MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The consolidated financial statements and all the information in this Annual Report are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements are prepared by the management of Island Telecom Inc., which is responsible for the integrity and objectivity of this information. The statements have been prepared using generally accepted accounting principles and methods appropriate to the Company including, where applicable, amounts based on management's best estimates. Financial information presented elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

The Company maintains a system of internal controls designed to provide reasonable assurance that transactions are recorded and executed in accordance with its authorizations practice, that assets are properly safeguarded and that reliable financial records are maintained. This system includes written policies and procedures, an organizational structure that segregates duties and a comprehensive program of periodic audits by the internal auditors.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility principally through its Audit Committee.

The Audit Committee, comprised of Directors who are not officers or employees of the Company, meets periodically with management, the Company's internal auditors and the external auditors to discuss audit and financial matters. In addition, this committee reviews the quarterly and annual financial statements of the Company and submits its report to the Board of Directors. The financial statements are submitted to the Board for approval.

Ernst & Young LLP, Chartered Accountants, the external auditors recommended by the Board of Directors and appointed by the shareholders, are engaged to provide an independent audit of the financial statements in accordance with generally accepted auditing standards. Ernst & Young LLP has full and free access to the Audit Committee.

Barry G Hubley

B.G. Hubley, CMA
Vice President Finance and Comptroller

AUDIT COMMITTEE REPORT

To the Shareholders of Island Telecom Inc.:

The Audit Committee oversees the financial reporting process on behalf of the Board of Directors. In order to carry out this responsibility, the Committee, composed entirely of Directors who are not officers or employees of the Company, meets quarterly to review the Company's consolidated financial statements and recommends their approval to the Board of Directors. The Audit Committee also reviews, on a continuing basis, any reports prepared by the Company's internal and external auditors relating to its accounting policies and procedures, as well as its internal controls. Financial information prepared for securities commissions and such regulatory bodies is also examined by the Audit Committee before filing. The Committee meets independently with management, internal auditors and external auditors to review the involvement of each in the financial reporting process. These meetings are designed to facilitate any private communication with the Committee desired by each party. The Audit Committee recommends the appointment of the Company's auditors, who are elected annually by the Company's shareholders.

John J. Howatt

John J. Howatt
Chairman of the Audit Committee

AUDITORS' REPORT

To the Shareholders of Island Telecom Inc.:

We have audited the consolidated balance sheets of Island Telecom Inc. as at December 31, 1998 and 1997, and the consolidated statements of income, retained earnings and cash flow for the years then ended. 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 the years then ended in accordance with generally accepted accounting principles.

Ernst & Young LLP

Charlottetown,
Prince Edward Island
January 29, 1999

Chartered Accountants

CONSOLIDATED INCOME STATEMENT

For the year ended December 31	1998	1997
Revenues		
Local service	$ 53,702,700	$ 50,393,800
Long distance service	25,890,000	30,056,500
Other revenues (Note 4)	5,776,800	4,409,100
Total Revenues	85,369,500	84,859,400
Expenses		
Depreciation	17,633,900	19,249,900
Other Operating	42,706,100	43,277,400
Total Expenses	60,340,000	62,527,300
Operating Income	25,029,500	22,332,100
Other income (loss) (Note 5)	292,300	(74,200)
Income Before Debt Expenses	25,321,800	22,257,900
Interest and other debt expenses (Note 6)	5,029,800	5,135,100
Income Before Income Taxes	20,292,000	17,122,800
Income taxes (Note 7)	9,402,000	7,837,500
Income Before Extraordinary Item	10,890,000	9,285,300
Extraordinary item (Note 2)	-	(11,306,700)
Net Income (Loss)	10,890,000	(2,021,400)
Preference dividends	-	102,000
Net Income (Loss) Applicable to Common Shares	$ 10,890,000	$ (2,123,400)
Earnings per Common Share before Extraordinary Item	$ 1.49	$ 1.25
Earnings (Loss) per Common Share	$ 1.49	$ (0.29)

See accompanying notes.

CONSOLIDATED RETAINED EARNINGS STATEMENT

For the year ended December 31	1998	1997
Balance at Beginning of Year	$ 31,128,900	$ 38,200,700
Net income (loss)	10,890,000	(2,021,400)
Preference dividends	-	(102,000)
Common dividends	(5,173,000)	(4,783,700)
Other capital items (Note 8)	(71,900)	(164,700)
Balance at End of Year	$ 36,774,000	$ 31,128,900
Dividends per Common Share	$ 0.71	$ 0.65

See accompanying notes.

CONSOLIDATED BALANCE SHEET

As at December 31	1998	1997
Assets		
Telecommunications Property (Note 2)		
Buildings, equipment and facilities in service	$ 225,786,600	$ 216,295,400
Less accumulated depreciation	120,113,600	105,879,500
Net depreciable property	105,673,000	110,415,900
Land and other property	3,288,500	848,000
Net Telecommunications Property (Note 9)	108,961,500	111,263,900
Current Assets		
Cash	273,200	482,000
Accounts receivable	13,129,800	12,954,800
Other prepayments	494,900	823,100
Total Current Assets	13,897,900	14,259,900
Other Assets		
Deferred long-term debt expenses	374,100	408,500
Prepaid pension cost	5,190,800	3,581,300
Deferred charges	866,100	1,328,500
Investments	88,100	535,900
Total Other Assets	6,519,100	5,854,200
Total Assets	$ 129,378,500	$ 131,378,000
Shareholders' Equity and Liabilities		
Shareholders' Equity		
Common stock (Note 8)	$ 9,289,200	$ 9,196,300
Premium on common stock	22,732,300	22,732,300
Retained earnings	36,774,000	31,128,900
Total Shareholders' Equity	68,795,500	63,057,500
Long-Term Debt (Notes 9 and 11)	41,417,200	41,432,400
Current Liabilities		
Debt due within one year (Notes 10 and 12)	7,770,300	11,309,400
Due to Maritime Telegraph and Telephone Company, Limited and its subsidiaries (Note 12)	644,300	748,700
Accounts payable (Note 12)	5,952,700	7,517,600
Income taxes payable	1,039,000	745,800
Interest and other current liabilities	2,636,900	4,197,600
Total Current Liabilities	18,043,200	24,519,100
Other Accrued Liabilities		
Future income taxes	832,300	2,141,900
Other deferred credits	290,300	227,100
Total Other Accrued Liabilities	1,122,600	2,369,000
Lease Commitments (Note 13)		
Total Shareholders' Equity and Liabilities	$ 129,378,500	$ 131,378,000

See accompanying notes.

On behalf of the Board

Colin Latham
Director

Frederick D. Morash
Director

CONSOLIDATED CASH FLOW STATEMENT

For the year ended December 31	1998	1997
Operating Activities		
Net income (loss)	$ 10,890,000	$ (2,021,400)
Non-cash items		
Depreciation	17,633,900	19,249,900
Extraordinary item	-	11,306,700
Other non-cash items (Note 14a)	(2,994,800)	(2,494,300)
Other items (Note 14b)	(71,900)	(117,000)
Operating cash flow	25,457,200	25,923,900
Change in non-cash working capital (Note 14c)	(2,978,300)	2,951,100
Net operating cash flow	22,478,900	28,875,000
Dividends paid	(5,173,000)	(4,885,700)
Net Cash Provided by Operating Activities	17,305,900	23,989,300
Financing Activities		
Issue of common stock	92,900	67,600
Redemption of preferred stock	-	(6,250,000)
(Decrease) increase in short-term debt	(1,068,600)	5,331,400
Repayment of long-term debt	(2,485,700)	(4,904,700)
Other financing activities, net	-	181,000
Cash Used in Financing Activities	(3,461,400)	(5,574,700)
Investing Activities		
Construction program expenditures	(15,154,500)	(18,720,500)
Other construction related items	96,200	570,600
Cash used for construction	(15,058,300)	(18,149,900)
Other investing activities, net	1,005,000	(290,000)
Cash Used in Investing Activities	(14,053,300)	(18,439,900)
Decrease in Cash	(208,800)	(25,300)
Balance at Beginning of Year	482,000	507,300
Balance at End of Year	$ 273,200	$ 482,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Island Telecom Inc. is incorporated by a private statute of the Province of Prince Edward Island.

The term "Company" is used to mean Island Telecom Inc. and, where the context of the narrative text permits or requires, its subsidiaries. On May 7, 1998 the shareholders of the Company approved a change in the legal name of the Company from The Island Telephone Company Limited to Island Telecom Inc.

The Company operates in the telecommunications industry, providing telephone, data and a wide range of telecommunications services throughout Prince Edward Island. The Company is subject to regulation by the Canadian Radio-television and Telecommunications Commission (CRTC).

During 1997 the CRTC issued a decision that changed the way the Company is regulated from a traditional rate of return approach to price cap regulation. The Company determined that it no longer met the criteria necessary for the continued application of the regulatory accounting model in its general purpose financial statements. Due to the changed regulatory environment and emerging local exchange competition, the Company adjusted, as at December 31, 1997, the net carrying values of assets and liabilities to reflect the amounts appropriate under generally accepted accounting principles. These adjustments were recorded in the income statement as an extraordinary item (see Note 2).

Set out below is a summary of significant accounting policies followed by the Company effective January 1, 1998. Summarized in Note 1(j) below are the accounting policies followed by the Company prior to January 1, 1998.

a) Consolidation

The accompanying financial statements consolidate the accounts of the Company and its wholly-owned subsidiaries, including Island Tel Advanced Solutions Inc.

b) Telecommunications property

Telecommunications property is recorded at cost. Depreciation is charged on a straight-line basis using rates determined by a continuing program of engineering studies and reflecting management's best estimates of service lives. The average depreciation rate was 8.0% for 1998 (1997, 8.7%).

When telecommunications property is retired, its original cost is adjusted by any disposal proceeds and removal costs are charged to accumulated depreciation.

Interest related to plant under construction is capitalized using the Company's average cost of debt.

c) Capital expenditures

Internally developed general and administrative software is expensed as incurred. Individual items of purchased software in excess of $100,000 are capitalized and amortized over three years.

Office equipment and specific telecommunications tools in excess of $1,500 are capitalized.

d) Pension costs and obligations

The Company provides retirement benefits for its employees under defined benefit and defined contribution pension plans. Pension costs of the defined benefit plan are actuarially determined on the basis of best estimate assumptions using the projected benefit method prorated on years of service. Adjustments to pension cost and experience gains and losses are amortized to income on a straight-line basis over the expected average remaining service life of pension plan members. Market related values of pension fund assets are calculated using a three year moving average of year end market values. The cumulative difference between the amount contributed to the pension plan and the amount charged to income is recorded on the balance sheet as prepaid pension cost.

e) Post-retirement benefits other than pensions

The Company contributes to the cost of health care and other benefits for its retirees. The costs of these post-retirement benefits are charged to income when the costs are incurred.

f) Deferred charges

Deferred long-term debt expenses and other deferred charges are being amortized on a straight-line basis over the life or duration of the related item.

g) Income taxes

The Company uses the accrual method of income tax allocation by providing for future income taxes on all timing differences between accounting income and taxable income. Under the accrual method, the future income tax liability is adjusted to reflect current statutory income tax rates.

h) Earnings per common share

Earnings per common share are computed based on the average number of shares outstanding each month during the year, after giving retroactive effect to any stock splits. Common shares held by the trustee under the Company stock plans have been excluded for purposes of this calculation.

i) Costs of separation offers

Costs of employment separation and curtailment are expensed in the period in which the decision is made.

j) Accounting policy changes

(i) Prior to December 31, 1997, the date upon which the Company discontinued the regulatory accounting model, the Company followed the accounting policies set out below:

(a) Depreciation rates were subject to the approval of the CRTC.

(b) As prescribed by the CRTC, the Company provided for the cost of capital invested in new telecommunications property while under construction by recording an allowance for funds used during construction as an addition to the cost of the property constructed. The rate was calculated using return on equity and the before-tax cost of debt.

(c) Expenditures on office equipment and specific telecommunications tools in excess of $200 were capitalized.

(d) Costs of employment separation and curtailment were deferred and amortized on a straight-line basis over five years.

(ii) Effective January 1, 1998, the Company adopted, retroactive to January 1, 1997, Canadian Institute of Chartered Accountants Handbook Section 1701, Segment Disclosures. Section 1701 establishes standards for the way that public companies report information about operating segments in annual and interim financial statements. Section 1701 also establishes standards for related disclosures about products and services, geographic areas, and major customers. The adoption of Section 1701 did not affect results of operations or financial position, but did affect the disclosure of segment information. See Note 3.

2. Extraordinary Item

The Company concluded that, effective December 31, 1997, it no longer met the criteria for application of the regulatory accounting model as a result of the change in the regulatory environment from rate of return to price-cap regulation, and the beginning of local exchange competition. Prior to 1997, depreciation on the Company's telephone plant and equipment and the deferral of certain costs and obligations were based on regulatory decisions. Telephone plant and equipment was adjusted December 31, 1997 through an increase in accumulated depreciation to reflect the difference between recorded depreciation and the amount of depreciation that would have been recorded had the Company not been subject to rate regulation. Other regulatory assets and liabilities were eliminated from the balance sheet effective the same date.

As a result of these adjustments, the Company recorded a non-cash extraordinary charge to 1997 income of $11,306,700, net of related income taxes of $8,462,500. The items that made up these adjustments are as follows:

Telephone plant and equipment	$ 17,435,200
Separation costs	1,201,000
Other	1,133,000
Extraordinary item before income taxes	19,769,200
Income taxes	8,462,500
Extraordinary item after income taxes	$ 11,306,700

The decrease in telephone plant and equipment was supported by a depreciation analysis, which identified inadequate depreciation reserve levels that the Company believes were principally due to the cumulative under-depreciation of telephone plant and equipment as a result of the rate of return regulatory process.

3. Segment Information

The Company has two reportable segments: Island Tel and Island Tel Mobility, each of which provides telecommunications products and services.

a) Measurement of segment income and segment assets

The Company evaluates performance based on earnings before interest, income taxes, depreciation and amortization (EBITDA). The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies.

b) Factors management used to identify the enterprise's reportable segments

The Company's reportable segments are business units that offer different products and services and are each managed separately. Island Tel provides local and long distance telecommunications services. Island Tel Mobility is the principal supplier of wireless communications in Prince Edward Island.

c) Segment information

Year ended December 31, 1998 (thousands of dollars)

	Island Tel	Island Tel Mobility	Totals
Revenues from external customers	$ 71,464	$ 10,134	$ 81,599
EBITDA	38,134	4,945	43,079

Year ended December 31, 1997 (thousands of dollars)

	Island Tel	Island Tel Mobility	Totals
Revenues from external customers	$ 73,146	$ 9,264	$ 82,409
EBITDA	38,418	3,249	41,667

d) Reconciliations

(thousands of dollars)	1998	1997
Revenues		
Total external revenues for reportable segments	$ 81,599	$ 82,409
Other revenues	3,771	2,450
Total consolidated revenues	$ 85,370	$ 84,859

(thousands of dollars)	1998	1997
Income (loss)		
EBITDA for reportable segments	$ 43,079	$ 41,667
Other income (loss)	292	(74)
Unallocated amounts	(23,079)	(24,470)
Total consolidated income before income taxes and extraordinary items	$ 20,292	$ 17,123

4. Other Revenues

	1998	1997
Directory advertising	$ 1,670,900	$ 1,606,800
Net equipment sales and maintenance revenues	329,800	477,500
Cellular roamer revenue	988,600	835,800
Internet and other Advanced Solutions revenues	2,099,500	843,100
Miscellaneous	688,000	645,900
	$ 5,776,800	$ 4,409,100

5. Other Income

	1998	1997
Investments and miscellaneous	$ (69,400)	$ (74,200)
Gain on sale of investment	361,700	-
	$ 292,300	$ (74,200)

6. Interest and Other Debt Expenses

	1998	1997
Interest on long-term debt	$ 4,696,700	$ 4,783,700
Amortization of long-term debt expenses	34,400	34,400
Capitalized interest	(75,700)	(154,600)
Interest on short-term debt	374,400	471,600
	$ 5,029,800	$ 5,135,100

7. Income Taxes

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

	1998	1997
Combined basic federal and provincial income tax rates	45.1%	44.6%
Capitalized interest, net	0.7	0.5
Large corporations tax	-	0.3
Other	0.5	0.4
Effective income tax rate	46.3%	45.8%

8. Capital Stock

The authorized share capital of the Company at December 31, 1998 consists of 16,000,000 common shares at $1.25 par value.

Common shares issued and outstanding, and changes therein during the year, are as follows:

	Number of Shares	$
January 1, 1997	3,675,360	9,188,400
Issued for cash	3,150	7,900
December 31, 1997	3,678,510	9,196,300
Two-for-one stock split	3,678,510	-
Exercise of stock options	7,900	92,900
December 31, 1998	7,364,920	9,289,200

Common stock plans

The Company has a Common Shareholder Dividend Reinvestment Plan (DRP) and an Employees' Stock Savings Plan (ESSP) for which the Company had reserved 312,332 shares at December 31, 1998 (1997, 312,332 shares). Under the plans, shares are issued at market price and participants in the DRP may acquire common shares through the reinvestment of dividends and may also purchase, to a maximum of $5,000 per quarter, additional common shares at market price. The plans allow the Company the option of distributing treasury shares or shares acquired in the open market by a trustee. Any excess or deficiency of proceeds over cost on resale of shares acquired by the trustee is credited or charged to the retained earnings of the Company. At December 31, 1998, 44,123 (1997, 13,448) shares were held in trust.

Employee Stock Option Plan

At December 31, 1998, 265,800 (1997, 273,700) common shares were reserved for issuance under the Company's Employee Stock Option Plan. Options for 152,600 shares had been granted and unexercised at December 31, 1998 (1997, 120,900). The options are exercisable in stages to January 2008 (1997, May 2007) at prices ranging from $10.625 to $19.125. During 1998, 7,900 (1997, 6,300) options were exercised.

Common stock

On May 7, 1998, the shareholders of the Company approved a two-for-one stock split of its issued and outstanding common shares. All share and per share information presented in these consolidated financial statements has been restated to give retroactive effect to this transaction.

Preference stock

On March 17, 1997 the Company redeemed all preference shares for $6,472,365 including accrued dividends and premiums on redemption.

9. Long-Term Debt

Bonds held are redeemable at the option of the Company prior to maturity at the prices, times, and conditions specified in each series.

The Bonds are secured by a Deed of Trust and Mortgage and by supplemental deeds. These instruments contain a first fixed and specific mortgage, a pledge and charge upon all real and immovable property and equipment of the Company, and a floating charge on all other property of the Company, both present and future.

9. Long-Term Debt (continued)

Series	Fixed Rate %	Maturing	1998 Principal	1997 Principal
Bonds				
Q	11.25	March 15, 2006	$ 4,000,000	$ 4,000,000
R	12.25	October 15, 2007	5,000,000	5,000,000
S	11.45	July 20, 2008	7,500,000	7,500,000
T	10.60	July 14, 2009	3,500,000	3,500,000
U	11.15	March 1, 2010	6.500,000	6,500,000
V	9.77	March 1, 2018	5,000,000	5,000,000
W	8.76	January 15, 2019	5,000,000	5,000,000
			36,500,000	36,500,000
Notes	6.46%(a)	December 1, 1998	-	2,470,500
	9.82%(a)	January 31, 2000	4,917,200	4,932,400
			4,917,200	7,402,900
			41,417,200	43,902,900
Less current portion (Note 10)			-	2,470,500
			$ 41,417,200	$ 41,432,400

Annual repayment of long-term debt is:	
1999	$ -
2000	4,917,200
2001	-
2002	-
2003	-
Thereafter	36,500,000
	$ 41,417,200

The 9.82% note for $4,917,200 due January 31, 2000, is secured by the Deed of Trust and Mortgage.

(a) These notes are issued under long-term floating rate facilities; however, at December 31, the Company had in place agreements which effectively fix the interest at the rates noted above for the indicated terms.

10. Debt Due Within One Year

	1998	1997
Short-term debt	$ 7,770,300	$ 8,838,900
Current portion of long-term debt	-	2,470,500
	$ 7,770,300	$11,309,400

11. Financial Instruments

(a) Primary instruments

The Company's primary financial instruments recognized in the balance sheet consist of cash, accounts receivable, current liabilities and long-term debt. The carrying values of the primary financial instruments of the Company, with the exception of long-term debt, approximate fair value due to the short-term maturity and normal trade credit terms of those instruments.

The Company has at any one time a significant number of commitments to extend credit. The accounts receivable are owed from a large number of customers on normal credit terms and therefore there is minimal customer concentration and credit risk.

The fair value of long-term debt has been estimated based upon the present value of expected cash flows at the rates currently available to the Company for debt with similar terms and remaining maturities or quoted market prices for issues of a similar nature. Based on these methods, the fair value of the Company's long-term debt is estimated to be $55,799,000 (1997, $57,063,358) with a carrying value of $41,417,200 (1997, $43,902,900). The Company intends to hold its long-term debt instruments to maturity and therefore does not anticipate that any difference between carrying value and fair value will be recorded for the accounts.

(b) Derivative instruments

Derivative instruments are primarily used to fix interest rates on floating rate debt and are not undertaken for speculative purposes. The Company utilizes instruments such as interest rate swaps, future rate agreements and interest rate caps in this process.

At December 31, 1998, the Company held one interest rate swap, at a rate of 9.82%, to protect floating rate long-term debt of approximately $5,000,000. An additional interest rate swap, at a rate of 4.75%, was held to protect floating rate short-term debt of $2,000,000. The maturity dates of the swaps, which range from one to two years, are the same as the debt instruments to which they relate. The Company intends to hold these instruments until maturity. The fair values of these derivative instruments at December 31, 1998 are not material.

The Company contracts derivative financial instruments through Canadian financial institutions that have a minimum rating of A on their senior securities and therefore does not anticipate non-performance by these institutions.

12. Related Party Transactions

Maritime Telegraph and Telephone Company, Limited (MT&T) beneficially owns 52.0% (1997, 52.0%) of the Company's issued common shares. BCE Inc. beneficially owns 34.4% (1997, 34.8%) of MT&T's issued common shares.

Pursuant to service agreements with subsidiaries of MT&T, during the year the Company paid $3,202,600 (1997, $3,243,700) for the supply of certain management, administrative, engineering and other operations support services and $1,218,700 (1997, $1,348,300) for the purchase of materials, supplies and telecommunications property. Included in debt due within one year at December 31, 1998 is $4,500,000 (1997, $6,250,000) owing to MT&T.

During the year, the Company also purchased telecommunications equipment, related supplies and services in the amount of $4,508,473 (1997, $8,836,300) from controlled investees of BCE Inc. Included in accounts payable at December 31, 1998, is $567,852 (1997, $977,146) owing to these controlled investees.

13. Lease Commitments

At December 31, 1998, minimum operating lease commitments covering telecommunications facilities are as follows:

1999	$ 1,542,480
2000	1,715,280
2001	1,888,080
2002	170,400
2003	170,400

14. Cash Flow

a) Other non-cash items

Other non-cash items are revenues or expenses that do not generate or consume cash.

	1998	1997
Future income taxes	$ (1,309,600)	$ (2,211,200)
Capitalized interest	(75,700)	(154,600)
Prepaid pension cost	(1,609,500)	(557,500)
Other	-	429,000
	$ (2,994,800)	$ (2,494,300)

b) Other items

Other items are operating items that generate or consume cash but are not included in net income.

c) Changes in non-cash working capital

	1998	1997
Cash provided by (used in):		
Accounts receivable	$ (175,000)	$ 540,200
Other prepayments	328,200	765,900
Accounts payable	(1,564,900)	2,886,400
Income taxes payable	293,200	(1,155,100)
Interest and other	(1,859,800)	(56,400)
	(2,978,300)	2,981,000
Effect of extraordinary item	-	(29,900)
	$ (2,978,300)	$ 2,951,100

15. Pension Plan

During 1997, the Company established an optional defined contribution plan for management employees and transferred assets and related obligations of $2,763,000 and $2,560,000 respectively, from the defined benefit plan to the defined contribution plan. As at December 31, 1998, the market related value of defined benefit pension fund assets, less amounts transferred to the defined contribution plan, was $57,909,000 (1997, $52,185,000) and the actuarial present value of accrued pension benefits related to the defined benefit plan was estimated to be $41,236,000 (1997, $38,120,000).

16. Year 2000 Issue

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. Management has developed and is implementing a plan designed to identify and address the expected effects of the Year 2000 Issue on the Company. An assessment of the readiness of third parties such as customers, suppliers and others is ongoing. However, it is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

17. Comparative Information

Certain of the comparative information has been reclassified to conform with the presentation adopted in the current year.

YEARS IN REVIEW

Financial Information (Consolidated)	1998	1997	1996	1995	1994	1993
Financial Position at December 31 (thousands)						
Telecommunications property	$ 229,075	$ 217,143	$ 217,522	$ 213,087	$ 206,246	$ 196,246
Accumulated depreciation	120,114	105,880	88,091	83,508	76,942	70,131
Current assets	13,898	14,260	15,591	15,094	12,604	11,936
Other assets	6,519	5,854	7,152	7,272	4,807	3,764
Shareholders' equity	68,796	63,058	76,312	70,748	65,908	63,750
Long-term debt	41,417	41,432	43,979	53,731	53,835	52,937
Current liabilities	18,043	24,519	19,658	13,818	12,930	12,509
Other accrued liabilities	1,123	2,369	12,225	13,648	14,042	12,619
Income *(thousands)*						
Revenues*						
Local service	$ 53,703	$ 50,394	$ 40,041	$ 35,951	$ 32,135	$ 27,390
Long distance service	25,890	30,056	24,190	23,055	24,164	26,126
Other revenues	5,777	4,409	4,516	4,024	4,212	3,784
Total revenues	85,370	84,859	68,747	63,030	60,511	57,300
Expenses*	60,340	62,527	48,046	43,485	42,039	39,331
Other income	292	(74)	449	330	355	797
Interest and other debt expenses	5,030	5,135	5,818	6,225	6,046	5,895
Income taxes	9,402	7,838	7,126	6,514	5,870	5,774
Net income before extraordinary item	10,890	9,285	8,206	7,136	6,911	7,097
Extraordinary item	-	(11,307)	-	-	-	-
Net income (loss) after extraordinary item	10,890	(2,021)	8,206	7,136	6,911	7,097
Financial Statistics at December 31						
Equity per common share	$ 9.46	$ 8.57	$ 9.53	$ 8.99	$ 8.60	$ 8.29
Embedded debt cost	10.8%	10.5%	10.2%	10.7%	10.7%	11.0%
Capital structure						
Debt (including short-term)	41.7%	45.6%	40.8%	45.2%	47.0%	47.0%
Preference equity	-	-	4.8	4.9	5.0	5.2
Common equity	58.3	54.4	54.4	49.9	48.0	47.8
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Financial Statistics for the Year						
Earnings per common share before extraordinary item	$ 1.49	$ 1.25	$ 1.08	$ 0.95	$ 0.94	$ 0.96
Earnings (loss) per common share	$ 1.49	$ (0.29)	$ 1.08	$ 0.95	$ 0.94	$ 0.96
Dividends per common share	$ 0.71	$ 0.65	$ 0.63	$ 0.61	$ 0.60	$ 0.59
Operating cash flow, less preferred dividends per common share	$ 3.48	$ 3.53	$ 3.14	$ 2.70	$ 3.07	$ 2.59
Return on average common equity before extraordinary item	16.8%	12.8%	11.7%	10.9%	11.2%	11.9%
Average common shares (thousands)	7,318	7,316	7,178	7,010	6,864	6,896
Times total interest charges earned - before taxes	5.0	4.3	3.6	3.2	3.1	3.2
Times total interest charges earned - after taxes	3.2	2.8	2.4	2.1	2.1	2.2
Interest and preference dividend coverage	5.0	4.3	3.2	2.8	2.7	2.8

Note: All share and per share information presented has been restated to give retroactive effect to the two-for-one stock split that was approved in May, 1998.

* Years prior to 1997 have not been restated to conform to current presentation.

YEARS IN REVIEW (CONTINUED)

Selected Telecommunications & Financial Statistics	1998	1997	1996	1995	1994	1993
For the Year Ended December 31 (thousands)						
Revenues*	$ 85,370	$ 84,859	$ 68,747	$ 62,335	$ 60,511	$ 56,977
Depreciation	17,634	19,250	16,763	15,253	13,835	12,742
Operating income	$ 25,030	$ 22,332	$ 20,702	$ 19,545	$ 18,472	$ 17,969
Operating cash flow applicable to common shares	25,457	25,822	22,506	18,903	21,134	17,825
Free cash flow after dividends and investing activities	3,253	5,549	3,802	(1,853)	(1,902)	(4,213)
Long distance conversation minutes	98,705	92,319	89,858	79,755	74,153	**
Construction program expenditures	$ 15,155	$ 18,721	$ 17,099	$ 16,472	$ 17,867	$ 18,473
Percent of net capital expenditures internally generated	114.9%	132.2%	109.8%	95.9%	101.0%	79.9%
Salaries and wages	$ 15,234	$ 15,307	$ 14,376	$ 14,433	$ 14,875	$ 14,622
As at December 31						
Network access services						
Residence	56,108	54,685	53,757	52,940	51,935	50,924
Business	30,673	28,717	26,918	23,951	22,608	20,750
Cellular	13,320	10,582	9,081	7,417	5,473	3,529
Total network access services	100,101	93,984	89,756	84,308	80,016	75,203
Employees	329	314	300	293	338	329
Telecommunications property per network access service (average)	$ 2,299	$ 2,402	$ 2,430	$ 2,511	$ 2,541	$ 2,581

* Years prior to 1997 have not been restated to conform to current presentation.
** 1993 and prior were not recorded.

Note: All share and per share information presented has been restated to give retroactive effect to the two-for-one stock split that was approved in May, 1998.

CORPORATE GOVERNANCE

The Company complies generally with the guidelines set out in the report of the Toronto Stock Exchange Committee on Corporate Governance in Canada dated December 1994 (the Report).

The mandate of the Board of Directors, as prescribed by the Company's Act of Incorporation, is to manage the business of the Company. In practice the business of the Company is managed by its senior management staff and the role of the Board is to oversee their performance. In so doing the Board has regard for the following matters, among others: strategic planning; risk management; appointment and monitoring of senior management; and the integrity of corporate internal control and management information systems.

The Board has a non-executive chairman, Mr. Colin Latham, and is composed of 11 directors, all of whom are external directors except for Mr. Frederick D. Morash, who is President and Chief Executive Officer of the Company and as such is a related director. The other ten directors are considered to be unrelated within the meaning of Section 5.8 of the Report.

Maritime Telegraph and Telephone Company, Limited, owns, directly or indirectly, about 52% of the Company's outstanding common shares. There are four officers of Maritime Telegraph and Telephone Company, Limited on the Board.

The Board has six committees:

1. An Audit Committee composed of four external directors.
The Audit Committee meets at least six times a year for the purpose of reviewing the interim and annual financial statements, news releases and recommending their approval to the Board. The Audit Committee reviews on behalf of the Board the systems of internal control over financial reporting (including the internal audit function), the external audit function (including recommending the appointment or reappointment of auditors for the Company), the system of internal control for compliance with legal, regulatory and ethical requirements, and other financial management and/or accounting issues brought to the committee by management, members of the committee or the Board of Directors.

2. A Human Resources & Compensation Committee
composed of five external directors. The Human Resources & Compensation Committee oversees the Company's executive structure and management compensation on behalf of the Board of Directors. The committee reviews and recommends to the Board proposed appointments, removals and compensation, including performance incentive payments, for the president and the vice president. The committee recommends for Board approval salary policy for all levels of management and all stock option awards.

3. A Corporate Governance Committee composed of five external directors.
The Corporate Governance Committee manages, on behalf of the Board, the corporate governance system, including the methods and processes for Board effectiveness and performance evaluation. It also acts as a nominating committee by identifying and proposing nominees for election or appointment to the Board of Directors. The Committee recommends directors' compensation for Board approval.

4. An Executive Committee composed of five directors.
The Executive Committee has the authority to act on behalf of the Board and meets as required.

5. A Pension Investment Committee
composed of two directors, one of whom is the President and Chief Executive Officer, and two other members of senior management. The Pension Investment Committee meets at least three times a year to oversee the administration of the non-contributory pension plan fund. The Committee ensures that the fund is managed prudently by professional investment managers in accordance with established policies and goals.

6. An External Directors Committee,
composed of all the non-executive directors of the Board, which meets when required.

The executive director and the officers attend meetings of the Audit Committee, the Human Resources & Compensation Committee and the Corporate Governance committee by invitation.

The Board reviews at least annually its expectations of management including the Company's strategic plans and annual business plans. In this work it is assisted by the various committees of the Board. The Board reviews annually the quality of its own performance with the assistance of the Corporate Governance Committee.

The Board also regularly reviews the effectiveness of the procedures in place for receiving and dealing with shareholder concerns.

Ivan E.H. Duvar
Chairman of the
Corporate Governance Committee

ISLAND TELECOM INC. BOARD OF DIRECTORS

Ivan E.H. Duvar, P.Eng., D.C.L. (Hon.)
Director since 1974
Chairman, Maritime Telegraph and Telephone Company, Limited; Fellow of Canadian Academy of Engineering; Director: Canadian Imperial Bank of Commerce, Air Nova, CorporaTel, Halifax Insurance and other organizations. Also active in several educational and community organizations. (a, d, f)

Wendy J. Paquette
Director since 1996
President and Chief Operating Officer, MT&T Mobility Inc.; Vice President, Major Customers, MT&T; Vice Chair, IWK-Grace Health Centre Foundation; Member, Board of Governors of Mount Saint Vincent University; Mentor, Business Development Bank of Canada. (a, b, f)

E. Anne Smith
Director since 1993
Investment Advisor, RBC Dominion Securities Inc.; Director, Canada Post Corporation; Fellow, Academy of Fellows Canadian Securities Institute; Member, Queen Elizabeth Hospital Foundation; Past Member, Board of Governors of University of Prince Edward Island. Involved in several community organizations. (c, d, f)

John J. Howatt
Director since 1974
President and Owner, Darlington Farms Ltd.; Manager, Jelpo Enterprises Inc. Active in various community and volunteer committees. (c, d, f)

David W. Rodd, BA
Director since 1994
President and Chief Executive Officer, Rodd Hotels & Resorts and Rodd Management Limited; Director, Tibbetts Paints Limited; Member, Acadia Business School Advisory Board and Canadian Cancer Society of PEI. Active in local community service and business organizations. (b, e, f)

Ronald E. Smith, FCA
Director since 1992
Vice President Finance and Corporate Services, Maritime Telegraph and Telephone Company, Limited; Member, Board of Governors of Acadia University; Chairman, Acadia Business School Advisory Board; Director: MMC/Blue Cross, IWK-Grace Health Centre for Women and Children; Council for Canadian Unity. (a, c, f)

Colin Latham, P.Eng.
Director since 1996
President and Chief Executive Officer, Maritime Telegraph and Telephone Company, Limited; Chairman: MT&T Mobility Inc., Island Telecom Inc., Stentor Alliance Council of CEOs, Atlantic Provinces Telecommunications Council, and Greater Halifax Partnership. (a, b, d, f)

Alan K. Scales, LLB., Q.C., LLD (Hon.)
Director since 1980
Partner, Stewart McKelvey Stirling Scales. Active in local political and business organizations. (a, b, d, f)

G. Arnold Wightman
Director since 1990
President, Down East Plaza Limited. (c, f)

Frederick D. Morash, FCMA
Director since 1992
President and Chief Executive Officer Island Telecom Inc.; Member, Stentor Alliance Council of CEOs; Director and Treasurer, Greater Charlottetown Area Chamber of Commerce. Director of numerous local, national and international charities and business organizations. (a, e)

Michael S. Schurman, P.Eng.
Director since 1988
President and General Manager, M.F. Schurman Company, Limited; Vice Chairman, Board of Governors of University of Prince Edward Island; Member, Board of Governors of Acadia University. (b, f)

BOARD COMMITTEES

a) Executive
b) Human Resources and Compensation
c) Audit Committee
d) Corporate Governance
e) Pension Investment
f) External Directors

OFFICERS

Colin Latham, Chairman of the Board
Frederick D. Morash, President and Chief Executive Officer
Philip A. Acorn, Vice President Operations
Barry G. Hubley, Vice President Finance & Comptroller
Douglas C. McDade, Treasurer
Glenn R. Murphy, Corporate Secretary
Alan G. Buchanan, Assistant Secretary

SENIOR MANAGERS

Alan G. Buchanan, Director Corporate Development
Sandra J. MacDonald, Director Sales & Customer Service
Bernard P. MacIntyre, Director Network Services
Ronald L. Waite, Director Business Development

INFORMATION FOR INVESTORS

Dividends

Quarterly dividends were paid on the 15th day of March, June, September and December of 1998 to the shareholders of record on the last business day of the month prior to payment. Common dividends paid amounted to $0.165 for the first quarter and $0.18 for the last three quarters for a total of $.705 in 1998.

Auditors

Ernst & Young LLP

Common Shareholder Dividend Reinvestment Plan

This plan offers holders of the Company's common shares the opportunity to acquire additional common shares at the prevailing average market price through the automatic reinvestment of cash dividends.

Plan participants may also make cash contributions of up to $5,000 per quarter for the purchase of additional common shares at the average market price. No fees are charged to participants under the plan.

Approximately 40 percent of fully registered common shareholders are currently taking advantage of this plan.

A brochure containing further information on the Dividend Reinvestment Plan may be obtained by contacting CIBC Mellon Trust Company at 1-800-565-2188.

Stock Listings

The Company's common stock is listed on the Toronto Stock Exchange and the Montreal Exchange under the symbol IT. Information on daily stock prices and trading volumes is available in the Toronto and Montreal Stock Exchange listings in most daily newspapers.

Shares Held in Nominee Name Shareholders whose shares are not registered in their name and who wish to receive the Company's reports on a timely basis should contact Investor Relations.

Annual Information Form

The Annual Information Form as filed with the Canadian securities commissions is available upon request. For further information about the Company, institutional investors, brokers and security analysts should contact the Vice President Finance and Comptroller.

Stock Registrar and Transfer Agent

CIBC Mellon Trust Company at its principal offices in Charlottetown, Halifax, Montreal, Toronto and Calgary. Internet address: www.cibcmellon.ca

Bond Trustee, Registrar and Transfer Agent

Montreal Trust Company at its principal offices in Charlottetown and Halifax.

Acknowledgements

Island Tel wishes to extend sincere thanks to all those who assisted in the research and compilation of material for this annual report, and to those customers who participated in the report.

Island Telecom Inc.

Incorporated under the laws of the Province of Prince Edward Island.
Head Office: 69 Belvedere Avenue,
P.O. Box 820, Charlottetown,
Prince Edward Island, Canada
C1A 7M1 (902) 566-0131.

Notice of Annual Meeting

The Annual General Meeting of the shareholders of Island Telecom Inc. will be held at the Harbourfront Jubilee Theatre, 124 Harbour Drive, Summerside, Prince Edward Island, on May 6, 1999 at 11:00 am. Shareholders will be entitled to vote shares held as of March 12, 1999, the record date established for determining voting.

Creative Development and Electronic Production: Hudson Design Group Photography: John Sylvester ; Heckbert Studio & Gallery Digitization and Film: Maritime Digital Colour Printing: Williams & Crue

SELECTED INFORMATION FOR SHAREHOLDERS

	1998	1997
Number of holders of common shares at December 31	1,532	1,520
Number of common shares outstanding at December 31	7,364,924	7,357,024
Distribution of shareholders (common)		
Prince Edward Island	43.3%	43.2%
Other Canadian	55.5%	55.4%
Other	1.2%	1.4%
	100.0%	100.0%
Volume of common shares traded on the Toronto and Montreal Stock Exchanges	531,300	601,600

Quarterly Financial Data

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	1998	1997	1998	1997	1998	1997	1998	1997
Operating revenues (thousands)	$ 19,939	$ 20,031	$ 21,718	$ 21,854	$ 22,842	$ 22,609	$ 20,871	$ 20,365
Net income (thousands)*	2,108	2,176	3,011	2,844	3,006	2,588	2,765	1,677
Earnings per common share *	0.29	0.29	0.41	0.39	0.41	0.35	0.38	0.22
Dividends declared per common share	0.165	0.16	0.18	0.16	0.18	0.165	0.18	0.165
Price ranges Toronto Exchange								
High	$ 23.000	$ 14.250	$ 30.100	$ 14.750	$ 26.800	$ 17.000	$ 24.500	$ 19.125
Low	$ 18.500	$ 12.500	$ 22.750	$ 13.050	$ 18.000	$ 14.250	$ 19.250	$ 16.500
Close	$ 23.000	$ 13.250	$ 26.000	$ 14.625	$ 21.750	$ 16.500	$ 21.100	$ 18.750

Valuation Day Prices	December 22, 1971	February 22, 1994
Common shares	$ 2.563	$ 11.938
4 1/2% preferred shares	$ 6.250	$ 5.500
4 3/4% preferred shares	$ 6.600	$ 5.625
5 1/2% preferred shares	$ 15.250	$ 13.500

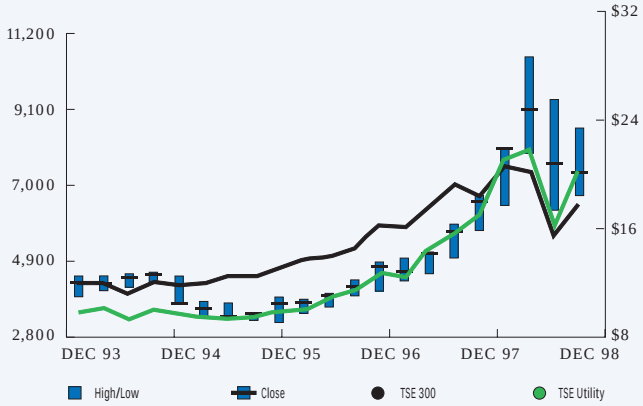
Market Performance *(to December 31, 1998)*

Price and Dividends**	1 year (since Jan 1, 98)	5 year (since Jan 1, 94)	10 year (since Jan 1, 89)
Island	16.1%	16.6%	15.7%
TSE UT	21.5%	21.0%	16.6%
TSE 300	(1.6)%	10.6%	9.5%

* 1997 data is before extraordinary item.
** Assumes dividend reinvested as of last day of quarter in which it was earned.

Note: All common share figures reflect the two-for-one stock split in May, 1998.

SHARE TRADING STATISTICS
compared to TSE Composite Indices
(5 year data indicated quarterly)



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