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Telephone Utilities, Inc. 1978  
Annual  
Report

file:

Pacific  
Telecom, Inc

***“Measured by any standard, 1978  
was a fine year for the Company.”***

## Highlights

		1978	1977	Percent Change
<b>The Shareholder</b>	Net income applicable to common stock	<b>\$ 7,787,386</b>	\$ 5,775,102	35%
	Average shares outstanding . . . . .	<b>4,724,202</b>	4,727,985	—
	Net income per common share . . . . .	<b>\$1.65</b>	\$1.22	35
	Total shareholders' equity . . . . .	<b>\$ 58,313,379</b>	\$ 53,133,641	10
	Dividends paid per common share . . . .	<b>\$ .54</b>	\$ .33	64
<b>The Company</b>	Operating revenues . . . . .	<b>\$ 44,698,124</b>	\$ 37,155,363	20
	Working capital from operations . . . . .	<b>\$ 17,369,738</b>	\$ 14,725,091	18
	Telephone plant in service, end of year .	<b>\$132,867,279</b>	\$121,067,841	10
	Telephones, end of year . . . . .	<b>170,719</b>	155,192	10
<b>The Employee</b>	Total employees, end of year . . . . .	<b>735</b>	659	12
	Total wages paid . . . . .	<b>\$ 11,728,783</b>	\$ 9,657,461	21

## To Our Shareholders

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**M**easured by any standard, 1978 was a fine year for the Company.

- *Net income increased 35% to \$1.65 per share from \$1.22 in the preceding year.*
- *Dividends paid per common share during 1978 increased 64% to \$.54 per share from \$.33 in the prior year.*
- *Revenues reached \$44,698,000, an increase of 20%.*
- *Telephones served totaled 170,719 by year end, an increase of 10% or 15,527 telephones, all from internal growth.*
- *Long distance telephone calls increased by 19%.*

These results represent our sixth consecutive year of unbroken growth, a period during which our earnings per common share have grown from \$.70 in 1973 to \$1.65 in 1978. That earnings per share increase represents a compound growth rate of 19%.

The value of our diversified service territory was evident in our internal growth patterns of 1978. During 1978 the growth rate in Montana declined and the Eastern Washington Division growth rate remained relatively stable, but the growth rates accelerated in both the Western Washington and Oregon Divisions. Our overall growth rate of 10% matched 1977 and is approximately twice the national average for the telephone industry.

Equally important to the internal growth rate in stations served, is the growth in toll usage. Our customers originated 12% more toll messages per customer in 1978 than 1977. This fact, plus the growth in the number of customers, produced a 19% increase in originating toll messages for the year.

Our June 1977 request for rate relief in Montana was favorably considered by the Montana Public Service Commission, and an order was issued April 4, 1978, providing \$1,008,000 of needed revenue or approximately 85% of the amount requested.

Our internal growth in customers served, toll usage, and the rate increase allowed in Montana were the principal reasons the Company achieved a 20% increase in operating revenues.

Telephone plant construction requirements necessary to meet the growth levels described above continue to place pressure on our organization, specifically our planning and construction processes. During 1978 our gross construction expenditures (including reuse of equipment and cost of removal) were \$17,650,000 or \$1,150,000 more than our original budget of \$16,500,000. This construction requirement was accomplished with internally generated and available funds. This was the fifth consecutive year in which outside borrowing was not required to fund the construction effort.

Construction plans for 1979 are very extensive, totaling approximately \$30,100,000. Although a portion of our construction program is contingent on approval of a Rural Electrification Administration (REA) loan to upgrade and rebuild facilities in our Eastern Oregon property, most of the funds are needed to meet new customer growth and increased calling volumes. We will fund our 1979 construction program predominately from internal sources and, to a lesser extent, from short-term borrowings and REA loans.

The first two of five digital electronic central office switches planned for completion in 1979

have already been placed in service and are meeting our performance expectations. Our preliminary planning for the next several years places a high priority on replacing electromechanical central offices with digital central offices in high growth areas. This equipment requires less building space, is readily expandable to meet future growth and permits us to offer marketable new features such as touch calling, speed calling, call forwarding, and call waiting.

The Board of Directors established the current annual dividend rate of \$.60 per share on April 24, 1978, up from the prior rate of \$.36 per share. The dividend rate will be reviewed again at the April, 1979 meeting of the Board of Directors.

1978 was certainly a banner year for our Company and prospects for 1979 appear very good. We look forward to continued growth in service together with improvement in earnings.



A.M. Gleason  
President



**Telephone Utilities, Inc.**  
SUMMARY OF OPERATIONS

Years ended December 31,	1978	1977	1976	1975	1974
Operating revenues .....	<b>\$44,698,124</b>	\$37,155,363	\$32,247,865	\$28,835,866	\$25,621,214
Operating expenses, other than federal income taxes .....	<b>27,168,676</b>	22,978,085	20,102,880	17,869,546	15,434,263
Federal income taxes .....	<b>6,955,750</b>	5,523,649	4,597,000	4,089,000	3,640,000
Total operating expenses .....	<b>34,124,426</b>	28,501,734	24,699,880	21,958,546	19,074,263
Operating income .....	<b>10,573,698</b>	8,653,629	7,547,985	6,877,320	6,546,951
Other income .....	<b>252,961</b>	290,597	510,001	725,347	743,961
Interest expense .....	<b>2,669,375</b>	2,742,470	2,932,483	2,985,781	3,188,204
Minority interest in net income and preferred stock dividends of subsidiaries .....	<b>43,967</b>	51,328	63,896	57,694	52,012
Income from telephone operations .....	<b>8,113,317</b>	6,150,428	5,061,607	4,559,192	4,050,696
Parent operations—interest and expenses—net .....	<b>295,759</b>	344,853	270,661	348,527	318,684
Net income .....	<b>7,817,558</b>	5,805,575	4,790,946	4,210,665	3,732,012
Preferred stock dividends .....	<b>30,172</b>	30,473	30,473	30,473	30,473
Net income applicable to common stock .....	<b>\$ 7,787,386</b>	\$ 5,775,102	\$ 4,760,473	\$ 4,180,192	\$ 3,701,539
Average number of common shares outstanding .....	<b>4,724,202</b>	4,727,985	4,724,487	4,728,079	4,728,079
Net income per common share .....	<b>\$1.65</b>	\$1.22	\$1.01	\$ .88	\$ .78



## Management's Discussion and Analysis of the Summary of Operations

The summary of operations includes the operations of Telephone Utilities, Inc. (TU) and its subsidiaries (Company).

Net income and net income per common share both increased by 35% in 1978 as compared to a 21% increase in 1977.

Operating revenues increased by 20% in 1978 after an increase of 15% in 1977. Local service revenue increases of 20% in 1978 and 14% in 1977 occurred primarily as a result of internal growth in the number of customers. In 1978 the Company also benefited from a rate increase applicable to its Montana operating properties; the increase which was effective in April 1978, provided an annual local service revenue increase in excess of \$1,000,000.

Toll service revenues increased by 23% in 1978 and 17% in 1977. The majority of TU's subsidiaries use the cost basis of settling toll revenues. Under the cost basis, the operating subsidiary's toll revenue is equal to the expenses associated with providing toll service plus a return on the investment in plant used to provide toll service. The Company's increased toll revenues in both 1978

and 1977 resulted primarily from increased usage by our customers while increased usage of both the state and the nationwide toll networks by all customers has resulted in an improved return on the investment in toll facilities.

Maintenance, traffic, commercial, administrative, and other operating expenses increased by 23% in 1978 after a 14% increase in 1977. These increases are due primarily to the increased telephone plant and telephones in service, and increases in wages and other costs. Depreciation expense increased in both 1978 and 1977 primarily as a result of increased plant in service. Taxes, other than federal income taxes, increased by 20% in 1978 after a 22% increase in 1977. These increases resulted from increased investment in plant, increased wages and wage-related tax rates, and increased revenue and income. A significant portion of these increased operating expenses is included as cost of providing toll service and recovered as revenue through the toll settlement process.

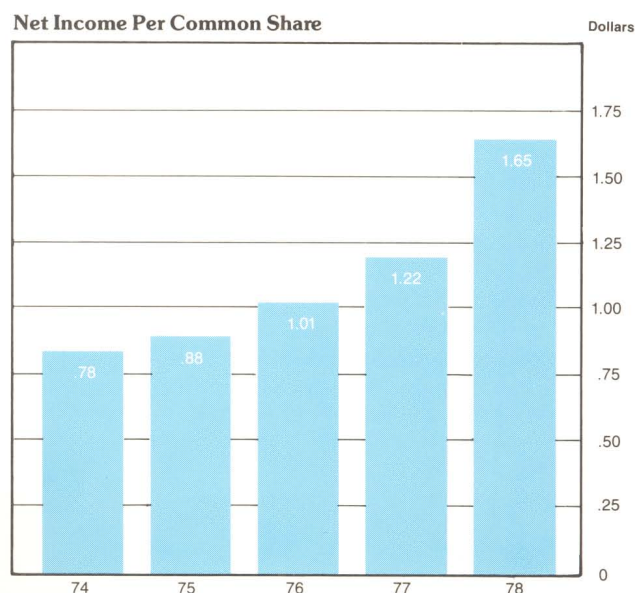
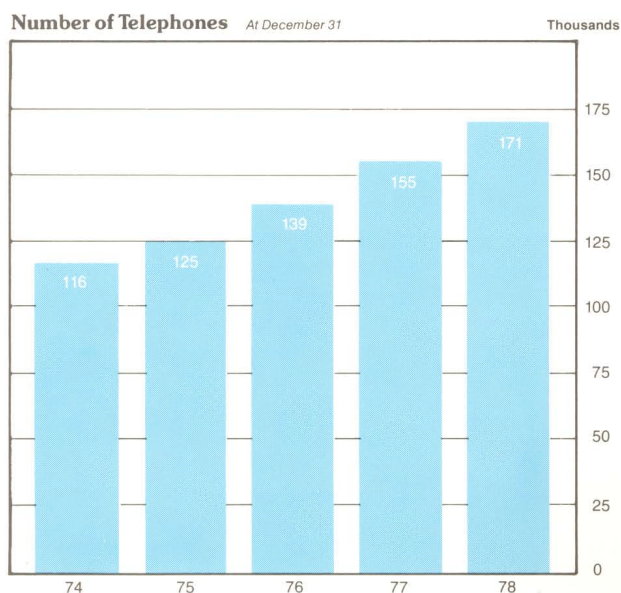
Federal income tax expense increased by 26% in 1978 and 20% in 1977 primarily as a result of increased

taxable income.

Other income declined by 13% in 1978 after a decrease of 43% in 1977. These decreases resulted primarily from a decrease in the average amounts of excess cash invested by the subsidiaries with TU under the intercompany short-term investment program.

Interest expense declined by 3% in 1978 and 6% in 1977 as the subsidiary companies made debt principal payments at due dates.

The parent operations reflect the interest income earned by TU's investment of excess cash, the interest and other expenses of TU, and the income tax effect of the parent operations. (See Note 5 of Notes to Consolidated Financial Statements.) The net effect of parent operations decreased by 14% in 1978 after a 27% increase in 1977. These changes occurred as a result of changes in the level of funds invested as temporary cash investments between TU and subsidiaries, the level of temporary cash investments by TU with its majority shareholder and as a result of TU issuing additional long-term debt during late 1976 and 1977.





## The Company

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Telephone Utilities, Inc. is a telephone holding company whose subsidiary operating companies serve 170,719 telephones located principally in Washington, Montana and Oregon and to a lesser extent in Idaho, Nevada and California. Included in our wide geographic area are suburbs of both Seattle and Portland, rapidly developing resort communities, diversified agricultural areas and areas which include integrated forest product manufacturers as well as light industrial activities covering a wide spectrum. All of the operating companies are subject to the jurisdiction of regulatory agencies in the states in which they operate. In addition to conventional telephone service, a subsidiary operates, under a contract with the Federal government, an Automatic Voice Network (Auto-

von) switching center located in North Bend, Washington.

TU Service Company, with warehouse facilities in Portland, Oregon, provides centralized purchasing and storage of material to support the company's operating properties throughout its multi-state operation.

In prior years' reports we stated that an active program was underway to consolidate our subsidiaries into larger units. During 1978 significant progress was made toward this goal. Five subsidiary companies located east of the Cascade Range in Oregon were merged into Telephone Utilities of Eastern Oregon, Inc. This company, together with our Idaho-Nevada subsidiary, serves relatively sparsely populated areas and will seek low cost financing from the REA to fund a sub-

stantial service improvement program.

In addition, two other consolidations were completed in Oregon reducing the number of operating subsidiaries in Oregon from eleven to five. On December 27, 1978, the Company received approval from the Washington Utilities and Transportation Commission to merge the fourteen operating subsidiaries of the Company in Washington into a single subsidiary, effective as of January 1, 1979. The operating economies achieved by these mergers should tend to minimize increases in operating costs which might otherwise occur. In addition, these consolidations will provide a broader investment base on which to finance future service improvements to the benefit of both our customers and shareholders.

## Construction and Service Improvements

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Gross construction expenditures (including reuse of equipment and cost of removal) for 1978 totaled \$17,650,000 or \$1,150,000 over our original budget for the year. These additional expenditures were required to meet the demands of new customers, prepare for 1979 growth, and to fund service improvement programs for our existing customers.

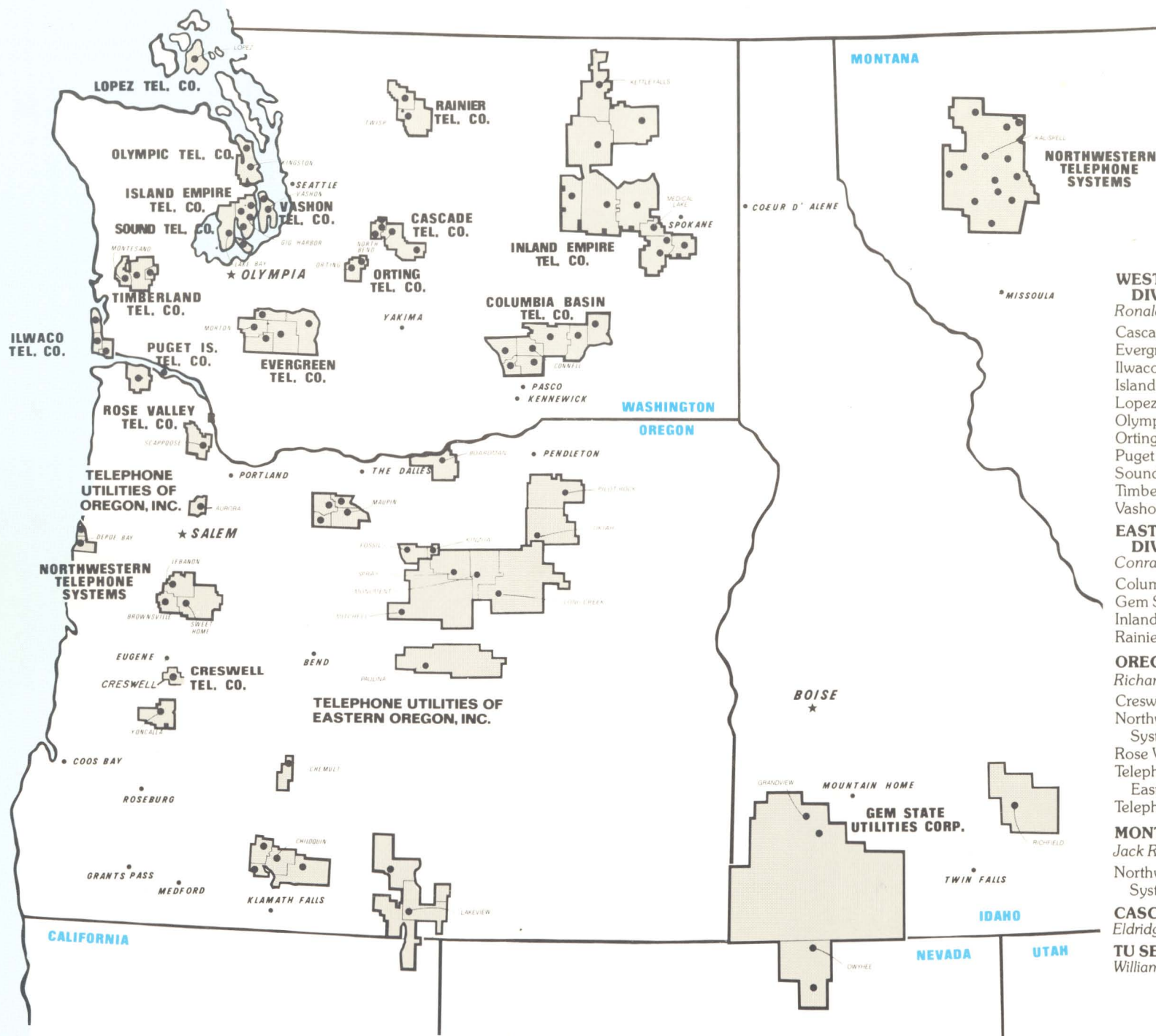
As a result of continuing high activity levels and the need to rebuild major parts of certain REA financed properties, a construction budget of approximately \$30,100,000 is planned for 1979. Included in this program is a significant start on a central office modernization program. A total of five electromechanical central offices will

be replaced in whole or in part by digital electronic switching systems in the current year. Through February, 1979 two of these five offices (Elma, Washington and Boardman, Oregon) were in service and performing at high levels. Switches serving Lebanon, Oregon; Kingston, Washington; and Montesano, Washington are scheduled to be cut into service later this year. These high technology digital electronic switching systems provide sophisticated calling features, are readily expandable, are low in maintenance, and require less building space. In addition, significant cost savings in outside plant facilities can be achieved by replacing small electromechanical central offices with remote switching

units applying electronic transmission techniques.

Service demands requiring plant construction continue to tax our ability to keep current. Presently it is very difficult to secure sufficient engineering manpower and construction contractors to meet demand. We are aggressively recruiting the necessary manpower and resources to maintain appropriate levels of service and to meet expanding customer requests.

We will generate a major portion of our construction funds internally. However, some outside borrowing will occur in 1979.



Operating Companies and Service Area



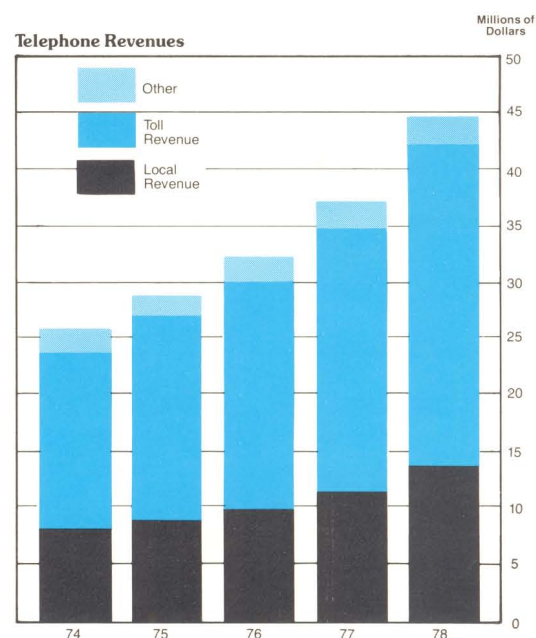
## Revenue and Rate Activities

An application to increase local telephone rates by \$1,188,000 was filed with the Montana Public Service Commission in 1977. After extensive hearings early in 1978, the Company received an order effective April 4, 1978, granting an increase of \$1,008,000 or approximately 85% of the amount requested. On May 5, 1978, the Montana Consumer Counsel filed a petition for review in State District Court seeking reduction of the rate increase. This matter has been heard by the court, and a decision is expected during the second quarter of 1979. The Company is optimistic that the order of the Montana Public Service Commission will be upheld by the court.

Reflecting the strong economic health of our growing service area, the Company experienced a 19% increase

in originating toll messages during 1978, up from the above-average increases of 17% in 1977 and 13% in 1976. This rate of growth continues to exceed our main station growth (number of customers) even though our main station growth continues at exceptionally high levels.

This internal growth in toll usage and customers served provided significant revenue increases. These increases, along with increased local rates and improved returns on toll investment, are reflected in a very fine revenue year as shown in the accompanying financials.



## Employees and Labor Relations

The Company provided full-time employment to 735 people at December 31, 1978 compared with 659 at the prior year end. This increase in employees has been necessary to meet our rapid growth in customers and our expanding construction program. Approximately 60 percent of our employees are covered by five different bargaining units, four of which are represented by either the International Brotherhood of Electrical Workers or the Communication Workers of America, both AFL-CIO affiliates. All of these contracts are multi-year

agreements with Cost of Living and productivity factors to be reflected in wage adjustments on the contract anniversaries. These wage increase factors closely parallel those of the major companies in our industry, thereby allowing us to attract competent telephone personnel.

During the year two important management changes were made. James P. Best joined the Company as Controller. Mr. Best is a CPA with extensive experience in both public accounting and telephone utility management. Bruce B. Stevenson joined

the Company as Central Office Services Manager. Mr. Stevenson has had management experience in the telephone industry and was employed as product manager for one of the major telephone industry suppliers.

Our work force projections for 1979 reflect a continued need to increase the labor force to keep abreast of our internal growth and expand our marketing effort to effectively meet competition brought about by the deregulation of the terminal equipment market.

**Telephone Utilities, Inc.****CONSOLIDATED STATEMENTS OF INCOME**

Years ended December 31, 1978 and 1977

**1978****1977**

## Operating revenues:

Local service .....	<b>\$13,346,499</b>	\$11,103,060
Toll service .....	<b>28,782,295</b>	23,405,313
Government communication service .....	<b>915,202</b>	1,261,320
Miscellaneous .....	<b>1,654,128</b>	1,385,670
Total operating revenues .....	<b>44,698,124</b>	37,155,363

## Operating expenses:

Maintenance .....	<b>8,440,743</b>	6,585,106
Depreciation (Note 1) .....	<b>6,966,763</b>	6,464,120
Traffic .....	<b>880,882</b>	801,808
Commercial, administrative and other .....	<b>7,012,283</b>	5,906,811
Taxes, other than federal income taxes .....	<b>3,868,005</b>	3,220,240
Federal income taxes (Notes 1 and 6) .....	<b>4,541,250</b>	3,280,749
Deferred federal income taxes (Notes 1 and 6) .....	<b>1,403,000</b>	1,241,000
Deferred investment tax credit, net (Notes 1 and 6) .....	<b>1,011,500</b>	1,001,900
Total operating expenses .....	<b>34,124,426</b>	28,501,734

Operating income .....	<b>10,573,698</b>	8,653,629
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## Other income:

Allowance for funds used during construction (Note 1) .....	<b>232,673</b>	226,903
Other, including interest income .....	<b>20,288</b>	63,694
	<b>252,961</b>	290,597

Interest expense—principally on long-term debt .....	<b>2,669,375</b>	2,742,470
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## Minority interest in net income and preferred stock

dividends of subsidiaries .....	<b>43,967</b>	51,328
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Income from telephone operations .....	<b>8,113,317</b>	6,150,428
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Parent operations—interest, expenses and taxes, net (Note 5) .....	<b>295,759</b>	344,853
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Net income .....	<b>7,817,558</b>	5,805,575
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Preferred stock dividends .....	<b>30,172</b>	30,473
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Net income applicable to common stock .....	<b>\$ 7,787,386</b>	\$ 5,775,102
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Net income per common share (Note 1) .....	<b>\$1.65</b>	\$1.22
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*See accompanying notes.*



**Telephone Utilities, Inc.**  
**CONSOLIDATED BALANCE SHEETS**

December 31, 1978 and 1977	1978	1977
<b>Assets</b>		
Telephone plant:		
Telephone plant in service (Notes 1 and 3) . . . . .	<b>\$132,867,279</b>	\$121,067,841
Less accumulated depreciation . . . . .	<b>30,436,607</b>	26,076,880
	<b>102,430,672</b>	94,990,961
Construction work in progress . . . . .	<b>4,293,515</b>	2,212,301
Net telephone plant . . . . .	<b>106,724,187</b>	97,203,262
Cost of acquisitions in excess of equity in net assets of subsidiaries (Note 1) . . . . .	<b>10,815,745</b>	10,856,173
Current assets:		
Cash . . . . .	<b>110,098</b>	371,626
Temporary cash investments (Note 2) . . . . .	<b>2,520,846</b>	3,476,114
Accounts receivable . . . . .	<b>5,218,813</b>	4,457,478
Material and supplies (Note 1) . . . . .	<b>4,260,953</b>	2,092,977
Prepayments . . . . .	<b>212,311</b>	257,670
Total current assets . . . . .	<b>12,323,021</b>	10,655,865
Unamortized debt expense and other deferred charges . . . . .	<b>323,319</b>	351,805
	<b>\$130,186,272</b>	\$119,067,105

See accompanying notes.

	1978	1977
<b>Capitalization and Liabilities</b>		
Shareholders' equity:		
Common stock, authorized 12,000,000 shares of \$1 par value, 4,728,079 shares issued . . . . .	<b>\$ 4,728,079</b>	\$ 4,728,079
Preferred stock, 6% cumulative, authorized 152,000 shares of \$25 par value, 23,628 shares issued . . . . .	<b>590,700</b>	590,700
Capital in excess of par value . . . . .	<b>26,782,317</b>	26,782,317
Retained earnings (Note 3) . . . . .	<b>26,373,115</b>	21,136,745
	<b>58,474,211</b>	53,237,841
Less treasury stock (at cost) common stock—6,861 shares in 1978 and 2,250 shares in 1977; preferred stock — 3,513 shares in 1978 and 3,313 shares in 1977 . . . . .	<b>160,832</b>	104,200
Total shareholders' equity . . . . .	<b>58,313,379</b>	53,133,641
Minority interest in subsidiaries . . . . .	<b>232,313</b>	368,479
Long-term debt (Note 3) . . . . .	<b>41,660,653</b>	43,440,583
Current liabilities:		
Accounts payable . . . . .	<b>7,750,383</b>	6,456,165
Income taxes payable . . . . .	<b>4,048,876</b>	939,094
Accrued liabilities . . . . .	<b>1,868,210</b>	1,565,947
Advance billings . . . . .	<b>1,161,841</b>	997,026
Current maturities on long-term debt (Note 3) . . . . .	<b>1,841,164</b>	1,734,149
Total current liabilities . . . . .	<b>16,670,474</b>	11,692,381
Deferred income taxes (Notes 1 and 6) . . . . .	<b>7,590,372</b>	6,066,372
Deferred investment tax credit (Note 1) . . . . .	<b>4,847,012</b>	3,837,012
Other deferred credits . . . . .	<b>872,069</b>	528,637
	<b>\$130,186,272</b>	\$119,067,105

See accompanying notes.



**Telephone Utilities, Inc.****CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION**

Years ended December 31, 1978 and 1977

**1978****1977**

## Sources of working capital:

## From operations:

Net income .....	<b>\$ 7,817,558</b>	\$ 5,805,575
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## Items not requiring working capital:

Depreciation and amortization .....	<b>7,356,853</b>	6,874,519
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Allowance for funds used during construction .....	<b>(232,673)</b>	(226,903)
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Deferred income taxes and investment tax credit, net .....	<b>2,428,000</b>	2,271,900
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Total from operations .....	<b>17,369,738</b>	14,725,091
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Long-term debt issued and assumed in connection with purchase of subsidiaries .....	<b>—</b>	440,750
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Other—net .....	<b>258,987</b>	262,642
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Decrease in working capital .....	<b>3,310,937</b>	1,887,389
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	<b><u>\$20,939,662</u></b>	<u>\$17,315,872</u>
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## Applications of working capital:

## Property, plant and equipment:

Additions to telephone plant in service .....	<b>\$14,416,902</b>	\$13,032,154
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Net change in construction work in progress .....	<b>2,081,214</b>	(529,282)
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	<b>16,498,116</b>	12,502,872
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Allowance for funds used during construction .....	<b>(232,673)</b>	(226,903)
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	<b>16,265,443</b>	12,275,969
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Acquired in connection with purchase of subsidiaries .....	<b>—</b>	938,151
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	<b>16,265,443</b>	13,214,120
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Addition to cost of acquisitions in excess of equity in net assets of subsidiaries .....	<b>—</b>	375,880
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Reduction of long-term debt .....	<b>1,779,930</b>	2,206,274
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Cost of removal of plant and equipment .....	<b>313,101</b>	307,106
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Dividends .....	<b>2,581,188</b>	1,212,492
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	<b><u>\$20,939,662</u></b>	<u>\$17,315,872</u>
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## Decreases (Increases) in elements of working capital:

Cash and temporary cash investments .....	<b>\$ 1,216,796</b>	\$ 2,154,847
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Accounts receivable .....	<b>(761,335)</b>	(665,913)
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Material and supplies .....	<b>(2,167,976)</b>	(516,563)
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Other current assets .....	<b>45,359</b>	(55,785)
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Accounts payable .....	<b>1,294,218</b>	612,231
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Income taxes payable .....	<b>3,109,782</b>	231,446
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Current maturities on long-term debt .....	<b>107,015</b>	249,861
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Other current liabilities .....	<b>467,078</b>	(122,735)
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	<b><u>\$ 3,310,937</u></b>	<u>\$ 1,887,389</u>
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See accompanying notes.



**Telephone Utilities, Inc.****CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**

Years ended December 31, 1978 and 1977

**1978**

1977

Balance at beginning of year .....	<b>\$21,136,745</b>	\$16,543,662
Net income .....	<b>7,817,558</b>	5,805,575
	<b>28,954,303</b>	22,349,237
Deduct:		
Cash dividends:		
Common stock (1978—\$.54; 1977—\$.25 per share) .....	<b>2,551,016</b>	1,182,019
Preferred stock .....	<b>30,172</b>	30,473
	<b>2,581,188</b>	1,212,492
Balance at end of year (Note 3) .....	<b>\$26,373,115</b>	\$21,136,745

*See accompanying notes.*



# Telephone Utilities, Inc.

## Notes to Consolidated Financial Statements

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### 1. Summary of significant accounting policies

#### *(a) Basis of presentation*

The consolidated financial statements include the accounts of Telephone Utilities, Inc. (TU) and its subsidiaries (Company). All appropriate intercompany transactions have been eliminated.

In June 1977 TU purchased approximately 94% of the outstanding stock of Creswell Telephone Company for \$793,000. Operating results for that company from the date of purchase are included in the accompanying consolidated statements of income. Consolidated results of operations for the year ended December 31, 1977, would not be materially affected by the inclusion, on a pro forma basis, of the annual operating results of the purchased company.

#### *(b) Regulatory authorities*

The accounting policies of the Company are in conformity with the requirements and authorizations of the regulatory agencies of the various states in which the Company operates.

#### *(c) Telephone plant*

Telephone plant is stated at cost. Additions to telephone plant represent direct costs, indirect charges for engineering, supervision and similar overhead items, and an allowance for funds used during construction. Maintenance and repairs are charged to expense as incurred. Betterments and renewals of items considered to be identifiable items of property are charged to plant accounts. Accumulated depreciation is charged for ordinary retirements and the removal cost of assets retired and is credited for proceeds from sales and salvage.

Depreciation is provided using the straight-line method based primarily on the estimated service lives of the various classes of depreciable assets. The average composite depreciation rate for depreciable telephone plant was 5.9% in 1978 and 6.0% in 1977.

#### *(d) Cost of acquisitions in excess of equity in net assets of subsidiaries*

At December 31, 1978, TU's investment in subsidiaries includes \$10,815,745 of cost in excess of the carrying value of net assets of purchased subsidiaries. Of that amount, \$9,238,835 applies to acquisitions initiated prior to November 1, 1970; these costs are not being amortized since, in the opinion of management, there has been no diminution of its value. Such costs applicable to subsidiaries purchased subsequent to November 1, 1970, are being amortized over 40 years; unamortized amounts were \$1,576,910 and \$1,617,338 at December 31, 1978 and 1977, respectively.

#### *(e) Material and supplies*

Material and supplies are stated at average cost.

#### *(f) Pension plans*

Substantially all employees are covered under the pension plans of the Company. Pension costs were \$626,000 in 1978 and \$505,000 in 1977, including applicable provisions for unfunded past service costs. Current service cost is funded as the liability accrues. Past service costs are being amortized over a ten-year period. At January 1, 1978, the unfunded past service costs were approximately \$837,000.

#### *(g) Income taxes*

Deferred income taxes are provided for the income tax reductions resulting from both the additional depreciation deduction allowed by the ADR provision of the Revenue Act of 1971 and the current deductions for income tax purposes of the cost of removal of retired assets.

Investment tax credit of \$1,364,000 in 1978 and \$1,285,300 in 1977 has been deferred in the accompanying financial statements and is being amortized to income over the estimated service lives of the related assets.

#### *(h) Net income per common share*

Net income per common share is based on the weighted average number of common shares outstanding during each year.

### 2. Transactions with related parties

At December 31, 1978 and 1977, approximately 80% of TU's outstanding common stock was beneficially owned by Pacific Power & Light Company (Pacific). The following is a summary of transactions with Pacific:

#### *(a) Management services*

Pacific provides, at cost, certain management and other services to the Company under a management services agreement. Billings under this management services agreement totaled \$170,000 in 1978 and \$197,000 in 1977.

#### *(b) Temporary cash investments*

At December 31, 1978 and 1977, temporary cash investments included \$2,450,000 and \$3,300,000, respectively, of short-term advances to Pacific. These advances were made under an agreement providing for temporary cash investment at the prime commercial rate of interest.

#### *(c) Income taxes*

The Company will join with Pacific in filing a consolidated federal income tax return. The Company's federal income tax provision is based on its filing a separate consolidated federal income tax return.



### 3. Long-term debt

Long-term debt at December 31, 1978 and 1977, consisted of the following:

	1978	1977
2%-8% First Mortgage notes payable to Rural Electrification Administration and Rural Telephone Bank, maturities through 2009 .....	\$ 1,710,488	\$ 1,895,987
5%-10¼% First Mortgage notes and bonds, maturities through 1998 .....	16,820,368	18,307,831
7¾% Second Mortgage note, due 1980 .....	11,000,000	11,000,000
5¾%-9¾% Unsecured notes, maturities through 2007 .....	13,970,961	13,970,914
	<u>43,501,817</u>	<u>45,174,732</u>
Less current maturities	<u>1,841,164</u>	<u>1,734,149</u>
	<u>\$41,660,653</u>	<u>\$43,440,583</u>

Substantially all of the telephone plant in service is pledged as collateral under loan agreements related to long-term debt. Certain of the agreements contain provisions restricting the payment of cash dividends, and one loan agreement, in addition to restricting cash dividends, contains limitations on purchases or redemptions of TU's stock. Retained earnings of \$12,351,000 are not restricted at December 31, 1978.

Total long-term debt maturing annually within each of the four years after December 31, 1979 is as follows:

1980	\$12,713,000	1982	\$1,250,000
1981	\$ 1,694,000	1983	\$1,301,000

### 4. Stock Option Plan

Under the Employee Stock Option Plan, approved by shareholders in 1973, options to purchase 100,000 shares of common stock at fair market value at date of grant may be granted to certain key employees. At December 31, 1978, no options had been granted under the plan.

### 5. Parent operations

Parent operations of TU are summarized as follows:

	1978	1977
Interest income:		
From subsidiaries .....	\$ 34,442	\$ 6,505
From temporary cash investments (Note 2) .....	404,460	357,499
	<u>438,902</u>	<u>364,004</u>
Interest expense:		
To subsidiaries .....	18,100	42,186
Other—principally on long-term debt .....	876,647	876,730
	<u>894,747</u>	<u>918,916</u>
Federal income tax (credit):		
Federal income taxes .....	(266,000)	(325,000)
Deferred federal income taxes .....	15,000	25,000
Net deferred investment tax credit .....	(1,500)	4,000
	<u>(252,500)</u>	<u>(296,000)</u>
Other expense—net .....	92,414	85,941
	<u>\$295,759</u>	<u>\$344,853</u>

### 6. Income taxes

Deferred income taxes result from timing differences in the recognition of expense for tax and financial statement purposes. The tax effects of these differences on federal income taxes are as follows:

	1978	1977
Excess of tax over book depreciation ..	\$1,173,000	\$1,153,000
Cost of removal of retired assets deducted for tax purposes .....	245,000	113,000
	<u>\$1,418,000</u>	<u>\$1,266,000</u>

The Company's effective combined state and federal income tax rate was 47.9% in 1978 and 48.4% in 1977. The difference between this effective rate and the 48% federal income tax statutory rate is attributable to the following:

	1978	1977
Interest, taxes and pensions capitalized, net .....	(.8)%	(1.3)%
Amortization of investment tax credit .....	(2.3)	(2.5)
Other .....	3.0	4.2
	<u>(.1)%</u>	<u>.4%</u>



## 7. Commitments

Expenditures in connection with the Company's construction program will approximate \$30,100,000 in 1979.

Total rental expenses for 1978 and 1977 are as follows:

	1978	1977
Pole attachment rentals . . . . .	<b>\$378,000</b>	\$300,000
Other, including short-term rentals .	<b>170,000</b>	134,000
	<b><u>\$548,000</u></b>	<u>\$434,000</u>

Commitments under several minor long-term leases are not material to results of operations or financial position.

## 8. Asset replacement cost

The impact of the inflation experienced in recent years has resulted in replacement costs (unaudited) of telephone plant that are significantly greater than the historical costs of such assets reported in the accompanying consolidated financial statements. The Company's ability to maintain its investment in telephone plant in the future will be contingent upon its ability to finance the needed additions. This, in turn, will depend primarily on the Company's ability to obtain adequate and timely rate relief.

The Company's annual report to the Securities and Exchange Commission on Form 10-K contains additional information with respect to estimated asset replacement cost at December 31, 1978 and 1977.

## 9. Quarterly financial data

Summarized quarterly financial data (unaudited) for 1978 and 1977 is as follows:

	Three Months ended			
	March 31 1978	June 30 1978	Sept. 30 1978	Dec. 31 1978
Operating revenues .	<u>\$10,134,356</u>	<u>\$11,009,452</u>	<u>\$11,168,893</u>	<u>\$12,385,423</u>
Operating income . . .	<u>\$ 2,304,650</u>	<u>\$ 2,574,522</u>	<u>\$ 2,667,748</u>	<u>\$ 3,026,778</u>
Net income	<u>\$ 1,586,577</u>	<u>\$ 1,849,261</u>	<u>\$ 1,977,441</u>	<u>\$ 2,404,279</u>
Net income per common share . . . . .	<u>\$.33</u>	<u>\$.39</u>	<u>\$.42</u>	<u>\$.51</u>

	Three Months ended			
	March 31 1977	June 30 1977	Sept. 30 1977	Dec. 31 1977
Operating revenues .	<u>\$ 8,680,590</u>	<u>\$ 8,913,524</u>	<u>\$ 9,339,574</u>	<u>\$10,221,675</u>
Operating income . . .	<u>\$ 2,003,914</u>	<u>\$ 2,042,738</u>	<u>\$ 2,157,462</u>	<u>\$ 2,449,515</u>
Net income	<u>\$ 1,301,695</u>	<u>\$ 1,318,892</u>	<u>\$ 1,443,005</u>	<u>\$ 1,741,983</u>
Net income per common share . . . . .	<u>\$.27</u>	<u>\$.28</u>	<u>\$.30</u>	<u>\$.37</u>

## 10. 1977 Financial Data

Certain reclassifications have been made to previously reported 1977 data to allow comparability with the 1978 presentation.



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## Auditors' Opinion

To the Directors and Shareholders  
of Telephone Utilities, Inc.:

We have examined the consolidated balance sheets of Telephone Utilities, Inc. and subsidiaries as of December 31, 1978 and 1977 and the related consolidated statements of income, retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the above-mentioned consolidated financial statements present fairly the financial position of Telephone Utilities, Inc. and subsidiaries at December 31, 1978 and 1977 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

*Deloitte Haskins & Sells*

Portland, Oregon  
January 26, 1979

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## Common Stock Telephone Utilities, Inc.

Range of Bid and Asked Prices for Quarters Ended

	Bid		Asked	
	High	Low	High	Low
March 31, 1977 .....	8½	6	9¼	6¾
June 30, 1977 .....	8¾	7¼	9¾	8
September 30, 1977 .....	10	7¾	11½	8½
December 31, 1977 .....	11¼	8½	12	9½
March 31, 1978 .....	9½	8¾	10¼	9¾
June 30, 1978 .....	12	9¼	12¾	10
September 30, 1978 .....	12	10¾	12¾	11½
December 31, 1978 .....	12	10½	12¾	11¼

Cash dividend payable dates:	Per Share
February 7, 1977 .....	\$.08
May 16, 1977 .....	\$.08
August 22, 1977 .....	\$.08
November 28, 1977 .....	\$.09
February 27, 1978 .....	\$.09
May 30, 1978 .....	\$.15
September 5, 1978 .....	\$.15
December 4, 1978 .....	\$.15

Stock is traded in National OTC Market

NASDAQ—TPHN



## Officers and Management

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**A. M. GLEASON**  
President and Chief  
Executive Officer

**LEWIS C. NEACE, M. D.**  
Senior Vice President

**VERN K. DUNHAM**  
Vice President

**JOHN H. GEIGER**  
Vice President

**C. E. PETERSON**  
Vice President

**JAMES P. BEST**  
Controller

**BRIAN M. WIRKKALA**  
Secretary-Treasurer

**BRUCE B. STEVENSON**  
Central Office Services Mgr.

**JOHN DETJENS III**  
Assistant Secretary

**MARGARET WANN**  
Assistant Secretary

**MARVA J. WIRKKALA**  
Assistant Treasurer

## Directors

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**B. LAMAR GAINES**  
Retired  
North Bend, Washington

**JOHN H. GEIGER**  
Vice President of the Company and  
Senior Vice President-Finance of  
Pacific Power & Light Company  
Portland, Oregon

**A. M. GLEASON**  
President of the Company

**LEWIS C. NEACE, M. D.**  
Senior Vice President  
of the Company  
and Practicing Physician

**R. C. REEVES**  
President  
Reeves Clothing Co.  
Lebanon, Oregon;  
retail clothing store

**CARL J. RONNING**  
Vice President and Manager,  
Trust Operations  
Title Insurance and Trust Company  
Los Angeles, California;  
title insurance and trust company

**SIDNEY R. SNYDER**  
President  
Sid's Super Market, Inc.  
Seaview, Washington;  
retail grocer

**HUBERT A. TONDREAU**  
Assistant Vice President  
Standard Insurance Company  
Portland, Oregon;  
life insurance company

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## Transfer Agent and Registrar

First National Bank of Oregon  
Portland, Oregon

## General Counsel

Rives, Bonyhadi & Smith  
Portland, Oregon

## Special Counsel

Bogle & Gates  
Seattle, Washington

## Auditors

Deloitte Haskins & Sells  
Portland, Oregon

#### FORM 10-K

On written request, the Company will furnish to Shareholders a copy of its annual report on Form 10-K for the Company's most recent year. The Form 10-K contains more detailed statistical and financial information than is included in the Annual Report to Shareholders. If you wish a copy of the Form 10-K, you may address your request to Mr. Brian M. Wirkkala, Secretary, Telephone Utilities, Inc., Ilwaco, Washington 98624.

#### ANNUAL MEETING

The Annual Meeting of Shareholders of Telephone Utilities, Inc. will be held at 2:00 p.m., Pacific Standard Time, on Monday, April 23, 1979 at the Thunderbird Motor Inn, Jantzen Beach, Portland, Oregon 97217.





**Telephone  
Utilities, Inc.**