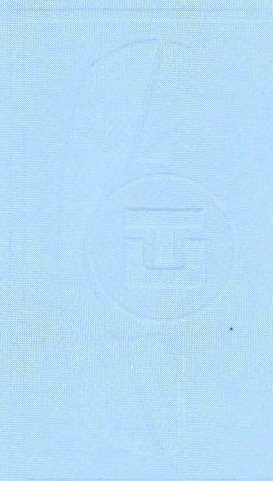


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**PACIFIC  
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ORGFIL**

file: Pacific Telecom, Inc



TELEPHONE  
UTILITIES,  
INC.

1979  
ANNUAL  
REPORT



## Highlights

		1979	1978	Percent Change
<b>The Shareholder</b>	Net income applicable to common stock	<b>\$ 9,104,880</b>	\$ 7,787,386	17%
	Average shares outstanding . . . . .	<b>4,673,040</b>	4,724,202	(1)
	Net income per common share . . . . .	<b>\$1.95</b>	\$1.65	18
	Total shareholders' equity . . . . .	<b>\$ 63,386,392</b>	\$ 58,313,379	9
	Dividends paid per common share . . . .	<b>\$ .75</b>	\$.54	39
<b>The Company</b>	Operating revenues . . . . .	<b>\$ 54,170,036</b>	\$ 44,698,124	21
	Working capital from operations . . . . .	<b>\$ 22,282,030</b>	\$ 17,369,738	28
	Telephone plant in service, end of year .	<b>\$156,002,186</b>	\$132,867,279	17
	Telephones, end of year . . . . .	<b>185,737</b>	170,719	9
<b>The Employee</b>	Total employees, end of year . . . . .	<b>877</b>	735	19
	Total wages paid . . . . .	<b>\$ 14,812,085</b>	\$ 11,728,783	26

## To Our Shareholders

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**R**esults for the year 1979 reflect continued strong gains for Telephone Utilities, Inc.

- *Net income per common share increased 18% to \$1.95 per share*
- *Dividends paid per common share increased 39% from \$.54 to \$.75*
- *Revenues totaled \$54,170,000 up 21%*
- *Telephones served totaled 185,737, an increase of 9%—all from internal growth*
- *Long distance telephone calls increased by 12% to a total of 34,800,000 originating messages, equivalent to more than 95,000 calls a day.*

The Company reached new highs in revenues, net income, earnings per share and number of telephones served in 1979. For the seven years ended December 31, 1979, earnings per common share have grown at a compound rate of 18%. These earnings increased from \$.70 in 1973 to \$1.95 in 1979.

These long-term results were attained primarily through careful budgetary control of capital expenditures. During this period of above-average station growth, the Company achieved maximum efficiency from existing plant facilities and, until 1979, financed required capital additions with internally generated funds.

Construction of telephone plant and facilities exceeded \$29,000,000 in 1979, the largest annual expenditure for new equipment in the Company's history. This program was necessary to accommodate our continued internal growth and to upgrade and improve service to existing customers. In addition to funds

generated within the business, 1979's plant additions were financed through short-term borrowings of \$13,700,000 from our affiliated company. During the year, a subsidiary of the Company received approval for a \$2,995,000 long-term loan from the Rural Electrification Administration (REA). (Approximately \$500,000 of REA funds were received during 1979.) The Company is awaiting final approval of another REA loan for a subsidiary which serves portions of Eastern Oregon. This \$9,500,000 REA loan will be used to finance the Eastern Oregon construction during a two year period.

Our 1979 construction program was highlighted by the placing in service of six digital electronic switching systems. With the completion of these installations, approximately 19% of our subscribers now enjoy the advantages of electronic switching and have available for their use extra features such as touch calling, call forwarding, speed calling, call waiting, etc. Demand for these special features continues to grow as our subscribers recognize the advantages these features offer. We are also pleased to report that the performance of these sophisticated switching systems are achieving our goals in regard to speed, reliability and service quality, and are providing essential building blocks for a modern communication system for our subscribers' future needs.

Construction expenditures of \$35,000,000 are budgeted for 1980. A construction program of this magnitude cannot be accomplished without some reliance on external sources of funds. As a result of the recent interest rate

increases, we are currently reviewing our 1980 construction program in an attempt to reduce our need for outside funds to the extent service considerations will allow. Even after this review, it is unlikely that the Company will be able to avoid some external financing. In addition the Company has redeemed an \$11,000,000, 7¾% note which matured on March 19, 1980. The need for these outside funds at today's high interest cost, the impact of inflation on our operating expenses, and some expected slowing of economic activity within our service areas will make it difficult to maintain the earnings growth rate of recent years.

The Company has reached an agreement in principle to acquire Greatland Telephone Company, a company which provides telephone service in an area near Fairbanks, Alaska. The acquisition, which is subject to approval by the Alaska Public Utilities Commission, would provide the Company with its first telephone property in the State of Alaska.

The Board of Directors established the current annual dividend rate of \$.80 per share on April 23, 1979, up from the prior rate of \$.60 per share. This dividend will be reviewed from time to time in view of our operating results and capital requirements.



A.M. Gleason  
President

March 26, 1980

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

Years ended December 31,	1979	1978	1977	1976	1975
Operating revenues .....	<b>\$54,170,036</b>	\$44,698,124	\$37,155,363	\$32,247,865	\$28,835,866
Operating expenses, other than federal income taxes .....	<b>33,420,887</b>	27,168,676	22,978,085	20,102,880	17,869,546
Federal income taxes .....	<b>8,135,650</b>	6,955,750	5,523,649	4,597,000	4,089,000
Total operating expenses .....	<b>41,556,537</b>	34,124,426	28,501,734	24,699,880	21,958,546
Operating income .....	<b>12,613,499</b>	10,573,698	8,653,629	7,547,985	6,877,320
Other income (expense) .....	<b>(6,211)</b>	252,961	290,597	510,001	725,347
Interest expense .....	<b>2,563,586</b>	2,669,375	2,742,470	2,932,483	2,985,781
Minority interest in net income and preferred stock dividends of subsidiaries .....	<b>33,666</b>	43,967	51,328	63,896	57,694
Income from telephone operations .....	<b>10,010,036</b>	8,113,317	6,150,428	5,061,607	4,559,192
Parent operations—interest, expenses, and taxes, net .....	<b>874,984</b>	295,759	344,853	270,661	348,527
Net income .....	<b>9,135,052</b>	7,817,558	5,805,575	4,790,946	4,210,665
Preferred stock dividends .....	<b>30,172</b>	30,172	30,473	30,473	30,473
Net income applicable to common stock .....	<b>\$ 9,104,880</b>	\$ 7,787,386	\$ 5,775,102	\$ 4,760,473	\$ 4,180,192
Average number of common shares outstanding .....	<b>4,673,040</b>	4,724,202	4,727,985	4,724,487	4,728,079
Net income per common share .....	<b>\$1.95</b>	\$1.65	\$1.22	\$1.01	\$ .88



## 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 increased by 17% and net income per common share increased by 18% during 1979 after a 35% increase during 1978.

Operating revenues increased by 21% in 1979 after an increase of 20% in 1978. The primary reason for the increase in local service revenues (14% in 1979 and 20% in 1978) was the internal growth in the number of customers. This is evidenced by the increases in number of telephones served (9% in 1979 and 10% in 1978). In addition to the internal growth in telephones, the Company benefited during both 1979 and 1978 from a Montana local service rate increase which increased revenues in excess of \$1,000,000 annually and was effective in April, 1978.

Toll service revenues increased by 26% during 1979 and 23% during 1978. These revenues represented 67% of the Company's total 1979 revenues and 64% of total 1978 revenues. The majority of the Company's toll revenue is determined through cost basis settlement procedures. Under these procedures, the operating subsidiary's toll revenue represents a recovery of the operating expenses associated with toll service plus a return on its investment in facilities used in providing toll service. During both 1979 and 1978, toll revenues increased from a combination of factors including increased usage of the toll network by our customers and increased operating expenses and investment associated with providing toll service.

Maintenance expense increased by 32% during 1979 after a 28% increase during 1978. These increases resulted from the additional maintenance effort required to provide service to our customers and maintenance expenses incurred in connection with the substantially increased construction program of 1979. Depreciation expense increased by 22% during 1979 after an 8% increase in 1978. The composite depreciation rate increased to 6.3% in 1979 from 5.9% in 1978. The

increased expense for both years resulted primarily from additions to telephone plant, and during 1979, approval of depreciation rate adjustments for the Company's Washington operating subsidiary. Traffic, commercial, administrative, and other operating expenses increased by 15% during 1979 and 18% during 1978. These increases resulted primarily from increased number of employees, wages and wage related costs.

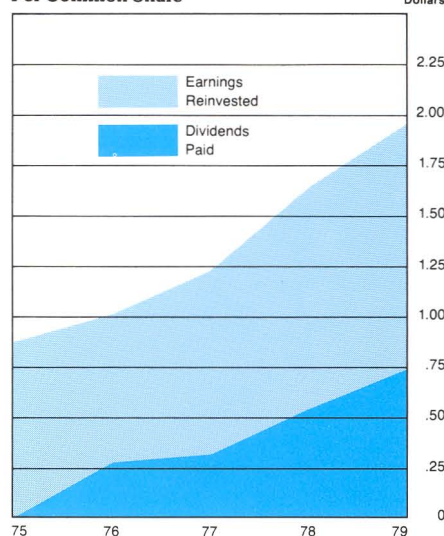
Taxes, other than federal income taxes, increased by 21% during 1979 after a 20% increase during 1978. These increased taxes occurred as a result of increased investment in plant, increased wages, revenue, and taxable income. Federal income taxes increased by 17% in 1979 and 26% in 1978. The increase in both years can be attributed to increased taxable income, a factor which was mitigated somewhat during 1979 as a result of the reduction in the federal statutory tax rate from 48% to 46%. Other income declined by 102% in 1979 after a decrease of 13% in 1978. The decrease in 1978 resulted primarily from a decrease in the average amounts of excess cash invested by the sub-

sidaries with TU under the intercompany short-term investment program. The 1979 decrease resulted from compliance with the FCC's change in accounting for the cost of funds associated with short-term construction projects (See Note 1 of Notes to Consolidated Financial Statements). Under that change, the Company capitalized none of the financing costs associated with its construction program.

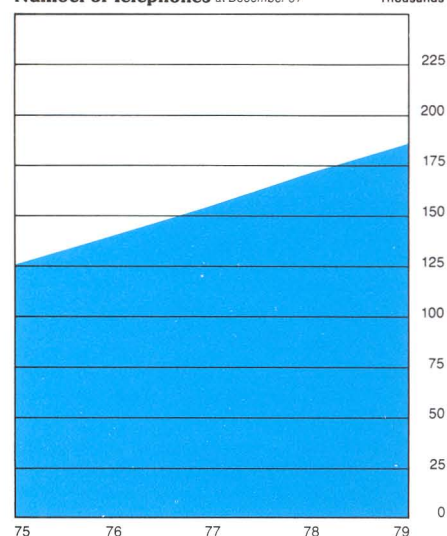
Interest expense declined by 4% in 1979 and 3% in 1978 as the subsidiary companies made debt principal payments as required by the related agreements.

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. The net effect of parent operations increased 196% in 1979 after a 14% decrease in 1978. These changes occurred primarily as a result of changes in the level of funds invested as temporary cash investments between TU and subsidiaries and the level of temporary cash investments and advances between TU and its majority shareholder.

**Net Income and Dividends Per Common Share**



**Number of Telephones at December 31**





## The Company

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**T**elephone Utilities, Inc. is a telephone holding company whose subsidiary operating companies serve 185,737 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 Seattle, Tacoma, Spokane and Portland. The areas in which the subsidiaries provide service include rapidly developing resort communities, diversified agricultural areas and areas which include integrated forest product manu-

facturers as well as a cross-section of light industrial activities. All of the operating companies are subject to the jurisdiction of regulatory agencies in the states in which they operate.

These service areas are either in or adjacent to rapidly growing portions of the Pacific Northwest. As a result, the company's internal growth rate in telephones has, for several years, doubled the national average for the industry. In addition, the company continues to experience increases in toll usage as its subscribers substitute telecommunica-

tions for higher cost travel alternatives. Competition continues to impact the activities of the company. However, through aggressive marketing and competitive pricing, very few losses in the terminal equipment market have occurred.

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.

## Construction and Service Improvements

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**G**ross construction expenditures (including reuse of equipment and cost of removal) for 1979 totaled \$29,025,000 or \$1,092,000 under our original budget for the year.

As a result of above-average station growth and the need to aggressively pursue the modernization of our system, a construction budget of approximately \$35,000,000 is planned for 1980. Conversion of our central offices to electronic switching is receiving high priority in the planning process. A total of 8 electromechanical central offices will be replaced by digital electronic switching systems in the current year. During 1979 central offices in Kingston, Hansville, Elma and Montesano, Washington, and Boardman, Oregon,

were replaced by digital electronic equipment. In addition, the switch at Lebanon, Oregon, was replaced in part by digital equipment. 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 and applying electronic transmission techniques.

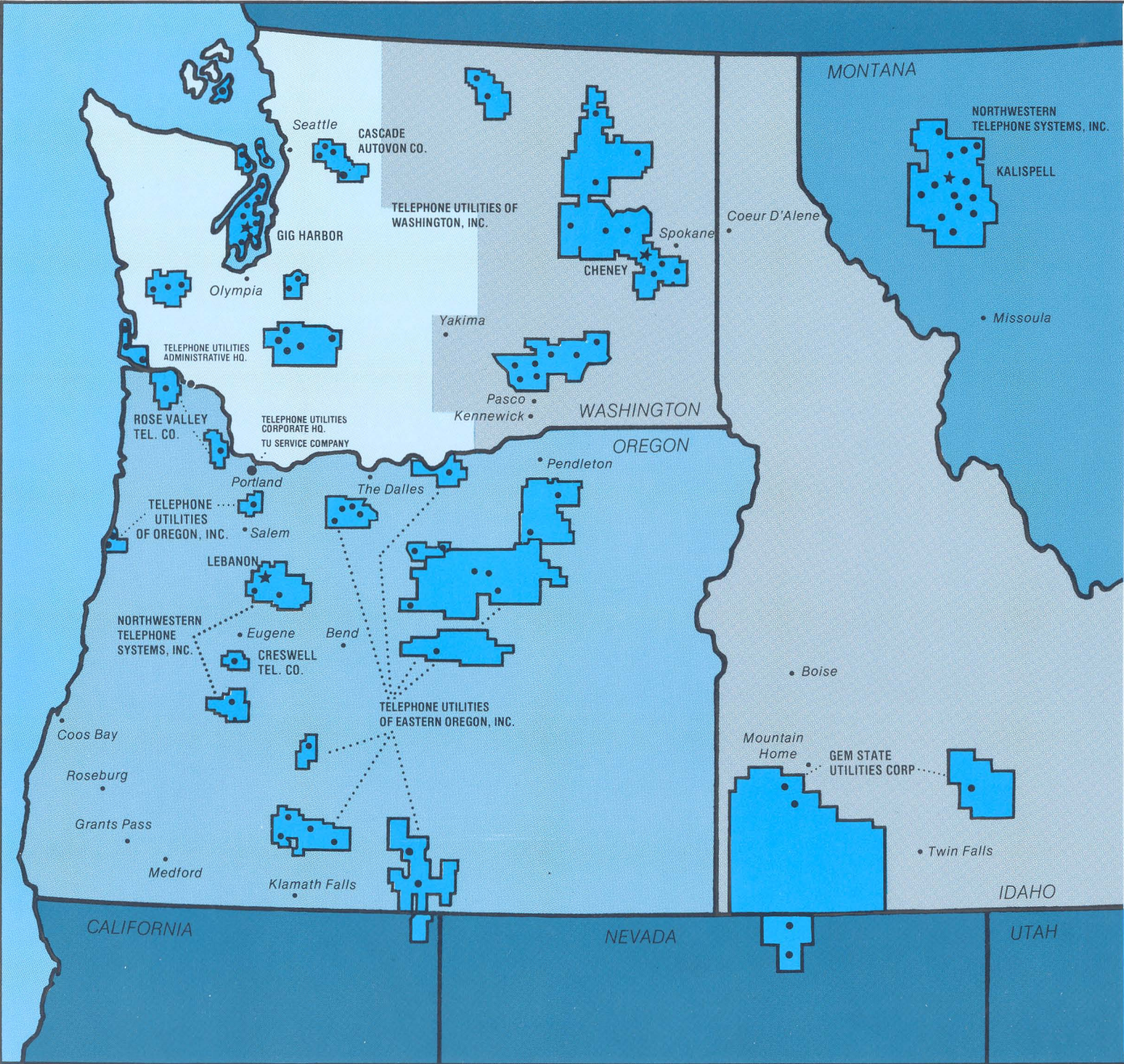
Service demands which require plant construction continue to press our ability to keep current, and we must continue to strive to maintain appropriate levels of service and to meet

expanding customer requests, while at the same time providing reasonable returns to our investors.

Under the planned \$35,000,000 1980 construction program, we will generate a major portion of our construction funds internally. However, under a program of this size, outside borrowing will be required in amounts similar to those needed during 1979. The budgeted expenditures are subject to continuing review and modification, and in light of the current high interest rates, may require downward adjustment during 1980. Any necessary deferrals or delays would be made with the goal of minimizing the impact on service to our customers.



TELEPHONE UTILITIES, Inc. Operating Companies & Service Area



- TELEPHONE UTILITIES, Inc. Service Area
- Eastern Washington Division (Idaho, Nevada)
- Western Washington Division
- Oregon Division
- Montana Division

EASTERN WASHINGTON DIVISION

Cheney — Headquarters

Amber	Kettle Falls	IDAHO
Spangle	Connell	
Medical Lake	Mesa	Grandview
Reardan	Basin City	Bruneau
Davenport	Eltopia	Richfield
Creston	Mathews Corner	
Hunters	Kahlotus	NEVADA
Valley	Washtucna	
Chewelah	Twisp	Owyhee
	Winthrop	Mountain City

WESTERN WASHINGTON DIVISION

Gig Harbor — Headquarters

Burley	Randle	Montesano
Fox Island	Packwood	Kingston
Arletta	Orting	Hansville
Long Beach	South Prairie	Vashon
Ocean Park	Lopez Island	North Vashon
Chinook	Puget Island	North Bend
Morton	Lakebay	Snoqualmie Pass
Mineral	McCleary	Fall City
Glenoma	Elma	Carnation

OREGON DIVISION

Lebanon — Headquarters

Sweet Home	Kinzua	Sprague River
Brownsville	Pilot Rock	Aurora
Yoncalla	Boardman	Depoe Bay
Creswell	Ukiah	Gleneden Beach
Spray	Lakeview	Maupin
Long Creek	Paisley	Wamie
Mitchell	Chiloquin	Tygh Valley
Monument	Fort Klamath	Pine Grove
Paulina	Chemult	Knappa
Fossil	Rocky Point	Scappoose

MONTANA DIVISION

Kalispell — Headquarters

Whitefish	Finley Point	Olney
Columbia Falls	Hungry Horse	Somers
Polson	Lakeside	Swan Lake
Big Fork	Marion	Yellow Bay
Elmo	McGregor Lake	

CASCADE AUTOVON COMPANY  
T U SERVICE COMPANY



## Revenue and Rate Activities

Continued good operating results allowed the Company to earn rates of return sufficiently high to allow us to complete the year without applying for major rate increases. Based on present projections rate increase applications are expected to have a minimal impact on 1980 operating results.

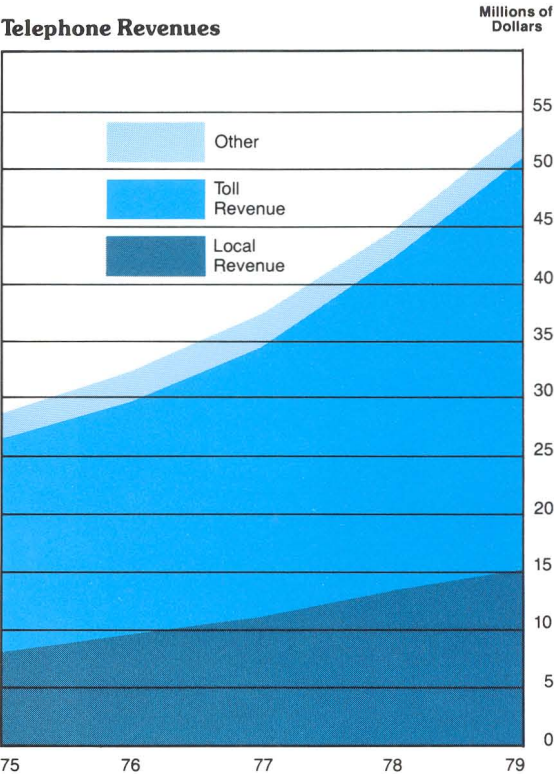
During May 1978 the Montana Consumer Counsel filed a petition for review in State District Court seeking reduction of the rate increase of \$1,008,000 granted by the Montana Public Service Commission. During April 1979 the State District Court upheld the Montana Public Service Commission's decision granting the increase.

Reflecting the strong economic health of our growing service area, the Company experienced a 12% increase

in originating toll messages during 1979 compared to the above-average increases of 19% in 1978 and 17% in 1977. 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 good returns on toll investment, are reflected in an excellent revenue year as shown in the accompanying financials.

Telephone Revenues



## Employees and Labor Relations

The Company provided full-time employment to 877 people at December 31, 1979 compared with 735 at the prior year end. This increase in employees was 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 rep-

resented by either the International Brotherhood of Electrical Workers or the Communications Workers of America, both AFL-CIO affiliates. Four of these agreements expire during 1980 and are subject to negotiation. The fifth agreement expires during 1982. Historically our wage increases closely parallel those of the major companies in our industry, thereby al-

lowing us to attract competent telephone personnel.

Our work force projections for 1980 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, 1979 and 1978

**1979**

1978

Operating revenues:		
Local service .....	<b>\$15,203,413</b>	\$13,346,499
Toll service .....	<b>36,192,977</b>	28,782,295
Government communication service .....	<b>841,255</b>	915,202
Miscellaneous .....	<b>1,932,391</b>	1,654,128
Total operating revenues .....	<b>54,170,036</b>	44,698,124
Operating expenses:		
Maintenance .....	<b>11,160,738</b>	8,440,743
Depreciation (Note 1) .....	<b>8,505,172</b>	6,966,763
Traffic .....	<b>982,555</b>	880,882
Commercial, administrative and other .....	<b>8,095,387</b>	7,012,283
Taxes, other than federal income taxes .....	<b>4,677,035</b>	3,868,005
Federal income taxes (Notes 1 and 6) .....	<b>4,120,650</b>	4,541,250
Deferred federal income taxes (Notes 1 and 6) .....	<b>1,789,000</b>	1,403,000
Net deferred investment tax credit (Notes 1 and 6) .....	<b>2,226,000</b>	1,011,500
Total operating expenses .....	<b>41,556,537</b>	34,124,426
Operating income .....	<b>12,613,499</b>	10,573,698
Other income (expense):		
Allowance for funds used during construction (Note 1) .....	—	232,673
Other, net .....	<b>(6211)</b>	20,288
	<b>(6,211)</b>	252,961
Interest expense—principally on long-term debt .....	<b>2,563,586</b>	2,669,375
Minority interest in net income and preferred stock dividends of subsidiaries .....	<b>33,666</b>	43,967
Income from telephone operations .....	<b>10,010,036</b>	8,113,317
Parent operations—interest, expenses and taxes, net (Note 5) .....	<b>874,984</b>	295,759
Net income .....	<b>9,135,052</b>	7,817,558
Preferred stock dividends .....	<b>30,172</b>	30,172
Net income applicable to common stock .....	<b>\$ 9,104,880</b>	\$ 7,787,386
Net income per common share (Note 1) .....	<b>\$1.95</b>	\$1.65

*See accompanying notes.*



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

December 31, 1979 and 1978	1979	1978
<b>Assets</b>		
Telephone plant:		
Telephone plant in service (Notes 1 and 3) . . . . .	<b>\$156,002,186</b>	\$132,867,279
Less accumulated depreciation . . . . .	<b>34,394,245</b>	30,436,607
	<b>121,607,941</b>	102,430,672
Construction work in progress . . . . .	<b>4,657,326</b>	4,293,515
Net telephone plant . . . . .	<b>126,265,267</b>	106,724,187
Cost of acquisitions in excess of equity in net assets of subsidiaries (Note 1) . . . . .	<b>10,779,111</b>	10,815,745
Current assets:		
Cash . . . . .	<b>268,093</b>	110,098
Temporary cash investments (Note 2) . . . . .	<b>—</b>	2,520,846
Accounts receivable . . . . .	<b>5,802,648</b>	5,218,813
Material and supplies (Note 1) . . . . .	<b>7,249,260</b>	4,260,953
Prepayments . . . . .	<b>239,044</b>	212,311
Total current assets . . . . .	<b>13,559,045</b>	12,323,021
Unamortized debt expense and other deferred charges . . . . .	<b>279,336</b>	323,319
	<b>\$150,882,759</b>	\$130,186,272

See accompanying notes.

	1979	1978
<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>32,047,219</b>	26,373,115
	<b>64,148,315</b>	58,474,211
Less treasury stock (at cost) common stock—57,134 shares in 1979 and 6,861 shares in 1978; preferred stock —3,513 shares in 1979 and 1978 . . . . .	<b>761,923</b>	160,832
Total shareholders' equity . . . . .	<b>63,386,392</b>	58,313,379
Minority interest in subsidiaries . . . . .	<b>208,580</b>	232,313
Long-term debt (Note 3) . . . . .	<b>29,404,211</b>	41,660,653
Current liabilities:		
Notes payable—affiliates (Note 2) . . . . .	<b>13,700,000</b>	—
Accounts payable . . . . .	<b>7,139,650</b>	7,750,383
Income taxes payable . . . . .	<b>2,903,866</b>	4,048,876
Accrued liabilities . . . . .	<b>2,342,813</b>	1,868,210
Advance billings . . . . .	<b>1,265,893</b>	1,161,841
Current maturities on long-term debt (Note 3) . . . . .	<b>12,709,844</b>	1,841,164
Total current liabilities . . . . .	<b>40,062,066</b>	16,670,474
Deferred income taxes (Notes 1 and 6) . . . . .	<b>9,548,372</b>	7,590,372
Deferred investment tax credit (Note 1) . . . . .	<b>7,092,012</b>	4,847,012
Other deferred credits . . . . .	<b>1,181,126</b>	872,069
	<b>\$150,882,759</b>	\$130,186,272

See accompanying notes.



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

Years ended December 31, 1979 and 1978

**1979****1978**

## Sources of working capital:

## From operations:

Net income .....	<b>\$ 9,135,052</b>	\$ 7,817,558
Items not involving working capital:		
Depreciation and amortization .....	<b>8,943,978</b>	7,356,853
Allowance for funds used during construction .....	<b>—</b>	(232,673)
Deferred income taxes and investment tax credit, net .....	<b>4,203,000</b>	2,428,000
Total from operations .....	<b>22,282,030</b>	17,369,738
Salvage from plant and equipment retired .....	<b>681,135</b>	837,194
Additions to long-term debt .....	<b>491,712</b>	—
Decrease in working capital .....	<b>22,155,568</b>	3,310,937
	<b><u>\$45,610,445</u></b>	<b><u>\$21,517,869</u></b>

## Application of working capital:

## Property, plant and equipment:

Additions to telephone plant in service .....	<b>\$28,294,224</b>	\$15,254,096
Net change in construction work in progress .....	<b>363,811</b>	2,081,214
	<b>28,658,035</b>	17,335,310
Allowance for funds used during construction .....	<b>—</b>	(232,673)
	<b>28,658,035</b>	17,102,637
Reduction of long-term debt .....	<b>12,748,154</b>	1,779,930
Cost of removal of plant and equipment .....	<b>366,772</b>	313,101
Dividends .....	<b>3,533,380</b>	2,581,188
Other—net .....	<b>304,104</b>	(258,987)
	<b><u>\$45,610,445</u></b>	<b><u>\$21,517,869</u></b>

## Decreases (Increases) in elements of working capital:

Cash and temporary cash investments .....	<b>\$ 2,362,851</b>	\$ 1,216,796
Accounts receivable .....	<b>(583,835)</b>	(761,335)
Material and supplies .....	<b>(2,988,307)</b>	(2,167,976)
Other current assets .....	<b>(26,733)</b>	45,359
Notes payable—affiliates .....	<b>13,700,000</b>	
Accounts payable .....	<b>(610,733)</b>	1,294,218
Income taxes payable .....	<b>(1,145,010)</b>	3,109,782
Current maturities on long-term debt .....	<b>10,868,680</b>	107,015
Other current liabilities .....	<b>578,655</b>	467,078
	<b><u>\$22,155,568</u></b>	<b><u>\$ 3,310,937</u></b>

See accompanying notes.



## Telephone Utilities, Inc.

### CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended December 31, 1979 and 1978	1979	1978
Balance at beginning of year . . . . .	<b>\$26,373,115</b>	\$21,136,745
Net income . . . . .	<b>9,135,052</b>	7,817,558
	<b>35,508,167</b>	28,954,303
Miscellaneous credits, per regulatory authority . . . . .	<b>72,432</b>	—
	<b>35,580,599</b>	28,954,303
Deduct:		
Cash dividends:		
Common stock (1979—\$.75; 1978—\$.54 per share) . . . . .	<b>3,503,208</b>	2,551,016
Preferred stock . . . . .	<b>30,172</b>	30,172
	<b>3,533,380</b>	2,581,188
Balance at end of year (Note 3) . . . . .	<b>\$32,047,219</b>	\$26,373,115

See accompanying notes.

## Notes to Consolidated Financial Statements

### 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.

(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 for 1978 expenditures, an allowance for funds used during construction (AFUDC). Effective January 1, 1979, the FCC amended its system of accounts to provide that AFUDC be capitalized only on long-term construction projects (one year or more in duration). Because none of the Company's construction projects in progress during 1979 had a construction period of one year or more, the Company did not capitalize any of the related financing costs. 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 6.3% in 1979 and 5.9% in 1978.

(d) *Cost of acquisitions in excess of equity in net assets of subsidiaries* — At December 31, 1979, TU's investment in subsidiaries includes \$10,779,111 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 \$1,540,276 and \$1,576,910 at December 31, 1979 and 1978, 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 \$779,000 in 1979 and \$626,000 in 1978, including applicable provisions for unfunded past service costs. Pension expense is funded as accrued including amortization of past service costs over a ten-year period. At January 1, 1979, the unfunded past service costs were approximately \$1,075,000.

(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 \$2,708,000 in 1979 and \$1,364,000 in 1978 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, 1979 and 1978, approximately 81% 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 \$123,000 in 1979 and \$170,000 in 1978.

(b) *Temporary cash investments/notes payable-affiliates* — At December 31, 1979, notes payable-affiliates represented \$13,700,000 of short-term advances from Pacific; at December 31, 1978, temporary cash investments included \$2,450,000 of short-term advances to Pacific. These transactions were made under an agreement providing for temporary cash investment or advances 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, 1979 and 1978, consisted of the following:

	1979	1978
2%-8% First Mortgage notes payable to Rural Electrification Administration and Rural Telephone Bank, maturities through 2009 .....	\$ 2,110,154	\$ 1,710,488
5.1%-10¼% First Mortgage notes and bonds, maturities through 1998 .....	15,567,848	16,820,368
7¾% Second Mortgage note, due 1980 (Note 8) .....	11,000,000	11,000,000
5¾%-9¾% Unsecured notes, maturities through 2007 .....	13,436,053	13,970,961
Total long-term debt .....	42,114,055	43,501,817
Less current maturities .....	12,709,844	1,841,164
	<u>\$29,404,211</u>	<u>\$41,660,653</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 \$16,850,000 are not restricted at December 31, 1979.

Total long-term debt maturing annually within each of the four years after December 31, 1980, is as follows:

1981	\$1,690,000	1983	\$1,306,000
1982	\$1,244,000	1984	\$1,259,000

## 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, 1979, no options had been granted under the plan.

## 5. Parent operations

Parent operations of TU are summarized as follows:

	1979	1978
Interest income:		
From subsidiaries .....	\$ 10,783	\$ 34,442
From temporary cash investments (Note 2) .....	59,173	404,460
	<u>69,956</u>	<u>438,902</u>
Interest expense:		
To subsidiaries .....	604	18,100
On long-term debt .....	842,577	864,794
On notes payable — affiliates (Note 2) .....	756,585	11,853
	<u>1,599,766</u>	<u>894,747</u>
Federal income tax (credit):		
Federal income taxes .....	(768,000)	(266,000)
Deferred federal income taxes .....	15,000	15,000
Net deferred investment tax credit .....	19,000	(1,500)
	<u>(734,000)</u>	<u>(252,500)</u>
Other expense — net .....	79,174	92,414
	<u>\$ 874,984</u>	<u>\$295,759</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:

	1979	1978
Excess of tax over book depreciation .....	<b>\$1,642,000</b>	\$1,173,000
Cost of removal of retired assets deducted for tax purposes .....	<b>162,000</b>	245,000
	<b><u>\$1,804,000</u></b>	<u>\$1,418,000</u>

The Company's effective combined state and federal income tax rate was 47.0% in 1979 and 47.9% in 1978. The difference between these effective tax rates and the federal income tax statutory rates of 46% in 1979 and 48% in 1978 is attributable to the following:

	1979	1978
Interest, taxes and pensions capitalized, net .....	<b>.1 %</b>	(.8)%
Amortization of investment tax credit .....	<b>(2.7)</b>	(2.3)
State income taxes, net of federal tax benefit .....	<b>2.3</b>	1.8
Other .....	<b>1.3</b>	1.2
	<b><u>1.0 %</u></b>	<u>(.1)%</u>

## 7. Commitments

Expenditures in connection with the Company's construction program will approximate \$35,000,000 in 1980.

Total rental expenses for 1979 and 1978 are as follows:

	1979	1978
Pole attachment rentals .....	<b>\$359,000</b>	\$378,000
Other, including short-term rentals .....	<b>201,000</b>	170,000
	<b><u>\$560,000</u></b>	<u>\$548,000</u>

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

## 8. Subsequent Event

On March 19, 1980 the Company signed an agreement effectively refinancing the \$11,000,000 Second Mortgage Note (Note 3). Under terms of the new agreement, the loan is unsecured, bears interest at 103% of the prime rate, and is to be repaid March 10, 1981.

## 9. Quarterly financial data (Unaudited)

Summarized quarterly financial data for 1979 and 1978 is as follows:

	Three Months Ended			
	March 31 1979	June 30 1979	Sept. 30 1979	Dec. 31 1979
Operating revenues .....	<u>\$12,438,208</u>	<u>\$13,207,988</u>	<u>\$13,527,842</u>	<u>\$14,995,998</u>
Operating income .....	<u>\$ 2,687,420</u>	<u>\$ 2,905,811</u>	<u>\$ 3,202,164</u>	<u>\$ 3,818,104</u>
Net income .....	<u>\$ 1,949,167</u>	<u>\$ 2,047,351</u>	<u>\$ 2,260,405</u>	<u>\$ 2,878,129</u>
Net income per common share .....	<u>\$.41</u>	<u>\$.44</u>	<u>\$.48</u>	<u>\$.62</u>
	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>



# 10. Supplementary information to disclose effects of changing prices (Unaudited)

The following supplementary information is supplied in accordance with the requirements of FASB Statement No. 33, "Financial Reporting and Changing Prices," for the purpose of providing certain information about the effects of changing prices. It should be viewed as an estimate of the approximate effect of inflation, rather than as a precise measure.

Constant dollar amounts represent historical costs stated in terms of dollars of equal purchasing power, as measured by the Consumer Price Index for All Urban Consumers (CPI-U). Current cost amounts reflect the changes in specific prices of plant from the date the plant was acquired to the present, and differ from constant dollar amounts to the extent that specific prices have increased more or less rapidly than prices in general.

The current cost of property, plant, and equipment represents the estimated cost of replacing existing plant assets and was determined through the application of telecommunication and general plant indices to the existing historic costs of telephone plant.

The provision for depreciation on the constant dollar and current cost amounts of property, plant, and equipment was determined by applying the Company's effective book depreciation rates by type of asset to the respective average indexed plant amounts.

As prescribed in Statement No. 33, income taxes were not adjusted.

Under the rate-making prescribed by the regulatory commissions to which the operating subsidiaries are subject, only the historical cost of plant is recoverable in revenues as depreciation. Therefore, the excess of the cost of plant stated in terms of constant dollars or current cost over the historical cost of plant is not presently recoverable in rates as depreciation, and a restatement to average 1979 constant dollars is reflected as a reduction to net recoverable cost. While the rate-making process gives no recognition to the current cost of replacing property, plant, and equipment, based on past practices, the Company will be allowed to earn on the increased cost of their net investment when replacement of facilities actually occurs.

To properly reflect the economics of rate regulation in the Statements of Consolidated Income, the reduction of net property, plant, and equipment should be offset by the gain from the decline in purchasing power of net amounts owed. During a period of inflation, holders of monetary assets suffer a loss of general purchasing power while holders of monetary liabilities experience a gain. The gain from the decline in purchasing power of net amounts owed is primarily attributable to the substantial amount of debt which has been used to finance property, plant, and equipment. Since the depreciation on this plant is limited to the recovery of historical costs, the company does not have the opportunity to realize a holding gain on debt and is limited to recovery only of the embedded cost of debt capital.

## Statement of Income Adjusted For Changing Prices (Unaudited)

For the year ended December 31, 1979

	As Recorded (Conventional Historical Cost)	As Adjusted for General Inflation (Constant Dollar)	As Adjusted for Changes in Specific Prices (Current Cost)
Operating revenues .....	\$54,170,036	\$ 54,170,036	\$ 54,170,036
Maintenance .....	11,160,738	11,160,738	11,160,738
Depreciation .....	8,505,172	13,299,090	14,011,049
Traffic .....	982,555	982,555	982,555
Commercial, Administrative and Other .....	8,095,387	8,095,387	8,095,387
Taxes other than federal income taxes .....	4,677,035	4,677,035	4,677,035
Federal income taxes .....	8,135,650	8,135,650	8,135,650
Other income, parent operations, etc. — net .....	914,861	914,861	914,861
Interest charges .....	2,563,586	2,563,586	2,563,586
	<u>45,034,984</u>	<u>49,828,902</u>	<u>50,540,861</u>
Income from continuing operations (excluding reduction to net recoverable cost) .....	<u>\$ 9,135,052</u>	<u>\$ 4,341,134*</u>	<u>\$ 3,629,175</u>
Increase in specific prices (current cost) of property, plant and equipment held during the year .....			\$ 25,309,960
Reduction to net recoverable cost .....		\$ (9,698,223)	(11,950,997)
Effect of increase in general price level .....			<u>(22,345,227)</u>
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost .....			(8,986,264)
Gain from decline in purchasing power of net amounts owed .....		8,210,193	8,210,193
Net .....		<u>\$ (1,488,030)</u>	<u>\$ (776,071)</u>

\*Including the reduction to net recoverable cost, the income on a constant dollar basis would have been a loss of \$5,357,092 for 1979.

At December 31, 1979, current cost of property, plant and equipment, net of accumulated depreciation was \$199,920,000, while historical cost or net cost recoverable through depreciation was \$126,265,267.



Supplementary Five-Year Comparison of Selected Financial  
Data Adjusted For The Effects of Changing Prices (Unaudited)

	Average 1979 Dollars				
	1979	1978	1977	1976	1975
Historical cost information adjusted for general inflation					
Operating revenues .....	\$54,170,036	\$49,730,666	\$44,504,551	\$41,118,392	\$38,889,065
Income from continuing operations	4,341,124				
Income from continuing operations per common share .....	.92				
Reduction of plant to net recoverable cost .....	9,698,223				
Net assets (shareholders' equity) at year end .....	59,939,981				
Current cost information					
Income from continuing operations .....	3,629,175				
Income from continuing operations per common share .....	.77				
Excess of increase in general price level of plant held during the year over changes in specific prices after reduction to net recoverable cost ....	8,986,264				
Net assets (shareholders' equity) at year end .....	59,939,981				
Other information					
Purchasing power gain on net monetary items held during the year .....	8,210,193				
Cash dividends declared per common share .....	\$ .76	\$ .60	\$ .31	\$ .37	\$ .09
Market price per common share at year end .....	\$11.11	\$12.59	\$10.22	\$ 7.80	\$ 6.21
Average Consumer Price Index .....	217.4	195.4	181.5	170.5	161.2

## 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, 1979 and 1978 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, 1979 and 1978 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 25, 1980, except for Note 8  
as to which the date is March 19, 1980



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## Officers and Management

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

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

**VERN K. DUNHAM**  
Senior Vice President

**C. E. PETERSON**  
Senior Vice President

**JOHN H. GEIGER**  
Vice President

**JAMES P. BEST**  
Vice President—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

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## Directors

**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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## Common Stock Telephone Utilities, Inc.

Range of Bid and Asked Prices for Quarters Ended

	Bid		Asked	
	High	Low	High	Low
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
March 31, 1979 .....	14½	11	16	11¾
June 30, 1979 .....	14¾	13¾	15¼	13¾
September 30, 1979 .....	14¾	13¾	15¼	14¾
December 31, 1979 .....	13¾	10	14¾	11

Cash dividend payable dates:	Per Share
February 27, 1978 .....	\$.09
May 30, 1978 .....	\$.15
September 5, 1978 .....	\$.15
December 4, 1978 .....	\$.15

March 5, 1979 .....	\$.15
June 4, 1979 .....	\$.20
September 4, 1979 .....	\$.20
December 3, 1979 .....	\$.20

Stock is traded in National OTC Market

NASDAQ—TPHN



**Transfer Agent and Registrar**

First National Bank of Oregon  
Portland, Oregon

**General Counsel**

Stoel, Rives, Boley, Fraser and Wyse  
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 Daylight Time, on Monday, April 28, 1980 at the Company's offices, 1221 Southwest Yamhill Street, Suite 200, Portland, Oregon 97205.



TELEPHONE  
UTILITIES,  
INC.

