BELL CANADA

1998 FINANCIAL INFORMATION

In our ongoing efforts to contain costs, Bell Canada will no longer publish a formal annual report. This document contains Bell Canada's Management's Discussion and Analysis and its financial statements for 1998. Annual Reports for BCE Inc. (the parent company of Bell Canada) are available from the Corporation.

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Management's Discussion and Analysis (MD&A) focuses on the results of operations and financial situation of Bell Canada and should be read in conjunction with the audited consolidated financial statements contained on pages 8 to 21. Certain sections of this report contain forward-looking statements with respect to Bell Canada. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. Bell Canada considers the assumptions on which these forward-looking statements are based to be reasonable at the time they were prepared, but cautions the reader that these assumptions regarding future events, many of which are beyond the control of Bell Canada, may ultimately prove to be incorrect. Factors which could cause actual results or events to differ materially from current expectations are discussed on pages 4 to 6 under "Risk Factors".

1. Total operating revenues (1)

($ millions)	1998	1997	% Change
Local and access services	**5,053**	4,657	8.5
Long distance and network services	**3,904**	4,217	(7.4)
Terminal sales, directory advertising and other revenues	**1,604**	1,616	(0.7)
Total operating revenues	**10,561**	10,490	0.7
(Thousands)			
Number of network access services (2)			
Business	**3,652**	3,414	7.0
Residence	**7,298**	7,193	1.5
	10,950	10,607	3.2

(1) Effective January 1, 1998, Bell Canada began reporting long distance and network settlements, local contribution and bad debts as operating expenses. These items had formerly been reported as reductions in revenues. Results for the year ended 1997 have been restated on a comparable basis. For further details see notes to consolidated financial statements, Note 2.

(2) Network access services represent, approximately, the number of lines in service as at December 31.

RESULTS OF OPERATIONS

Bell Canada's results for 1998 reflect lower depreciation and amortization, growth in revenues from local and access services and network services, cost reductions related to workforce reduction and process improvement programs implemented in prior periods, partially offset by lower long distance revenues, cost increases associated with increased volumes, increased rental charges and costs related to the January 1998 ice storm. In addition, 1998 results were impacted by restructuring and other charges (see notes to consolidated financial statements, Note 4), as well as one-time net gains, included under "other expenses", mainly related to the sale of the Electronic Business Solutions (EBS) unit of Bell Emergis (see notes to consolidated financial statements, Note 7).

Operating revenues

Local and access services revenues represent 48% of total operating revenues for 1998 and are earned principally by connecting business and residence customers to Bell Canada's network and providing them with local area service.

Local and access services revenues increased $396 million for 1998 compared with 1997 due mainly to the impact of the $2.57 per month residential local service rate increase which became effective January 1, 1998, growth in network access services, increased payments to access the local network by users of private line digital services, and increased revenues from long distance competitors accessing the local network. These increases were partially offset by a reduction in local business rates, which became effective May 1, 1998.

Long distance and network services revenues represent 37% of total operating revenues for 1998 and are earned by carrying long distance traffic and by providing network services such as private line and business data services. Bell Canada provides these services in its territory and, jointly with other telecommunications providers, throughout Canada and the world.

Long distance and network services revenues decreased $313 million for 1998 compared with 1997. Long distance revenues for 1998 decreased due to lower average prices which were partially offset by higher volumes. The lower average prices were primarily due to increased penetration of discount calling plans such as **Advantage Optimum**™ and **First Rate**†. Price reductions and concentrated marketing efforts led to an increase in long distance services volumes, as measured in conversation minutes, of 516 million (5.2%) for 1998, compared with 1997. During 1998, Bell Canada's share of the long distance market increased by 1.2% to an estimated market share of 64.3% as at December 31, 1998, compared with an estimated market share of 63.1% as at December 31, 1997. The gain in market share, the first since the introduction of competition in the long distance market, reflected the success of Bell Canada's **First Rate**† long distance discount calling plan. The decrease in long distance services revenues was partially offset by an increase in network services revenues for 1998, compared with 1997, due mainly to growth in digital data services and in digital frame-relay services.

On December 16, 1998, Bell Canada gave notice to the Stentor Operating Companies of the termination, effective December 31, 1999, of the connecting agreement which defines the rules of connection and payment between the Stentor Operating Companies, and the governance agreement concerning Stentor Canadian Network Management. New agreements are under negotiation which are intended to reflect the more competitive and less-regulated environment in Canada's telecommunications industry, as well as the fact that Bell Canada will be originating and terminating traffic and exchanging strategic plans with alliance partners on its own behalf in the future. Bell Canada does not expect the financial impact from the foregoing to be material.

Terminal sales, directory advertising and other revenues represent 15% of total operating revenues for 1998 and consist of the rental, sales and maintenance of terminal equipment, directory advertising,

Advantage Optimum is a trademark of Stentor Resource Centre Inc., Bell Canada is a licensed user.

†**First Rate** is a trademark of MTS NetCom Inc., Bell Canada is a licensed user.

Internet access, network management services and revenues related to public telephones. Terminal sales, directory advertising and other revenues for 1998 were essentially flat compared with 1997 as increased revenues related to terminal equipment sales and Internet access were offset by the impact of the disposition of Bell Sygma's Telecom Solutions and International divisions to CGI Group Inc. (CGI), effective July 1, 1998 (see notes to consolidated financial statements, Note 7).

During 1999, Bell Canada will seek growth in local and access services revenues driven by growth in network access services as well as in optional services, partially offset by an increase in local service competition and lower average local rates due to the continuing impact of the price cap regime. Bell Canada expects continued pressures from intense competition related to long distance revenues. In addition, Bell Canada will seek revenue growth in data network services and through the provision of emerging services such as broadband, and other Internet services as well as from the launch of Bell Canada's new Internet Protocol (IP)/broadband company, in the first quarter of 1999. The Canadian and United States operations of this company were named BCE Nexxia Inc., carrying on business under the name Bell Nexxia, and BCE Nexxia Corporation, respectively (collectively BCE Nexxia). Bell Canada will continue to pursue new sources of revenues through emerging technologies and will explore ways of integrating its business.

2. Total operating expenses

($ millions)	**1998**	1997	% Change
Operating expenses	**5,530**	5,551	(0.4)
Depreciation and amortization	**2,230**	2,614	(14.7)
	7,760	8,165	(5.0)
Restructuring and other charges	**608**	–	n. m.
Total operating expenses	**8,368**	8,165	2.5

n. m.: not meaningful

Operating expenses

Operating expenses (excluding depreciation and amortization and restructuring and other charges) were essentially flat for 1998 compared with 1997 as the impact of workforce reduction and process improvement programs implemented in prior periods and lower long distance settlement payments were offset by costs associated with the January 1998 ice storm, increased rental charges related to the sale of real estate properties, and volume increases.

EBITDA, which excludes pension credits, restructuring and other charges, and one-time net gains, was $4,714 million for 1998 representing an increase of $90 million compared with 1997. The increase was due primarily to the overall revenue growth and to cost reduction programs, partially offset by higher rental charges and costs associated with the January 1998 ice storm.

The depreciation and amortization expense decrease of $384 million in 1998 compared with 1997 was primarily due to the write-down of capital assets and write-off of regulatory assets as at December 31, 1997, reflecting the impact of the transition from rate-of-return regulation, combined with the sale of real estate properties. The impact of these factors was partially offset by a reduction of capital asset lives compared with 1997 lives reflecting technological and market changes.

At December 31, 1998, the total number of employees was 38,049, down 1,279 or 3.3% from December 31, 1997, mainly as a result of the sale of Bell Sygma's Telecom Solutions and International divisions to CGI. Total salaries and wages (including capitalized amounts and excluding payments made under workforce reduction programs) were $2,038 million, down $185 million from 1997. The 8.3% decrease in salary and wages is higher than the 3.3% decrease in the total number of employees due primarily to workforce reductions which occured in 1997, partially offset by increased overtime related to the January 1998 ice storm.

During 1998, Bell Canada and its clerical and associated employees, represented by the Canadian Telephone Employees' Association, reached a new collective agreement. The new agreement will expire May 31, 2002. Bell Canada and its Operator Services employees and Craft and Services employees, represented by the Communications, Energy and Paperworkers' Union (CEP), started negotiations on October 15, 1998. The collective agreements expired on November 24, 1998 and November 30, 1998, respectively. On January 11, 1999, Bell Canada tabled a comprehensive offer of settlement in resolution of all outstanding issues with the Craft and Services employees. On the same day, Bell Canada also informed the Operator Services employees of plans to partner with Excell Global Services Inc., an international operator services provider, to create a new company to provide operator services to Bell Canada and other companies. On January 14, 1999, Bell Canada and the CEP both requested the appointment of a federal government conciliator to facilitate contract negotiations. The conciliation process began on February 1, 1999. On February 4, 1999, Bell Canada and the CEP, after both agreeing that they had reached an impasse in conciliation, requested that the conciliators file their report with the federal Minister of Labour (Minister). On February 19, 1999, the Minister informed Bell Canada and the CEP of her decision not to extend the conciliation process in contract negotiations for the renewal of the Craft and Operator Services collective agreements. However, the Minister appointed two mediators to assist the parties in reaching an agreement. The right to strike or lock-out will be acquired on February 27, 1999.

During the second quarter of 1998, Bell Canada recorded pre-tax charges in the aggregate of $608 million representing restructuring and other charges of $102 million and $506 million, respectively. The restructuring charges related to plans for rationalization of real estate and the integration of business units. Included in the charges are costs relating to lease terminations and associated costs and employee severance. Other charges include a provision for the costs of implementing local service competition and providing local number portability, to the extent such costs are estimated not to be recoverable. Also included are costs relating to the write-down of certain assets and other provisions.

During 1999, Bell Canada anticipates increased expenses related to revenue growth principally from emerging services, including

BCE Nexxia. These costs are expected to be offset by the impact of workforce reduction programs and process improvement projects implemented in prior periods and benefits to be derived from Bell Canada's information systems and information technology modernization program. Bell Canada will continue to explore ways of improving its cost structure in 1999 in order to continue to be more competitive.

Interest expense

Interest expense of $557 million was $45 million lower compared with 1997 as a result of a lower average level of borrowing substantially related to the proceeds from the sale of real estate properties in the first quarter of 1998.

Extraordinary Item

As at December 31, 1997, Bell Canada determined that it no longer met the criteria necessary for the continued application of regulatory accounting provisions as a result of the introduction of price cap regulation and the opening of the local exchange market to competition. Accordingly, Bell Canada adjusted the net carrying values of assets and liabilities as at December 31, 1997, to reflect values appropriate under generally accepted accounting principles for enterprises no longer subject to rate-of-return regulation. The adjustment resulted in an extraordinary charge of $2,725 million on an after-tax basis. Included in this extraordinary charge was an adjustment to the net carrying values of capital assets and a write-off of assets and liabilities specifically recognized through the regulatory process.

For more details please see notes to consolidated financial statements, Note 3.

LIQUIDITY AND CAPITAL RESOURCES

For information concerning the principal components of Bell Canada's cash flows, please refer to the consolidated statement of changes in financial position (p. 10).

Operating cash flow was essentially flat for 1998 compared with 1997. Free cash flow of $923 million in 1998 represented an increase of $485 million over 1997 due primarily to the net proceeds of $753 million related to the sale of certain real estate properties in the first quarter of 1998 and the termination of the business transformation program, partially offset by increased working capital requirements and other items and increased net capital expenditures.

Net capital expenditures increased by $279 million for 1998 compared with 1997 due principally to the information systems and information technology modernization program. Net capital expenditures for 1999 are expected to remain relatively flat compared with 1998 as increases related to Internet technologies (broadband) are expected to be offset by reduced net capital expenditures related to voice technologies (narrowband) and by reduced expenditures related to information systems and information technology.

During 1998, Bell Canada repaid some $862 million of debt comprised of $544 million of long-term debt which matured, $127 million of long-term debt which was redeemed prior to maturity, and $191 million of notes payable and bank advances. Bell Canada's cash requirements during 1998, including the financing of capital expenditures and early redemptions, were primarily met by internally generated funds. Approximately $640 million of Bell Canada's long-term debt and other long-term liabilities will mature during 1999. Bell Canada's cash requirements during 1999, including the financing of capital expenditures and investments, are expected to be met by internally generated funds and by the issuance of debt.

On December 31, 1998, outstanding commercial paper totalled $105 million in Canadian funds. The commercial paper program is supported by lines of credit, extended by several banks, totalling $750 million.

Bell Canada's debt ratio was 52.8% at December 31, 1998 compared with 55.6% at December 31, 1997.

RISK FACTORS

In addition to the other risk factors outlined in this document, the following additional factors should be considered. Collectively these factors could cause the results contemplated by the forward-looking statements contained in this document to materially differ from current expectations. Bell Canada disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Bell Canada's future operating results may be affected by various trends and factors which must be managed in order to achieve favourable operating results. In addition, there are trends and factors beyond Bell Canada's control which affect its operations. Such trends and factors include adverse changes in the conditions in the specific markets for Bell Canada's products and services, the conditions in the broader market for communications, and the conditions in the domestic or global economy generally.

Increasing Competition

With the advent of competition in the local service market in 1998, all parts of Bell Canada's business are facing substantial and intensifying competition. Factors such as product pricing and service are under continued pressure while the necessity to reduce costs is ongoing. Bell Canada must not only try to anticipate, but must also respond promptly to, continuous and rapid developments in its businesses and their markets. In addition, the significant growth and size, as well as increasing global scope, of the telecommunications industry are attracting new entrants and encouraging parties other than existing participants to expand their services and their markets. Mergers and acquisitions, as well as alliances and joint ventures, are creating new or larger participants with broad skills and significant resources which will further impact the competitive landscape. Current and future competitors are coming not just from within Canada, but also globally, and will include not only major telecommunications companies, such as AT&T Canada and Sprint Canada, but also cable companies, Internet companies, wireless service providers and other companies that offer network services, such as providers of business information systems and system integrators, as well as an increasing number of other companies who deal with or have access to customers through various communications networks. Many of these companies are significant in size and resources and have a significant market presence with brand recognition and existing customer relationships.

Technology

The telecommunications industry, as with many others, is characterized by rapidly changing technology with the related changes

in customer demands and the need for new products and services at competitive prices. Technological developments are also shortening product life cycles and facilitating convergence of different segments of the increasingly global information industry. Bell Canada's future success will be impacted by its ability to anticipate, invest in and implement new technologies with the levels of service and prices that consumers demand. Technological advances may also affect Bell Canada's level of earnings by shortening the useful life of some of its assets. Furthermore, technological advances may well emerge that could reduce or replace the costs of plant and equipment and eliminate or reduce barriers that deter other companies from competing in particular market segments.

Decisions of the Canadian Radio-television and Telecommunications Commission (CRTC)

During 1997, the CRTC released several important decisions which set out the rules for the evolution to total competition in Canada's telecommunications industry. Included in these decisions were those related to the introduction of local service competition, the implementation of price cap regulation, and forbearance from long distance and private line service regulation. These decisions, which are described in Bell Canada's Annual Information Form for the year ended December 31, 1998, represent significant challenges and opportunities for Bell Canada and are expected, together with continued intense competition across all lines of business coupled with the rapid pace of technological change (as previously discussed), to have a significant impact on Bell Canada's results in the future.

Expenditures, Capital and Demand for Services

The level of expenditures necessary to maintain quality of service, the availability and cost of capital, and the extent of demand for telephone access lines, optional services and basic long distance services, in the markets served by Bell Canada, constitute factors which could materially affect Bell Canada's results of operations and financial condition in the future.

Impact of Year 2000 Issue (Year 2000 Readiness Disclosure)

The Year 2000 issue relates to the way dates have traditionally been stored and used in computing systems. To conserve expensive memory space, years were stored as two digits, so that the year 2000 will appear in many computing systems as "00". Many systems and computers will interpret "00" as the year 1900 instead of the year 2000. This could create difficulties in performing certain computing functions or potentially cause system failures. This in turn could result in miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in other normal business activities. 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.

The practical consequences of the Year 2000 issue are a significant risk and challenge to telecommunications companies such as Bell Canada because the nature of their business is highly dependent on complex systems and technology which have date-sensitive aspects and a significant portion of their software must be modified or replaced. The Year 2000 issue could impact across most of Bell Canada's operations including the network (both its own and that shared with its business partners), the products and services provided to customers and its own internal systems and support activities. For example, network switching equipment is highly dependent on date-sensitive software programs that assist with the routing, reporting and management of telephone calls. A wide range of network management systems is also highly dependent on date-related functions. Bell Canada has several hundred information systems (e.g., call centre management systems, ordering and provisioning systems, repair reporting and management systems, and billing systems) which depend on date functionality to properly transact business affairs. Many products and services, as well as their supporting elements (e.g., voice mail) are also dependent on date-related functionality.

A Year 2000 Program Management Office (PMO) was established in 1997 with the mandate to minimize the impact of the Year 2000 issue on Bell Canada's operations. The Year 2000 PMO has the responsibility to ensure that all aspects of Bell Canada's operations are being addressed to meet the Year 2000 issue. Bell Canada and the other Stentor Operating Companies have also set up a National Year 2000 Program Management Office (PMO). The Stentor Year 2000 PMO has developed a Year 2000 action plan to address the continued functionality of nationally delivered services up to, through, and beyond the year 2000.

A comprehensive governance process has been established to oversee Bell Canada's Year 2000 program. The Year 2000 program is reviewed monthly with the President of Bell Canada and other senior officers of the company. Updates are provided at least on a quarterly basis to the Bell Canada Board of Directors. In addition and in collaboration with the Stentor Year 2000 PMO, the Stentor National Year 2000 program is reviewed monthly with the Board of Directors of Stentor Canadian Network Management ("SCNM").

At the outset of Bell Canada's Year 2000 program, Bell Canada identified the following requirements in order to get ready for Year 2000: of approximately 125 million lines of software code in Bell Canada's support systems, it was determined that 83 million lines of code required detailed review and conversion; in addition, Bell Canada's business critical and customer affecting systems, applications and network elements (consisting of hardware, software and other components in over 300 central offices) required conversion or upgrading in order to make them Year 2000 ready. Progress towards Year 2000 readiness has been made as disclosed below.

As of December 31, 1998, Bell Canada had completed the majority of the effort required to convert or upgrade, test and deploy (i.e., put back into service) the network elements required to be Year 2000 compliant. In fact, all of the network elements comprising the Public Switched Telephone Network (PSTN) have been converted or upgraded, tested and put back into service as of December 31, 1998. However, as part of Bell Canada's ongoing Year 2000 test program, further testing of the PSTN will occur in 1999. Bell Canada anticipates that it will substantially complete the deployment of its network elements by approximately the end of March 1999. Similarly, as of December 31, 1998, the renovation, upgrade and code conversion of the majority of Bell Canada's information systems

and information technology (IS/IT) was complete, with the mission critical components of these systems being in excess of 95% completed as of December 31, 1998. Each application is subject to an internal certification process and tested before it is put back into service. It is anticipated that all Bell Canada mission critical applications will be substantially complete by the end of March 1999 and that the national mission critical applications that Bell Canada uses in collaboration with its business partners will be substantially complete by the end of June 1999. Bell Canada further expects that the majority of its products and services will be Year 2000 ready by March 31, 1999, with substantially all products and services being targeted to be ready by approximately June 30, 1999. As to national products and services which Bell Canada offers in collaboration with its business partners, it is anticipated that the majority of those products will be ready by March 31, 1999, with substantially all products and services being targeted to be ready by approximately June 30, 1999.

Bell Canada has undertaken a detailed testing and internal certification program which seeks to ensure that each Bell Canada Year 2000 IS/IT project is reviewed and approved by the appropriate officers or other employees of Bell Canada. Each IS/IT application and network element is subject to a series of date related tests that seek to ensure that it will continue to work before and beyond the Year 2000. In addition, Bell Canada, in cooperation with the other Stentor Operating Companies, has begun to conduct national interoperability tests and will continue to do so in 1999. Bell Canada is also taking steps which seek to ensure that its mission critical and priority building systems, as well as the IS/IT systems that support the physical environment, are being prepared for the Year 2000.

The Year 2000 program is integrated with Bell Canada's IS/IT modernization program, network evolution planning and product line simplification, the implementation of which is a dynamic process and therefore is likely to be modified or adjusted prior to Year 2000. Bell Canada estimates that it will spend approximately $350 million on the Year 2000 program. Of such amount, approximately half is related to network elements and new systems platforms which will be expensed or capitalized in accordance with Bell Canada's existing practice. The other half is related to the analysis, conversion and redeployment of compliant programming code, which will be expensed. As these cost projections are based on management's best estimates, actual results could differ materially from those plans. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, and similar uncertainties. Bell Canada has and will continue to use both internal and external resources to reprogram, or replace, and test its software for Year 2000 modifications. Total investment as of December 31, 1998 in Bell Canada's Year 2000 program was approximately $260 million, which was financed through operating cash flow. Of such amount, approximately $170 million has been capitalized and approximately $90 million has been expensed.

Bell Canada performs reviews of its Year 2000 program on a regular basis. In addition, three specific reviews have been conducted by an independent third party, and further independent reviews of key aspects of Bell Canada's Year 2000 program may be conducted in the future. Although there are significant risks and uncertainties associated with a program of this magnitude, Bell Canada believes it will meet its overall schedule. However, a delay in any critical element of Bell Canada's Year 2000 program could materially impact Bell Canada's ability to meet its projected target dates and its ability to be ready by January 1, 2000. Some of these critical elements include the delivery of compliant products and services from Bell Canada's suppliers, delays in the conversion and deployment of critical network elements, and cross-impacts of Bell Canada's modernization program delays. Contingency plans would be invoked should any delay or failure be deemed to significantly jeopardize Bell Canada's operations. Bell Canada anticipates it will have substantially completed its development of contingency plans by the end of March 1999. The plans will be implemented and tested throughout the remainder of the year.

The risk and challenge of Bell Canada's Year 2000 program is amplified by the fact that many of Bell Canada's applications and systems interact with those of customers and other third parties which are beyond the control of Bell Canada but whose failure to make their systems Year 2000 compliant could materially impact Bell Canada. Bell Canada is highly dependent on many suppliers who provide Bell Canada with an extensive array of products and services critical to its operations.

Since January 1997, Bell Canada has instituted a comprehensive vendor management program, which seeks to ensure that the products and services it receives from its suppliers are or will be Year 2000 compliant. As of December 31, 1998, Bell Canada had completed its due diligence process with most of its suppliers and intends to continue its monitoring of its suppliers to seek to ensure that products and services will be Year 2000 compliant and that Year 2000 ready products will be delivered when promised. However, there can be no assurance that the products or systems of other companies which Bell Canada or its customers utilize or rely upon will be converted in a timely and effective manner, or that a failure to convert by another company or a conversion that is incompatible with Bell Canada's systems, would not have material adverse effects on Bell Canada or its customers.

Bell Canada also believes that the restructuring of the Stentor alliance will not materially affect its Year 2000 program. The Stentor alliance is evolving, but it is envisaged that SCNM will continue to be responsible for the Stentor National Year 2000 program.

While Bell Canada believes it has an appropriate plan in place, the Year 2000 issue is a unique event, which raises unprecedented challenges and risks. Bell Canada presently believes that with modifications to existing software and conversions to new software, the Year 2000 issue can be mitigated. However, if such modifications and conversions are not completed on a timely basis, if any of Bell Canada's mission critical suppliers fail to deliver Year 2000 ready products and services, if products or systems of other companies which Bell Canada or its customers utilize or rely on are not converted in a timely and effective manner, or if there is a failure to convert by another company or a conversion that is incompatible with Bell Canada's systems, and if Bell Canada's contingency plans are ineffective, the Year 2000 issue could have a material adverse effect on the financial condition and results of Bell Canada.

management's report

The accompanying consolidated financial statements of Bell Canada and its subsidiaries (collectively Bell Canada), and all information in this document are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in conformity with Canadian generally accepted accounting principles. The financial statements include some amounts that are based on best estimates and judgements of management, and in their opinion present fairly Bell Canada's financial position, results of operations and changes in financial position. Financial information presented elsewhere in this document is consistent with that in the financial statements.

Management of Bell Canada, in furtherance of the integrity and objectivity of the financial statements, has developed and maintains a system of internal controls and supports an extensive program of internal audits. Management believes the internal controls provide reasonable assurance that financial records are reliable and form a proper basis for the preparation of financial statements and that Bell Canada's assets are properly accounted for and safeguarded. The internal control process includes management's communication to employees of policies which govern ethical business conduct.

The Board of Directors carries out its responsibility for the financial statements in this document principally through its Audit Committee, consisting solely of outside and unrelated directors. The Audit Committee reviews Bell Canada's annual consolidated financial statements and other information in this document, and recommends their approval by the Board of Directors. The internal and the shareholders' auditors have free and independent access to the Audit Committee.

These financial statements have been audited by the shareholders' auditors, Deloitte & Touche LLP, Chartered Accountants, and their report is presented below.

Jean C. Monty
Chairman and Chief Executive Officer
February 22, 1999

William D. Anderson
Chief Financial Officer

auditors' report

To the shareholders of Bell Canada

We have audited the consolidated balance sheets of Bell Canada and its subsidiaries as at December 31, 1998 and 1997 and the consolidated statements of operations, retained earnings and changes in financial position for the years then ended as they appear on pages 8 to 21. These financial statements are the responsibility of the Corporation'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. These 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 Corporation 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 Canadian generally accepted accounting principles.

Deloitte & Touche LLP
Chartered Accountants

Montréal (Québec)
February 22, 1999

consolidated statement of operations

($ millions) For the years ended December 31	Notes	1998	1997
Operating revenues	(2)		
Local and access services		**5,053**	4,657
Long distance and network services		**3,904**	4,217
Terminal sales, directory advertising and other revenues		**1,604**	1,616
Total operating revenues		**10,561**	10,490
Operating expenses	(2)		
Operating expenses		**5,530**	5,551
Depreciation and amortization		**2,230**	2,614
Restructuring and other charges	(4)	**608**	–
Total operating expenses		**8,368**	8,165
Net operating revenues		**2,193**	2,325
Other expenses		**23**	40
Interest expense		**557**	602
Earnings before income taxes and extraordinary item		**1,613**	1,683
Income taxes	(5)	**781**	795
Net earnings before extraordinary item		**832**	888
Extraordinary item	(3)	**–**	(2,725)
Net earnings (loss)		**832**	(1,837)
Dividends on perpetual preferred shares		**33**	36
Net earnings (loss) applicable to common shares		**799**	(1,873)

consolidated statement of retained earnings

($ millions) For the years ended December 31	Notes	1998	1997
Balance at beginning of year		**–**	2,051
Net earnings (loss)		**832**	(1,837)
		832	214
Dividends			
Perpetual preferred shares		**(33)**	(36)
Common shares		**(822)**	(822)
		(855)	(858)
Reclassification of premium on share capital	(15)	**23**	644
Balance at end of year		**–**	–

($ millions) At December 31	Notes	1998	1997
ASSETS			
Current assets			
Cash and temporary cash investments, at cost (approximates market value)		**54**	9
Accounts receivable	(8)	**1,076**	1,116
Other current assets		**255**	197
		1,385	1,322
Capital assets – at cost	(9)		
Buildings, plant and equipment		**27,094**	28,427
Less: accumulated depreciation		**16,605**	16,839
		10,489	11,588
Land		**58**	111
Plant under construction		**576**	274
Material and supplies		**80**	85
		11,203	12,058
Other assets			
Investments in associated and other companies	(1)	**191**	133
Deferred charges and other assets	(10)	**1,741**	1,175
		1,932	1,308
Total assets		**14,520**	14,688
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Cheques outstanding in excess of bank balances		**–**	56
Accounts payable and accrued liabilities	(8)	**2,225**	2,189
Income and other taxes payable		**366**	115
Debt due within one year	(11)	**760**	846
Total current liabilities		**3,351**	3,206
Long-term debt	(12)	**4,924**	5,567
Deferred income taxes		**315**	389
Other long-term liabilities		**655**	228
Retractable preferred shares	(14)	**100**	100
Perpetual preferred shares	(14)	**630**	630
Common shareholders' equity	(15)		
Stated capital of common shares		**4,178**	4,178
Premium on share capital		**367**	390
Retained earnings		**–**	–
Total common shareholders' equity		**4,545**	4,568
Commitments and contingent liabilities	(18)		
Total liabilities and shareholders' equity		**14,520**	14,688

On behalf of the Board of Directors:

Director

Director

consolidated statement of changes in financial position

($ millions) For the years ended December 31	Notes	1998	1997
Cash provided by (used for) operations			
Net earnings (loss)		**832**	(1,837)
Items not affecting cash			
Extraordinary item	(3)	**–**	2,725
Depreciation and amortization		**2,230**	2,614
Restructuring and other charges	(4)	**471**	–
Deferred income taxes		**(154)**	(112)
Pension and other items		**(349)**	(316)
Operating cash flow		**3,030**	3,074
(Increase) decrease in working capital and other items		**(42)**	303
Business transformation and other workforce reduction costs (net of tax)		**–**	(427)
Cash flow from operations		**2,988**	2,950
Cash provided by (used for) investments			
Net capital expenditures		**(1,947)**	(1,668)
Proceeds from disposition of assets, net of investments		**689**	(91)
Long-term receivables and other items		**48**	105
		(1,210)	(1,654)
Dividends declared		**(855)**	(858)
Free cash flow		**923**	438
Cash provided by (used for) financing			
Decrease in notes payable and bank advances		**(191)**	(18)
Repayment of long-term debt		**(671)**	(586)
Proceeds from issue of long-term debt		**–**	295
Other items		**40**	40
		(822)	(269)
Cash position			
Increase during the year		**101**	169
At beginning of year		**(47)**	(216)
At end of year [1]		**54**	(47)
[1] Represented by:			
Cash and temporary cash investments		**54**	9
Cheques outstanding in excess of bank balances		**–**	(56)
		54	(47)

1. ACCOUNTING POLICIES

Basis of presentation

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and all amounts are in Canadian dollars unless otherwise indicated. As at December 31, 1997, Bell Canada determined that it no longer met the criteria necessary for the continued application of regulatory accounting provisions as a result of the introduction of price cap regulation and the opening of the local exchange market to competition, and as such, adjusted the net carrying values of assets and liabilities as at December 31, 1997, to reflect values appropriate under GAAP for enterprises no longer subject to rate-of-return regulation. The adjustment was recorded in 1997 as an extraordinary item, net of tax (see Note 3).

With respect to the consolidated financial statements of Bell Canada, the material differences between Canadian and United States GAAP are described and reconciled in Note 19. As used herein "Bell Canada" means Bell Canada, its subsidiaries and the directory business division of Tele-Direct (Publications) Inc. (which was renamed Bell ActiMedia Inc. on January 29, 1999 (Bell ActiMedia)).

Certain previously reported amounts have been reclassified to conform with the current presentation.

Consolidation

The consolidated financial statements include the accounts of all subsidiaries (defined as companies controlled by Bell Canada) and those of the directory business division of Bell ActiMedia. Bell ActiMedia, which was a wholly-owned subsidiary prior to 1989, is now a majority-owned subsidiary of BCE Inc. (BCE), the parent company of Bell Canada. Although Bell Canada does not have voting control, it retains exclusive control over and the right to earnings of the directory business division; further, it is BCE's policy that the establishment and operation of the other business activities of Bell ActiMedia will not affect Bell Canada. Bell Canada's principal subsidiary company, at December 31, 1998, was MPACT Immedia Corporation (renamed BCE Emergis Inc. on January 21, 1999).

Investments in associated companies, defined as companies under significant influence, are accounted for by the equity method and amounted to $49 million ($53 million in 1997). In 1998, Bell Canada sold its investment in Nortel Technology Limited (formerly Bell-Northern Research Ltd.) to Northern Telecom Limited at net book value. Investments in other companies are accounted for at cost and amounted to $142 million ($80 million in 1997). Bell Canada's principal investment at cost was CGI Group Inc. and amounted to $127 million ($62 million in 1997).

Capital assets

Capital assets are carried at cost less accumulated depreciation, where applicable. When depreciable capital assets are retired the carrying value of such assets is charged to accumulated depreciation. Switching machine software and certain other administrative application software are included in plant and equipment. Depreciation is computed on a straight-line basis.

Derivative financial instruments

Bell Canada does not actively trade derivative financial instruments but uses them to manage foreign currency and interest rate positions associated with its debt instruments. The costs and benefits, gains and losses, related to these instruments are generally recognized in earnings on the same basis as the foreign exchange gains and losses on the underlying debt instruments, which is usually over the remaining life of the debt. Amounts receivable or payable under interest rate swaps are accrued and recorded as adjustments to interest expense.

Translation of foreign currencies

Monetary items are translated at the rates in effect at the balance sheet date, whereas non-monetary items are translated at the rates prevailing at the respective transaction dates.

Revenues and expenses are translated at average rates prevailing during the year, except for depreciation and amortization which are translated at exchange rates prevailing when the related assets were acquired. Currency gains and losses are reflected in net earnings of the year except for unrealized foreign currency gains and losses on long-term monetary assets and liabilities, which are reported as deferred items and amortized over the remaining lives of the related items on a straight-line basis.

Leases

Where Bell Canada is the lessor, rental revenue from operating leases is recognized as service is rendered to customers. For leases, which qualify as sales-type leases, the sales revenue is recognized at the inception of the lease. Where Bell Canada is the lessee, assets recorded under capital leases are amortized on a straight-line method using rates based on the estimated useful life of the asset or based on the lease term, as appropriate. Obligations recorded under capital leases are reduced by rental payments net of imputed interest.

Income taxes

Bell Canada, prior to January 1, 1998, used the modified liability method of income tax allocation as directed by the Canadian Radio-television Telecommunications Commission (CRTC). As a result of the discontinued application of regulatory accounting provisions, Bell Canada adopted the deferral method of income tax allocation and adjusted its deferred income tax balance as at December 31, 1997 to reflect the appropriate balance under the deferral method. The adjustment was reflected in the extraordinary item (see Note 3). Under the modified liability method of accounting for income taxes, Bell Canada's deferred income tax balance was adjusted to reflect changes to income tax rates. The resulting adjustments were taken into earnings in the year in which the changes occurred.

The deferred income tax balance reported on the consolidated balance sheet results from timing differences in the recognition of income and expense for financial statement and income tax purposes.

Pensions and other postretirement benefits

Bell Canada maintains defined benefit pension plans, which cover substantially all of its employees. The plans provide pensions to retired employees based on years of service and best average earnings at retirement. These plans are non-contributory, with Bell Canada being responsible for contributions to adequately fund the plans.

Pension costs are determined using the projected benefit method prorated over years of service and based on management's best estimates. A valuation is performed each year to determine the actuarial present value of the accrued pension benefits, including the impact of workforce reduction programs. Pension plan assets are valued at market value. Adjustments arising from plan amendments, changes in assumptions, experience gains and losses and the transition adjustment (the excess of plan assets over plan obligations) as at January 1, 1987, when the present accounting standards became effective, are amortized and recognized over the expected average remaining service life of the plan participants. The recognition in earnings, of adjustments, may be accelerated upon a significant reduction in the remaining service life of the employee group or significant changes to the projected benefit obligation.

Bell Canada also provides certain health care and life insurance benefits for inactive employees. The cost of these benefits, excluding life insurance, is recorded in operating expenses as paid. Life insurance for retired employees is largely funded during their working lives.

2. RECLASSIFICATION OF OPERATING REVENUES AND OPERATING EXPENSES

Reclassification of revenues within total operating revenues

Bell Canada reclassified certain sources of revenue within its three general categories of revenues to conform with Bell Canada's management of these revenue items. Figures for prior years were restated accordingly. The main components of the reclassification between revenue categories are noted in the following paragraph.

Local and access services revenues now include rental revenue related to single-line terminal equipment which were formerly in the terminal sales, directory advertising, and other revenues category, as well as certain optional features which were formerly recorded as part of long distance and network services. Long distance and network services revenues now include all revenues related to the provision of private line (dedicated) voice, data, and video services, a portion of which, were formerly included in the local and access services category. Revenues related to public telephones were reclassified as part of terminal sales, directory advertising and other revenues from the other main categories.

Reclassification of total operating revenues and total operating expenses

Long distance and network services settlements

As a result of the introduction of new Stentor settlement plans which became effective January 1, 1997 for long distance services and January 1, 1998 for network services, Bell Canada is required to remit to other service providers a fee for the use of their facilities in the provisioning of these services. Prior to these new Stentor settlement plans, revenues related to the provisioning of long distance and network services were shared by Stentor members and allocated to individual members based on a set formula. Bell Canada had, prior to 1998, recorded as long distance and network services revenues, total revenues billed to customers net of these settlements.

Effective January 1, 1998, Bell Canada recorded payments made to other long distance and network services providers for the use of their facilities as operating expenses. Bell Canada restated the 1997 results to conform to the current presentation. The impact of the restatement was to increase long distance and network services revenues and operating expenses by $1,011 million for 1997.

Local service contribution

Effective January 1, 1998, Bell Canada and other long distance services providers are required to remit payments to a central fund for the subsidization of local residential telephone service in Canada. Payments from the central fund are then made to the appropriate local residential service provider. Bell Canada recorded as an increase to local and access services revenues its share of the central fund, which accrues to its local and access services. Operating expenses have increased to reflect Bell Canada's payments. Bell Canada restated the 1997 results to reflect the amount of the contribution that Bell Canada was deemed to have made in 1997 for the subsidization of the local residential services. As a result, local and access services revenues and operating expenses were increased by $151 million for 1997.

Bad debt expenses

Effective January 1, 1998, Bell Canada recorded bad debt expenses as an operating expense. Prior to 1998, bad debt expenses were reported as a reduction in terminal sales, directory advertising and other revenues. Bell Canada restated the 1997 results to conform to the current presentation. The impact of the restatement was to increase terminal sales, directory advertising, and other revenues and operating expenses by $82 million for 1997.

3. EXTRAORDINARY ITEM

As at December 31, 1997, Bell Canada determined that it no longer met the criteria necessary for the continued application of regulatory accounting provisions. As a result, Bell Canada recorded an extraordinary non-cash charge of $2,725 million, net of an income tax benefit of $1,772 million.

The operations of Bell Canada no longer met the criteria for application of regulatory accounting provisions due to significant changes in regulation including the implementation of price cap regulation which replaced rate-of-return regulation effective January 1, 1998 and the concurrent introduction of competition in the local exchange market. Accordingly, Bell Canada adjusted the net carrying values of assets and liabilities as at December 31, 1997 to reflect values appropriate under GAAP for enterprises no longer subject to rate-of-return regulation.

Before the advent of price cap regulation and the introduction of competition in the local exchange market, Bell Canada's accounting practices were based on a regulatory regime which provided Bell Canada with reasonable assurance of the recovery of costs through rates set by the regulator and charged to customers. These regulatory accounting provisions resulted in the recognition of certain assets and liabilities along with capital asset lives which were substantially different from enterprises not subject to rate-of-return regulation.

The extraordinary charge consisted of a pre-tax charge of $3,350 million related to capital assets and a pre-tax charge of $1,147 million to adjust the carrying values of other assets and liabilities to arrive at carrying values appropriate for enterprises not subject to rate-of-return regulation. The amount of the charge related to capital assets was determined based on an estimate of the underlying cash flows using management's best estimate assumptions concerning Bell Canada's most likely course of action and other factors relating to competition, technological changes, and the evolution of products and services. The net carrying values of capital assets were adjusted primarily through an increase in accumulated depreciation. The primary component of the $1,147 million charge related to the write-off of deferred business transformation and workforce reduction costs. Prior to the discontinued application of regulatory accounting provisions, the deferred business transformation costs, which include workforce reduction and process optimization costs incurred as part of the business transformation program, and deferred workforce reduction costs, which include costs relating to workforce reduction programs implemented prior to the implementation of the business transformation program, were amortized to earnings over 5 years.

4. RESTRUCTURING AND OTHER CHARGES

Bell Canada recorded pre-tax charges in the aggregate of $608 million representing restructuring and other charges of $102 million and $506 million, respectively. The restructuring charges relate to plans for rationalization of real estate and the integration of business units. Included in the charges are costs relating to lease terminations and associated costs and employee severance. Other charges include a provision for the costs of implementing local service competition and providing local number portability to the extent such costs are estimated not to be recoverable. Also included are costs relating to the write-down of certain assets and other provisions.

5. INCOME TAXES

A reconciliation of income taxes at Canadian statutory rates with the reported income taxes follows:

	1998	1997[1]
Earnings before income taxes and extraordinary item	**1,613**	1,683
Statutory income tax rates in Canada	**42.4%**	42.3%
Income taxes at Canadian statutory rates	**684**	712
Large corporations tax	**1**	24
Non-deductible and other items	**96**	59
Total income taxes	**781**	795
Details of income taxes:		
Income taxes		
Current	**954**	740
Deferred	**(173)**	55
	781	795

(1) Excludes the impact of the extraordinary item (see Note 3) and the income tax benefit related to it in the amount of $1,772 million. The income tax benefit includes an adjustment made to switch from the modified liability method of income tax allocation to the deferral method resulting from the discontinued application of regulatory accounting provisions.

6. SEGMENTED INFORMATION

Bell Canada manages its operations under one segment which provides telecommunications products and services to its customers. Telecommunications products and services are grouped into three major revenue generating streams: local and access services, long distance and network services and terminal sales, directory advertising and other revenues. Operating expenses are managed at the total company level by major type of expense category and as such are not allocated to the major revenue generating categories. This represents the manner in which Bell Canada is organized and managed for assessing performance and making resource allocation decisions.

7. ACQUISITION AND DISPOSITION OF BUSINESSES

Sale of systems development and maintenance operations
Effective July 1, 1998, Bell Canada sold to CGI Group Inc. (CGI) its Bell Sygma Telecom Solutions (BSTS) and Bell Sygma International (BSI) divisions in exchange for 17.2 million First Preferred Shares, Series 6, of CGI. On the same date, Bell Canada converted all of the 17.2 million First Preferred Shares Series 6 into 17.2 million Class A Subordinate Shares of CGI. Bell Canada recorded its investment in CGI at the net book values of BSTS and BSI.

In addition, under the terms of a ten-year outsourcing agreement, which became effective July 1, 1998, a wholly-owned subsidiary of CGI is the preferred provider of Bell Canada's required information systems and information technology services. Bell Canada's minimum commitment between January 1, 1999 and June 30, 2001 is approximately $750 million. Beyond this period the amount of these expenditures will depend upon Bell Canada's business strategies and directions and the associated information systems and information technology requirements.

Bell Canada now holds a total of 44,356,432 Class A Subordinate Shares of CGI representing approximately 15% of the voting rights attached to all of CGI's outstanding shares and approximately 33% of the equity. Bell Canada is using the cost method to record its ownership interest in CGI.

Acquisition of MPACT Immedia Corporation (MPACT) (renamed BCE Emergis Inc. on January 21, 1999)
Effective August 31, 1998, Bell Canada acquired a 65% controlling interest in MPACT in exchange for the Electronic Business Solutions (EBS) unit of Bell Emergis and a cash investment of $68 million. MPACT specializes in providing electronic commerce related products and services. As a result of the exchange of the EBS unit, Bell Canada recorded a pre-tax gain of $74 million.

8. ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

At December 31, 1998, accounts receivable are principally from customers and include $109 million ($27 million in 1997) from parent, affiliated and associated companies. Accounts payable and accrued liabilities include $732 million ($632 million in 1997) due to parent, affiliated and associated companies.

Under an agreement effective October 14, 1997, Bell Canada sold accounts receivable for aggregate cash proceeds of $650 million. Pursuant to the agreement, the purchaser will use the funds from collections to purchase further receivables from Bell Canada until expiration of the agreement on October 6, 2002. Bell Canada is obligated to pay monthly certain predefined fees.

9. CAPITAL ASSETS

At December 31	Cost 1998	Cost 1997	Accumulated depreciation 1998	Accumulated depreciation 1997
Buildings	**1,634**	2,476	**812**	1,128
Plant	**22,870**	23,238	**13,939**	13,897
Equipment	**2,590**	2,713	**1,854**	1,814
	27,094	28,427	**16,605**	16,839

Composite depreciation rates		
Buildings	**3.21%**	4.09%
Plant	**6.88%**	8.12%
Equipment	**21.14%**	12.33%

Capital assets include property recorded under capital leases net of accumulated depreciation in the amount of $16 million as at December 31, 1998 ($19 million in 1997).

Depreciation and amortization expense includes depreciation of $2,203 million ($2,350 million in 1997) related to buildings, plant and equipment. Retirements charged to accumulated depreciation amounted to $2,038 million in 1998 ($1,394 million in 1997). Capital asset lives may be reduced, where applicable, subject to technological change and market conditions.

Prior to the discontinued application of regulatory accounting provisions, depreciation rates were reviewed and approved by the CRTC as part of the rate-setting process. Accordingly, Bell Canada's depreciation expense for 1996 and prior years, reflected asset lives as approved by the CRTC. Effective January 1, 1997, Bell Canada, in anticipation of obtaining CRTC approval with respect to asset lives to be used for 1997, used shorter asset lives than those used in 1996. The CRTC subsequently ordered that for the purposes of calculating the contribution rates in 1997, the company use asset lives approved for use in 1996. Bell Canada did not adjust its 1997 depreciation expense to reflect the CRTC approved asset lives. As a result, Bell Canada's 1997 depreciation expense was approximately $335 million higher than the expense which would have resulted from the use of CRTC approved asset lives for 1997. The 1998 depreciation rates reflect the impact of changes in market and technological conditions on the estimated useful lives of assets.

In the first quarter of 1998, Bell Canada sold commercial properties to TrizecHahn Corporation. The net proceeds from the sale were $753 million.

10. DEFERRED CHARGES AND OTHER ASSETS

At December 31	1998	1997
Prepaid pension costs (Note 16)	**1,337**	953
Unrealized foreign currency losses, net of amortization	**165**	135
Goodwill, net of amortization	**99**	23
Amounts receivable under cross currency contracts	**28**	14
Long-term receivables	**4**	40
Other	**108**	10
	1,741	1,175

11. DEBT DUE WITHIN ONE YEAR

At December 31	1998	1997
Long-term debt – current portion	**640**	536
Notes payable (including $6 million due to parent and affiliated companies, $93 million in 1997)	**113**	300
Bank advances	**7**	10
	760	846

12. LONG-TERM DEBT

Long-term debt is issued at fixed interest rates of which $750 million includes call options giving Bell Canada the right to repay such debt prior to maturity upon payment of certain premiums in addition to the principal amount of the debt.

At December 31	Weighted average rate of interest %	1998	1997
Debentures and notes [(a)]			
1998	8.61	**–**	475
1999	9.60	**600**	600
2000	9.28	**538**	519
2001	7.25	**150**	150
2002	7.58	**300**	300
2003	6.62	**534**	618
2004-2013	9.77	**1,862**	1,822
2014-2054	9.64	**1,225**	1,225
		5,209	5,709
Subordinated debentures			
Due 2026-2031	8.21	**275**	275
Other [(b)]	–	**80**	119
Sub-total		**5,564**	6,103
Less: due within one year		**640**	536
		4,924	5,567

(a) Debentures and notes include US $400 million maturing in 2006 and 2010; 300 million Swiss francs, due 2003, and Canadian $180 million, due 1999, swapped into U.S. dollar obligations as to principal and interest obligations; and 150 million German marks, due 2000, swapped into Canadian dollar obligations as to principal and interest obligations.

(b) "Other" includes $22 million in obligations under capital leases, $40 million (US $26 million) under a letter of credit and indemnity, $16 million in cross currency contract payables and other debt of $2 million.

At December 31, 1998, the estimated amounts of long-term debt payable by Bell Canada in the years 1999 to 2003 are $640 million, $564 million, $152 million, $303 million and $537 million, respectively.

At December 31, 1998, unused bank lines of credit, for general corporate purposes and to support commercial paper borrowings, generally at the banks' prime rate of interest, amounted to approximately $770 million.

13. FINANCIAL INSTRUMENTS

Bell Canada does not actively trade derivative financial instruments but uses them to manage foreign currency and interest rate positions associated with its debt instruments (see Note 12). The terms of these derivative contracts generally match the terms associated with the underlying debt instruments. These contracts are generally used to reduce financing costs and to diversify Bell Canada's access to capital markets. Bell Canada currently has six such contracts outstanding, two of which synthetically create U.S. dollar denominated debt, one contract hedges a foreign currency denominated debt back into Canadian dollars and three interest rate swaps convert fixed interest rate payments on debt to floating interest rate payments.

At December 31, 1998, Bell Canada had outstanding cross currency swaps and forward contracts to deliver US $78 million and US $322 million for interest and principal payments, respectively, during the years 1999-2003 related to Canadian dollar and Swiss franc debt instruments outstanding. Bell Canada also holds a cross currency swap to pay Canadian dollars to hedge its 150 million German marks Series 7 notes principal and interest payments. The aggregate amounts receivable and payable under these cross currency contracts are reported as other deferred charges ($28 million in 1998 and $14 million in 1997) and other long-term debt ($16 million in 1998 and $62 million in 1997), respectively.

Except as shown in the table below, the fair value of Bell Canada's financial instruments approximates carrying amounts. The fair values of the financial instruments in the table below have been estimated by management using available market information and do not necessarily represent amounts that Bell Canada could potentially realize in a current market exchange transaction between willing parties. Potential income taxes and other expenses that would be incurred on disposition of these financial instruments have not been reflected in fair values.

Credit risk

Bell Canada is exposed to credit risk in the event of non-performance by counterparties to its derivative financial instruments. Non-performance by any counterparty is not anticipated. Bell Canada monitors the credit risk and credit standing of counterparties on a regular basis and has a policy in place to deal only with highly rated financial institutions. Bell Canada manages its credit exposure so that there is no substantial concentration of credit risk resulting from cross currency swaps, forward contracts and interest rate swaps. In addition, Bell Canada is exposed to credit risk from customers. However, Bell Canada has a large number of diverse customers which minimizes concentration of this risk. The introduction of competition in the local exchange market may increase credit risk.

	1998		1997	
At December 31	**Carrying Value**	**Fair Value**	Carrying Value	Fair Value
Assets				
Investments in companies at cost	**142**	**1,347**	80	341
Cross currency contracts	**28**	**53**	14	43
Interest rate swaps	**–**	**3**	–	–
Liabilities				
Debt (Note 12)	**5,564**	**6,940**	6,103	7,127
Retractable preferred shares (Note 14)	**100**	**104**	100	118
Cross currency contracts	**16**	**18**	62	57

14. PREFERRED SHARES

Authorized

The articles of incorporation of Bell Canada provide for an unlimited number of Class A preferred shares. The articles authorize the directors of Bell Canada to issue such shares in one or more series and to fix the number of shares of each series, and the conditions attaching thereto, prior to their issue.

At December 31	1998		1997	
Outstanding	**Number of shares**	**Stated capital**	Number of shares	Stated capital
Non-convertible Class A preferred shares [a]				
Retractable preferred shares (Note 13)				
Series 10 [b]	**4,000,000**	**100**	4,000,000	100
Perpetual preferred shares [c]				
Series 11	**300**	**150**	300	150
Series 12	**400**	**200**	400	200
Series 13	**290**	**145**	290	145
Series 14	**270**	**135**	270	135
		630		630

(a) All preferred shares are non-voting and redeemable at Bell Canada's option.

The holders of Cumulative Redeemable Retractable Class A Preferred Shares Series 10 are entitled to fixed cumulative annual dividends at the rate of $1.86 per share.

The holders of Perpetual Cumulative Reset Redeemable Class A Preferred Shares Series 11, 12, 13 and 14 are entitled to annual cumulative dividends at rates of 5.08%, 4.64%, 6.35% and 4.62% of the stated capital of such shares, respectively, until March 30, 1999, October 30, 2000, September 30, 1999 and September 29, 2000, respectively, at which times the dividend rates will be reset. Thereafter, the dividend rates of the series 11, 12, 13 and 14 preferred shares may be reset from time to time pursuant to the terms and conditions of each series.

(b) The series 10 preferred shares are not redeemable prior to August 15, 2000. On or after August 15, 2000, the series 10 preferred shares are redeemable at $25 per share. The series 10 preferred shares are retractable at the option of the holders on August 15, 2000, at a price of $25 per share.

(c) The series 11, 12, 13 and 14 preferred shares are redeemable at $500,000 per share at any time. The series 11, 12, 13 and 14 preferred shares are not retractable at the option of the holders.

15. COMMON SHARES

Authorized

The articles of incorporation of Bell Canada provide for an unlimited number of common shares.

At December 31	1998		1997	
Outstanding	**Number of shares**	**Stated capital**	Number of shares	Stated capital
	293,952,001	**4,178**	293,952,001	4,178

All outstanding Bell Canada common shares are owned, directly or indirectly, by its parent company, BCE. During 1998, 209,662,568 shares (209,662,568 shares in 1997) were issued to BCE and the same number of shares were acquired for cancellation.

The premium on share capital represents the consideration received in excess of the then par value of common shares issued before Bell Canada was continued under the Canada Business Corporations Act on April 21, 1982. In 1998, Bell Canada reclassified an amount of $23 million ($644 million in 1997) related to the premium paid on share capital to retained earnings.

16. PENSIONS

Bell Canada operates non-contributory defined benefit plans that provide for pensions for substantially all its employees based on length of service and rate of pay. Plan assets are represented primarily by Canadian and foreign equities, government and corporate bonds, debentures, secured mortgages and real estate. The pension credit and the projected plan benefits are based on management's best estimates including long-term rate of return on the pension asset portfolio and long-term salary escalation rates. Variances between such estimates and actual experience, which may be material, are amortized over the average remaining service lives of the employees.

Bell Canada bears the risk of experience loss and credit risk associated with the plan asset portfolio. Maximum credit risk is equal to the fair value of the plan assets. This risk is managed by placing plan assets in trust and through the pension plan investment policy, which defines the funds' allowable investments.

Bell Canada has no intention of settling its projected plan benefits in the near term. The fair value of the projected plan benefits on a settlement basis is not provided, as it is not practical to do so.

The following table sets forth the consolidated financial position of the pension plans and Bell Canada's net pension asset.

At December 31	**1998**	1997
Plan assets at market value	**10,090**	10,301
Actuarially projected plan benefits:		
Accumulated plan benefits	**6,143**	6,233
Effect of salary projections	**602**	701
Projected plan benefits	**6,745**	6,934
Plan assets in excess of projected plan benefits	**3,345**	3,367
Less: unrecognized items		
Unrecognized net experience gains	**(2,108)**	(2,512)
Unrecognized prior period costs	**92**	105
Unrecognized net assets existing at January 1, 1987	**(44)**	(50)
Net pension asset reflected on the consolidated balance sheet	**1,285**	910
Prepaid pension costs, included in Deferred charges and other assets (Note 10)	**1,337**	953
Pension obligations, included in Other long-term liabilities	**(52)**	(43)
Net pension asset	**1,285**	910
Total pension credit for the year	**(317)**	(314)

The unamortized balance of pension credits related to the business transformation and workforce reduction program was written-off and included in the extraordinary item (see Note 3). In addition, included in the restructuring charges (see Note 4) are pension credits associated with employee severance.

17. RELATED PARTY TRANSACTIONS

During the year, Bell Canada purchased equipment and related supplies from Northern Telecom Limited (Nortel Networks) totalling $781 million ($704 million in 1997), incurred $144 million ($186 million in 1997) for services from Stentor Resource Centre Inc. (SRCI) and earned $12 million ($29 million in 1997) in revenues from SRCI. Bell Canada also purchased equipment and related services from CGI amounting to $283 million in 1998. Bell Canada also entered into research and development arrangements with Nortel Networks. Nortel Networks is an associated company of BCE, the parent company of Bell Canada.

18. COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

The future minimum lease payments under capital leases net of estimated executory costs and imputed interest, as at December 31, 1998, were $21 million. At December 31, 1998, the future minimum lease payments under operating leases with initial non-cancellable lease terms in excess of one year were $119 million in 1999, $116 million in 2000, $114 million in 2001, $93 million in 2002, $84 million in 2003 and $594 million thereafter. Rental expense applicable to operating leases for the year 1998 was $235 million ($128 million in 1997).

Uncertainty due to the year 2000 issue (Year 2000 readiness disclosure)

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. While Bell Canada is addressing the issue, 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.

Litigation

In the normal course of operations, Bell Canada becomes involved in various claims and legal proceedings. While the final outcome with respect to claims and legal proceedings pending at December 31, 1998, cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on Bell Canada's financial position or results of operations.

19. RECONCILIATION OF EARNINGS REPORTED IN ACCORDANCE WITH CANADIAN GAAP WITH UNITED STATES GAAP

The accompanying financial statements have been prepared in accordance with Canadian GAAP. The material differences between Canadian and United States GAAP affecting the consolidated financial statements of Bell Canada are reconciled in the table below.

The cumulative effect of differences between Canadian and United States GAAP is to reduce retained earnings by $506 million as at December 31, 1998 and $405 million as at December 31, 1997. Comprehensive earnings (loss) for the years ended December 31, 1998 and 1997 was $698 million and ($1,919) million, respectively.

	1998	1997
Net earnings (loss) applicable to common shares – Canadian GAAP	**799**	(1,873)
Adjustments		
Foreign exchange [(a)]	**(20)**	(16)
Pension credit [(b)]	**(13)**	20
Postretirement benefit costs [(c)]	**(40)**	(40)
Postemployment benefit costs [(d)]	**(19)**	(10)
Other	**(9)**	–
Net earnings (loss) applicable to common shares – U.S. GAAP	**698**	(1,919)

(a) The difference arises from the method of accounting for unrealized foreign currency gains and losses on long-term debt under Canadian GAAP as opposed to under Financial Accounting Standards Board (FASB) Statement No. 52 – Foreign Currency Translation. The cumulative effect of this difference is to reduce retained earnings as reported under Canadian GAAP by $115 million.

(b) The difference arises from variations in methodology for calculating pension expense, curtailments and settlements under Canadian GAAP as opposed to under FASB Statement No. 87 – "Employers' Accounting for Pensions" and FASB Statement No. 88 – "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits". The cumulative effect of this difference is to reduce retained earnings as reported under Canadian GAAP by $14 million.

(c) Under FASB Statement No. 106 – "Employers' Accounting for Postretirement Benefits Other Than Pensions", the expected cost of health care and other postretirement benefits are accrued during the years employees provide service to the employer. In the absence of a similar Canadian standard, these costs are charged to income when paid. The cumulative effect of this difference is to reduce retained earnings as reported under Canadian GAAP by $253 million.

(d) Under FASB Statement No. 112 – "Employers' Accounting for Postemployment Benefits", the estimated costs of benefits to former or inactive employees after employment but before retirement are accrued over applicable employee service periods or using a terminal accrual approach. In the absence of a similar Canadian standard, these costs are charged to income when paid. The cumulative effect of this difference is to reduce retained earnings as reported under Canadian GAAP by $115 million.

20. SUBSEQUENT EVENT

Strategic alliance with Manitoba Telecom Services Inc. (MTS)

On January 27, 1999, Bell Canada announced a strategic alliance with MTS that will make the two companies partners in the Manitoba, Alberta and British Columbia telecommunications markets. As part of its agreement with MTS, Bell Canada invested $336 million to acquire from treasury 6.2 million common shares of MTS and 7.8 million preferred shares of MTS which, upon successful completion of the MTS issuer bid for 14 million common shares, will give Bell Canada 20% of the issued and outstanding shares of MTS. In addition, Bell Canada and MTS will found a new telecommunications company to offer local access, long distance and data and integrated services and distribute BCE Nexxia Inc. broadband/IP services to large national business customers who require regional coverage in Alberta and British Columbia. The new company will be owned two thirds by MTS and one third by Bell Canada.

directors*

Ralph MacKenzie Barford
Toronto, Ontario
President of Valleydene Corporation Limited.
Director since March 1996 and member of the Management Resources and Nominating Committee.
Director of BCE Inc. and Northern Telecom Limited.

Jacques Bougie, O.C.
Outremont, Québec
President and Chief Executive Officer of Alcan Aluminium Limited.
Director since May 1992, Chairman of the Pension Fund Policy Committee, and member of the Management Resources and Nominating Committee.

Richard James Currie, C.M.
Toronto, Ontario
President and Director of George Weston Limited.
Director since May 1998 and member of the Management Resources and Nominating Committee.
Director of BCE Inc. and Northern Telecom Limited.

Geno Frederick Francolini, F.C.A.
London, Ontario
President and Chief Executive Officer of Xenon Capital Corporation.
Director since January 1986 and member of the Social and Environmental Affairs Committee.

Jeannine Guillevin Wood, O.C.
Montréal, Québec
Chairman of the Board of Laurentian Bank of Canada.
Director since February 1997 and member of the Audit Committee and the Pension Fund Policy Committee.
Director of BCE Inc.

Thomas Edward Kierans
Toronto, Ontario
President and Chief Executive Officer of C.D. Howe Institute.
Director since May 1998 and member of the Audit Committee.

John Anthony MacDonald
Manotick, Ontario
President and Chief Operating Officer of Bell Canada.
Director since February 1998 and member of the Social and Environmental Affairs Committee.
Director of Bruncor Inc., CGI Group Inc. and NBTel Inc.

Jean Claude Monty, C.M.
Montréal, Québec
Chairman and Chief Executive Officer of Bell Canada.
President and Chief Executive Officer of BCE Inc.
Director since October 1997.
Chairman of the Board of Bell Satellite Services Inc. and director of BCE Inc., BCE Mobile Communications Inc., Bell Canada International Inc., CGI Group Inc., Northern Telecom Limited, Teleglobe Inc. and Telesat Canada.

James Edward Newall, O.C.
Calgary, Alberta
Chairman, Newall and Associates.
Director since May 1998 and Chairman of the Audit Committee.
Director of BCE Inc. and Bell Canada International Inc.

Gordon Francis Osbaldeston, P.C., O.C.
London, Ontario
Professor Emeritus of Richard Ivey School of Business.
Director since October 1988 and member of the Social and Environmental Affairs Committee.

John Harry Panabaker, C.M.
Waterloo, Ontario
Company director.
Director since May 1986, Chairman of the Management Resources and Nominating Committee and member of the Pension Fund Policy Committee.
Director of BCE Mobile Communications Inc.

Charles Wesley Moore Scott
Toronto, Ontario
Vice-Chairman of Bell Canada.
Director since January 1999.

Paul Mathias Tellier, P.C., C.C., Q.C.
Westmount, Québec
President and Chief Executive Officer of Canadian National Railway Company.
Director since March 1996, Chairman of the Social and Environmental Affairs Committee and member of the Audit Committee.

Paul-Gaston Tremblay, C.M., C.A.
Chicoutimi, Québec
President of Primo-Gestion Inc.
Director since August 1983, member of the Audit Committee and the Pension Fund Policy Committee.

Lynton Ronald Wilson, O.C.
Oakville, Ontario
Chairman of the Board of BCE Inc.
Director since November 1990 and member of the Management Resources and Nominating Committee.
Director of Bell Canada International Inc. and Northern Telecom Limited.

* As of February 22, 1999

officers*

Jean C. Monty
Chairman and
Chief Executive Officer

John A. MacDonald
President and Chief Operating Officer

William D. Anderson
Chief Financial Officer

Richard D. Barnes
Senior Vice-President –
Operations & Financial Management

Pierre J. Blouin
Senior Vice-President –
Sourcing & Logistics

Charles A. Childers
Senior Vice-President – Sales

Martine Corriveau-Gougeon
Senior Vice-President –
Operations Process

Bernard A. Courtois
Chief Regulatory Officer

David R. Cox
Chief Information Officer

Gary M. Davis
Vice-President
and Corporate Controller

Rudi Engel
Senior Vice-President –
Business Markets & Sales

Josef J. Fridman
Chief Legal Officer

Josée Goulet
Senior Vice-President –
Consumer Markets & Sales, Ontario

Terence J. Jarman
President and CEO
Bell Nexxia

Sylvie Lalande
Senior Vice-President –
Consumer Markets & Sales
& Marketing Communications

Pierre N. Lessard
Vice-President and Treasurer

Guy Marier
President – Bell Québec

R. Terrance Mosey
Senior Vice-President –
Product Portfolio Management

Peter J.M. Nicholson
Chief Strategy Officer

Barry W. Pickford
Vice-President – Taxation

Shaun W. Purdue
Senior Vice-President –
Product Development

Marc J. Ryan
Vice-President,
Associate General Counsel
& Corporate Secretary

C. Wesley M. Scott
Vice-Chairman

Peter M. Sharpe
Chief Human Resources
& Administration Officer

Pierre Shedleur
Senior Vice-President –
Québec Public Sector Markets & Sales

John W. Sheridan
President – Bell Ontario

David A. Southwell
Chief Technology Officer

* As of February 22, 1999

committees of the board

AUDIT COMMITTEE
J.E. Newall – *chairman*
J. Guillevin Wood
T.E. Kierans
P.M. Tellier
P.-G. Tremblay

PENSION FUND POLICY COMMITTEE
J. Bougie – *chairman*
J. Guillevin Wood
J.H. Panabaker
P.-G. Tremblay

MANAGEMENT RESOURCES AND NOMINATING COMMITTEE
J.H. Panabaker – *chairman*
R. M. Barford
J. Bougie
R.J. Currie
L.R. Wilson

SOCIAL AND ENVIRONMENTAL AFFAIRS COMMITTEE
P.M. Tellier – *chairman*
G. F. Francolini
J.A. MacDonald
G.F. Osbaldeston

selected consolidated financial and other data

unaudited	1998	1997	1996	1995	1994	1993
Selected consolidated financial data ($ millions)						
Total operating revenues	**10,561**	10,490[1]	8,700	8,183	8,066	7,957
Net operating revenues	**2,193**	2,325	2,066	1,801	2,058	2,164
Net earnings before extraordinary item	**832**	888	754	543	765	843
Net earnings applicable to common shares before extraordinary item	**799**	852	714	502	722	796
Extraordinary item (net of tax)	**–**	(2,725)	–	–	–	–
Net earnings (loss) applicable to common shares	**799**	(1,873)	714	502	722	796
Dividends on common shares	**822**	822	821	821	821	812
EBITDA	**4,714**	4,624	4,166	3,721	3,992	3,790
Free cash flow	**923**	438	204	(44)	(136)	(293)
Total assets	**14,520**	14,688	19,055	19,012	19,055	19,032
Long-term debt (including current portion)	**5,564**	6,103	6,323	6,650	6,349	6,118
Retractable preferred shares	**100**	100	100	250	375	375
Perpetual preferred shares	**630**	630	630	630	610	585
Common shareholders' equity	**4,545**	4,568	7,263	7,380	7,703	7,803
Net capital expenditures	**1,947**	1,668	1,621	1,500	1,640	2,138
Financial ratios						
Per cent return on average common equity[2]	**17.7**	11.7	9.8	6.7	9.3	10.4
Per cent return on average total capital[2]	**11.5**	10.1	9.3	8.0	9.2	9.9
Interest coverage ratio[2]	**3.90**	3.80	3.13	2.63	3.02	3.22
Interest coverage[2][3]	**6.4**	6.1	5.2	4.6	5.0	4.9
Net operating cash flow as a per cent of net capital expenditures[2][4]	**112**	133	117	105	107	80
Net operating cash flow as a per cent of average total debt[2][4]	**35**	33	27	22	25	25
Debt as a per cent of total capital	**52.8**	55.6	46.1	46.7	45.8	45.0
Other statistics						
Network access services (thousands)	**10,950**	10,607	10,266	10,001	9,727	9,462
Conversation minutes (millions)	**10,451**	9,935	10,101	9,933	9,962	9,828
Number of employees	**38,049**	39,328	44,895	48,333	51,503	50,982
Salaries and wages (excl. workforce reduction costs)	**2,038**	2,223	2,365	2,437	2,360	2,481

quarterly financial data

unaudited	4th Quarter		3rd Quarter		2nd Quarter		1st Quarter	
($ millions)	1998	1997	1998	1997	1998	1997	1998	1997
Total operating revenues	**2,765**	2,748[1]	**2,623**	2,641[1]	**2,596**	2,570[1]	**2,577**	2,531[1]
Net operating revenues	**771**	659	**712**	608	**30**	531	**680**	527
Net earnings (loss) before extraordinary item	**330**	258	**341**	240	**(121)**	193	**282**	197
Extraordinary item (net of tax)	**–**	(2,725)	**–**	–	**–**	–	**–**	–
Net earnings (loss) applicable to common shares	**322**	(2,475)	**333**	230	**(130)**	184	**274**	188
EBITDA	**1,254**	1,238	**1,193**	1,192	**1,109**	1,077	**1,158**	1,117
Free cash flow	**190**	364	**132**	210	**174**	34	**427**	(170)

(1) Reclassified (see notes to consolidated financial statements, Note 2)

(2) Excludes impact of extraordinary item

(3) Operating cash flow plus interest charges divided by interest charges

(4) Net operating cash flow = operating cash flow minus dividends