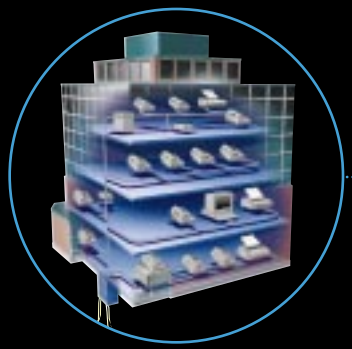
1998 ANNUAL REPORT

METRONET COMMUNICATIONS CORP.

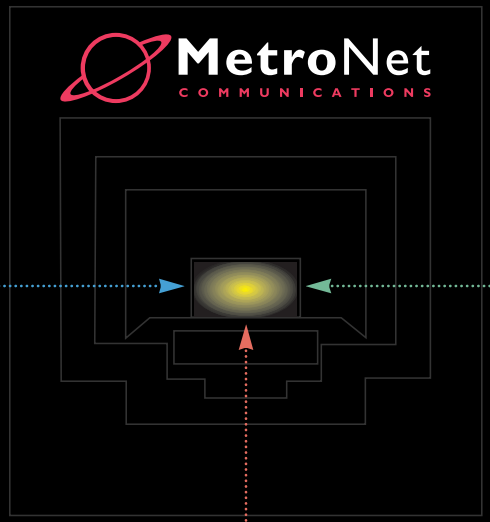
Connect here

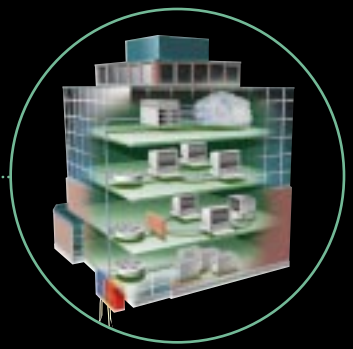
MetroNet Communications is Built for Business™. Founded in 1995, MetroNet has aggressively expanded its market coverage and product breadth to become Canada's leading competitive telecommunications provider and the country's only national competitive local exchange carrier (CLEC). MetroNet offers a new choice in local and long distance, voice, data networking and Internet services to business and government customers across the country.



Voice Services

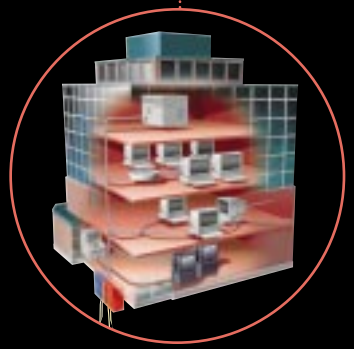
- Local
- Long Distance
- Centrex
- Advanced Features
- Shared Tenant Services





Internet Services

- Business Internet
- Internet Server Parks
- Virtual Point of Presence
- Web Hosting



Data Services

- ATM
- Frame Relay
- Private Line
- Managed WAN
- Transparent LAN

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FINANCIAL HIGHLIGHTS

(in thousands, except per share amounts)
Years ended December 31

	1998	1997	1996
Revenue	$ 76,238	$ 5,893	$ 578
Net loss	$ (212,801)	$ (36,449)	$ (2,289)
Net loss per share[1]	$ (6.04)	$ (11.41)	$ (1.68)
Weighted average shares outstanding[1]	35,252	3,195	1,365
EBITDA[2]	$ (49,986)	$ (20,934)	$ (2,229)
Capital expenditures	$ 396,109	$ 112,642	$ 3,081

OPERATING DATA

Years ended December 31

	1998	1997	1996
Cities in operation	11	5	1
Cities under development	6	6	4
Intracity Route kilometres	3,513	170	32
Intracity Fibre kilometres	175,093	10,368	145
Buildings connected on-net	1,675	153	28
Lines in service	59,456	3,996	0
Voice grade equivalent (VGE) circuits	681,791	22,085	8,749
Voice switches operational	8	5	0
Frame Relay switches	11	5	0
ATM switches	385	46	19
Number of employees	955	428	13
Number of sales employees	252	83	2

AT YEAR END

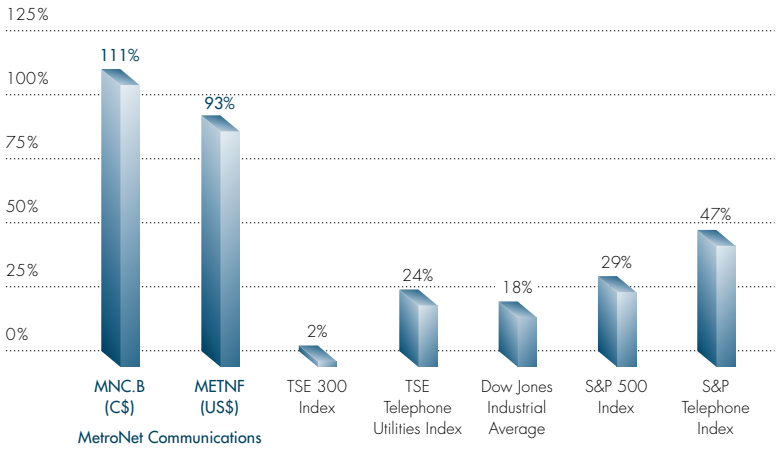
(in thousands)
Years ended December 31

	1998	1997	1996
Cash and short-term deposits	$ 854,729	$ 455,725	$ 10,748
Working capital	$ 851,745	$ 444,531	$ 9,090
Gross property, plant and equipment	$ 870,819	$ 116,802	$ 4,093
Total assets	$ 2,657,711	$ 732,705	$ 15,101
Common shares outstanding[1]	45,564	25,626	3,472

(1) Share and per share amounts reflect a 1-for-2 stock consolidation coincident with the Company's share reorganization at the time of its December, 1997 Initial Public Offering.

(2) EBITDA is earnings before interest, taxes, depreciation and amortization, and non-recurring charge, and is commonly used as a measure to assist in understanding operating results.

1998 TOTAL SHAREHOLDER RETURN



Message
to Shareholders

an exciting year of progress | As we reflect back on the many accomplishments of the past twelve months, it is clear that MetroNet now proudly carries the flag as the pioneer and leader in competitive local exchange services in Canada.

MetroNet Communications is the first, the largest, and the only national facilities-based competitive local exchange carrier (CLEC) in Canada. Established in 1995 with our roots in the data business, we built our first fibre optic network to deliver asynchronous transfer mode (ATM) services to fill the unmet needs of the oil and gas industry in Calgary, Alberta. Since then we have rapidly evolved into a national, full service local and long distance telecommunications and data networking services provider.

The Canadian voice and data telecommunications market generates over $15 billion in revenue and is growing at almost ten per cent per annum. With rapid growth and key acquisitions throughout 1998, MetroNet is well positioned for success in this market, as well as penetration of the U.S.-Canada telecommunications traffic corridor, the largest and most heavily utilized international telecommunications traffic route in the world. MetroNet now has significant time to market and scale advantages over any other actual or potential CLEC in Canada. We operate under one of the most conducive and simple regulatory environments in the world for facilities-based competitive new entrants.

1998 began with a historic change in telecommunications in Canada. The Canadian Radio-television and Telecommunications Commission (CRTC) opened the local telephone market to competition on January 1st, presenting MetroNet with an unprecedented opportunity to garner a share of this large and growing market. Because MetroNet had anticipated this deregulation and had begun constructing its networks and building its sales and marketing teams, the Company was uniquely positioned to attack this exciting market as soon as it opened. To mark the occasion, on January 1st in Montreal, MetroNet made the first

telephone call over our own network to our first customer connected to these facilities.

focus | Throughout 1998 our focus was twofold. First, we focused intently upon operational excellence. Our definition of operational excellence is the focus, process and discipline around the hundreds of little things in this very complicated business that, when combined in harmony, enable low cost, high quality and rapid cycle time. Operational excellence is never fully attained: It is a mindset and a perpetual mission, the product of which is creating value for our shareholders and, through doing so, for our customers, employees and communities. Operational excellence is only achieved through the work of experienced and motivated employees and leaders, and we are extremely proud of the top-notch team of 955 MetroNet employees who brought this Company so very far during 1998.

Second, because we are in a business where scale and early market entry are rewarded, in 1998 we focused on achieving both, through organic growth and acquisition. This enabled us to rapidly expand our formidable lead over our competitors and further solidify our competitive advantage. Our rapid internal growth during 1998 expanded both the number of cities in which we operate, from 5 to 11, and the number of route kilometres of fibre optic network, from 170 to 3,513. Most significantly, we grew the number of telephone access lines in service more than fourteen-fold, from 3,996 to 59,456 as of December 31, 1998.

defining acquisitions | We made two defining acquisitions during 1998 that further strengthened MetroNet's strategic position and opened multiple opportunities for us to continue delivering exceptional returns on your investment in MetroNet Communications in the future.

On June 30, 1998, MetroNet acquired Rogers Telecom Inc. (RTI), the competitive telecommunications division of Rogers Communications, one of

1998 HIGHLIGHTS

- *Revenue in 1998 grew more than twelve-fold to over $76 million.*
- *Access lines in service grew 14 times to 59,456 at year end, versus 3,996 at the end of 1997.*
- *Concluded the year with 3,513 route kilometres of fibre optics, accessing 1,675 buildings.*
- *The acquisitions of a nationwide fibre optic intercity network and Rogers Telecom Inc. further strengthened our strategic positioning in the marketplace.*
- *Raised approximately $1.5 billion in additional financing during the year, which we exited with $855 million in cash and short-term deposits to continue funding our rapid growth.*

Canada's largest cable television and media conglomerates. This transaction added more than 3,100 fibre route kilometres and over 1,100 additional on-net buildings. It also extended the reach of our fibre optic networks well beyond the footprint that we had originally planned. We now have fibre routes and access to portions of the market that we could not have economically justified prior to this acquisition. This was enabled by the cost advantage that RTI gained by jointly constructing portions of their network with Rogers Communications' cable television network fibre rings. This exciting acquisition also accelerated and expanded the development of our wholesale business, something that we were in the formative stages of developing and that is important to optimizing the utilization of our network and contributing to financial returns. Overall, the acquisition of RTI accelerated our business plan by more than three years, eliminated what would likely have been one of our largest facilities-based competitors, and absolutely solidified our position as Canada's largest CLEC.

Another very significant transaction for MetroNet this year was our October 1998 agreement to acquire a nationwide intercity and cross-border fibre optic network that will span more than 9,700 kilometres. We will use this network to interconnect all of our CLEC networks in cities across Canada utilizing today's most sophisticated Internet Protocol (IP) technology. This strategic asset will help create considerable economic benefits for MetroNet, now and well into the future. As this network is deployed through to the end of 1999, MetroNet will possess the largest and most advanced end-to-end facilities-based competitive telecommunications network in Canada.

MetroNet had another very successful year in what were often turbulent capital markets. During 1998, we raised more than $1.5 billion of additional financing to execute our strategy of building state-of-the-art, integrated local and long distance voice and data networks in and between all of the major business centres across Canada. These financings included two ten-year note offerings and a very successful equity offering. MetroNet exited 1998 with over $855 million of unrestricted cash and short-term deposits on its balance sheet to fund its exciting and rapid growth.

positioned for success | Through the combination of our aggressive network construction, back office development programs and key acquisitions, MetroNet has built one of the most advanced, comprehensive and strategic telecommunications assets in the world. With sales, installations and network deployment all accelerating and the integration of the RTI acquisition completed, we are executing across the business to rapidly capitalize on the significant MetroNet opportunity. We exit 1998 with the scale, momentum and resources necessary to carry out our strategy. As thousands of businesses have already discovered, MetroNet is delivering on its commitment to provide real choice and value in the Canadian telecommunications market.

We thank you for your continued support and investment in MetroNet Communications.

(signed) D. Craig Young

D. Craig Young
President and Chief Executive Officer

(signed) Philip R. Ladouceur

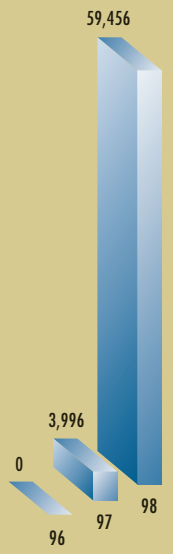
Philip R. Ladouceur
Chairman of the Board

At MetroNet we have focused our growth around one thing – the advanced telecommunications needs of business and government customers. With state-of-the-art networks and service platforms, we are delivering a new and exciting choice for telecommunications at exceptional value, backed by exceptional service, to thousands of Canadian businesses. From our team of highly qualified employees to our advanced infrastructure and systems, we have built a unique set of tailored capabilities to respond to the needs of business.

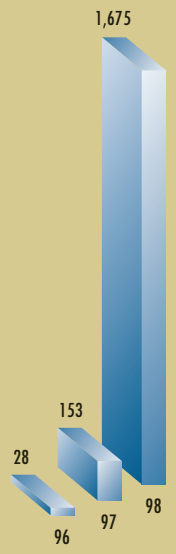
l to r: PHILIP R. LADOUCEUR, Chairman of the Board and D. CRAIG YOUNG, President and Chief Executive Officer

DEMONSTRATED AND SUSTAINABLE GROWTH

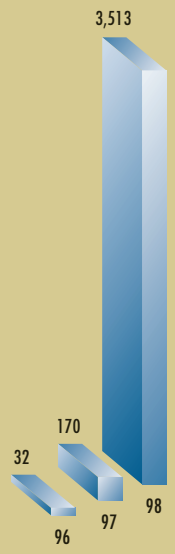
ACCESS LINES IN SERVICE



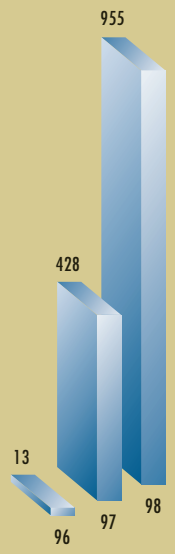
ON-NET BUILDINGS



INTRACITY FIBRE ROUTE KILOMETRES

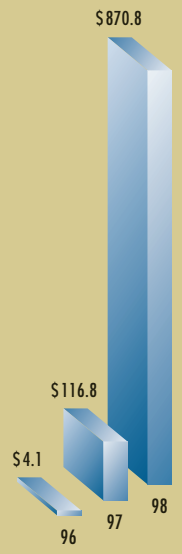


EMPLOYEES



GROSS PROPERTY, PLANT AND EQUIPMENT

(in millions)



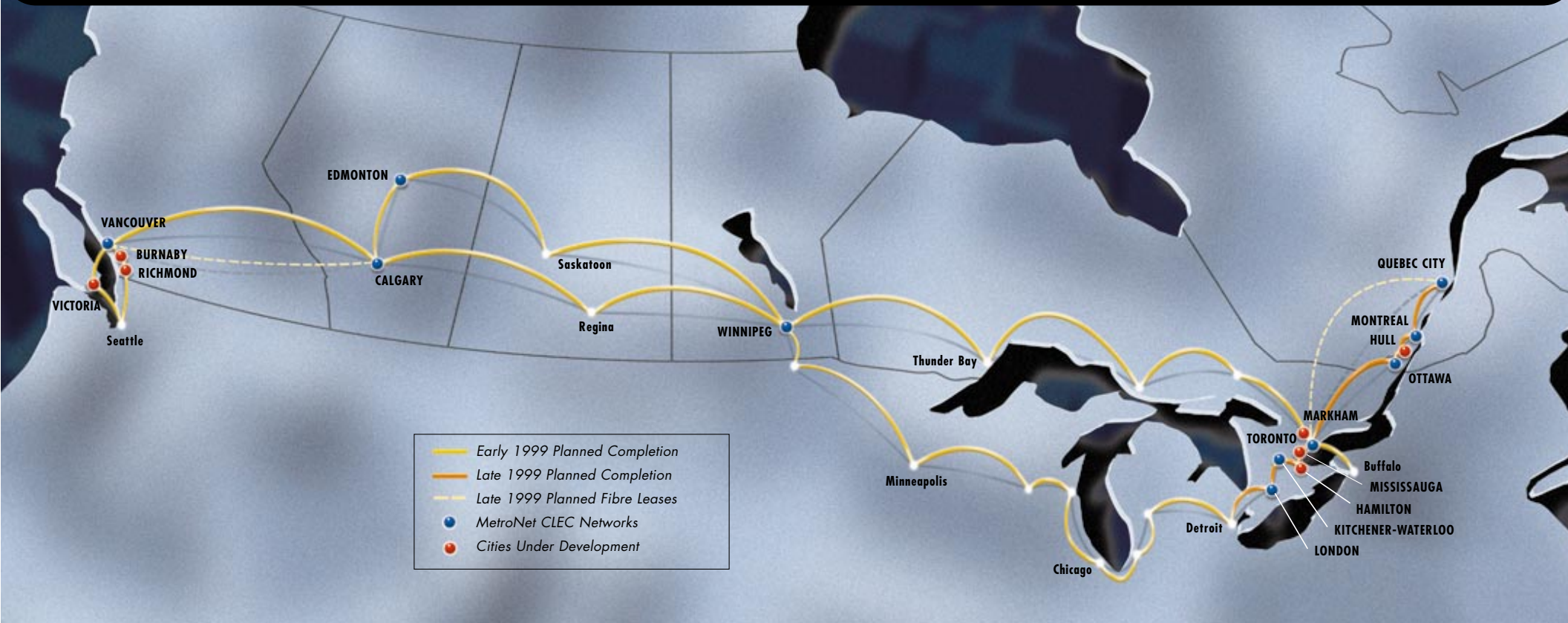
What We Do

the opportunity | Canada's local telecommunications services market was officially opened to competition on January 1, 1998. On that historic date, MetroNet was the first competitive carrier to complete a telephone call using its own local telecommunications facilities and fibre optic network. With its successful early entry strategy and rapid fibre optic network build-out, MetroNet has established a formidable lead as the premier alternative facilities-based provider of competitive telecommunications services to business and government in this $10 billion market.

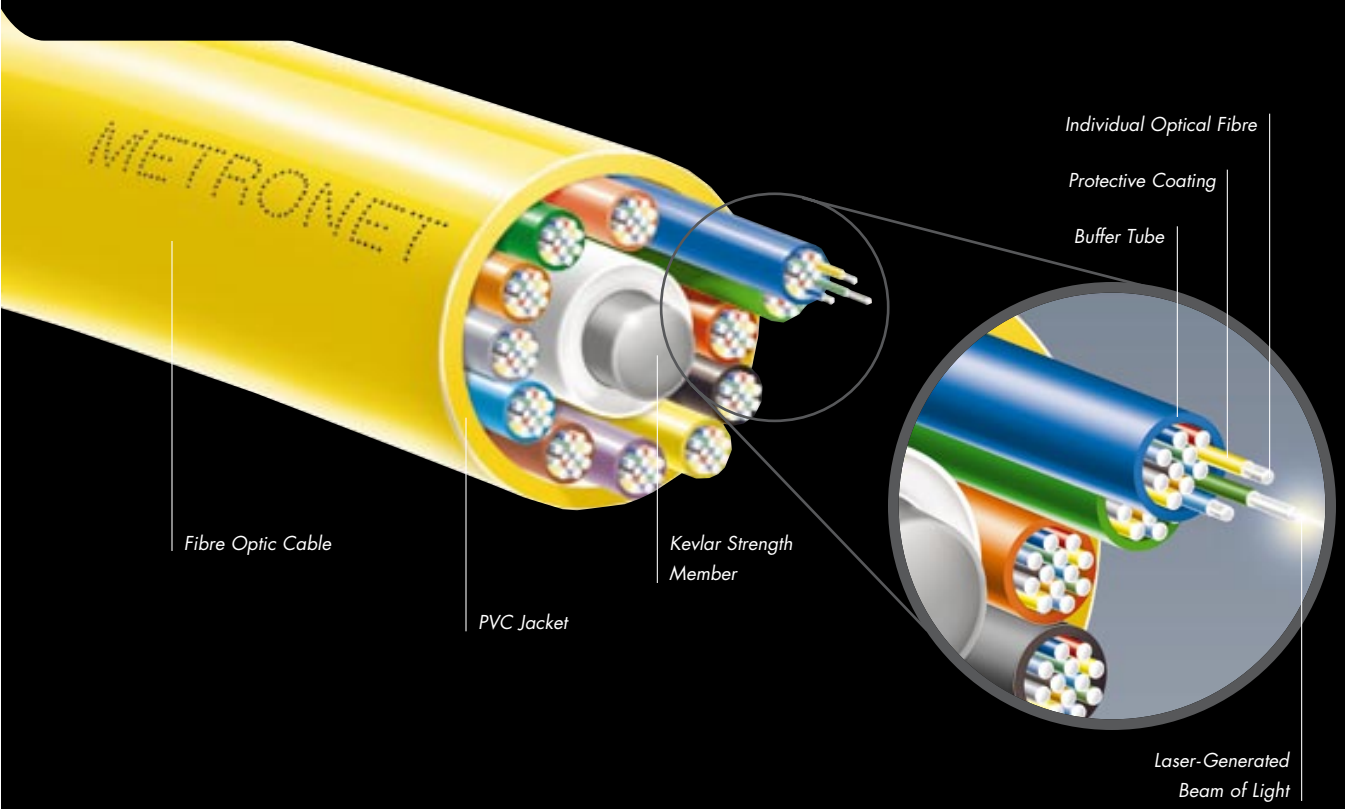
built for business | Simply put, MetroNet provides telecommunications services, including local and long distance voice, data and Internet services to business and government customers in markets across Canada. Literally from the ground up, MetroNet has built its services, networks and systems around the unique and advanced needs of business customers.

MetroNet is deploying highly advanced and reliable fibre optic networks and digital switching platforms within major metropolitan areas and across Canada. Over these networks, MetroNet provides businesses with Canada's only competitive, fully end-to-end nationwide solution for local and long distance voice, data and Internet services.

LOCAL PRESENCE, NATIONAL REACH



A CLOSE-UP LOOK AT FIBRE OPTICS



A fibre optic cable is a bundle of glass strands, each approximately the same width as a human hair. Laser-generated light signals are transmitted through these fibre optic strands and converted into digital signals representing voice, data, Internet and video traffic. These strands are wrapped in protective plastic coatings to prevent signal interference and are bundled around a Kevlar core to provide strength and rigidity. MetroNet typically buries these cables in conduits, deep under roads and through key rights-of-way in the urban cores of our markets, extending all the way into buildings where business customers are located.

Fibre optic systems deployed by MetroNet are far superior to existing copper networks in terms of reliability, transmission speed and capacity. A single pair of fibre optic strands is capable of carrying the equivalent of up to more than 20,000 times as much information as a 4-inch cable containing 400 copper wires.

How We Do It

throughout each city | MetroNet builds digital networks using leading-edge fibre optics and the latest voice and data switching technologies. Fibre optic networks use laser-generated light to transmit voice, data and video in digital format through ultra-thin strands of glass. These networks are deployed in extremely reliable ring topologies to buildings in which business customers are located. Fibre and facilities are also connected to switching offices of the incumbent telephone companies in collocation arrangements that further extend the reach of MetroNet's network within a given city.

across the country | In October 1998, MetroNet acquired a cross-country, broadband fibre optic network to interconnect its city networks and to provide reach into the United States via strategic border crossing points. Upon completion of this network, MetroNet will be the first company to provide a total local and long distance voice and data telecommunications solution across Canada using its own facilities from end to end.

Voice

built for business | MetroNet has deployed a core set of voice telecommunications services designed specifically to help businesses do business faster, better and more cost effectively. MetroNet's core set of voice telecommunications services can be combined with our most popular business calling features, such as Call Waiting, Call Forwarding and Calling Name and Number Display, as well as more sophisticated services, such as Voice Messaging, Centrex, ISDN and PBX trunks. The long distance voice products launched in 1998 feature rate plans that are among the simplest and most cost effective in the industry, with a single calling rate that applies 365 days a year, 24 hours a day to all North American locations.

the backbone of business | Telephone service has long been the backbone of virtually all businesses. No other tool is so widely used and so cost effective in driving sales and servicing customers. In January 1998, MetroNet was the first national competitive provider in Canada to launch its own facilities-based local telephone service. By the end of the year MetroNet served approximately 5,000 local service business customers with 59,456 access lines.

Our local and long distance voice portfolio today includes local business lines, a full suite of calling features, trunks, Centrex services and ISDN. To complement these services and provide "one-stop shopping" for our customers, MetroNet also provides the latest in voice messaging service and telephone sets.

As an early entry strategy in business communities where MetroNet is currently constructing or is planning to construct networks, resale arrangements are used to allow early selling and customer acquisition. As networks are completed, customers' services are then seamlessly migrated to the MetroNet fibre optic networks. Through the 1998 acquisition of Posicom, a Canadian long distance company, and arrangements with most major long distance carriers, MetroNet has amassed a powerful portfolio of long distance services. In the crowded long distance market, MetroNet

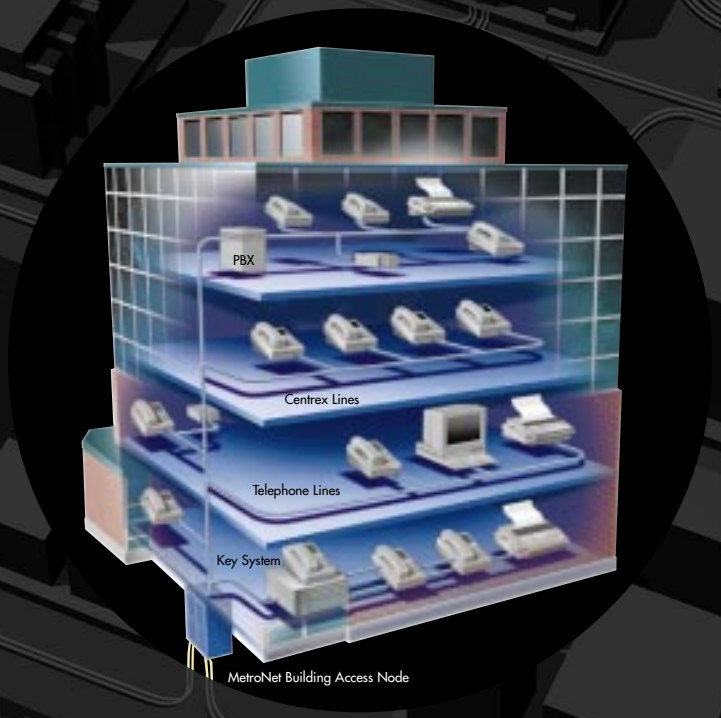
has differentiated itself with simple pricing programs that feature one rate for all North American long distance calling. Similar rate plans have also been launched for inbound, toll free calling. With the acquisition of our nationwide intercity network late in 1998, long distance traffic between MetroNet business centres will be migrated to our own intercity fibre facilities, assuring the ultimate end-to-end control over service and cost.

value for business | MetroNet voice telecommunications services are strategically priced to offer businesses better value for their telecommunications investment. In general, customers switching to MetroNet realize at least a 10% to 15% savings versus their total spending with their old service provider. MetroNet does not "nickel and dime" customers with added charges and fees. MetroNet offers national coverage and a leading-edge billing system that allows customization and consolidation of billing for services and locations across the country and assists in reducing customers' administration costs.

reaching customers | In 1998, MetroNet created a sales force dedicated exclusively to the distribution of its voice service offerings. This specialized team of highly trained and motivated individuals is focused on marketing to businesses in buildings connected to MetroNet's networks. To augment this sales channel, a national network of specially certified agents is used to efficiently expand MetroNet's distribution capabilities. For selected products and targeted programs, telemarketing strategies are deployed. MetroNet has also established a unique sales force to capitalize on wholesale opportunities for voice services, marketing to large carrier customers including long distance carriers, wireless service providers, other local exchange carriers and international telecommunications companies.

an exciting new choice | In 1998, thousands of customers discovered that MetroNet delivers an exciting new choice in local telephone service. With the development of Local Number Portability (LNP), that choice is now even easier to make. LNP allows our customers to switch to MetroNet's local service without having to change their telephone numbers. The past year was one of significant progress in implementing LNP. As a leader on the regulatory, technological and procedural fronts, MetroNet was able to spearhead significant regulatory progress and early testing and development of LNP. At year-end, LNP was available in many of MetroNet's largest markets, with the remaining markets to begin rollout over the first few months of 1999. The successful delivery of LNP was achieved significantly faster than similar rollouts in the U.S. markets.

In January 1998, MetroNet was the first competitive local exchange carrier (CLEC) in Canada to launch its own facilities-based local telephone service. By the end of the year, MetroNet was serving more than 5,000 local service customers and had sold over 81,750 business access lines.



"As a small business, every opportunity for savings needs to be exploited. When the local telephone services market opened up, we switched to MetroNet for better value and because they showed a genuine interest in my business. The transition was smooth, the service since has been exemplary and we're saving money that goes right to the bottom line."

LARRY KENDALL, President, Kendall Printing Company Limited – Toronto, Ontario

METRONET VOICE SERVICES

LOCAL

MetroNet is the first to offer business a national alternative for local telephone service. Our local service, available in single lines, trunks and ISDN, features dial tone, a full suite of calling features and standard ancillary services, such as 411, 611, 911, operator services and directory listings.

LONG DISTANCE

Simple all-day, all-week rate plans with competitive pricing for both outbound and toll free calling make MetroNet's service an exciting new alternative for business. Local and long distance charges for all customer locations can be integrated onto a single bill.

CENTREX

Our Centrex service is a fully managed and fully featured business communications service that takes the power of MetroNet's digital switches into customer locations. Telephone lines and features are tailored to specific customer needs and are an attractive alternative to Key system or PBX system purchases.

ADVANCED FEATURES

Via our highly advanced digital platforms, MetroNet offers calling features specifically designed to enhance business productivity. These features include voice messaging service, call waiting, call forwarding, three-way calling, call identification and many others.

SHARED TENANT SERVICES

A single point of contact in selected office buildings offers tenants a bundled alternative to existing local, long distance and voice mail services as well as telecommunications equipment. This scalable and cost effective on-site alternative offers convenience and value for both tenants and building owners.

Data

built for business | MetroNet's heritage is in the data communications business. The first products offered by MetroNet were ATM (Asynchronous Transfer Mode) services launched in mid-1995, providing service to the oil and gas industry over the Company's first fibre optic network in Calgary. This service provided a unique solution to a business problem for oil and gas companies: how to quickly move information to the right place at the right time for use in making multi-million dollar exploration and drilling decisions. This application of technology saved significant amounts of time and dramatically improved the quality of business decisions made by MetroNet's customers. From the outset, MetroNet has been Built for Business™.

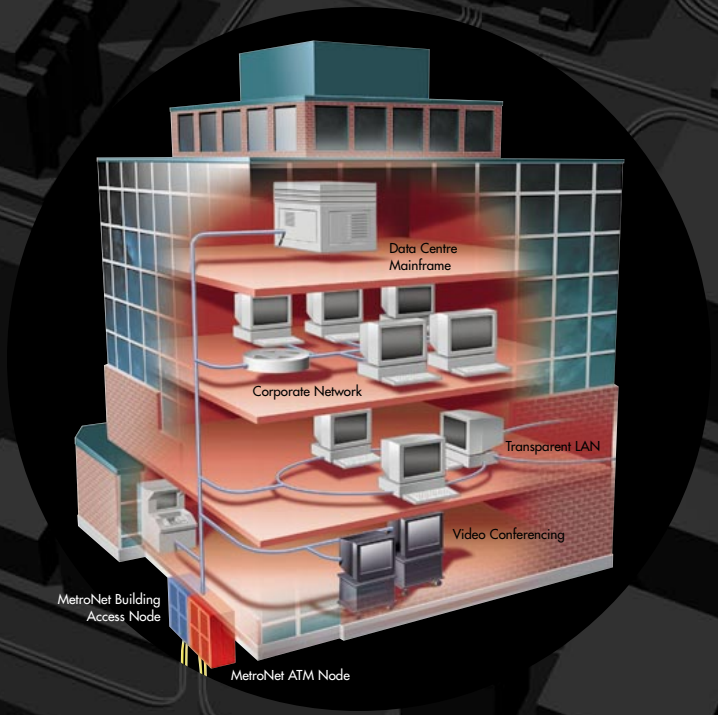
business enabler | MetroNet's data services are used by our customers to move data between business locations and trading partners, whether it is across the city, across the country or around the world. Because doing business profitably is about having the right information in the right place at the right time, MetroNet has built an advanced data network, connecting thousands of business locations across the country. MetroNet's nation-wide ATM and Frame Relay data networks can meet the most advanced and wide ranging data networking services needs of business and offer the flexibility and scalability required in today's rapidly changing business environment. MetroNet grew its data networking capability significantly during 1998. The MetroNet data network now includes 385 ATM switches, 11 Frame Relay switches and more than 1,630 high-speed data ports in service.

data solutions | MetroNet has rapidly evolved its product portfolio, and now offers a full suite of data networking services. Through the acquisition of Rogers Telecom Inc. (RTI) in mid-1998, MetroNet significantly expanded its data network reach, customer

base and data product expertise. MetroNet's data services portfolio now consists of five core product lines: ATM, Frame Relay, Private Line Services, Managed WAN and Transparent LAN. This powerful portfolio of advanced services can provide business solutions for a broad range of applications, including LAN interconnections, file transfers, videoconferencing, e-mail, server back-ups and interconnection of PBXs, to name just a few. Access speeds for data transfer range from 56 kilobits per second to OC-48 (2.4 gigabits per second). MetroNet sales and engineering teams work with customers to provide a total solution for data networking, including the installation, configuration and maintenance of the customer's data equipment in many cases. Data network usage reporting options are available to assist businesses in assessing their network usage, performance and capacity requirements. MetroNet's highly competitive pricing structures have been developed to offer customers unparalleled value in network performance. MetroNet's Network Operations Centres (NOCs) in Toronto and Calgary proactively monitor the status of our networks every minute of every day to assure the uninterrupted performance of our fibre optic networks across the country.

reaching customers | In 1998, MetroNet created a sales force dedicated exclusively to the distribution of its advanced data networking service offerings. This specialized team of highly trained and motivated individuals is focused on marketing data networking services to businesses in MetroNet's markets. This sales force targets medium to large business and government customers, including businesses in the financial, resource, entertainment and information technology sectors. In addition, MetroNet has also created a sales force dedicated to serving the unique needs of our wholesale customers which include many of Canada's long distance, cellular, PCS, cable television and Internet providers.

Doing business profitably is about having the right information in the right place at the right time. To help our customers do their business better, MetroNet has built an advanced broadband data network that supports thousands of businesses with ATM, Frame Relay and Internet Protocol services.



We've been delighted with MetroNet's service from the beginning. Everyone we deal with at MetroNet has been very supportive and quick to address our needs. Not only do they deliver on service and performance, they deliver on cost as well.

DAVID LEZETC, Clearly Canadian Beverage Corp. – Vancouver, British Columbia

METRONET DATA SERVICES

ATM

ATM Service is designed for customers seeking the next generation of technology for data communications. MetroNet's ATM services are offered over a fibre optic based 155 Mbps connection, allowing customers to aggregate multiple applications over a common network.

FRAME RELAY

Frame Relay Service is designed for data communications over a wide area, interconnecting many business locations and consolidating multiple applications onto a common network using a single physical network access. Access speeds range from 56 kbps to 1.5 Mbps.

PRIVATE LINE

Private Line Service is a dedicated network solution for connecting business locations in a point-to-point configuration. Private Line Services are available from speeds of 56 kbps (DS-0) to 45 Mbps (DS-3) and up to OC-48 (2.4 Gbps) in special circumstances.

MANAGED WAN

Managed WAN Service is a managed Internet Protocol (IP) service, providing customers with an outsourced Wide Area Network (WAN) solution. Managed WAN Service provides all required network access equipment and management services, including router configuration, installation and ongoing maintenance.

TRANSPARENT LAN

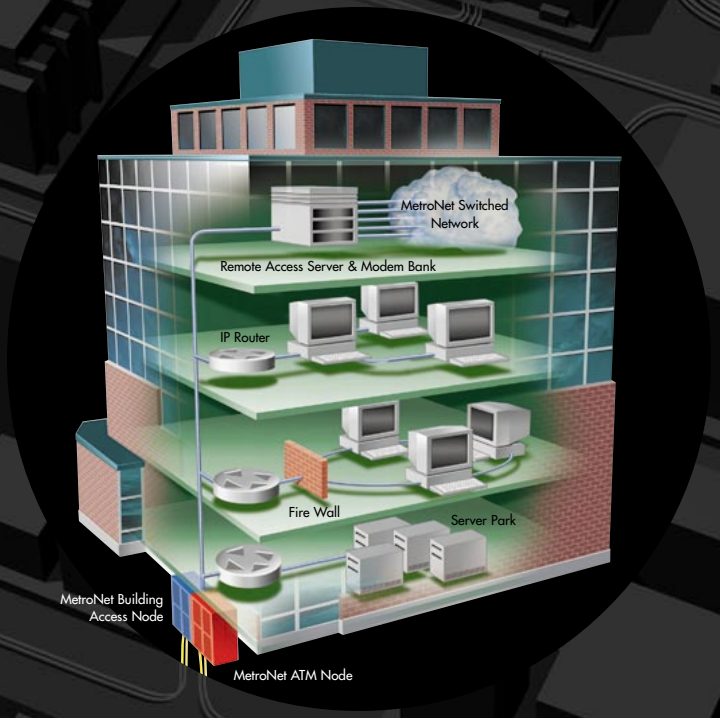
Transparent LAN Service is a LAN-to-LAN interconnection linking Local Area Networks (LANs) across the city or across the country at native LAN speeds (as if they were on the same LAN). Transparent LAN access is available at interface speeds of 10 Mbps Ethernet, 100 Mbps Ethernet or 16 Mbps Token Ring.

Internet

a new reality | The Internet revolution rages on. But the hype of years past has been replaced by a new reality. The Internet is now a standard business tool and an essential enabler of the new information age. Many businesses are abandoning private networks in favour of lower-cost, secure Internet access. In turn, suppliers and customers need reliable, high-speed connectivity in order to stay connected to their business partners. MetroNet is helping business harness this new reality and use the Internet as a powerful weapon to do business faster, better and cheaper.

internet solutions | Our Business Internet Service leverages our extensive fibre optic networks in major metropolitan areas and across Canada, delivering a wide range of high-speed Internet access options, ranging from fractional DS-1 (128 kbps) to ATM-based Internet connections of up to 45 Mbps. The network is configured with multiple, diverse DS-3 links to the U.S. Internet backbone, with over 300 Mbps of available bandwidth. In addition to offering high-speed Internet access to business customers, MetroNet serves the Internet Service Provider (ISP) community with a selection of services specifically designed to improve their technical and business performance. MetroNet's Virtual Point of Presence Service (VPOP), the first competitive offering of its kind in Canada, provides ISPs and corporate customers with a scalable and flexible platform for managing modem pools using ISDN or dial-up connections. ISPs can also utilize MetroNet's Server Park Service to economically extend their reach into remote markets without having to establish a physical presence of their own.

built for business | Whether serving corporate users or ISPs, MetroNet's portfolio of Internet Services is designed to enable business transactions using the new reality of the Internet. MetroNet's pricing and service levels offer the even newer reality of value from an alternative provider.



"MetroNet is the first competitive local exchange carrier that is investing heavily in its national infrastructure, including service, support and consolidated billing. Beyond upwards of a 20% cost savings on monthly invoices, the level of service and support from MetroNet is phenomenal compared to the incumbent telephone company. MetroNet is an ideal strategic partner for our business."

P. S. (PARM) GILL, Executive Vice President, Cyberus Online Inc.– Ottawa, Ontario

METRONET INTERNET SERVICES

BUSINESS INTERNET

MetroNet provides dedicated connectivity solutions for access to the Internet with a variety of access speed and protocol options. Customers can establish a Web presence, take advantage of the wealth of information available on the Internet and communicate with customers, suppliers and employees quickly and cost effectively.

VIRTUAL POINT OF PRESENCE

VPOP Service provides Internet Service Providers and corporate customers with a scalable and flexible managed modem service to offer remote access to their customers or users via traditional dial-up or ISDN capabilities.

INTERNET SERVER PARKS

MetroNet provides customers physically and environmentally secure housing for their telecommunications equipment within MetroNet's primary hub locations, enabling ISPs to establish a presence in remote markets by cost effectively deploying and locating their equipment.

WEB HOSTING

MetroNet has positioned itself to provide a full suite of scalable and flexible Web hosting, e-mail, domain name and firewall services that enable businesses to establish and grow a presence on the Internet and leverage the power of e-commerce.

Customer Care

MetroNet utilizes superior customer service to distinguish itself from incumbent local telephone carriers through proactive initiatives and effective response to our business customers' needs. MetroNet's Customer Care philosophy is centered on the three simple notions of prevention, access and resolution.

prevention | Before any of our services are sold to customers, they are built to be the most reliable, efficient and maintainable in the industry. Our networks are built with full redundancy and routing diversity. Our digital switching equipment is the very latest from world-class providers. Our highly trained sales and customer contact personnel educate and assist customers in using our services.

access | The second step in providing exceptional service is making sure that customers can quickly and easily reach a person who can enhance their service or solve a problem. Through our National Customer Care Centres with toll free access anytime, MetroNet delivers single point of contact service across the country. As well, our Customer Care Centres can be reached via e-mail and our secure Web facilities. All systems that customers contact are monitored 7 days a week, 24 hours a day.

resolution | MetroNet has built provisioning and billing tools that allow modifications and repairs to services or billing to occur quickly and efficiently, often even remotely. Our two national Network Operations Centres are powerful and intelligent centres to assist in solving problems quickly.

Our goal is simple: to provide our customers with the best customer service available in the Canadian telecommunications industry.

Financial Review

1998 was an impressive year of achievement for MetroNet that saw explosive growth in revenue, access lines and network asset deployment. Through strong organic growth and several key acquisitions, MetroNet has assembled a unique and scarce set of strategic telecommunications assets. With $855 million of unrestricted cash and short-term deposits, MetroNet exited 1998 well funded to continue executing its growth strategy.

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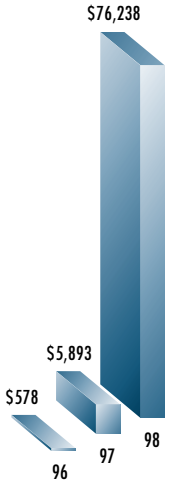
The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and the notes thereto and the other financial data appearing elsewhere herein.

(All amounts are stated in thousands of Canadian dollars, except where otherwise noted.)

OVERVIEW

MetroNet Communications Corp. (the "Company" or "MetroNet") was founded in 1995 to provide broadband local telecommunications services to business and government customers. MetroNet currently offers, or is preparing to offer, local voice and data services in Canada's largest cities. MetroNet's goal is to be the first and leading national facilities-based provider of competitive local telecommunications services to business and government customers in Canada, and the principal and preferred choice to the incumbent local exchange carrier ("ILEC") in each of the Company's target markets. The Company believes that with the May 1, 1997 release by the CRTC of a series of decisions, which effectively opened Canada's local switched telecommunications services market to competition on January 1, 1998, MetroNet is well positioned to compete for a portion of the ILEC's historically monopoly-controlled local business and government market.

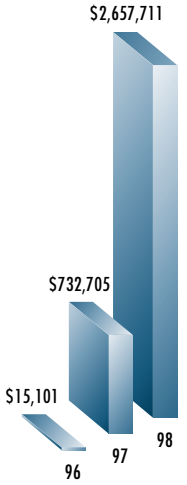


ANNUAL REVENUE
(in thousands)

The development of the Company's business and the build out of its networks in its target markets will require significant expenditures. The Company has made the strategic decision to build high capacity networks with broad market coverage, which increases its level of capital expenditures and operating losses during the early phase of its development, but which the Company believes will enhance the future financial performance by enabling greater margins as the business matures.

The Company's principal operating expenses consist of service costs; selling, general and administrative costs ("SG&A"); and depreciation. Service costs consist of costs directly associated with servicing the operations of the Company's networks, such as service personnel, expenses associated with fibre leases where it does not presently have its own facilities, local and long distance transport, maintenance agreements, rights-of-ways fees, municipal access fees, hub site lease expenses and leases of utility space in buildings connected to the Company's networks. SG&A costs include the costs of sales and marketing, including the costs of sales and marketing personnel, promotional and advertising expenses, corporate administrative expenses and general office costs. As the Company further develops its target markets and expands into new markets, both service costs and SG&A will continue to increase in advance of realizing corresponding revenue levels. Significant amounts of marketing expenditures may be necessary for such development and expansion in order for the Company to build a customer base large enough to generate sufficient revenue to offset such marketing expenses. In addition, SG&A may increase as a percentage of total revenue in the short-term after the Company enters a new market, because many of the fixed costs of

providing service in new markets are incurred before significant revenue can be expected from those markets. As anticipated in the Company's plan, MetroNet has experienced operating losses and generated negative cash flow from operations since its inception. The Company expects to continue to incur operating losses and to generate negative cash flow from operations at least through 1999 and expects negative cash flows from operations and net losses to continue for the next several years thereafter due to the activities undertaken while it installs and expands its networks and develops its business.



TOTAL ASSETS
(in thousands)

note offerings | The Company has issued and sold notes in four offerings during 1997 and 1998 with stated amounts totaling US$1,581.0 million. The details are as follows:

10.625% Note Offering

On November 12, 1998, the Company issued and sold US$225.0 million of 10.625% Senior Notes due 2008 (the "10.625% Notes") at a price of 100% of the principal amount per Note ("the 10.625% Note Offering"). The 10.625% Notes will mature on November 1, 2008. Interest on the 10.625% Notes will be payable semiannually on May 1 and November 1 of each calendar year at the rate of 10.625% per annum, commencing May 1, 1999.

9.95% Note Offering

On June 10, 1998, the Company issued and sold US$936.0 million stated amount at maturity of its 9.95% Senior Discount Notes due 2008 ("the 9.95% Notes") (US$971.0 million after taking into account the effect of the initial purchasers' exercise of their over-allotment option which closed on July 7, 1998). The 9.95% Notes will mature on June 15, 2008. The 9.95% Notes were issued at an issue price of US$614.55 per US$1,000 stated amount at maturity to generate gross proceeds of US$575.2 million (US$596.7 million after taking into account the effect of the initial purchasers' exercise of their over-allotment option), (the "9.95% Note Offering"). The 9.95% Notes bear interest on the issue price at a rate of 9.95% per annum computed on a semiannual bond equivalent basis from the date of issuance.

10.75% Note Offering

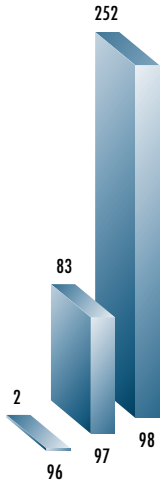
On October 30, 1997, the Company issued and sold US$170.0 million stated amount at maturity of its 10.75% Senior Discount Notes ("the 10.75% Notes"). The 10.75% Notes will mature on November 1, 2007. The 10.75% Notes were issued at an issue price of US$592.24 per US$1,000 stated amount at maturity, to generate gross proceeds of US$100.7 million (the "10.75% Note Offering"). The 10.75% Notes will bear interest on the issue price at a rate of 10.75% per annum computed on a semiannual bond equivalent basis from the date of issuance. In the period prior to November 1, 2002, interest at a rate of 10.75% per annum will accrue on the issue price but will not be payable in cash. From November 1, 2002, interest at a rate of 10.75% per annum on the stated amount at maturity of the 10.75% Notes will be payable in cash semiannually on May 1 and November 1 of each year, beginning May 1, 2003.

12.0% Note Offering

On July 25, 1997, the Company issued and sold 250,000 Units, each consisting of a US$1,000 principal amount 12.0% Senior Note ("the 12.0% Notes") and one warrant to acquire 1.715 Class B Non-Voting Shares, for an aggregate purchase price of US$250.0 million (the "12.0% Note Offering"). The 12.0% Notes will mature on

August 15, 2007. Interest on the 12.0% Notes will be payable semi-annually on February 15 and August 15 of each year at the rate of 12.0% per annum, commencing February 15, 1998. Upon the closing of the 12.0% Note Offering, the Company purchased US$46.7 million of US government obligations which are held by the Company in a separate account to pay for the first three regularly scheduled interest payments due on the 12.0% Notes from February 15, 1998 through February 15, 1999. In addition, the Company purchased and placed in a pledge account US$38.8 million of US government obligations ("the Pledged Securities") which will, upon receipt of scheduled principal and interest payments on such securities, provide for payment in full of the three regularly scheduled interest payments due on the 12.0% Notes from August 15, 1999 through August 15, 2000. The Pledged Securities have been pledged as security for the benefit of the holders of the 12.0% Notes. The 250,000 warrants to acquire a total of 428,625 Class B Non-Voting Shares are exercisable after July 25, 1998 and before August 15, 2007 at an exercise price of US $0.02 per share which was paid as part of the 12.0% Note Offering.

See additional discussion of the Note Offerings in Note 7 to Consolidated Financial Statements.



SALES EMPLOYEES

acquisitions | Effective June 30, 1998 the Company purchased all of the issued and outstanding shares of Rogers Telecom Inc. (subsequently renamed MetroNet Telecom Inc. or "MTI"). The acquisition has been accounted for by the purchase method of accounting and the results of operations have been included from the date of acquisition. Purchase consideration, before acquisition expenses and any working capital adjustment was approximately $1.05 billion, comprised of $600.0 million in cash and $450.0 million in common shares.

On October 30, 1998, the Company entered into two agreements to purchase 12 fibre optic strands and associated communication shelters for a total purchase price of $213.1 million. The Company has paid $90.2 million of this purchase price to date, of which $80.2 million has been allocated to property, plant and equipment. The Company has committed to pay the balance as the routes are completed. The remaining $10.0 million paid represents a deposit on uncompleted segments and has been included in other assets. Completion of the final route is scheduled for December 1999.

credit facilities | The Company has entered into an agreement with a Canadian chartered bank ("the Bank") under which the Bank has agreed to loan $40 million to the Company on a three-year revolving credit basis (the "Bank Facility"). At December 31, 1998, nothing was drawn on this facility but there were letters of credit outstanding against the facility of approximately $5.7 million.

On August 21, 1998 MetroNet cancelled its vendor financing facility with Northern Telecom Limited ("Nortel") and on September 4, 1998 MetroNet cancelled its equipment loan facility with General Electric Capital Canada, Inc.

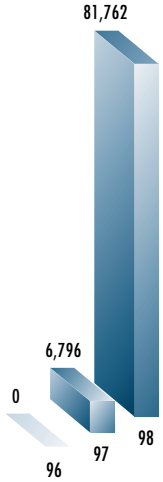
On February 23, 1999, the Company entered into a $200 million bank facility with a syndication of various financial institutions. $75 million of the facility is Non-Revolving and $125 million is Revolving. Draws under the Non-Revolving and Revolving facilities shall be made on or prior to December 31, 2002 and March 31, 2006, respectively. The bank facility can be cancelled or reduced at any time at the option of the Company without penalty. The bank facility has scheduled quarterly repayments of principal starting on March 31, 2003 until December 31, 2006, when the bank facility is cancelled.

Outstanding principal amounts under the bank facility bear interest, at the Company's option, equal to the Prime Rate plus 2% or the market rate for bankers acceptance plus 3%. The bank facility is secured by supporting security granted by the Company's wholly owned subsidiaries and a general security agreement. The bank facility includes financial and other covenants such as restrictions on the Company's ability to create additional or alter the provision of, or make prepayments on existing debt, permit liens, sell assets, and make investments. Security under this bank facility must be put in place by August 31, 1999 or the facility will be cancelled. Once security is in place, this bank facility will replace the $40 million bank facility described above.

RESULTS OF OPERATIONS

Year ended December 31, 1998
Compared to Year ended December 31, 1997

revenue | Revenue for the year ended December 31, 1998 was $76,238 compared to $5,893 for the year ended December 31, 1997. For the year ended December 31, 1998, voice service revenue was approximately $26,754 of which $15,344 was derived from local service and $11,410 was derived from long distance. Data and transport revenues were approximately $44,465 of which $12,762 was generated from a combination of Asynchronous Transfer Mode ("ATM"), frame relay and LAN interconnect services, $5,976 was generated from Internet related services and $25,727 was generated from private line sales. Data and telecommunications equipment and service sales of $5,019 comprised the remainder of the revenue for the year. For the year ended December 31, 1997, revenue was comprised primarily of data transmission, dedicated access and private line fees of $3,031 and fees related to management of desktop computers and routers of $2,482. The remaining $380 was comprised of resale fees and equipment sales.



ACCESS LINES SOLD

costs and expenses | Service costs increased to $64,487 for the year ended December 31, 1998 from $7,687 for the year ended December 31, 1997. The increase was primarily attributable to the Company's continued growth and offering of private line, dedicated access and frame relay services during 1998. In addition, increased rental expense under the Company's fibre leases with the City of Calgary and Toronto Hydro, the underlying costs of resold voice telecommunications services, and service costs associated with the acquired businesses added to the service costs in 1998. The Company expects service costs, and the ratio of these service costs to system fee revenue, to increase through the end of 1999 as the Company continues its expansion into its target markets and continues to expand its product offerings.

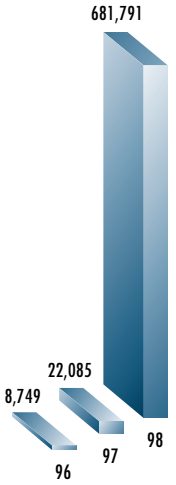
The Company's SG&A expenses increased to $61,737 for the year ended December 31, 1998 from $19,140 for the year ended December 31, 1997. The largest contributor to the increase was salary and benefits which rose to $30,450 for the year ended December 31, 1998 from $9,733 for the year ended December 31, 1997. This increase resulted primarily from the Company's

continued expansion of its administrative and sales personnel in connection with the introduction of dedicated access, private line and frame relay services during 1998 as well as costs associated with employees gained from the acquisition of MTI. The number of employees employed by the Company increased from 428 employees at December 31, 1997 to 955 at December 31, 1998.

Depreciation and amortization expense increased to $54,668 for the year ended December 31, 1998 from $3,103 for the year ended December 31, 1997. The increase is a result of increased levels of telephone network equipment and computer equipment the Company has placed into service and the amortization of goodwill and the non-compete agreement related to the acquisition of MTI.

During the year ended December 31, 1998 the Company recorded a charge of $9,200 for integration costs related to its acquisition of MTI. This charge includes costs related to the consolidation of the network operation centres of the Company and MTI, costs to consolidate office locations and other one-time costs to integrate the operations of the two companies.

interest income (expense) | The Company had interest income of $36,659 for the year ended December 31, 1998 compared to interest income of $10,066 for the same period in 1997. Interest income for 1998 was earned primarily on the balance of proceeds of the 12.0% Note Offering, the 10.75% Note Offering, the Initial Public Offering completed in December 1997, the 9.95% Note Offering, the equity offering completed in August 1998 and the 10.625% Note Offering. Interest income for 1997 was earned primarily on the proceeds of the 1996 Private Placement which generated $15 million, the 12.0% Note Offering and the 10.75% Note Offering. Interest expense of $127,891 for the year ended December 31, 1998 represents primarily the interest accrued on the 12.0% Notes, the 10.75% Notes, the 9.95% Notes and the 10.625% Notes. Interest expense of $20,978 for the year ended December 31, 1997 represents interest on the 12.0% Note Offering which was completed in July 1997 and the 10.75% Note Offering which was completed in November 1997.



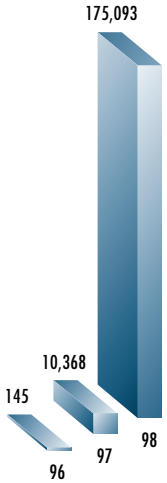
CIRCUITS IN SERVICE (VGEs)

net loss | The Company's net loss increased to $212,801 for the year ended December 31, 1998 from $36,449 for the year ended December 31, 1997. These losses are consistent with the Company's plans and the start-up nature of its current operations.

EBITDA and cash flow from operations | EBITDA losses increased to $59,186 for the year ended December 31, 1998 ($49,986 excluding the integration costs related to the acquisition of MTI), from $20,934 for the year ended December 31, 1997. Cash flow used in operations, as portrayed in the accompanying statements of changes in financial position, also increased from $6,004 for the year ended December 31, 1997 to $83,232 for the year ended December 31, 1998. The EBITDA losses and negative cash flow from operations reflect the increasing operating and SG&A expenses noted above resulting from the development and expansion of the Company's networks and systems. EBITDA is a financial measure commonly used in telecommunications and other industries and is presented to assist in understanding the Company's operating results. However, it is not intended to represent cash flow or results of operations in accordance with Canadian or U.S. GAAP.

Year ended December 31, 1997
Compared to Year ended December 31, 1996

revenue | Revenue for the year ended December 31, 1997 was $5,893 compared to $578 for the year ended December 31, 1996. For the year ended December 31, 1997, revenue was comprised primarily of data transmission, dedicated access and private line fees of $3,031 and fees related to management of desktop computers and routers of $2,482. The remaining $380 was comprised of resale fees and equipment sales. Revenue for 1996 was derived primarily from the Company's ATM service and installation fees in Calgary. The Company began offering ATM services in Calgary in July 1995 and in early 1997 expanded its data transmission services in Calgary to include frame relay and commenced offering dedicated access and private line services.



FIBRE STRAND KILOMETRES

costs and expenses | Service costs increased to $7,687 for the year ended December 31, 1997 from $409 for the year ended December 31, 1996. This increase in service costs was primarily attributable to the Company's continued growth and offering of private line, dedicated access and frame relay services during 1997. In addition, increased rental expense under the Company's fibre leases with the City of Calgary and Toronto Hydro, the underlying costs of resold voice telecommunications services and service costs associated with the acquired businesses added to the service costs in 1997.

The Company's SG&A expenses increased from $2,398 for the year ended December 31, 1996 to $19,140 for the year ended December 31, 1997. The largest contributor to the increase in SG&A expense was an $8,039 increase in salaries and benefits from $1,694 in 1996 to $9,733 in 1997. This resulted primarily from the Company's continued expansion of its administrative and sales personnel in connection with the introduction of dedicated access, private line and frame relay services during 1997. Salaries and benefits to employees of the acquired businesses also accounted for a portion of the increase in 1997. The number of employees employed by the Company increased from 13 employees at December 31, 1996 to 428 at December 31, 1997.

Depreciation and amortization expense increased to $3,103 for the year ended December 31, 1997 from $262 for the year ended December 31, 1996. The increase was a result of increased levels of telephone network equipment, computer equipment and vehicles the Company has placed into service and the amortization of costs associated with the purchase of acquired businesses.

interest income (expense) | The Company had interest income of $10,066 for the year ended December 31, 1997 compared to interest income of $221 in 1996. Interest income in 1997 was earned on the balance of proceeds of the 1996 Private Placement, the 1997 Private Placement, the proceeds of the 12.0% Note Offering, the 10.75% Note Offering and the Initial Public Offering. Interest income in 1996 was earned on the proceeds of the 1996 Private Placement. Interest expense of $20,978 for the year ended December 31, 1997 represents the interest accrued on the 12.0% Notes and 10.75% Notes. Interest expense of $19 for the year ended December 31, 1996 includes interest on funds borrowed under a bank credit facility that was repaid in July 1996.

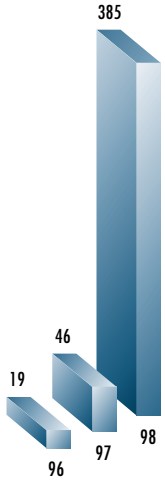
net loss | The Company's net loss increased to $36,449 for the year ended December 31, 1997 from $2,289 for the year ended December 31, 1996. These losses are consistent with the Company's plans and the current start-up nature of its operations.

EBITDA and cash flow from operations | EBITDA losses increased to $20,934 for the year ended December 31, 1997, from $2,229 for the year ended December 31, 1996. Cash flow used in operations, as portrayed in the accompanying statements of changes in financial position, also increased from $2,028 for the year ended December 31, 1996 to $6,004 for the year ended December 31, 1997. The EBITDA losses and negative cash flow from operations reflect the increasing operating and SG&A expenses noted above resulting from the development and expansion of the Company's networks and systems. EBITDA is a financial measure commonly used in the telecommunications and other industries and is presented to assist in understanding the Company's operating results. However, it is not intended to represent cash flow or results of operations in accordance with Canadian or U.S. GAAP.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 1998, the Company's current assets of $947,762, including cash and short-term deposits of $854,729, exceeded current liabilities of $96,017 which provided a working capital surplus of $851,745. Working capital surplus at December 31, 1997 was $444,531. The increase in working capital is attributable to the proceeds of the 9.95% Note Offering, the equity offering completed in August 1998 and the 10.625% Note Offering less expenditures on property, plant and equipment and the acquisition of MTI and other business and related assets.

Expenditures on networks, equipment and related assets totaled $396,109 during the year ended December 31, 1998. These expenditures reflect the purchase of equipment, rights-of-ways, development of a customer care system and laying fibre to facilitate the Company's continued expansion of its dedicated access, private line, and data networking services in its target markets.

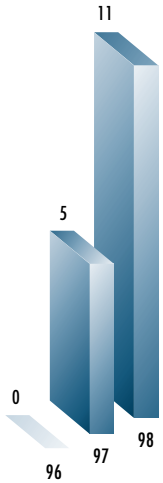


ATM SWITCHES

Other long-term assets increased to $155,721 at December 31, 1998 from $23,286 at December 31, 1997. The increase relates to the value assigned to the non-compete agreement signed in conjunction with the acquisition of MTI, premiums paid on two options purchased to hedge exchange rate fluctuations on debt denominated in U.S. dollars and costs associated with the issuance of debt. Debt issuance costs have been deferred and will be amortized over the respective terms of the related debt.

As expected, the Company's start-up operations have not generated sufficient cash flow from its inception in 1995 through December 31, 1998 to enable it to meet its capital expenditure, debt service and other cash needs. Cash for the aforementioned items was provided by private placements, the 12.0%, 10.75%, 9.95% and 10.625% Note Offerings, the Company's Initial Public Offering and the equity offering completed in August 1998.

The Company is a holding company that derives, and will derive, all of its operating income from MetroNet Group and any future subsidiaries. The Company expects that interest income and principal repayments on loans made to its subsidiaries, and, to a lesser extent, fees paid to the Company by MetroNet Group pursuant to an agreement in respect of management services provided by the Company, will be the principal sources for the funds necessary for it to meet its obligations. MetroNet Group and any future subsidiary of the Company will be separate and distinct legal entities and will have no obligation, contingent or otherwise, to pay any dividend or to make any other distribution to the Company, other than for such management services and the payment of interest and principal payments on such loans from the Company, or otherwise to pay amounts due with respect to the Company's indebtedness or to make funds available for such payments. The ability of the Company's subsidiaries to make payments will be subject to, among other things, the availability of sufficient cash.



FRAME RELAY SWITCHES

The competitive local services business is capital intensive. The Company's operations will continue to require substantial capital to fund the development and build out of its networks and services in its target markets, to fund the continued development of its planned services and for its other general corporate purposes, including funding operating losses and working capital needs. The Company plans to continue deploying capital for the development and expansion of networks in its target markets in order to offer a full array of dedicated access, private line, data transmission and local switched voice services in those markets. The Company's capital expenditures are expected to be $460 million for the twelve months ending December 31, 1999. The majority of these expenditures will be made to continue to build out the Company's networks. The Company believes that the net proceeds of the recently completed 10.625% Offering, together with other sources of funds available to it, will provide it with sufficient liquidity to fund its costs of constructing, developing, acquiring and improving its telecommunications networks through at least the next 18 months. Thereafter, the Company may require additional financing. The extent of additional financing required will depend upon the rate of the Company's expansion and the success of its business.

If the Company requires additional capital to complete the planned build out of its networks in its target markets, or if customer demand in such markets exceeds current expectations, the Company's funding needs may increase, possibly to a significant degree. The Company will continue to evaluate additional revenue opportunities and strategic initiatives in each of its markets, as well as in additional markets. As economically attractive opportunities develop, the Company may make additional capital investments in its networks, build new networks or consummate strategic alliances or acquisitions to pursue such opportunities. The Company expects that potential additional funding needs could be met by raising additional equity and/or debt capital, borrowing under future credit facilities, entering into joint ventures with strategic partners or a combination of such options. There can be no assurance, however, that the terms of its existing or future indebtedness or credit facilities will permit the Company to raise sufficient additional debt capital, or that the Company will be successful in raising sufficient additional capital, obtaining such borrowings or entering into such joint ventures to meet its funding needs or that such options, if available at all, will be available on a timely basis or on terms that are acceptable to the Company.

The Company's expectations of required future capital expenditures are based on the Company's current estimates and plans. There can be no assurance that the amount of funds actually required to complete the planned build out of the Company's networks in its target markets will not exceed the Company's currently anticipated expenditures.

risk management | Some of the Company's assets and liabilities are denominated in U.S dollars. The Company hedges its exposure to foreign currency exchange risk on long-term debt by designating existing foreign currency denominated monetary assets as hedge instruments and through the use of options, cross-currency swaps and forwards. Foreign exchange gains and losses on hedge instruments are recorded in the same period as the corresponding gains and losses on long-term debt.

The Company is also exposed to fluctuations in interest rates. The Company's long term debt is set at fixed rates, but there are significant monetary assets that are dependent on floating interest rates. The Company uses a rigorous system of internal controls and investment criteria to maintain minimum exposure to possible interest rate fluctuations.

IMPACT OF YEAR 2000

Many computer programs and microprocessors were designed and developed without considering the impact of the transition to the year 2000. As a result, these programs and microprocessors may not be able to differentiate between the years "1900" and "2000"; the year 2000 may be recognized as the two-digit number "00". If not corrected, this could cause difficulties in obtaining accurate system data and support.

The Company is currently in the midst of its Year 2000 project which will determine what actions yet need to be taken in order to be ready for the Year 2000. The Company's definition for Year 2000 readiness is as follows:

"The capability of a Product, when used in accordance with its associated documentation, to correctly process, provide and/or receive date data within and between the 20th and 21st centuries, provided that all products used with the Product properly exchange date data with it."

project scope | The scope of the Year 2000 project within the Company is to address the following areas of its business as it relates to Year 2000 readiness: hardware, vendor-owned software, internal software, facilities, manual processes, outside suppliers, contingency planning, internal awareness, vendor assurance and customer assurance.

There is a six-step Year 2000 methodology: inventory, assessment, triage, construction and remediation, testing and implementation.

1. *Inventory:* The first phase was to inventory all systems, capture current Year 2000 status information, and obtain Year 2000 compliance statements from vendors. The Company has completed the inventory step.
2. *Assessment:* In this phase, the repair options for each inventory item were determined. Assessment has been completed for all of the Company's business units. The issues considered in developing the repair option included the following:

- Cost – what is the cost of the repair options and whether it is more effective to replace the item or repair it.
- Time – what is the effort (time) required to execute the repair options. Those items requiring longer lead times are given priority.
- Resource requirements – what resources are required to fix the item.
- Contingency requirements – what alternatives can be found to mitigate the Year 2000 issue.

3. *Triage:* The purpose of this phase in the Year 2000 process was to prioritize the Company's efforts for repairing the non-compliant Year 2000 items. Triage has been completed for all of the Company's business units.

4. *Construction:* When the repair option has been selected, the Company will execute the repair option determined in the assessment. Construction is currently under way and is expected to be completed by March 31, 1999. The repair phase may include unit testing and validating the system using the current date values before proceeding with testing future dates.
5. *Testing:* This phase ensures that the repair phase has resulted in Year 2000 readiness and has not introduced other errors into the system. Testing is expected to be completed by March 31, 1999. Several test cases are run for each of the following suspect dates: 9/9/1999; 12/31/99; 1/1/2000; 1/2/2000; 2/28/2000; 2/29/2000; 3/1/2000; 12/31/2000; 1/1/2001; 2/28/2001 and 3/1/2001. Date testing will be incorporated into the Company's application life-cycle management, as all future enhancements must be determined to be Year 2000 compliant. Additionally, the Company has introduced Year 2000 compliance clauses into supplier contracts.
6. *Implementation:* When the repaired module/system is ready for production, the implementation may include more than just implementing hardware and software. It may also include: post-implementation data integrity tests, changing regression tests for all future enhancements, completion of any required data conversions, provision of any required training and life cycle management of any temporary bridges. The implementation of all repairs is expected to be completed by June 1999.

industry collaboration | The Company, along with every large Canadian telecommunications company, is a member of the National Year 2000 Telecommunications Industry Forum (the "Forum"). The goal of the Forum is the continued integrity and operation of the Canadian telecom system for basic national services (emergency, local, long distance, toll-free, wireless and operator services). Each member represents the Forum on behalf of its customers and audiences. The key areas of focus are: managing discussions with vendors, thorough testing of interconnected telecommunications networks and establishing industry contingency plan.

MetroNet has purchased and designed numerous computer systems since its inception. MetroNet believes, based on advice from its vendors, that its systems will be Year 2000 compliant and capable of functioning after December 31, 1999. However, the Company does and will continue to interconnect certain portions of its networks and systems with other companies' networks and systems, certain of which may not be as Year 2000 compliant as those installed by MetroNet. While MetroNet has and will continue to make all reasonable efforts to assure the full functionality of its networks and systems after December 31, 1999, and is actively working with those companies whose systems it interfaces with and/or relies upon, there can be no assurance its own systems, or those of third parties with which it interacts, will be fully Year 2000 compliant before December 31, 1999. The Company also sells its telecommunications services to many companies who rely upon computerized systems to make payments for such services. There can be no assurance that these companies will make their own systems fully compliant before December 31, 1999 to assure timely payments to the Company for telecommunications services which it provides. While the Company has discussed these matters with other companies it interconnects with and sells its services to, there can be no assurance that any potential impact associated with incompatible systems after December 31, 1999 would not have a material adverse effect on the Company's business, financial condition, results of operations or prospects.

The Company currently estimates that it will incur expenses of approximately $1.8 million to complete its Year 2000 readiness efforts, $1.0 million of which has been incurred through December 31, 1998. The costs include the cost of consultants used to implement the Year 2000 plan, hardware costs and software costs. These costs, which may vary from the estimates, have been, and will continue to be, expensed as incurred. Such costs, however, are not expected to have a material adverse effect on the

Company's business, financial condition, results of operations and prospects. Additionally, such costs do not include costs that may be incurred by the Company as a result of the failure of any third parties, including suppliers, to become Year 2000 compliant or costs to implement any contingency plan.

The Company has begun to develop contingency plans to handle its most reasonably likely worst case Year 2000 scenarios and expects to have a contingency plan completed by June 1999.

While the Company's efforts are designed to be successful, because of the complexity of Year 2000 issues and the interdependence of organizations using computer systems, there can be no assurance that the Company's efforts or those of a third party with which the Company interacts will be satisfactorily completed in a timely fashion. Failure by the Company, its major vendors, other material service providers or customers to adequately address their respective Year 2000 issues in a timely manner (insofar as they relate to the Company's business) could have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

CORPORATE GOVERNANCE

The Board of Directors of MetroNet is responsible for the overall stewardship of the Company including planning, directing and controlling issues which are pivotal in determining the direction and strategy of the Company. The Board considers management development, business development, financing arrangements and other matters requiring Board approval by law. The Board reviews the systems being put in place to manage the identifiable risks of the Company as well as the integrity of the internal control and management information systems. The Board also reviews and confirms decisions and recommendations made by senior management where appropriate, but does not generally involve itself in the day-to-day operations of the Company.

The Board is comprised of eleven members and has extensive knowledge of the Company and of the telecommunications industry, which enhances its overall effectiveness. The Board has established several committees to assist it in carrying out its responsibilities.

The Compensation Committee is comprised of four members who meet periodically to consider and approve compensation plans for all officers and employees. The Audit Committee has three members and is responsible for overseeing the Company's internal controls and the systems in place to manage the risks that face the Company. The Executive Committee is comprised of three members who work closely with management on various projects and who assist management on an ongoing basis. The three member Corporate Governance Committee reviews Board governance practices and evaluates director and Board performance.

The information set forth above in "Management's Discussion and Analysis of Financial Conditions and Results of Operations" includes forward-looking statements that involve numerous risks and uncertainties. The Company's actual results could differ materially from those anticipated in such forward-looking statements as a result of certain factors, including those set forth in the sections entitled "Risk Factors" in the Company's Registration Statement on Form F-4 (No. 333-9222) filed with the Securities and Exchange Commission on August 3, 1998.

report of management

The accompanying consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles. Management is responsible for their integrity, objectivity and reliability and, where necessary, they reflect management's best estimates and judgements. To provide reasonable assurance that the Corporation's assets are safeguarded and that reliable financial information is produced, management is also responsible for developing and maintaining an effective system of internal controls.

Management believes that the system of internal controls provides reasonable assurance that the financial records are adequate and can be relied upon for the preparation of financial statements in conformity with generally accepted accounting principles and that access to assets occurs only in accordance with management's authorizations.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board exercises these responsibilities through its Audit Committee whose members are not involved in the daily activities of the Corporation. The Audit Committee meets periodically with management and with the independent auditors, KPMG LLP, to satisfy itself that management's responsibilities are properly discharged and to review and report to the Board with respect to auditing, internal controls, and the consolidated financial statements.

The consolidated financial statements have been reviewed and approved by the Board and have been audited by KPMG LLP, whose report and professional opinion is presented herein.

(signed) Robert C. Bicksler

Robert C. Bicksler
Executive Vice President and
Chief Financial Officer

(signed) Philip R. Ladouceur

Philip R. Ladouceur
Chairman of the Board

auditors' report

To the Shareholders of MetroNet Communications Corp.

We have audited the consolidated balance sheets of MetroNet Communications Corp. as at December 31, 1998 and 1997 and the consolidated statements of operations and deficit and changes in financial position for each of the years in the three year period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for each of the years in the three year period ended December 31, 1998 in accordance with generally accepted accounting principles in Canada.

Generally accepted accounting principles in Canada differ in some respects from those applicable in the United States (note 13).

(signed) KPMG LLP

Chartered Accountants
Toronto, Canada
January 29, 1999 (February 23, 1999 as to note 12 (b))

Consolidated Balance Sheets

(In thousands of Canadian dollars)
As at December 31, 1998 and 1997

ASSETS	1998	1997
Current assets:		
Cash and short-term deposits (note 3)	$ 854,729	$ 455,725
Restricted investments (note 3)	47,081	46,354
Accounts receivable	29,302	2,868
Other current assets	16,650	7,658
	947,762	512,605
Restricted investments (note 3)	42,526	78,826
Property, plant and equipment (note 4)	832,874	114,275
Goodwill (note 5)	678,828	3,713
Other assets (note 6)	155,721	23,286
	$ 2,657,711	$ 732,705

LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 65,264	$ 42,689
Accrued liabilities	2,517	5,327
Accrued interest payable	22,326	18,578
Income taxes payable	4,950	1,480
Current portion of long-term debt (note 7)	960	—
	96,017	68,074
Long-term debt (note 7)	1,882,424	500,372
Shareholders' equity (notes 7(a) and 8):		
Common shares	928,052	200,240
Warrants	3,429	3,429
Deficit	(252,211)	(39,410)
	679,270	164,259
	$ 2,657,711	$ 732,705

Commitments and contingencies (note 10)
Subsequent events (note 12)
Canadian and United States accounting policy differences (note 13)

See accompanying notes to consolidated financial statements.

On behalf of the Board:

(signed) Philip R. Ladouceur

Philip R. Ladouceur
Director

(signed) Robert W. McKenzie

Robert W. McKenzie
Director

Consolidated Statements of Operations and Deficit

OPERATIONS

(In thousands of Canadian dollars, except per share amounts)
Years ended December 31, 1998, 1997 and 1996

	1998	1997	1996
Revenue	$ 76,238	$ 5,893	$ 578
Expenses:			
Service costs	64,487	7,687	409
Selling, general and administrative	61,737	19,140	2,398
Depreciation and amortization	54,668	3,103	262
Integration costs related to acquisition (note 2)	9,200	—	—
	190,092	29,930	3,069
Loss before the undernoted	(113,854)	(24,037)	(2,491)
Other income (expense):			
Interest income	36,659	10,066	221
Interest expense	(127,981)	(20,978)	(19)
	(91,322)	(10,912)	202
Loss before income taxes	(205,176)	(34,949)	(2,289)
Income taxes (note 9)	7,625	1,500	—
Loss for the year	(212,801)	(36,449)	(2,289)

DEFICIT

Deficit, beginning of year	(39,410)	(2,961)	(672)
Deficit, end of year	$ (252,211)	$ (39,410)	$ (2,961)
Loss per common share	$ (6.04)	$ (11.41)	$ (1.68)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

CASH PROVIDED BY (USED IN):

(In thousands of Canadian dollars)
Years ended December 31, 1998, 1997 and 1996

	1998	1997	1996
Operations:			
Loss for the year	$ (212,801)	$ (36,449)	$ (2,289)
Items not affecting cash:			
Depreciation and amortization	54,668	3,103	262
Accretion of Senior Discount Note interest	67,458	2,621	—
Other	8,978	145	—
	(81,697)	(30,580)	(2,027)
Changes in non-cash working capital:			
Accounts receivable	(15,982)	(2,695)	(138)
Other current assets	(7,287)	(7,211)	(351)
Accounts payable	17,326	9,233	352
Accrued liabilities	(2,810)	5,191	136
Accrued interest payable	3,470	18,578	—
Income taxes payable	3,748	1,480	—
	(83,232)	(6,004)	(2,028)
Financing:			
Share capital issued, net of issue costs	727,495	184,456	14,763
Warrants	—	3,429	—
Issues (repayment) of long-term debt	1,244,153	485,029	(549)
Debt issue costs	(33,807)	(24,073)	—
Option premiums on financial instruments	(38,271)	—	—
	1,899,570	648,841	14,214
Investments:			
Acquisitions	(1,068,509)	—	—
Additions to property, plant and equipment	(396,109)	(112,642)	(3,081)
Additions to other assets	(12,286)	(3,929)	—
Reduction of (additions to) restricted investments	41,502	(120,838)	—
Change in non-cash working capital	(18,676)	31,315	1,653
	(1,454,078)	(206,094)	(1,428)
Effect of exchange rate changes on cash	36,744	8,234	—
Increase in cash position	399,004	444,977	10,758
Cash position, beginning of year	455,725	10,748	(10)
Cash position, end of year	$ 854,729	$ 455,725	$ 10,748

Cash position includes cash and short-term deposits.

See accompanying notes to consolidated financial statements.

organization and nature of operations

The Company engages in the telecommunications business in Canada through its operating subsidiaries. The Company is the largest competitive facilities-based, local telecommunications provider and access provider in Canada.

NOTE 1

significant accounting policies

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada which, in the case of the Company, conform in all material respects with those in the United States, except as outlined in note 13. All amounts are expressed in Canadian dollars unless otherwise indicated.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses. Actual results could differ from these estimates.

Ultimate recoverability of the Company's investments is dependent upon its subsidiaries, after an expected period of initial losses, achieving and maintaining profitability which depend on market conditions, the Canadian telecommunications regulatory environment and the Company's ability to obtain adequate financing to meet capital requirements.

The Company's significant accounting policies are as follows:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All intercompany transactions and balances have been eliminated on consolidation.

(b) Cash and short-term deposits:

The Company's short-term deposits have an original maturity of less than three months and, accordingly, are considered to be cash equivalents. Short-term deposits are recorded at cost, which approximates current market value.

(c) Revenue recognition:

Telecommunications service revenue is recognized as services are provided.

(d) Restricted investments:

Restricted investments consist of U.S. government securities which are restricted in connection with the payment of interest on certain debt and are stated at cost plus accrued interest.

(e) Property, plant and equipment:

Property, plant and equipment are recorded at cost. Provisions for depreciation are computed using the straight-line method over the estimated useful lives of the assets as follows:

Telecommunications networks	20 years
Electronics and related equipment	7 years
Computer hardware and software	3 – 5 years
Furniture and office equipment	5 – 7 years
Building	20 years
Power equipment	7 years
Leasehold improvements	term of lease

Telecommunications networks are installed on rights-of-ways granted by others and construction costs are capitalized and amortized over the lives of rights-of-ways including option periods. Costs incurred in developing new networks or expanding existing networks, including costs of acquiring rights-of-ways and network design, are included within telecommunications networks. Telecommunications networks and electronics and related equipment begin to depreciate once the network is put in service.

(f) Goodwill and other intangible assets:

Goodwill is recorded at the date of acquisition and is amortized on a straight-line basis over its estimated useful life of 25 years.

Other intangible assets comprise the fair value of the non-compete agreement which was determined by an independent valuation. The balance is amortized on a straight-line basis over its estimated useful life of 4 years.

(g) Impairment of long-lived assets:

Capital assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. This review consists of a comparison of the carrying value of the asset with the asset's expected future undiscounted net cash flows. Estimates of expected future net cash flows represent management's best estimate based on reasonable and supportable assumptions and projections. If the expected future net cash flows exceed the carrying value of the asset, including the unamortized portion of goodwill, no impairment is recognized. If the carrying value of the asset, including the unamortized portion of goodwill, exceeds the expected future net cash flows, an impairment exists and is measured by the excess of the carrying value over the expected future undiscounted net cash flows. Any impairment recognized in accordance with this policy is permanent and may not be restored in the future. No adjustments to the carrying value of long-lived assets have been recognized in these financial statements.

(h) Debt issuance costs:

Debt issuance costs are amortized on a straight-line basis over the terms of the related debt financing.

(i) Foreign currency translation:

Foreign currency denominated monetary items are translated at the current rate of exchange. Translation gains or losses are included in income except for those related to long-term monetary items which are deferred and amortized over the remaining lives of the long-term monetary items.

(j) Financial instruments:

The Company hedges its exposure to foreign currency exchange rate risk on long-term debt by designating existing foreign currency denominated monetary assets as hedge instruments and, from time to time, through the purchase of currency options, cross currency swaps and forward exchange contracts. All such instruments are only used for risk management purposes and are designated as hedges of specific debt instruments. The Company accounts for these financial instruments as hedges and as a result, foreign exchange gains and losses on hedge instruments are recorded in the same period as the corresponding gains and losses on the related long-term debt. Premiums paid to acquire currency options, cross currency swaps and forward exchange contracts are deferred and amortized on a straight-line basis over the term of the instruments.

(k) Income taxes:

The Company uses the liability method of accounting for income taxes. Future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. When necessary, a valuation allowance is recorded to reduce future income tax assets to an amount where realization is more likely than not. Future income tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized as part of the provision for income taxes in the period that includes the enactment date.

(l) Loss per common share:

Loss per common share is based on the weighted average number of common shares outstanding after giving retroactive effect to the share reorganization and consolidation described in note 8. The exercise of options and warrants outstanding at December 31, 1998, 1997 and 1996 would have an anti-dilutive effect on loss per common share.

(m) Segmented information:

The Company's operations fall into one industry segment, the telecommunications industry in Canada.

NOTE 2

acquisitions

Effective June 30, 1998, the Company purchased all of the issued and outstanding shares of Rogers Telecom Inc., a company in the business of providing local high-speed telecommunications and internet access services to business customers in three major cities in Canada (the "Acquisition"). The Acquisition has been accounted for by the purchase method of accounting and the results of operations included from the date of acquisition. Purchase consideration, before acquisition expenses and any working capital adjustment was approximately $1.05 billion.

Details of the net assets acquired at fair value, are as follows:

Purchase price:	
Cash	$ 600,000
Ascribed value of 12.5 million Class B Non-Voting Shares issued	450,000
Working capital adjustment	(9,991)
Acquisition expenses	5,000
	$ 1,045,009
Allocation of purchase consideration:	
Property, plant and equipment	$ 355,922
Working capital deficiency	(9,991)
Non-compete agreement	32,500
Goodwill	666,578
	$ 1,045,009

In connection with the Acquisition, the Company recorded a non-recurring charge of $9.2 million to reflect one-time costs associated with integrating this operation. The charge includes the costs of consolidating and integrating office locations, consolidation of network operation centres and other one-time costs.

The following pro forma consolidated financial information reflects the Acquisition assuming it had occurred on January 1, 1998.

(unaudited)

Revenue	$ 107,341
Service costs	70,797
Selling, general and administrative expenses	74,653
Depreciation and amortization	86,824
Integration costs related to acquisition	9,200
Loss before the undernoted	(134,133)
Interest expense, net	(132,256)
Loss before income taxes	(266,389)
Income taxes	5,918
Loss for the year	$ (272,307)
Loss per common share	$ (7.03)

The pro forma consolidated financial information has been provided for information purposes only and is not necessarily indicative of the results of operations or financial condition that actually would have been achieved if the Acquisition had been completed on the date indicated or that may be reported in the future.

On October 30, 1998, the Company entered into two agreements to purchase 12 fibre optic strands and associated communication shelters for a total purchase price of $213.1 million. The Company has paid $90.2 million of this purchase price to date, of which $80.2 million has been allocated to property, plant and equipment. The remaining $10.0 million paid represents a deposit on uncompleted segments and has been included in other assets. Completion is scheduled over 1999, with the final route scheduled for completion in December 1999. The Company has committed to pay the balance of the purchase price as the routes are completed.

During 1997, the Company acquired certain other businesses for an aggregate purchase price of $4.7 million. All the acquisitions were accounted for using the purchase method of accounting.

NOTE 3

short-term deposits and restricted investments

(a) Cash and short-term deposits:

U.S. dollar denominated amounts included within cash and short-term deposits at December 31, 1998 and 1997 are $649.8 million (U.S. $424.6 million) and $389.1 million (U.S. $272.3 million), respectively, and within restricted investments at December 31, 1998 and 1997 are $89.6 million (U.S. $58.5 million) and $125.2 million (U.S. $87.6 million), respectively.

(b) Restricted investments:

Pursuant to the Indenture governing the 12.0% Senior Notes due 2007 (note 7(a)), a portion of the net proceeds from the sale of the 12.0% Senior Notes was used to purchase U.S. government securities which mature at dates and in amounts sufficient to provide for payment in full of the interest on the 12.0% Senior Notes through August 15, 2000. Restricted investments include eligible and pledged securities. The pledged securities are pledged as security for the benefit of the holders of the 12.0% Senior Notes.

	1998	1997
Eligible securities	$ 24,906	$ 68,325
Pledge securities	64,701	56,855
	89,607	125,180
Less eligible securities, current portion	47,081	46,354
	$ 42,526	$ 78,826

NOTE 4

property, plant and equipment

	1998	1997
Telecommunications networks	$ 157,678	$ 35,107
Electronics and related equipment	608,466	48,004
Computer hardware and software	43,691	14,564
Furniture and office equipment	10,091	12,410
Land and building	4,332	2,374
Power equipment	37,503	1,899
Leasehold improvements	9,058	2,444
	870,819	116,802
Less accumulated depreciation	37,945	2,527
	$ 832,874	$ 114,275

As of December 31, 1998 and 1997, property, plant and equipment includes $199.3 million and $83.5 million, respectively, of networks in progress that are not in service and, accordingly, have not been depreciated.

NOTE 5

goodwill

			1998	1997
	Cost	Accumulated amortization	Net book value	Net book value
Goodwill	$ 692,818	$ 13,990	$ 678,828	$ 3,713

NOTE 6

other assets

	1998	1997
Debt issuance costs	$ 57,741	$ 24,073
Option premiums on financial instruments (note 11)	38,271	—
Non-compete agreement (note 2)	32,500	—
Deferred foreign exchange	28,327	—
Other	12,192	23
	169,031	24,096
Less accumulated amortization	13,310	810
	$ 155,721	$ 23,286

NOTE 7

long-term debt

	1998	1997
12.0% Senior Notes (U.S. $247.9 million) (a)	$ 379,357	$ 353,868
10.75% Senior Discount Notes (U.S. $113.8 million) (b)	174,219	146,504
9.95% Senior Discount Notes (U.S. $630.0 million) (c)	964,236	—
10.625% Senior Notes (U.S. $225.0 million) (d)	344,363	—
Capital lease obligations (e)	21,209	—
	1,883,384	500,372
Less current portion of capital lease obligations	960	—
	$ 1,882,424	$ 500,372

At December 31, 1998, there are no principal repayments on long-term debt required within five years.

(a) 12.0% Senior Notes:

In 1997, the Company issued and sold 250,000 units, each consisting of a U.S. $1,000 principal amount, 12.0% Senior Note due 2007 (the "12.0% Note") and a warrant to acquire 1.715 Class B Non-Voting shares, for gross proceeds of U.S. $250.0 million. The Company allocated $3.4 million to the warrants, representing their estimated fair value at the date of issuance. The 12.0% Notes mature on August 15, 2007 and are repayable in the amount of U.S. $250.0 million. Interest on the 12.0% Notes is paid semi-annually on February 15 and August 15, commencing in 1998. The 12.0% Notes are redeemable, at the option of the Company, in whole or in part, on or after August 15, 2002, beginning at 106% of par value and declining to par value in 2005, plus accrued and unpaid interest. Each holder of 12.0% Notes will have the right to require the Company to repurchase all or any part of such holder's 12.0% Notes in the event of a change of control of the Company as specified in the Indenture governing the 12.0% Notes (the "12.0% Note Indenture"). If, after giving effect to the Company's offer to purchase the 12.0% Notes following such change of control, at least 95% of the original principal amount of the 12.0% Notes has been redeemed or repurchased, the Company shall have the right to redeem the balance of the 12.0% Notes. In addition, prior to August 15, 2000, in the event the Company receives net cash proceeds of not less than $50.0 million from certain equity issuances, it may use all or a portion of such net cash proceeds to redeem up to 25.0% of the gross proceeds allocated to the 12.0% Notes at a redemption price equal to 112% of par value, plus accrued and unpaid interest. The 12.0% Note Indenture contains certain covenants including limits on the incurrence of additional indebtedness or liens, payment of dividends and redemption of shares.

(b) 10.75% Senior Discount Notes:

In 1997, the Company issued and sold U.S. $170.0 million stated amount at maturity of its 10.75% Senior Discount Notes due 2007 (the "10.75% Notes"). The 10.75% Notes were issued at a price of U.S. $592.24 per U.S. $1,000 stated amount at maturity to generate gross proceeds of U.S. $100.68 million. The 10.75% Notes mature on November 1, 2007 and bear interest on the issue price at a rate of 10.75% per annum. In the period prior to November 1, 2002, interest at a rate of 10.75% per annum will accrue on the issue price but will not be payable in cash. From November 1, 2002, interest at a rate of 10.75% per annum on the stated amount at maturity of the 10.75% Notes will be payable in cash semi-annually on May 1 and November 1 of each year, beginning on May 1, 2003. The 10.75% Notes are unsecured and rank pari passu in right of payment with all existing and future senior indebtedness of the Company, and rank senior in right of payment to all existing and future subordinated indebtedness of the Company. The 10.75% Notes are redeemable at the option of the Company in whole or in part at any time on or after November 1, 2002, as well as prior to November 1, 2000 in the event of certain strategic equity investments in the Company specified in the Indenture governing the 10.75% Notes (the "10.75% Note Indenture"). Each holder of 10.75% Notes will have the right to require the Company to repurchase all or any part of such holder's 10.75% Notes in the event of a change of control of the Company as specified in the 10.75% Note Indenture. If, after giving effect to the Company's offer to purchase the 10.75% Notes following such change of control, at least 95% of the original principal amount of the 10.75% Notes has been redeemed or repurchased, the Company shall have the right to redeem the balance of the 10.75% Notes. The 10.75% Note Indenture contains certain covenants including limits on the incurrence of additional indebtedness or liens, payment of dividends and redemption of shares.

(c) 9.95% Senior Discount Notes:

On June 10, 1998, the Company issued and sold U.S. $936.0 million stated amount at maturity of its 9.95% Senior Discount Notes due 2008 (the "9.95% Notes") (U.S. $971.0 million after taking into account the effect of the initial purchasers' exercise of their over-allotment option which closed on July 7, 1998). The 9.95% Notes were issued at an issue price of U.S. $614.55 per U.S. $1,000 stated amount at maturity to generate gross proceeds of U.S. $575.2 million (U.S. $596.7 million after giving effect to the initial purchasers' exercise of their over-allotment option). The 9.95% Notes mature on June 15, 2008 and bear interest on the issue price at a rate of 9.95% per annum computed on a semiannual bond equivalent basis from the date of issuance. Prior to June 15, 2003, interest will accrue on the issue price but will not be payable in cash. Thereafter, interest will be payable in cash semi-annually on June 15 and December 15 of each year, beginning December 2003. The 9.95% Notes are unsecured and will rank pari passu in right of payment with all existing and future senior debt of the Company and will rank senior in right of payment to all existing and future subordinated debt of the Company. The 9.95% Note Indenture contains certain covenants including limits on the incurrence of additional indebtedness or liens, payment of dividends and redemption of shares.

(d) 10.625% Senior Notes:

On November 12, 1998, the Company issued and sold U.S. $225.0 million 10.625% Senior Notes due 2008 (the "10.625% Notes") at a price of 100% of the principal amount per note. The 10.625% Notes mature on November 1, 2008 and bear interest at 10.625% per annum. Interest on the 10.625% Notes will be payable in cash semi-annually in arrears on November 1 and May 1 of each year, commencing May 1, 1999. At any time on or after November 1, 2003, the Notes will be redeemable at the option of the Company, in whole or in part, at specified redemption prices plus accrued and unpaid interest. 25% of the 10.625% Notes are also redeemable prior to November 1, 2001, upon an equity offering, at a redemption price of 110.625%. The 10.625% Notes are unsecured and will rank pari passu in right of payment with all existing and future senior debt of the Company and will rank senior in right of payment to all existing and future subordinated debt of the Company. The 10.625% Note Indenture contains certain covenants including limits on the incurrence of additional indebtedness or liens, payment of dividends and redemption of shares.

(e) Capital lease obligations:

Capital leases have a weighted average interest rate of approximately 7.5% and expire at various dates to 2018. In 1998, interest expense includes $1.4 million related to interest on capital leases (1997 and 1996 – $nil).

(f) Equipment facility:

The Company's operating subsidiary had entered into a Vendor Facility pursuant to which the Vendor had agreed to sell to the operating subsidiary and to finance the operating subsidiary's purchase of digital telephone switches and related electronics equipment. The amount financed under this Vendor Facility was not expected to exceed $110 million. On August 21, 1998, with none of the facility outstanding, the Company cancelled the facility.

(g) Bank facility:

The Company has entered into a bank facility pursuant to which a large Canadian bank has agreed under certain conditions related to the projected growth of the Company and its networks to loan up to $40.0 million to the Company on a three year revolving credit basis. Borrowings under the bank facility are payable in full on June 30, 2000 subject to an extension for a further year at the Company's request and the bank's sole option. Outstanding principal amounts under the bank facility bear interest, at the Company's option, at a rate per annum equal to the bank's prime rate plus 2.75% or the bank's prime acceptance fee plus 3.75%. The facility will be secured by certain assets of the Company. The bank facility includes restrictions on the Company's ability to sell assets, permit liens, pay dividends and to alter the provision of, or make prepayments on, other debt.

NOTE 8

share capital

(a) Authorized:

Common: Unlimited number of convertible Class A Voting Shares without nominal or par value, each Class A Share has one vote; unlimited number of Class B Non-Voting Shares without nominal or par value; and unlimited number of convertible Class C Non-Voting Shares without nominal or par value. Other than with respect to voting rights and conversion rights, the three classes of common shares have identical rights. Each Class A Voting Share may, under certain circumstances at the option of the holder, be converted into one Class B Non-Voting Share or Class C Non-Voting Share. Each Class C Non-Voting Share may, under certain circumstances at the option of the holder, be converted into one Class A Voting Share or Class B Non-Voting Share. The holders of Common Shares are entitled to receive dividends as determined by the Board of Directors, subject to the rights of the holders of the Preferred Shares. The holders of Common Shares are also entitled to participate equally in the event of liquidation of the Company, subject to the rights of the holders of the Preferred Shares.

Preferred: Unlimited number of Non-Voting Preferred Shares without nominal or par value. The Preferred Shares may be issued in one or more series. The Board of Directors of the Company may fix the number of shares in each series and designate rights, privileges, restrictions, conditions and other provisions. The Preferred Shares shall be entitled to preference over any other shares of the Company with respect to the payment of dividends and in the event of liquidation of the Company.

The Common and Preferred Shares were authorized in 1997 as part of a share capital reorganization. All previously authorized and issued common and preferred shares were either cancelled or converted to the newly authorized classes of shares on completion of the Company's Initial Public Offering.

Upon all the restrictions of the foreign ownership of voting shares being removed by the Canadian Radio-television and Telecommunications Commission, the Class B Non-Voting Shares shall be converted into Class A Voting Shares on a one for one basis.

(b) Issued:

	Number of shares (in thousands)						
Class	A	A-1	B	B-1	C	C-1	Total
Preferred shares							
Balance, January 1, 1996	—	—	—	—	—	—	—
Issued for cash	587	—	6,503	—	135	—	7,225
Balance December 31, 1996	587	—	6,503	—	135	—	7,225
Issued for cash	—	2,933	157	18,346	—	7,828	29,264
Share reorganization (i)	(587)	(2,933)	(6,660)	(18,346)	(135)	(7,828)	(36,489)
Balance, December 31, 1997 and 1998	—	—	—	—	—	—	—

	Amounts						
Class	A	A-1	B	B-1	C	C-1	Total
Preferred shares							
Balance, January 1, 1996	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Issued for cash	1,123	—	12,431	—	259	—	13,813
Balance December 31, 1996	1,123	—	12,431	—	259	—	13,813
Issued for cash	—	6,566	716	41,066	—	17,522	65,870
Share reorganization (i)	(1,123)	(6,566)	(13,147)	(41,066)	(259)	(17,522)	(79,683)
Balance, December 31, 1997 and 1998	$ —	$ —	$ —	$ —	$ —	$ —	$ —

	Number of shares (in thousands)				
Class	Voting A	Non-Voting B	Non-Voting C	Common	Total
Common shares					
Balance, January 1, 1996	—	—	—	2,000	2,000
Issued for cash	—	—	—	1,400	1,400
Reallocated	340	3,060	—	(3,400)	—
Issued for cash	7	65	—	—	72
Balance, December 31, 1996	347	3,125	—	—	3,472
Share reorganization (i)	197	28,465	7,828	—	36,490
Consolidation (ii)	(272)	(15,795)	(3,914)	—	(19,981)
Conversion (iii)	(117)	3,706	(3,589)	—	—
Issued – options	—	20	—	—	20
Issued – public offering	—	5,625	—	—	5,625
Balance, December 31, 1997	155	25,146	325	—	25,626
Issued – options	—	671	—	—	671
Issued – public offering	—	6,542	—	—	6,542
Issued for acquisitions	—	12,725	—	—	12,725
Balance, December 31, 1998	155	45,084	325	—	45,564

	Amounts				
Class	Voting A	Non-Voting B	Non-Voting C	Common	Total
Common Shares					
Balance, January 1, 1996	$ —	$ —	$ —	$ 1,021	$ 1,021
Issued for cash	—	—	—	800	800
Reallocated	183	1,638	—	(1,821)	—
Issued for cash	15	135	—	—	150
Balance, December 31, 1996	198	1,773	—	—	1,971
Share reorganization (i)	372	61,789	17,522	—	79,683
Conversion (iii)	(154)	16,313	(16,159)	—	—
Issued – options	—	20	—	—	20
Issued – public offering	—	118,566	—	—	118,566
Balance, December 31, 1997	416	198,461	1,363	—	200,240
Issued – options	—	9,847	—	—	9,847
Issued – public offering	—	259,965	—	—	259,965
Issued for acquisitions	—	458,000	—	—	458,000
Balance, December 31, 1998	$ 416	$ 926,273	$ 1,363	$ —	$ 928,052

Warrants	Number	Amount
Issued on July 25, 1997 and balance at December 31, 1998 and 1997 (iv)	250,000	$ 3,429

(i) Share reorganization and exchange:

In conjunction with the Company's Initial Public Offering, the Company filed Articles of Amendment ("the Amendment") which effected a capital reorganization. The Company created 4 new classes of shares having an unlimited number of shares: Class A Voting Shares, Class B Non-Voting Shares, Class C Non-Voting Shares and Non-Voting Preferred Shares.

(ii) Share consolidation:

All Class A Voting, Class B Non-Voting and Class C Non-Voting Shares were consolidated on a one for two basis.

(iii) Share conversions:

As a condition to filing the Amendment, the following conversions also occurred:

1. Conversion of 116,945 Class A Voting Shares into Class B Non-Voting Shares.
2. Conversion of 3,589,155 Class C Non-Voting Shares into Class B Non-Voting Shares.

(iv) Warrants will entitle the holder thereof to acquire 1.715 Class B Non-Voting Shares at an exercise price of U.S. $0.02 expiring August 15, 2007. The warrants were issued as part of the unit offering described in note 7(a) and the amount of $3.4 million reflects the valuation of the warrants on the issue date.

(c) Share purchase options:

The Board of Directors has established a Stock Option Plan under which options to purchase Class B Non-Voting Shares are granted to directors, officers and key employees of the Company. Pursuant to the Stock Option Plan, 4,000,000 Class B Non-Voting Shares have been reserved for options. These options were granted at exercise prices estimated to be at least equal to the fair value of Class B Non-Voting Shares, vest over a three year period and generally expire five years from the date of grant. The option information below has been retroactively restated for the one for two share consolidation.

	Number of shares	Exercise prices per share	Weighted average exercise price
Outstanding at January 1, 1996	—		
Granted	557,500	$1.00 to $10.40	$ 4.90
Cancelled	(500)	$1.00	1.00
Outstanding, December 31, 1996	557,000		4.90
Granted	1,468,375	$4.50 to $23.00	9.94
Cancelled	(70,278)	$1.00 to $8.60	3.98
Exercised	(24,307)	$1.00 to $4.50	4.14
Outstanding, December 31, 1997	1,930,790		8.77
Granted	1,922,967	$23.00 to $46.75	30.74
Cancelled	(171,533)	$4.50 to $43.50	24.24
Exercised	(468,947)	$1.00 to $31.70	6.53
Outstanding, December 31, 1998	3,213,277		$ 21.19

At December 31, 1998 and 1997, 906,826 options, and 912,167 options, respectively, were exercisable at weighted average exercise prices of $7.76 per share and $5.00 per share, respectively.

NOTE 9

income taxes

The Company uses the liability method of accounting for income taxes. The tax effects of temporary differences that give rise to significant portions of future income tax assets are as follows:

	1998	1997
Future income tax assets:		
Debt and share issue costs	$ 10,678	$ 613
Future income tax deductions	3,555	$ —
Operating loss carryforwards	118,100	17,907
	132,333	18,520
Less valuation allowance	(132,333)	(18,520)
Net future income tax assets	$ —	$ —

The provision for income taxes at December 31, 1998 and 1997 relates solely to capital taxes. The income tax provision differs from the expected amount calculated by applying the Canadian combined federal and provincial corporate tax rate to earnings before income taxes, because the future income tax asset relating to losses has not been recognized. At December 31, 1998, the Company has non-capital losses of approximately $264.8 million, available to reduce future years' taxable income, which expire as follows:

2001	$ 300
2002	1,800
2003	5,100
2004	61,600
2005	196,000

NOTE 10

commitments and contingencies

(a) Under the terms of its lease agreements for fibre optics maintenance, operating facilities and equipment rentals, the Company is obligated at December 31, 1998 to make the following principal payments over the years ending December 31, as follows:

1999	$ 10,080
2000	9,396
2001	9,302
2002	857
2003	6,311

(b) The Company is committed to payments of $122.9 million over 1999 in connection with the purchase of 12 fibre optic strands and associated communication equipment shelters (note 2).

(c) The Company is planning to use a substantial portion of its proceeds from share issuances and financing received and available under the arrangements described in note 7, in addition to other sources, for network and equipment purchases, telecommunications network development costs, and debt service costs.

(d) A legal proceeding was commenced against the Company in July 1997, seeking certain declarations, general damages and injunctive relief. The claim arises out of the selection of the Company to negotiate for the management of the City of Toronto's abandoned underground water pipe system for use as a telecommunications conduit. Among other things, the plaintiff is seeking participation as a 50% joint venture partner with the Company in the control and management of the pipe system, which, under the arrangement with the City of Toronto, will not generate a profit to the Company. The Company believes that this proceeding, if successful, would not result in damages which would have a material adverse effect on its financial position, results of operations or business. In addition, the Company has been advised by its counsel that good defenses are available to the claims in this proceeding and that the plaintiff would be unlikely to succeed. The Company has filed a defense to the claim and intends to contest the claim vigorously.

(e) The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 issue affecting the Company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

NOTE 11

financial instruments and risk management

(a) Fair values of financial assets and liabilities:

The fair values of cash and short-term deposits, restricted investments, accounts receivable, other current assets, accounts payable and accrued liabilities approximate their carrying values due to the short-term nature of these instruments.

The fair value of long-term debt, including the attached warrants, at December 31, 1998 was approximately $1,828.4 million (1997 – $558.0 million), based on current trading values.

The fair value of foreign currency options, cross currency swaps and forward contracts at December 31, 1998 was approximately $56.7 million, based on current trading values.

(b) Foreign currency risk:

The Company is exposed to foreign currency fluctuations on its U.S. dollar denominated debt, cash and short-term deposits and restricted investments. Foreign currency risks are managed whenever possible by matching U.S. dollar denominated assets with related liabilities through the use of financial instruments, including, from time to time, purchasing foreign currency options, cross currency swaps and forward exchange contracts. During the year ended December 31, 1998, concurrent with the conversion of the proceeds of financings completed by the Company, the Company purchased the following financial instruments to hedge the following financings:

(i) 10.75% Notes:

Foreign currency option which gives the Company the right (a) to acquire U.S. $170.0 million at the current exchange rate between the Canadian and U.S. dollar on November 1, 2002; (b) to acquire U.S. $170.0 million at an exchange rate of Cdn. $1.435 to U.S. $1.00 on November 1, 2002; or (c) on November 1, 2002, to enter into a cross currency interest rate exchange agreement which will convert U.S. dollar interest payments from May 2003 to November 2007 to a rate of 11.25% on a notional Canadian dollar principal amount. The cross currency interest rate exchange rate will also have the effect of converting the principal repayment to Canadian dollars at the lesser of the October 31, 2002 spot exchange rate or a rate of Cdn. $1.435 to U.S. $1.00. This option is accounted for as a hedge of the 10.75% Notes. The premium paid to purchase the option is being amortized over the period to November 2002. At December 31, 1998, the fair value of the option was $23.4 million.

(ii) 9.95% Notes:

Foreign currency option which gives the Company the right (a) to acquire U.S. $244.0 million at the current exchange rate between the Canadian and U.S. dollar on June 16, 2003; (b) to acquire U.S. $244.0 million at a rate of Cdn. $1.515 to U.S. $1.00 on June 16, 2003; or (c) on June 16, 2003, to enter into a cross currency interest rate exchange agreement which will convert U.S. dollar interest payments from June 15, 2003 to June 2008 to a rate of 10.45% on a notional Canadian dollar principal amount. The cross currency interest rate exchange rate will

also have the effect of converting the U.S. $244.0 million principal repayment on maturity at the lesser of the June 2003 spot rate or a rate of Cdn. $1.515 to U.S. $1.00. At December 31, 1998, the fair value of the option was $23.3 million.

Cross currency swap under which the Company sold U.S. $100.0 million at a rate of Cdn. $1.55 to U.S. $1.00 on October 16, 1998 and received $155.0 million. The Company is obligated to purchase U.S. $163 million on June 15, 2008 at a rate of Cdn. $1.55 to U.S. $1.00. The Company is also obligated to purchase U.S. $8.1 million every six months starting December 15, 2003 at a rate of Cdn. $1.55 to U.S. $1.00. At December 31, 1998, the fair value of this swap was $(8.0) million.

Two forward exchange contracts under which the Company sold U.S. dollars. Under the first contract, the Company sold $300.0 million at a rate of Cdn. $1.46881 to U.S. $1.00. The Company was obligated to buy U.S. $300.0 million at a rate of Cdn. $1.46844 to U.S. $1.00 on January 29, 1999, which was extended to March 29, 1999. Under the second contract, the Company sold U.S. $75.0 million at a rate of Cdn. $1.5525 to U.S. $1.00. The Company was obligated to buy U.S. $75.0 million at a rate of Cdn. $1.5587 to U.S. $1.00 on January 29, 1999, which was extended to March 29, 1999. Although these contracts are short-term in nature, the Company has designated these as hedges and demonstrated their ability to continue to renew these contracts at the hedged rates.

The above derivative instruments are accounted for as a hedge of the 9.95% Notes. The premiums paid to purchase these instruments are being amortized over the period to June 2003.

(iii) All other financings:

All other U.S. dollar denominated obligations have been hedged with U.S. dollar cash and short-term deposits and restricted investments (note 3).

(c) Interest rate risk:

The following table summarizes the Company's exposure to interest rate risk.

		Fixed interest rate maturing within			
December 31, 1998	Floating rate	1 year	1-5 years	After 5 years	Non-interest bearing
Financial assets:					
Cash and short-term deposits	$ 394,848	$ 459,881	$ —	$ —	$ —
Restricted investments	—	47,081	42,526	—	—
Accounts receivable	—	—	—	—	29,302
Other current assets	—	—	—	—	16,650
Financial liabilities:					
Current liabilities	—	960	—	—	95,057
Long-term debt	—	—	1,870	1,880,554	—

December 31, 1997	Floating rate	Fixed interest rate maturing within 1 year	1-5 years	After 5 years	Non-interest bearing
Financial assets:					
Cash and short-term deposits	$ 455,725	$ —	$ —	$ —	$ —
Restricted investments	—	46,354	78,826	—	—
Accounts receivable	—	—	—	—	2,868
Other current assets	106	—	—	—	4,943
Financial liabilities:					
Current liabilities	—	—	—	—	68,074
Long-term debt	—	—	—	500,372	—

(d) Credit risk:

The Company's financial instruments that are exposed to credit risk are cash and short-term deposits, restricted investments and accounts receivable. Cash and short-term deposits and restricted investments are on deposit at major financial institutions. Credit risk with respect to accounts receivable is limited due to the large number of customers the Company provides services to.

During the year ended December 31, 1998 and 1997, no customers of the Company individually represented more than 10% of the Company's revenues. During 1996, three customers of the Company individually represented 15.9%, 14.7% and 10.3%, respectively, of the Company's revenues.

The Company monitors revenue by product line on an enterprise wide basis. In 1998, revenues by product line were: voice service revenues of $26.8 million (1997 – $0.2 million, 1996 – nil), data and transport revenues of $39.0 million (1997 – $5.5 million, 1996 – $0.6 million), internet and related service revenues of $5.6 million (1997 – nil, 1996 – nil), and data and telecommunications equipment and services revenues of $4.8 million (1997 – $0.2 million, 1996 – nil).

NOTE 12

subsequent event

(a) On February 1, 1999, the Company announced that it had reached a definitive agreement to acquire a controlling interest in Netcom Canada from ICG Communications of Englewood, Colorado. Under terms of the agreement, the Company will purchase a 51% ownership stake in Netcom Canada for $20.5 million in cash and $5.0 million in common shares. The transaction is expected to close during the first quarter of 1999.

(b) On February 23, 1999, the Company entered into a $200 million bank facility with a syndication of various financial institutions of which $75 million of the facility is non-revolving and $125 million is revolving. Draws under the non-revolving and revolving facilities shall be made on or prior to December 31, 2002 and March 31, 2006, respectively. The facility can be canceled or reduced at any time, at the option of the Company, without penalty. The facility has scheduled quarterly repayments of principal starting on March 31, 2003 until December 31, 2006, when the facility is canceled.

Outstanding principal amounts bear interest, at the Company's option, at an annual rate equal to the bank's prime rate plus 2% or the market rate for bankers acceptance plus 3%. The facility is secured by supporting security granted by the Company's wholly owned subsidiaries and a general security agreement which pledges substantially all assets of the Company. The facility includes financial and other covenants such as restrictions on the Company's ability to create additional indebtedness or alter the provision of or make prepayments on existing indebtedness, permit liens, sell assets, make investments or pay dividends. Security under the facility must be in place prior to August 31, 1999 or the facility will be canceled. Once secured, this facility will replace the $40 million facility described in Note 7(g).

NOTE 13

reconciliation to accounting principles generally accepted in the United States

The Company's consolidated financial statements have been prepared in accordance with accounting principles generally accepted ("GAAP") in Canada which, in the case of the Company, conform in all material respects with those in the United States, except as outlined below:

(a) Statements of operations:

The application of U.S. GAAP would have the following effect on loss for the year, deficit and basic loss per common share as reported:

Years ended December 31

	1998	1997	1996
Loss for the year, Canadian GAAP	$ (212,801)	$ (36,449)	$ (2,289)
Stock-based compensation expense (i)	(597)	(2,390)	—
Loss for the year, U.S. GAAP	(213,398)	(38,839)	(2,289)
Shares subject to Put Agreement (ii)	—	(5,528)	—
Opening deficit, U.S. GAAP	(47,328)	(2,961)	(672)
Closing deficit, U.S. GAAP	$ (260,726)	$ (47,328)	$ (2,961)
Basic loss per common share under U.S. GAAP	$ (6.05)	$ (13.89)	$ (1.68)

(i) Stock-based compensation expense:

For U.S. GAAP purposes, the Company has chosen to account for stock-based compensations using the intrinsic value method prescribed in Accounting Principles Board Opinion ("APB") No. 25 "Accounting for Stock Issued to Employees". Accordingly, compensation expense for U.S. GAAP purposes has been recognized at the date of share purchases or option grants at the amount by which the quoted market price of the stock exceeds the amount an employee must pay to acquire the stock.

(ii) Shares subject to Put Agreement:

Prior to the Company's Initial Public Offering on December 10, 1997, the Company and certain holders of Preferred Shares entered into a Put Agreement whereby the shares subject to the Put Agreement would be classified as redeemable Preferred Shares under U.S. GAAP, presented on the balance sheet between long-term debt and shareholders' equity. Changes to the carrying amounts for U.S. GAAP purposes of shares subject to the Put Agreement were recorded as charges to deficit until they were exchanged pursuant to the Company's Initial Public Offering. Such adjustments were amortized over the period commencing when sufficient share or related transactions had occurred to establish a new estimated fair market value for purposes of establishing a redemption price, to 2001 when the Put option would have become exercisable. The estimated fair market value used for establishing the redemption price was $4.50 to July 25, 1997 and $8.00 per share thereafter to December 10, 1997.

The Put Agreement terminated on the Company's Initial Public Offering and share capital related to redeemable Preferred Shares, including the adjustment above, was included with share capital attributable to common shares for U.S. GAAP purposes.

(iii) Foreign exchange:

Under Canadian GAAP, unrealized gains and losses on translation of foreign currency denominated long-term monetary items which are not hedged, are deferred and amortized over the remaining lives of the related items. Under U.S. GAAP, gains or losses on translation of foreign currency denominated long-term monetary items which are not hedged are credited or charged to earnings. Under Canadian GAAP, all long-term debt has been fully hedged thus no foreign exchange gains or losses have been amortized.

In addition, foreign currency denominated monetary assets which are designated as hedges of long-term debt for Canadian GAAP purposes would not be considered effective hedges for U.S. GAAP purposes and the foreign currency gain or loss on these items would be credited or charged to earnings. The combined net effect of these hedges not being effective is immaterial to these consolidated financial statements.

(b) Statements of changes in financial position:

(i) Canadian GAAP permits the disclosure of a subtotal of the amount of funds provided by operations before changes in non-cash working capital items in the statement of changes in financial position. U.S. GAAP does not permit this subtotal to be included.

(ii) Under U.S. GAAP, the non-cash issue of shares on the acquisitions in the amount of $458.0 million would not be included in the consolidated statements of changes in financial position as a financing or investing activity, resulting in an increase of $458.0 million to the amount of net cash provided by investing activities and a decrease to the amount of net cash provided by financing activities by the same amount.

The following table discloses the subtotals of operations, financing and investments in accordance with U.S. GAAP:

Years ended December 31

	1998	1997	1996
Operations	$ (83,232)	$ (6,004)	$ (2,028)
Financing	$ 1,441,570	$ 648,841	$ 14,214
Investments	$ (996,078)	$ (206,094)	$ (1,428)

(iii) Interest and taxes paid:

Years ended December 31

	1998	1997	1996
Paid during the year:			
Interest	$ 47,855	$ —	$ —
Taxes	$ 4,521	$ —	$ —

(iv) Depreciation and amortization:

Years ended December 31

	1998	1997	1996
Depreciation of property, plant and equipment	$ 35,418	$ 2,167	$ 262
Amortization of goodwill	13,864	126	—
Amortization of non-compete agreements	4,062	—	—
Other	1,324	810	—
	$ 54,668	$ 3,103	$ 262

(c) Other disclosures:

Stock-based compensation expense disclosure:

Had the Company determined compensation costs based on the fair value at the date of grant for stock options under SFAS No. 123, loss attributable to common shareholders and basic loss per share would have increased as indicated below.

The Company utilized the Black-Scholes option pricing model to estimate the fair value at the date of grant for options granted subsequent to the Company's Initial Public Offering. Under the Black-Scholes model, 1,922,967 options (1997 – 178,750) with a weighted-average fair value of $14.50 per share (1997 – $9.28 per share) were granted using the following assumptions; risk free rate of return of 5.5%, estimated volatility factor of 0.35, estimated option life of 5 years, vesting period of 3 years and no estimated dividend payments. In 1997 and 1996, the minimum value method was used for options granted prior to the date of the Initial Public Offering, as there was no market for the Company's common shares in which to monitor stock price volatility. Under the minimum value method 1997 – 1,018,125 (1996 – 557,000) options were granted with a weighted-average fair value of 1997 – $1.96 per share (1996 – $0.80

per share) using the following assumptions; risk free rate of return of 1997 – 5.5% (1996 – 6.5%), an estimated option life of 5 years, vesting period of 3 years and weighted average exercise price of 1997 – $8 per share (1996 – $4.90 per share).

	1998	1997	1996
Loss attributable to common shareholders, U.S. GAAP – as reported	$ (213,398)	$ (44,367)	$ (2,289)
Loss attributable to common shareholders, U.S. GAAP – pro forma	(223,798)	(46,416)	(2,334)
Loss per share – as reported	(6.05)	(13.89)	(1.68)
Loss per share – pro forma	(6.35)	(14.53)	(1.71)
Weighted average number of shares outstanding (in thousands)	35,252	3,195	1,365

(d) Accounts receivable:

Accounts receivable are net of an allowance for doubtful accounts of $3.3 million at December 31, 1998 (1997 – $0.2 million).

(e) Comprehensive income:

The Company's comprehensive income as determined under SFAS No. 130 would not differ from loss for the year as shown above for all periods presented.

Recent accounting pronouncements:

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes methods of accounting for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. The Company has not assessed the impact on its financial position, results of operations or cash flows of adopting SFAS No. 133. The Company will be required to implement SFAS No. 133 for its fiscal year ended December 31, 2000.

In March 1998, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use". SOP 98-1 requires that entities capitalize certain costs related to internal-use software once certain criteria have been met. The Company has not yet determined the impact of SOP 98-1 on its financial position, results of operations, or cash flows. The Company will be required to implement SOP 98-1 for its fiscal year ended December 31, 1999.

In April 1998, the AICPA issued SOP 98-5, "Reporting on the Costs of Start-Up Activities." SOP 98-5 requires that all start-up costs related to new operations must be expensed as incurred. In addition, all start-up costs that were capitalized in the past must be written off when SOP 98-5 is adopted. The Company expects that the adoption of SOP 98-5 will have no material impact on its financial position, results of operations or cash flows. The Company will be required to implement SOP 98-5 for its fiscal year ended December 31, 1999.

board of directors

Philip R. Ladouceur
Chairman of the Board

D. Craig Young [4]
President and
Chief Executive Officer

James C. Allen [1,2]

Marc G. Fortier [2,3]

Eric Hobson [2,4]

Alan D. Horn [1]

J. Mark A. MacDonald [4]

Robert W. McKenzie [1,3]

Jonathan M. Nelson [4]

Edward S. Rogers

Paul J. Salem [2,3]

[1] *Member of the Audit Committee*
[2] *Member of the Compensation Committee*
[3] *Member of the Corporate Governance Committee*
[4] *Member of the Executive Committee*

corporate officers

D. Craig Young
President and
Chief Executive Officer

Robert C. Bicksler
Executive Vice President and
Chief Financial Officer

Gary B. Oliver
Executive Vice President,
Marketing and Carrier Sales

Mark W. Senda
Executive Vice President and
General Manager

Steven B. Chisholm
Senior Vice President,
General Counsel and Corporate Secretary

Gary R. McCone
Senior Vice President,
Long Distance Services

Ronald W. Preston
Senior Vice President,
Network Operations and
Technology

Mark G. Sampson
Senior Vice President and
General Manager, Data Services

James A. Smith, Jr.
Senior Vice President,
Operations

Pierre Collins
Regional Vice President and
General Manager, Eastern Region

Andrew J. Kyle
Regional Vice President and
General Manager, Western Region

Deborah L. McDonald
Vice President,
Human Resources

David J. Pasieka
Regional Vice President and
General Manager, Central Region

Barbara A. Richardson
Vice President,
Strategic Planning

other vice presidents

Harold W. Teets
Senior Vice President and
Chief Information Officer

Leslie Ann Kalman
Vice President,
Treasury

Craig Huke
Vice President,
Financial Accounting and Control

Bruce M. Mann
Vice President,
Investor Relations

Shirley J. Soehn
Vice President,
Regulatory and Government Affairs

Rick Stern
Vice President,
Financial Planning and Analysis

Investor Information

corporate information

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Web Site: www.metronet.ca

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For general company information and press releases:
Web Site: www.metronet.ca

Transfer Agent and Registrar:
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E-mail: inquiries@cibcmellon.ca

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Auditors:
KPMG LLP
Toronto, Ontario

Counsel:
Osler Hoskin & Harcourt
Toronto, Ontario

stock and market information

	1st Quarter			2nd Quarter			3rd Quarter			4th Quarter		
	high	low	close	high	low	close	high	low	close	high	low	close
1998												
MNC.B (C$)	42.00	23.50	36.00	42.50	33.75	41.00	50.00	27.90	27.95	51.00	24.00	51.00
METNF (US$)	30.000	16.250	25.250	29.250	23.625	28.250	34.750	17.875	17.875	33.500	15.500	33.500
1997												
MNC.B (C$)	–	–	–	–	–	–	–	–	–	25.25	20.50	24.20
METNF (US$)	–	–	–	–	–	–	–	–	–	17.813	15.000	17.385

The common stock is listed for trading in Canada on the Toronto Stock Exchange and the Montreal Exchange under the symbol **MNC.B** and in the United States on the NASDAQ National Market System under the symbol **METNF**.

The approximate high and low prices for the common stock are as reported by the Toronto Stock Exchange and the NASDAQ National Market System, and do not include retail markups, markdowns or commissions. Such prices do not necessarily represent actual transactions.

The Company's shares began trading publicly on December 3, 1997 coincident with its Initial Public Offering. The 1997 high, low and close prices represent trading activity from December 3 through December 31, 1997.

The Company currently does not pay dividends.

Note for Investors:
This annual report includes statements about expected future events and financial results that are forward-looking in nature and subject to risks and uncertainties. For those statements, we claim the protection of the safe harbour for forward-looking statements provisions contained in the Private Securities Litigation Reform Act of 1995. The Company cautions that actual performance will be affected by a number of factors, many of which are beyond the Company's control, and that future events and results may vary substantially from what the Company currently foresees. Discussion of the various factors that may affect future results is contained in recent filings by the Company with the Securities and Exchange Commission and the Ontario Securities Commission.

Annual Meeting:
The date, time and location of MetroNet's Annual General Meeting of shareholders will be distributed to shareholders in the coming weeks.

sales offices

For more information on any of our services, please contact one of our regional sales offices:

Customer Care:
1-888-8METNET (1-888-863-8638)

Vancouver:
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Vancouver, British Columbia V6B 5A1
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Fax: (604) 899-2550

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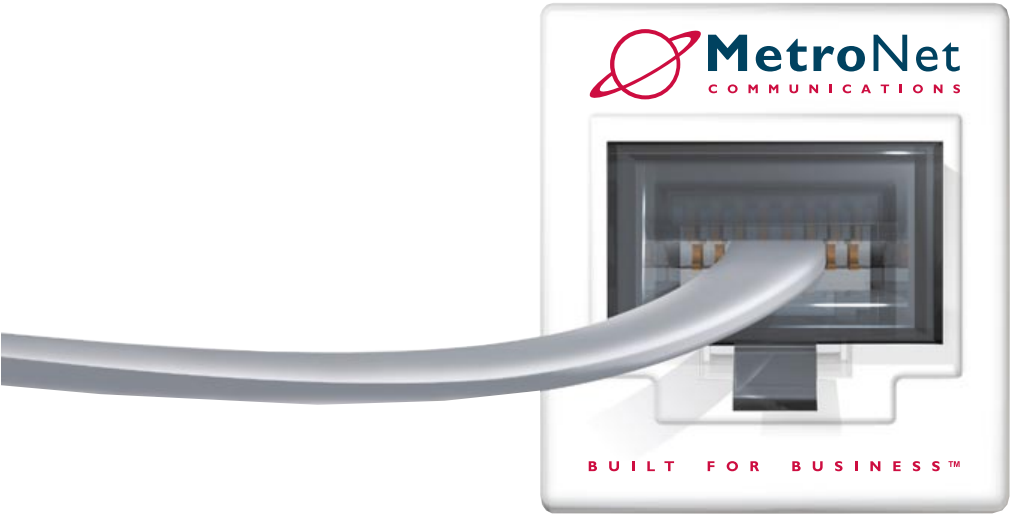
Design: Craib Corporate Graphics Inc.
Illustration: Dan Kangas
Printed in Canada on recycled paper



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