. The Company's \$27.7 million of goodwill has been allocated as follows: \$20.6 million to the MTS Unit, excluding AAA Alarms, and \$7.1 million to AAA Alarms.

The Company also has indefinite life intangible assets of \$51.4 million (December 31, 2011 – \$51.4 million) which have been allocated to the MTS Unit, excluding AAA Alarms, for purposes of annual impairment testing. The impairment tests performed during the year did not result in the recognition of any impairment losses.

In performing the annual impairment testing for each of the Company's cash-generating units, the Company measured the recoverable amount of the cash-generating unit based on a value in use calculation using certain key management assumptions. Cash flow projections, which were made over a five-year period based on financial budgets approved by the Board, include key assumptions about revenues, expenses and other cash flows. Revenue forecasts were based on management's estimate of growth in the markets served and are not considered to exceed the long-term average growth rates for those markets. Operating expenses were estimated based upon past experience, adjusted for the increase in activity levels supporting the cash flow projections. Discount rates applied to the cash flow forecasts are derived from the group's pre-tax weighted average cost of capital, adjusted to reflect management's estimate of the specific risk profiles of the individual cash-generating units. The cash flows related to the MTS Unit, excluding AAA Alarms, and AAA Alarms were discounted using pre-tax rates of 11.8% to 12.8% and 13.2% to 14.6%, respectively.

Based on the sensitivity analysis performed, the Company has concluded that no reasonably possible changes in the key assumptions on which the recoverable amount is based would cause the carrying amount of the cash-generating unit to exceed the recoverable amount.

13. OTHER ASSETS

	December 31, 2012	December 31, 2011
Investment tax credits recoverable	52.2	48.1
Long-term prepaid costs	13.7	15.1
Other long-term assets	6.0	4.6
	71.9	67.8

14. PROVISIONS

The composition and changes in provisions are as follows:

	Restructuring	Tax-related	Decommissioning	Other	Total
December 31, 2010	12.9	11.2	6.3	5.2	35.6
Provisions recognized	7.9	5.2	0.4	0.1	13.6
Provisions utilized	(8.9)	(0.5)	(0.5)	(0.4)	(10.3)
Provisions reversed	(0.4)	—	—	(0.1)	(0.5)
Accretion	0.1	—	0.3	—	0.4
December 31, 2011	11.6	15.9	6.5	4.8	38.8
Provisions recognized	7.6	3.1	0.5	0.3	11.5
Provisions utilized	(5.1)	(7.4)	(0.1)	(0.6)	(13.2)
Provisions reversed	(5.9)	(1.3)	—	(0.7)	(7.9)
Accretion	0.1	—	0.1	—	0.2
December 31, 2012	8.3	10.3	7.0	3.8	29.4

Presented as:

	8.2	10.3	1.9	3.5	23.9
Current provisions					
Long-term provisions	0.1	—	5.1	0.3	5.5
Total provisions	8.3	10.3	7.0	3.8	29.4

(i) Restructuring

Restructuring provisions relate to the Company's efficiency programs aimed at achieving process improvements and expense reductions. Restructuring costs include costs for severance and other employee-related expenses that supported workforce reduction initiatives undertaken throughout the year and facility consolidation of select real estate. These provisions are expected to be settled over periods ranging from one month to 12 months.

(ii) Tax-related

The Company recognizes tax-related provisions for uncertain tax positions related to sales taxes, capital taxes and property taxes. The provisions reflect the potential obligation for the Company to remit additional taxes, penalties and/or interest as a result of decisions by taxation authorities.

(iii) Decommissioning

Decommissioning provisions arise from legal and constructive obligations that exist for the removal of equipment or the restoration of premises upon the termination of certain agreements. These provisions, which are expected to be settled over periods ranging from four months to 39 years, are associated with underground and above ground cable, microwave towers and related structures, building accesses and leased facilities.

The undiscounted amount of the estimated cash flows required to settle the decommissioning provisions as at December 31, 2012 is approximately \$12 million (December 31, 2011 – \$12 million).

(iv) Other

Other provisions include amounts provided for legal or constructive obligations arising from regulatory decisions and litigation claims.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial assets and liabilities

Financial assets and liabilities in the consolidated statements of financial position are as follows:

December 31, 2012	Financial assets/liabilities at fair value	Loans and receivables at amortized cost	Other financial liabilities at amortized cost	Total
Financial assets				
Accounts receivable	—	165.7	—	165.7
	—	165.7	—	165.7
Financial liabilities				
Bank indebtedness	12.6	—	—	12.6
Accounts payable and accrued liabilities	0.1	—	307.5	307.6
Notes payable	—	—	54.5	54.5
Long-term debt	—	—	921.9	921.9
Other long-term liabilities	—	—	15.5	15.5
	12.7	—	1,299.4	1,312.1

December 31, 2011	Financial assets/liabilities at fair value	Loans and receivables at amortized cost	Other financial liabilities at amortized cost	Total
Financial assets				
Cash and cash equivalents	16.8	—	—	16.8
Accounts receivable	—	156.6	—	156.6
	16.8	156.6	—	173.4
Financial liabilities				
Accounts payable and accrued liabilities	—	—	311.9	311.9
Current portion of long-term debt	—	—	100.0	100.0
Long-term debt	—	—	920.8	920.8
Other long-term liabilities	—	—	17.0	17.0
	—	—	1,349.7	1,349.7

Notes payable

As at December 31, 2012, the Company had a \$400 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, 2012, the Company had \$119.6 million in undrawn letters of credit outstanding under this facility. The Company also had a \$150 million credit facility with a financial institution, which is used solely for the issuance of letters of credit. As at December 31, 2012, the Company had \$149.3 million in undrawn letters of credit outstanding under this facility.

Under the terms of the Company's accounts receivable securitization program, the Company has the ability to transfer, on a revolving basis, an undivided ownership interest in its accounts receivable to a securitization trust, up to a maximum of \$110.0 million. The terms of the Company's accounts receivable securitization program require the Company to maintain reserve accounts, in the form of additional accounts receivable over and above the cash proceeds received, to absorb credit losses on the receivables sold.

As at December 31, 2012, the Company had \$54.5 million (December 31, 2011 – nil) outstanding on its accounts receivable securitization program, which is recorded as notes payable. This is secured by an outstanding undivided ownership interest held by the trust of \$69.7 million (December 31, 2011 – nil) in trade receivables, including \$15.2 million (December 31, 2011 – nil) of reserve accounts. The fair value of the reserve accounts approximates carrying value as a result of the short collection cycle and negligible credit losses. The trust has no recourse to the undivided ownership interest in the retained receivables, other than through the reserve accounts.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)**Long-term debt**

Long-term debt is comprised of the following:

	Interest rate	Maturity	December 31, 2012	December 31, 2011
Medium Term Note	5.05%	May 11, 2012	—	100.0
Loan Payable	6.59%	May 14, 2014	75.0	75.0
Medium Term Note	6.15%	June 10, 2014	200.0	200.0
Medium Term Note	6.65%	May 11, 2016	250.0	250.0
Medium Term Note	4.59%	October 1, 2018	200.0	200.0
Medium Term Note	5.625%	December 16, 2019	200.0	200.0
			925.0	1,025.0
Less: debt issue costs			(3.1)	(4.2)
			921.9	1,020.8
Less: current portion of long-term debt			—	(100.0)
			921.9	920.8

The Company's notes are issued under trust indentures and are unsecured.

Fair value

With the exception of long-term debt, the carrying value of the Company's financial assets and liabilities, which are subject to normal trade terms, approximate fair value. The fair value of long-term debt as at December 31, 2012, including the current portion, was \$1,019.5 million (December 31, 2011 – \$1,105.2 million).

Financial risk management**Credit risk**

The Company is exposed to credit risk from its customers. This risk is minimized by the Company's large and diverse customer base.

The following table provides an aging analysis of the Company's accounts receivable:

	December 31, 2012	December 31, 2011
0-30 days	115.9	109.5
31-60 days	33.0	33.2
61-90 days	7.9	6.5
Past 90 days	8.9	7.4
Total	165.7	156.6

The Company maintains an allowance for doubtful accounts for potential credit losses. This allowance is based on management's best estimates and assumptions regarding current market conditions, customer analysis and historical payment trends. These factors are considered when determining whether past due accounts are allowed for or written off. The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Company's maximum exposure to credit risk.

The Company's allowance for doubtful accounts for large business accounts receivable is calculated as a specific percentage of total large business accounts outstanding plus an additional provision for certain high-risk large business accounts. For all other accounts receivable, the allowance for doubtful accounts represents all accounts over 90 days past due.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

The following table provides a continuity of the Company's allowance for doubtful accounts receivable:

	2012	2011
Balance, beginning of the year	7.3	7.5
Charge for the year	8.8	6.0
Accounts written-off (net of recoveries)	(7.6)	(6.2)
Balance, end of the year	8.5	7.3

Liquidity risk

The Company is exposed to liquidity risk from its debt. This risk is minimized by the Company's capital structure management policies and by maintaining bank credit facilities. The following table provides a summary of the maturity dates for various financial liabilities, based on contractual undiscounted payments. The table includes both interest and principal cash flows.

2012	Less than 1 year	1 - 2 years	2 - 3 years	3+ years
Accounts payable and accrued liabilities	307.6	—	—	—
Notes payable	54.5	—	—	—
Long-term debt – principal	—	275.0	—	650.0
Interest on long-term debt	54.3	45.6	37.0	75.8
Other long-term liabilities	2.5	2.5	2.5	13.7
Forward contracts	26.8	—	—	—
	445.7	323.1	39.5	739.5

2011

Accounts payable and accrued liabilities	311.9	—	—	—
Long-term debt – principal	100.0	—	275.0	650.0
Interest on long-term debt	56.1	54.3	45.6	112.8
Other long-term liabilities	2.5	2.5	2.5	16.1
	470.5	56.8	323.1	778.9

Market risk

The Company is exposed to market risk from interest rates related to its debt and from foreign exchange rates related to normal business operations in foreign currencies.

Interest rate risk is minimized by the Company's capital structure management policies.

The Company enters into foreign currency forward contracts to manage foreign currency exposure, which arises in the normal course of business operations. The Company's accounting policy is to adjust outstanding foreign currency forward contracts from book value to fair value as at the balance sheet date. As at December 31, 2012, the Company had \$26.8 million U.S. of outstanding foreign currency forward contracts (December 31, 2011 – nil) and a related financial liability recorded in accounts payable and accrued liabilities of \$0.1 million (December 31, 2011 – nil). During the year ended December 31, 2012, the Company recognized \$0.1 million of expense in other income related to the adjustment of outstanding foreign currency forward contracts to fair value. In January 2013, the Company had outstanding foreign currency forward contracts to purchase \$31.3 million U.S.

Reasonable fluctuations in market interest rates and foreign currency exchange rates would not have a material impact on the Company's net income and comprehensive income.

Capital structure management policies

The Company's objectives when managing capital are: (i) to maintain an acceptable level of liquidity, so that the Company can continue to cover its financial obligations and investment requirements under the current business model; and (ii) to enhance shareholder value by maintaining an efficient cost of capital.

The Company manages capital through the monitoring of a number of measures, with the primary one being debt to capitalization. This metric illustrates the amount of assets that are financed by debt versus equity. As part of managing the capital structure, the Company will make adjustments based on changes in economic conditions and the risk characteristics

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

of the underlying assets. In order to maintain an optimal capital structure, the Company may buy back shares to reduce shareholders' equity or sell assets to reduce debt.

The following table provides information on the Company's debt to capitalization ratio:

	December 31, 2012	December 31, 2011
Bank indebtedness (cash and cash equivalents)	12.6	(16.8)
Notes payable	54.5	—
Finance lease obligations, including current portion	14.0	15.0
Long-term debt, including current portion	921.9	1,020.8
Total debt	1,003.0	1,019.0
Shareholders' equity	809.1	789.7
Total capitalization	1,812.1	1,808.7
Debt to capitalization	55.4%	56.3%

The Company must comply with two types of covenants regarding capital structure. The first is a debt to earnings before interest, taxes, depreciation and amortization, and other income (expense) ("EBITDA") covenant on the Company's bank credit facility that requires the Company to maintain a ratio of debt to EBITDA below a certain threshold. The second is a level of debt covenant on the Company's medium term notes that requires the Company not to exceed a specified debt to total capitalization level. The Company continually monitors these covenants and is in full compliance as at December 31, 2012.

16. EMPLOYEE BENEFITS**Pension benefits**

The Company and its subsidiaries provide pension benefits through two contributory and one non-contributory defined benefit best average pension plans, which cover most of the employees of the Company and its subsidiaries. These plans provide pensions based on length of service and best average earnings. Two of the defined benefit plans have provisions for periodic cost of living adjustments to benefit payments for certain members, based on a percentage of the increase in the Consumer Price Index. The Company's policy is to fund the plans as determined through periodic actuarial valuations. Contributions reflect actuarial assumptions regarding salary projections and future service benefits.

The Company also has two defined contribution pension plans that cover certain employees of the Company. One plan requires the Company to contribute, on behalf of each member, an amount equal to 2.5% of the member's earnings. The second plan requires members to contribute a minimum of 1% to a maximum of 9% of earnings. The Company is required to match member contributions, subject to limits that vary by years of continuous service.

The Company also provides supplemental pension benefits to certain current and retired employees. One of the Company's supplemental pension benefit plans has assets set aside in trust to fund benefits.

The Company measures its defined benefit obligations and the fair value of plan assets as at December 31 each year. The most recent actuarial valuation of the pension plans for funding purposes was as at January 1, 2012. The next funding valuations are required to be completed as at January 1, 2013. Future funding requirements will depend on the results of annual actuarial funding valuations, which are affected by various factors such as actuarial experience of the plans, return on plan assets and interest rate fluctuations.

Effective April 1, 2011, new regulations under the *Pension Benefits Standards Act, 1985* (Canada) 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, the Company has arranged for \$235.9 million (2011 – \$155.4 million) in letters of credit to be held by RBC Dexia Investor Services Trust, the trustee for the defined benefit pension plans.

Other benefits

The Company provides other non-pension employee future benefits, including life, medical and dental insurance, which are unfunded. The Company's costs for medical and dental insurance available for certain retirees are fixed and not subject to changes in medical cost trend rates.

16. EMPLOYEE BENEFITS (continued)

The Company also has a long-term disability plan for certain employees, for which the Company had assets set aside to fund benefits. These assets have been used to fund benefits, with a small residual amount reallocated to general corporate purposes in 2011.

Defined benefit plans

Net benefit expense

The amounts recognized in the Company's consolidated statements of net income in operations expense and the actual return on plan assets are as follows:

	Pension benefits		Other benefits	
	2012	2011	2012	2011
Current service cost	32.7	29.4	2.4	2.2
Interest cost	102.6	107.1	1.4	1.4
Expected return on plan assets	(127.0)	(133.5)	—	—
Net benefit expense	8.3	3.0	3.8	3.6

The amounts recognized in the Company's consolidated statements of other comprehensive loss are as follows:

Net actuarial losses	107.2	193.7	1.0	0.2
Deferred tax recovery on actuarial losses	(31.0)	(50.8)	(0.3)	—
Total recognized in other comprehensive loss	76.2	142.9	0.7	0.2

Net benefit liability

The components of the net benefit liability, as recognized in the Company's consolidated statements of financial position are as follows:

Present value of funded defined benefit obligation	(2,376.1)	(2,198.3)	—	—
Fair value of plan assets	1,956.8	1,853.7	—	—
	(419.3)	(344.6)	—	—
Present value of unfunded defined benefit obligations	(23.0)	(20.5)	(30.9)	(29.1)
Net benefit liability – recorded in employee benefits	(442.3)	(365.1)	(30.9)	(29.1)

16. EMPLOYEE BENEFITS (continued)
Benefit obligation and plan assets

The changes in the present value of the defined benefit obligation and the fair value of plan assets are as follows:

	Pension benefits		Other benefits	
	2012	2011	2012	2011
Present value of defined benefit obligation, beginning of year	2,218.8	2,099.7	29.1	28.4
Employer current service cost	32.7	29.4	2.4	2.2
Employee contributions	11.8	12.1	—	—
Interest cost	102.6	107.1	1.4	1.4
Actuarial loss on obligation	157.8	82.1	1.0	0.2
Benefit payments and transfers	(124.6)	(111.6)	(3.0)	(3.1)
Present value of defined benefit obligation, end of year	2,399.1	2,218.8	30.9	29.1
Fair value of plan assets, beginning of year	1,853.7	1,873.7	—	3.0
Employee contributions	11.8	12.1	—	—
Employer contributions	38.3	57.6	3.0	0.9
Expected return on plan assets	127.0	133.5	—	—
Actuarial gain (loss) on plan assets	50.6	(111.6)	—	—
Benefit payments and transfers	(124.6)	(111.6)	(3.0)	(3.1)
Asset reallocation	—	—	—	(0.8)
Fair value of plan assets, end of year	1,956.8	1,853.7	—	—

The actual return on plan assets are as follows:

Actual return on plan assets	177.6	21.9	—	—
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The cumulative gains and losses recognized in other comprehensive income are as follows:

Actuarial losses, beginning of year	373.4	179.7	2.3	2.1
Net actuarial losses recognized in year	107.2	193.7	1.0	0.2
Actuarial losses, end of year	480.6	373.4	3.3	2.3

The Company expects to contribute approximately \$98 million in cash funding and arrange for approximately \$35 million in new letters of credit to be issued to the defined benefit plans in 2013.

Other financial information about the Company's benefit plans is as follows:

	Pension benefits			Other benefits		
	2012	2011	2010	2012	2011	2010
Present value of defined benefit obligation	2,399.1	2,218.8	2,099.7	30.9	29.1	28.4
Fair value of plan assets	1,956.8	1,853.7	1,873.7	—	—	3.0
Net benefit liability	(442.3)	(365.1)	(226.0)	(30.9)	(29.1)	(25.4)
Experience loss on defined benefit obligation	(157.8)	(82.1)	(209.0)	(1.0)	(0.2)	(1.9)
Experience gain (loss) on plan assets	50.6	(111.6)	29.3	—	—	(0.2)

16. EMPLOYEE BENEFITS (continued)

The major categories of the defined benefit pension plans' assets as a percentage of the fair value of the total plans' assets are as follows:

	2012	2011
Equity securities	55%	52%
Debt securities	40%	42%
Real estate	5%	6%
	100%	100%

The plans' assets do not include any direct investment in the Company's own financial instruments nor any property occupied or other assets used by the Company. Some of the plans' assets are invested in units of certain Canadian equity and bond pooled funds that may hold financial instruments of the Company from time to time.

Actuarial assumptions

Management must make assumptions about the expected long-term rate of return on plan assets. In determining the long-term rate of return assumption, management considers input from its actuaries regarding the expected long-term rates of return, assuming the Company's targeted investment portfolio mix.

The actuarial assumptions used to determine the defined benefit obligation and net benefit expense are as follows:

	Pension benefits		Other benefits	
	2012	2011	2012	2011
Defined benefit obligation				
Discount rate	4.30%	4.75%	4.30%	4.50-4.75%
Future salary increases	3.25%	3.25%	3.25%	3.25%
Net benefit expense				
Discount rate	4.75%	5.25%	4.50-4.75%	5.00-5.25%
Expected rate of return on plan assets	7.00%	7.25%	N/A	N/A
Future salary increases	3.25%	3.50%	3.25%	3.50%

Defined contribution plan

During 2012, the Company recognized an expense, representing employer contributions to the defined contribution plans, in the amount of \$3.1 million (2011 – \$2.8 million).

17. OTHER LONG-TERM LIABILITIES

	December 31, 2012	December 31, 2011
Deferred revenue	17.9	18.8
Rights-of-way and network access contracts	2.4	4.2
Other	26.7	26.9
	47.0	49.9

18. SHARE CAPITAL

Authorized

Unlimited number of Preference Shares of two classes
 Unlimited number of Common Shares of a single class

Preference Shares

The two classes of Preference Shares are issuable in one or more series, for which the Board of Directors of the Company may fix the number of shares and determine the designation, rights, privileges, restrictions and conditions. One class of Preference Shares of a single series has been designated as Class A Preference Shares. Another class of Preference Shares of a single series has been designated as Class B Preference Shares. There are no Preference Shares outstanding.

Class A Preference Shares

The rights, privileges, restrictions and conditions of the Class A Preference Shares are identical in all respects to those of the Common Shares, except for the following:

- The holders of Class A Preference Shares are not entitled to vote at meetings of shareholders on resolutions electing directors.
- The Class A Preference Shares are convertible, at any time, into Common Shares, on a one-for-one basis.

Class B Preference Shares

The rights, privileges, restrictions and conditions of the Class B Preference Shares are identical in all respects to those of the Common Shares, except for the following:

- The holders of Class B Preference Shares are not entitled to vote at meetings of shareholders, and are not entitled to share in the distribution of the assets of the Company upon a liquidation, winding-up or dissolution.
- The Class B Preference Shares are convertible into Common Shares on a one-for-one basis at the option of the holder at any time subject to foreign ownership restrictions, or upon the occurrence of certain events, or at the option of the Company at any time.

Dividends on each class of Preference Shares are payable on the same dates as dividends are paid on the Common Shares of the Company, using the same record date for determining holders of Preference Shares entitled to dividends as the record date for Common Share dividends, in an amount per Preference Share equal to the corresponding amount of dividends per Common Share.

Both classes of Preference Shares participate in the earnings of the Company on an equal basis with the Common Shares. Therefore, any shares issued are included in the weighted average number of shares outstanding for purposes of calculating basic and diluted earnings per share.

Common Shares

The holders of the Common Shares have the right to receive notice of, and attend and vote at, meetings of shareholders, to receive such dividends as may be declared by the Board of Directors of the Company, and to share in the distribution of the assets of the Company upon liquidation, winding-up or dissolution, subject to the rights, privileges and conditions attaching to any other class of shares ranking in priority thereto. Common shares have no par value.

During the year ended December 31, 2010, the Company established a Dividend Reinvestment Plan and Share Purchase Plan ("the Plan") which enables eligible holders of its Common Shares to automatically reinvest their regular quarterly dividends in additional Common Shares of the Company. Participants in the Plan also have the option to make cash payments to purchase additional Common Shares. The shares are issued from treasury at a discount of 3% from the average market price.

Issued	2012		2011	
	Number	Value	Number	Value
Common Shares				
Balance, beginning of year	65,936,973	1,303.7	64,959,635	1,275.0
Issued pursuant to the Plan	1,057,879	33.5	962,447	28.1
Share cancellation	—	—	(709)	—
Issued pursuant to stock options	—	—	15,600	0.6
Balance, end of year	66,994,852	1,337.2	65,936,973	1,303.7

18. SHARE CAPITAL (continued)

During the year ended December 31, 2012, 1,057,879 Common Shares were issued (2011 – 962,447 Common Shares) as a result of participation in the Plan in exchange for \$33.5 million (2011 – \$28.1 million), which was credited to share capital.

During the year ended December 31, 2012, no Common Shares were cancelled (2011 – 709 Common Shares). The shares cancelled in 2011 were originally issued as part of the acquisition of Allstream Inc. in 2004 and after the seven year tender period expired the Company cancelled them.

During the year ended December 31, 2012, no stock options were exercised. During the year ended December 31, 2011, 15,600 stock options were exercised for cash consideration of \$0.5 million, of which \$0.6 million was credited to share capital and \$0.1 million was charged to contributed surplus.

Dividends

On February 13, 2013, the Company's Board of Directors declared a quarterly cash dividend of \$0.425 per share. During 2012, the Company paid \$1.70 per share to shareholders of record (2011 – \$1.70).

19. CONTRIBUTED SURPLUS

Contributed surplus is used to recognize the value of equity-settled share-based payment transactions provided to employees, as part of their remuneration.

20. SHARE-BASED COMPENSATION

The Company has various share-based compensation arrangements, which are described below. During the year, the Company recognized expense in the amount of \$12.5 million (2011 – \$12.6 million) related to these plans, of which \$0.6 million (2011 – \$0.5 million) was for equity-settled share-based plans and \$11.9 million (2011 – \$12.1 million) was for cash-settled share-based plans. As at December 31, 2012, the liability arising from the cash-settled share-based compensation plans is \$19.3 million (2011 – \$16.6 million). The vested amount of this liability is \$5.3 million (2011 – \$5.1 million).

Stock options

The Company has a stock option plan under which the Board of Directors may grant options to purchase Common Shares to employees at a price not less than the weighted average of the prices at which the Common Shares traded on the TSX for the five days immediately preceding the date of grant of the option. The options are exercisable during a period not to exceed 10 years. The right to exercise the options accrues over a period of five years of continuous employment at a rate of 20% per year, effective on the anniversary of the date on which the options were granted. The Company has reserved a maximum of 7.0 million (2011 – 7.0 million) Common Shares to meet rights outstanding under the stock option plan. The Company also has reserved 450,000 Common Shares to meet rights outstanding under an additional security-based compensation arrangement. This compensation arrangement has the same terms and conditions as the stock options granted under the stock option plan described above.

The following tables provide further information on outstanding stock options:

	2012		2011	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Outstanding, beginning of year	2,813,294	38.33	3,027,490	38.70
Granted	355,720	32.36	99,953	30.98
Exercised	—	—	(15,600)	33.84
Forfeited	(3,469)	37.49	(89,809)	37.21
Expired	(214,873)	38.34	(208,740)	40.98
Outstanding, end of year	2,950,672	37.61	2,813,294	38.33
Exercisable, end of year	1,838,525	39.83	1,703,661	40.52

20. SHARE-BASED COMPENSATION (continued)

Range of exercise price	Options outstanding	Weighted Average Remaining Contractual Life (Years)
\$30 – \$40	2,259,092	6.02
\$41 – \$50	691,580	3.88
	2,950,672	5.52

The fair value of stock options is estimated at the date of grant using the Black-Scholes option pricing model, with the following weighted average assumptions:

	2012	2011	
		February	June
Fair value	\$2.78	\$3.24	\$3.30
Risk-free interest rate	1.44%-2.15%	2.69%-3.55%	2.11%-3.01%
Expected volatility	20.14%	20.25%	20.15%
Expected dividend yield	5.27%	5.47%	5.11%
Expected life	6 years	6 years	6 years
Probability of forfeiture	35.13%	35.13%	35.13%
Share price	\$32.23	\$31.07	\$33.26
Exercise price	\$32.36	\$30.91	\$33.60

Volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in the Company's option pricing model is the natural log of the Company's weekly historical stock prices, adjusted for unusual swings in the stock price due to events that are not expected to occur in the future.

Employee share ownership plan

The Company has an employee share ownership plan under which eligible employees can purchase Common Shares of the Company. Eligible employees may contribute between 1% and 6% of salary, with the Company contributing an amount equal to 25% of employee contributions. The Company recognizes its contributions as a component of operating expenses. During the year ended December 31, 2012, the Company recognized expenses in the amount of \$3.2 million (2011 – \$3.1 million) related to this plan. During the year, all Common Shares purchased on behalf of employees under this plan were purchased at fair market value.

Performance share unit plan

The Company has a performance share unit ("PSU") plan under which the Board of Directors may grant PSUs to specified employees. The performance vesting conditions applicable to PSUs are established each year, with the final payout value subject to the achievement of the predetermined performance objectives. PSUs have a maximum vesting period of three years and require continuous employment throughout the vesting period. Except under certain circumstances requiring Board approval, PSUs that have not vested at the time a participant in the PSU plan ceases to be employed are forfeited. The PSUs, like Common Shares, are entitled to dividend equivalents that are paid in the form of additional PSUs, which are issued at the time dividends are paid on the Company's Common Shares. The vesting of these additional PSUs is subject to the same performance vesting conditions and vesting date as the original grant of PSUs.

The number of PSUs granted and the accrued dividend equivalents are adjusted as at the vesting date, by a performance factor which takes into account actual performance achieved in relation to specific predetermined corporate objectives. The payout price is calculated based on the market value of the PSUs at the time of vesting and is paid out, at the option of the holder, in cash, in Common Shares of the Company that are acquired on the open market by a trustee on behalf of the Company or a combination thereof. The market value of a PSU is equal to the weighted average of the trading prices of the Company's Common Shares on the TSX on the five trading days preceding the vesting date.

20. SHARE-BASED COMPENSATION (continued)

The following table provides further information on outstanding performance share units:

	2012	2011
Outstanding, beginning of year	206,047	225,921
Granted	99,961	105,352
Dividend equivalents	11,534	12,056
Settled in cash	(44,617)	(58,029)
Forfeited	(48,942)	(79,253)
Outstanding, end of year	223,983	206,047

Restricted share unit plan

The Company has a restricted share unit ("RSU") plan, under which the Board of Directors may grant RSUs to specified employees. RSUs are granted based on individual performance potential and market competitiveness. The vesting of RSUs is not subject to the achievement of performance vesting conditions.

RSUs have a maximum vesting period of three years, and will vest only if there has been continuous employment throughout the vesting period. Except under certain circumstances requiring Board approval, RSUs that have not vested at the time a participant in the RSU Plan ceases to be employed are forfeited. Similar to PSUs, the RSUs attract dividend units equivalent to the dividends paid on the Company's Common Shares.

The number of RSUs granted and the accrued dividend equivalents are multiplied by the payout price at the vesting date. The payout price is calculated based on the market value of the RSUs at the time of vesting and is paid out, at the option of the holder, in cash, in Common Shares of the Company that are acquired on the open market by a trustee on behalf of the Company or a combination thereof. The market value of a RSU is equal to the weighted average of the trading prices of the Company's Common Shares on the TSX on the five trading days preceding the vesting date.

The following table provides further information on outstanding restricted share units:

	2012	2011
Outstanding, beginning of year	367,623	286,337
Granted	148,317	151,318
Dividend equivalents	20,256	20,544
Settled in cash	(120,543)	(45,438)
Forfeited	(22,683)	(45,138)
Outstanding, end of year	392,970	367,623

Directors' share appreciation plan

The Company has a share appreciation plan for its non-executive Directors, requiring Directors to receive a minimum of 25% of their annual compensation in deferred compensation units ("DCU"), which are redeemable only when the Director ceases to be a Board member. Directors may elect to receive up to 100% of their compensation in the form of DCUs. DCUs attract dividends in the form of additional DCUs at the same rate as dividends on the Company's Common Shares.

The following table provides further information on outstanding deferred compensation units:

	2012	2011
Outstanding, beginning of year	154,908	152,388
Granted	18,095	27,007
Dividend equivalents	7,765	7,613
Settled in cash	(21,249)	(32,100)
Outstanding, end of year	159,519	154,908

21. SEGMENTED INFORMATION

As at December 31, 2012, the Company had two reportable operating segments: MTS and Allstream. MTS provides a full range of wireless, broadband, high-speed Internet, IPTV, converged IP, unified communications, security, home alarm monitoring, local access and long distance services to residential and business customers in Manitoba. Allstream provides IP-based communications, unified communications, hosting, voice and data connectivity, and security services to business customers in Canada.

The Company evaluates performance based on EBITDA. 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.

The following tables provide further segmented information:

	MTS		Allstream		Other		Intersegment Eliminations		Consolidated	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Operating revenues										
Wireless	362.1	356.3	—	—	—	—	—	—	362.1	356.3
Broadband and converged IP	212.9	195.3	243.6	239.8	—	—	—	—	456.5	435.1
Unified communications, hosting, security and monitoring services	36.2	35.0	78.3	86.7	—	—	—	—	114.5	121.7
Local access	266.5	277.3	179.7	196.6	—	—	—	—	446.2	473.9
Long distance and legacy data	76.1	84.1	186.0	210.9	—	—	—	—	262.1	295.0
Other	26.8	28.3	70.6	91.7	—	—	(34.7)	(36.4)	62.7	83.6
Total operating revenues	980.6	976.3	758.2	825.7	—	—	(34.7)	(36.4)	1,704.1	1,765.6
EBITDA	495.5	490.1	115.3	108.5	(1.3)	(4.2)	—	—	609.5	594.4
Depreciation and amortization	237.2	219.0	85.0	79.3	0.6	0.6	—	—	322.8	298.9
Assets	1,677.0	1,488.3	705.1	671.8	8.4	34.5	(174.0)	(48.1)	2,216.5	2,146.5
Goodwill	27.7	27.7	—	—	—	—	—	—	27.7	27.7
Capital expenditures	219.0	183.6	119.0	104.0	—	0.4	—	—	338.0	288.0

Reconciliation to consolidated income before income taxes is as follows:

	2012	2011
Income before income taxes		
Total EBITDA	609.5	594.4
Depreciation and amortization	(322.8)	(298.9)
Other (expense) income	(1.1)	2.5
Finance costs	(60.2)	(65.5)
Income before income taxes	225.4	232.5
Assets		
Assets for operating segments	2,216.5	2,146.5
Deferred income taxes	515.8	535.0
Total assets	2,732.3	2,681.5

22. RELATED PARTY TRANSACTIONS

Related parties include the Company's wholly-owned subsidiaries, post-employment benefit plans and key management personnel. Balances and transactions during the year between the Company and its wholly-owned subsidiaries are eliminated on consolidation and, therefore, are not disclosed. Amounts paid to the group's post-employment benefit plans are set out in note 16.

22. RELATED PARTY TRANSACTIONS (continued)

Key management personnel include the members of the Company's Board of Directors and Executive Committee. Compensation expense, related to key management personnel during the year is as follows:

	2012	2011
Short-term employee benefits	6.9	6.5
Share-based compensation ¹	5.5	5.3
Post-employment benefits	1.3	0.9
Benefits paid to terminated employees	—	2.0
	13.7	14.7

¹ Share-based compensation expense excludes the impact of fluctuations in market values of the Company's Common Shares and changes in the achieved performance vesting conditions (expense of \$0.9 million for 2012 and \$1.5 million for 2011).

23. COMMITMENTS, GUARANTEES AND CONTINGENCIES

Operating lease commitments

In the normal course of operations, the Company has entered into operating lease agreements for building, operating facilities, construction equipment and other equipment. These leases have an average life of between 1 and 66 years, with renewal options contained within some contracts. The Company recorded rental expense related to operating leases of \$45.0 million in 2012. The Company's future non-cancellable operating lease commitments as at December 31 are summarized in the following table:

	2012	2011
Not later than 1 year	57.6	57.9
Later than 1 year and not later than 5 years	183.2	198.5
Later than 5 years	191.6	233.4
	432.4	489.8

Finance lease commitments

This finance lease is for the right to use network infrastructure and expires in 2017. The Company's future minimum lease payments under finance leases as at December 31 are summarized in the following table:

	Minimum lease payments		Present value of minimum lease payments	
	2012	2011	2012	2011
Not later than 1 year	6.5	5.4	6.1	4.9
Later than 1 year and not later than 5 years	8.5	11.1	7.9	10.1
	15.0	16.5	14.0	15.0
Less: future finance charges	(1.0)	(1.5)	—	—
	14.0	15.0	14.0	15.0

Interest expense on finance leases totaled \$0.5 million in 2012 (2011 – \$0.6 million).

Capital commitments

The Company has commitments for the purchase of property, plant and equipment in the amount of \$18.3 million as at December 31, 2012 (December 31, 2011 – \$18.3 million). These commitments are for the acquisition of property, plant and equipment used in the normal course of operations.

Guarantees

In the normal course of business and in connection with the disposition or sale of assets, the Company enters into agreements providing indemnifications that may require the Company to pay for costs or losses incurred by the parties to these agreements. These indemnifications relate to various matters such as intellectual property right infringement, loss or damage to property, claims arising from the provision of services, violation of laws or regulations, and breaches of representations or warranties. The nature of these indemnifications prevents the Company from making reasonable estimates of the maximum potential amount it could be required to pay, and no amount has been recorded in the financial statements relating to these indemnifications. Historically, the Company has not made significant payments related to these indemnifications.

23. COMMITMENTS, GUARANTEES AND CONTINGENCIES (continued)

The Company also indemnifies its directors, officers and certain other employees against claims and damages that are incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance in respect of its directors and officers.

The Company obtains letters of credit with financial institutions for the benefit of third parties. In general, the terms of these letters of credit permit third parties to draw on the letters of credit to recover any loss incurred, as defined in the particular letter of credit. Certain of these letters of credit guarantee future funding of the Company's registered pension plans. As at December 31, 2012, the Company had undrawn letters of credit outstanding in the amount of \$268.9 million (2011 – \$186.7 million).

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 eight 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.

On September 13, 2012, the Company began a wide-ranging strategic review of its Allstream business. As a result of this strategic review process, the Company could incur certain costs which will be determined at the time the Board approves a particular course of action. There is no assurance or expectation that any costs will be incurred as a result of this process.

The Company's legal department performs an assessment of the legal proceedings and claims which have occurred as a result of regular business activities during the period. Based on the information and estimates available, the outcomes of these contingent liabilities are uncertain and they do not satisfy the requirements to be recognized in the consolidated statement of financial position as liabilities. The Company believes that there will be no material adverse effect on its results of operations and financial position as a result of any pending legal proceedings including those described above.

THREE YEARS IN REVIEW

(Not subject to Auditors' Report)

FINANCIAL INFORMATION

(in \$ millions, except earnings per share & ratios)

	2012	2011	2010
Consolidated operations			
Total operating revenues	1,704.1	1,765.6	1,782.6
Total operating expenses	1,417.4	1,470.1	1,508.5
Operating income	286.7	295.5	274.1
Finance costs	60.2	65.5	64.0
Net income	175.4	167.1	141.3
Basic earnings per share (\$)	2.63	2.55	2.18
EBITDA ¹	609.5	594.4	564.8
Dividends	113.2	111.5	139.3
Capital expenditures, net	338.0	288.0	361.9
Free cash flow	117.6	129.8	34.1
Consolidated balance sheet			
Total assets	2,732.3	2,681.5	2,630.6
Property, plant and equipment, net book value	1,560.0	1,543.3	1,497.6
Long-term debt and notes payable ²	976.4	1,020.8	1,040.6
Shareholders' equity	809.1	789.7	848.0
Debt to capitalization (%)	55.4	56.3	54.3

OPERATIONAL STATISTICS

Wireless customers	497,367	496,432	483,754
High-speed Internet customers	193,690	189,366	183,571
IPTV customers	97,232	95,476	89,967
Number of employees ³	5,349	5,340	5,418

¹ Earnings before other (expense) income, interest, taxes, and depreciation and amortization.

² Includes current portion of long-term debt.

³ Represents number of regular full-time and regular part-time employees.

BOARD OF DIRECTORS



David G. Leith
Chair of the Company's Board and Corporate Director
Mr. Leith has been a director of the Company since 2009. He became Chair of the Board in January 2010.



Gregory J. Hanson, FCA, FCIP, FLMI
Corporate Director
Mr. Hanson has been a director of the Company since 2007. He is a member of the Audit Committee.



Pierre J. Blouin
Chief Executive Officer of the Company
Mr. Blouin has been a director of the Company since 2006.



Kishore Kapoor, CA
Corporate Director
Mr. Kapoor has been a director of the Company since 2006. He is the Chair of the Audit Committee and Chair of the Strategic Committee.



Jocelyne M. Côté-O'Hara, C.M.
Corporate Director
Ms. Côté-O'Hara has been a director of the Company since 1997. She is a member of the Human Resources & Compensation Committee and the Governance & Nominating Committee.



H. Sanford Riley, C.M., J.D.
President and Chief Executive Officer, Richardson Financial Group, Ltd.
Mr. Riley has been a director of the Company since 2011. He is a member of the Audit Committee and the Strategic Committee.



N. Ashleigh Everett
President and Corporate Secretary, Royal Canadian Securities Limited
Ms. Everett has been a director of the Company since 1997. She is the Chair of the Governance & Nominating Committee and is a member of the Human Resources & Compensation Committee.



D. Samuel Schellenberg
Corporate Director
Mr. Schellenberg has been a director of the Company since 1989. He is a member of the Audit Committee.



The Honourable Gary A. Filmon, P.C., O.C., O.M.
Corporate Director
Mr. Filmon has been a director of the Company since 2003. He is the Chair of the Human Resources & Compensation Committee, and is a member of the Governance & Nominating Committee.



Carol M. Stephenson, O.C.
Dean, Richard Ivey School of Business at Western University
Ms. Stephenson has been a director of the Company since 2008. She is a member of the Governance & Nominating Committee and the Human Resources & Compensation Committee.

OFFICERS OF THE COMPANY AND EXECUTIVE COMMITTEE

EXECUTIVE COMMITTEE



Pierre J. Blouin
Chief Executive Officer



Wayne S. Demkey
Chief Financial Officer



Kelvin A. Shepherd
President MTS



Christopher W. Peirce
Chief Corporate Officer



Dean L. Prevost
President Allstream



Aliana Rozenek
Chief Human Resources Officer



Paul A. Beauregard
*Chief Legal Officer and
Corporate Secretary*



Michael R. Strople
Chief Technology Officer

OFFICERS OF MANITOBA TELECOM SERVICES INC.*

Pierre J. Blouin
Chief Executive Officer

Kelvin A. Shepherd
President MTS

Dean L. Prevost
President Allstream

Paul A. Beauregard
*Chief Legal Officer and
Corporate Secretary*

Wayne S. Demkey
Chief Financial Officer

Christopher W. Peirce
Chief Corporate Officer

Aliana Rozenek
Chief Human Resources Officer

Michael R. Strople
Chief Technology Officer

Brenda M. McInnes
Vice President and Treasurer

* As at January 1, 2013.

INVESTOR INFORMATION

HEAD OFFICE

P.O. Box 6666
333 Main Street
Winnipeg, MB R3C 3V6

OPERATING SUBSIDIARIES

MTS Inc.
Allstream Inc.
AAA Alarm Systems Ltd.
Delphi Solutions Corp.

CONTACT INFORMATION

Investor Relations

e-mail: investor.relations@mtsallstream.com
Telephone: 1-888-544-5554 or (204) 958-3549
or, visit the Investors section on our website at
www.mtsallstream.com

Media

e-mail: media.relations@mtsallstream.com
Telephone: (204) 958-3230 or (416) 345-3576

Customer Care

MTS customers: (204) 225-5687 (204-CALLMTS) or
Toll-free outside Manitoba: 1-800-883-2054
www.mts.ca/customer-care

Allstream customers: 1-855-299-7050
www.allstream.com/customer-care

TRANSFER AGENT AND REGISTRAR

For shareholder inquiries or services (including share transfers or dividends, address change, lost certificates), please contact our Transfer Agent and Registrar:

Computershare Investor Services Inc.
600, 530 - 8th Avenue SW
Calgary, Alberta T2P 3S8
1-800-564-6253

CORPORATE OFFICES

MTS

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R3C 3V6

Brandon

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Brandon, MB
R7A 5Y9

ALLSTREAM

Toronto

200 Wellington Street West
Toronto, ON
M5V 2G2

Montreal

625 Rue Belmont
Montreal, QC
H3B 2M1

Quebec City

2710 Rue Einstein
Quebec, QC
G1P 4R5

SHARE FACTS

Symbol

MBT

Listing

The common shares of Manitoba Telecom Services Inc. are listed on Toronto Stock Exchange.

Common Shares Outstanding

66,994,852 as of December 31, 2012

2013 Expected Quarterly Earnings Release Dates*

First Quarter	May 9, 2013
Second Quarter	August 2, 2013
Third Quarter	November 7, 2013
Fourth Quarter	February 6, 2014

* Subject to change

Annual General Meeting

May 9, 2013
11 a.m. Central Time
The Fort Garry Hotel, Winnipeg, MB

Multiple Mailings

If you receive duplicate copies of this Annual Report, please contact Computershare Investor Services Inc. at 1-800-564-6253.

Independent Auditors

Deloitte LLP, Winnipeg, MB

OUR ADVANCED NETWORKS

30,000+ROUTE KM NATIONAL IP FIBRE NETWORK



Our world-class IP fibre-optic network ensures the delivery of highly reliable, highly secure and managed communications services across Canada. Our 30,000+ route km national fibre-optic network (over a million strand kilometres) combines IP connectivity, Ethernet-featured services, cloud enablement, and the most advanced managed and security capabilities. Our end-to-end IP infrastructure converges data and video with local, long-distance and private voice traffic. In Manitoba, we launched the province's first 4G LTE wireless network and have the most extensive wireless and wireline coverage, including 97% of the population having access to our advanced 4G wireless network. A growing number of Manitobans are also experiencing the benefits of our advanced fibre-to-the-home network technology. This next generation network supplies a huge amount of bandwidth directly into customers' homes, providing excellent support for MTS's current voice, IPTV and high-speed Internet services, while laying the groundwork for the future.



NETWORK STRENGTHS

1st
provider with LTE wireless
coverage in Manitoba

97%
Manitoba population with access
to our 4G wireless network

250 Mbps
speed capability to homes
on our FTTH network in Manitoba

2,723
number of Allstream fibre-fed
buildings at year-end 2012

8
U.S. network access points

100G
capable DWDM transport network
for enterprise requirements



OUR COMMITMENT

MTS Allstream strives to be a responsible corporate citizen



As a constituent of the Jantzi Social Index, our company ranks among the top socially responsible and environmentally progressive companies in Canada. We continue to make progress toward our goal of reducing our impact on the environment with our commitment to reduce our absolute greenhouse gas emissions by 20% by the end of 2020. In addition to our efforts to minimize the impact of our operations on the environment, we continue to engage our customers in the “green” potential of innovative communications solutions. We offer cell phone recycling, as well as e-billing options in order to minimize waste. We participate in the nation-wide mobile device recycling “Recycle My Cell” program which donates net proceeds to Manitoba-based non-profit environmental organizations. We also offer virtual workplace communication solutions for our business customers in order to promote telecommuting and alternative work arrangements. In all communities we serve, our employees and retirees volunteer more than 50,000 hours every year. Acknowledged by the Corporate Knights, MTS Allstream is the top telecommunications provider on its 2012 Diversity Index rankings. In 2012, MTS Allstream also became a proud signatory of the Catalyst Accord, a multi-stakeholder initiative of corporations focused on increasing board representation by women in Canadian corporations.

RECOGNITION AND DESIGNATIONS



ENVIRONMENTALLY RESPONSIBLE CHOICES

At MTS Allstream, we are committed to reducing our impact on the environment and helping our customers, employees and stakeholders do the same. As part of that commitment, the papers selected for this report are certified by the Forest Stewardship Council® (FSC®), which means they come from well-managed forests and known sources, ensuring local communities benefit and sensitive areas are protected.

The text of this report is printed using acid-free paper. The cover of this report is manufactured from sustainable raw materials and is free of chlorine chemistry. It contains 100% post-consumer fibre and is made with 100% Certified Renewable Energy. By using this cover paper, we are: saving 12,916 litres of wastewater / eliminating 94 kilograms of solid waste / saving 2 million BTUs of energy / preserving 7 trees.

Please consider the environment and recycle this report, which can also be viewed at: www.mtsallstream.com/annualreport2012

Forward-looking statements herein reflect our expectations as of February 13, 2013. Actual results may differ from expectations. Therefore, forward-looking statements should be considered carefully and undue reliance should not be placed on them. 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.

All figures are as of December 31, 2012.

On the cover: MTS Centre - photo credit to Winnipeg Jets Hockey Club

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