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TELEPHONE UTILITIES, INC.

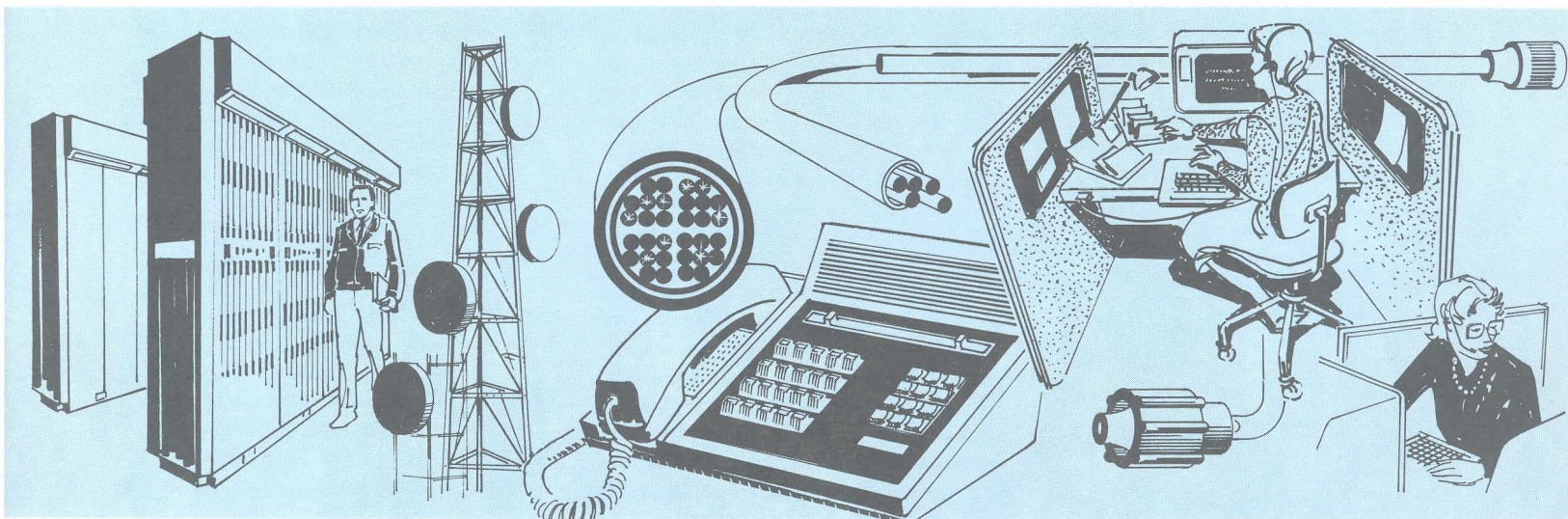
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1980

ANNUAL REPORT

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Highlights

		1980	1979	Percent Change
The Shareholder	Net income applicable to common stock .	\$ 9,878,940	\$ 9,104,880	9%
	Average shares outstanding	4,653,924	4,673,040	—
	Net income per common share	\$2.12	\$1.95	9
	Total shareholders' equity	\$ 70,058,859	\$ 63,386,392	11
	Dividends paid per common share	\$.83	\$.75	11
The Company	Operating revenues	\$ 64,982,239	\$ 54,170,036	20
	Working capital from operations	\$ 25,505,439	\$ 22,282,030	14
	Telephone plant in service, end of year . .	\$191,753,863	\$156,002,186	23
	Telephones, end of year	205,004	185,737	10
The Employee	Total employees, end of year	996	877	14
	Total wages paid	\$ 18,536,962	\$ 14,812,085	25

To Our Shareholders

The year 1980 results of the Company reflected healthy gains in our business in spite of a generally weak economy and extremely high interest rates.

- Net income per common share increased 9% to \$2.12 per share.
- Dividends paid per common share increased 11% to \$.83.
- Revenues were \$64,982,000 up 20%.
- Telephones served totaled 205,000, an increase of 10%.
- Long distance toll calling reflected an 11% increase in originating messages.
- Two Alaska operating subsidiaries were acquired, marking our entry into that growing state.

The Company continued its eighth year of uninterrupted growth in achieving new highs in revenues, net income, earnings per share and number of telephones served during 1980. Earnings per share have more than quadrupled during that eight-year period from \$.46 in 1972 to \$2.12 in 1980.

The cumulative effects of the Company's growth continued to impact our plant facilities, requiring construction expenditures of \$36,700,000 for telephone plant and facilities. This amount exceeded our previous year's construction requirement by 27% and required reliance on outside sources of funds for the second successive year. The outside financing requirements for 1979 and 1980 resulted in the following 1980 financing activity:

- Funds totaling \$4,890,000 were drawn against \$12,500,000 of long-term loans previously approved by the Rural Electrification Administration (REA). These loans are specifically for service improvements to our

Idaho and Eastern Oregon properties and the unborrowed balance of nearly \$7,500,000 is available for those improvements.

- A series of three year variable interest rate loans representing additional long-term funds totaling \$20,000,000 were received near the end of the third quarter in 1980 allowing repayment of the outstanding affiliated company advances and providing funds for current construction.
- Additional affiliated company advances totaling \$5,000,000 were received during the last quarter of 1980.

Our 1980 construction program continued to focus on adding capacity to our outside plant facilities and on the modernization of our switching centers to provide for growth and allow us to offer our subscribers the latest in special calling features. At year-end 1980, one-third of our subscribers could enjoy the advantage of electronic switching and had available extra features such as touch calling, call forwarding, speed calling, call waiting, etc.

Construction expenditures for 1981 are budgeted at \$39,000,000, an amount that is needed to continue our ongoing service improvement program and continue the development of a system capable of handling our customers' communications needs. However, as a result of continued high interest rates for short-term funds, we are currently reevaluating our program with the goal of spreading certain improvements over longer periods so that our expenditures can be more nearly funded by internally generated funds.

The Company continues to seek acquisition opportunities consistent with our earnings growth goals. The year 1980 saw the con-

summation of the acquisition of the Greatland Telephone Company near Fairbanks, Alaska and Sitka Telephone Company serving Sitka, Alaska and a number of smaller communities in the southeastern part of that state. At year-end 1980, these two companies served approximately 10,000 telephones and will contribute to our near-term earnings growth.

Early in 1981, the Company completed acquisition of the Audio Group, Inc., a Portland, Oregon based company providing background music and related services to many of Oregon's major communities. This business is unregulated, compatible with our basic business, has good growth and cash flow potential and should contribute \$2,000,000 of revenue to the Company in 1981. Other acquisitions are under study and discussion, but none have progressed to an extent of probability.

During the fourth quarter of 1980, the Board of Directors established the current annual dividend rate of \$.92 per share, a 15 percent increase from the prior rate of \$.80 per share. This dividend level will be reviewed from time to time in view of our earnings improvements and the relationship of our outside capital needs to the cost of borrowed funds.

If any stockholder has questions as a result of this report or subsequent events, I welcome your inquiry.



A. M. Gleason
President

March 20, 1981

Telephone Utilities, Inc.
SELECTED FINANCIAL DATA

Years ended December 31—	1980	1979	1978	1977	1976
Operating revenues	\$ 64,982,239	\$ 54,170,036	\$ 44,698,124	\$ 37,155,363	\$ 32,247,865
Operating expenses, other than federal income taxes	41,260,324	33,420,887	27,168,676	22,978,085	20,102,880
Federal income taxes	8,735,700	8,135,650	6,955,750	5,523,649	4,597,000
Total operating expenses	49,996,024	41,556,537	34,124,426	28,501,734	24,699,880
Operating income	14,986,215	12,613,499	10,573,698	8,653,629	7,547,985
Other income (expense)	5,958	(6,211)	252,961	290,597	510,001
Interest expense	3,588,670	2,563,586	2,669,375	2,742,470	2,932,483
Minority interest in net income and preferred stock dividends of subsidiaries	29,053	33,666	43,967	51,328	63,896
Income from telephone operations . .	11,374,450	10,010,036	8,113,317	6,150,428	5,061,607
Parent operations—interest, expenses, and taxes, net	1,465,338	874,984	295,759	344,853	270,661
Net income	9,909,112	9,135,052	7,817,558	5,805,575	4,790,946
Preferred stock dividends	30,172	30,172	30,172	30,473	30,473
Net income applicable to common stock	\$ 9,878,940	\$ 9,104,880	\$ 7,787,386	\$ 5,775,102	\$ 4,760,473
Average number of common shares outstanding	4,653,924	4,673,040	4,724,202	4,727,985	4,724,487
Data per common share:					
Net income	\$2.12	\$1.95	\$1.65	\$1.22	\$1.01
Dividends declared	\$.83	\$.75	\$.54	\$.25	\$.29
Dividends paid	\$.83	\$.75	\$.54	\$.33	\$.28
Total assets	\$184,673,346	\$150,882,759	\$130,186,272	\$119,067,105	\$112,771,549
Long-term debt	\$ 66,537,920	\$ 29,404,211	\$ 41,660,653	\$ 43,440,583	\$ 45,206,107

Management's Discussion and Analysis of Financial Condition and Results of Operations

Certain phenomena during 1980 significantly affected Telephone Utilities, Inc. (TU) as well as TU and its subsidiaries (Company):

- 1) Accomplishment of a construction program totaling \$36,700,000 after 1979 expenditures of \$29,000,000.
- 2) Increase in internal generation of funds to \$25,505,000 (approximately 69% of construction expenditures).
- 3) Issuance of long-term debt totaling \$35,890,000.
- 4) Acquisition of two operating subsidiaries in the State of Alaska.
- 5) Experience of record level interest rates.

The acquisitions of two operating subsidiaries in Alaska had a minimal effect on the current results of operations due to the nature and timing of acquisition (see Note 8 of Notes to Consolidated Financial Statements). However, they will contribute to the long-term strength and earnings of the Company.

Results of Operations

In spite of the record construction program and the record interest rate levels, the Company again achieved new highs in operating revenues, operating income, income from telephone operations, net income and net income per common share.

Net income increased \$774,000 or 8% after a 17% increase in 1979 while net income per common share increased \$.17 or 9% following an 18% gain in 1979.

Operating revenues increased 20% or \$10,812,000 during 1980 following a 21% increase in 1979. Local service revenue increased 11% in 1980 and 14% in 1979. The decline in rate of increase can be attributed to a decline in the rate of internal growth associated with the general weakening of the economy and reduction of housing starts. The 205,004 telephones in service at year-end 1980 includes approximately 10,000 telephones acquired through the above-discussed acquisitions and reflects a 5% annual internal growth rate as compared to a 9% growth rate in 1979. Toll service revenues (which represent 69% of total operating rev-

enues in 1980 and 67% in 1979) increased 24% in 1980 and 26% in 1979. These increases occurred as a result of increased toll usage by our customers and increased costs and investment associated with providing toll service.

Operating expenses other than federal income taxes increased 23% or \$7,839,000 in 1980 and 23% in 1979. In this classification, the major increases occurred in maintenance, depreciation, and commercial, administrative and other expenses. The maintenance expense increases of \$2,711,000 or 24% in 1980 and 32% in 1979 reflected maintenance costs associated with the greatly-increased construction programs of both years. Depreciation expense increased \$2,104,000 or 25% in 1980 after a 22% increase in 1979. These increases reflect the additions to plant related to the record-level construction of both years and increased composite depreciation rates (6.6% in 1980, 6.3% in 1979 and 5.9% in 1978). The increased composite rates resulted from rate changes applicable to TU's Oregon (effective January 1, 1980) and Washington (effective January 1, 1979) properties. Commercial, administrative and other operating expenses increased \$2,741,000 or 34% in 1980 after a 15% increase in 1979. The commercial expense increase resulted primarily from increased directory expense (as a consequence of increased directory revenues), increased salaries, and increased personnel to meet customer needs. The increased administrative and other operating expenses resulted from increased salaries and increased personnel in the administrative and support functions to meet operating subsidiary needs.

Both the \$600,000 or 7% increase in federal income taxes for 1980 and the 17% increase in 1979 occurred as a result of increased taxable income.

Interest expense increased 40% or \$1,025,000 during 1980 after a 4% decline in 1979. The 1980 increase reflected the increased operating subsidiary interest costs related to short and long-term obligations whose interest rates are tied to the prime rate of interest. These obligations include

the interim financing through TU, the September 1980 issuance of a \$5,000,000 three-year unsecured loan by one subsidiary and the required refinancing of another subsidiary's \$11,000,000, 7.75%, second mortgage note during March 1980. (See Note 3 of Notes to Consolidated Financial Statements).

The parent operations increase of \$590,000 or 67% in 1980 following a 196% increase in 1979, reflects the increase in the prime interest rate including its impact on the borrowings of TU from its majority shareholder. In addition, TU issued \$15,000,000 in unsecured long-term debt in September 1980. That debt carried an interest rate of 12.99% from its date of issue through year end. (See Note 3 of Notes to Consolidated Financial Statements).

The estimated effects of inflation on the Company's results of operations are set forth in Note 10 of Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

Internal generation of funds for 1980 equaled 69% of the \$36,700,000 in construction expenditures as compared to 77% of the \$29,000,000 expended in 1979. During 1980, the Company refinanced a subsidiary's \$11,000,000 second mortgage note and issued an additional \$24,890,000 in long-term debt including \$4,890,000 in Rural Electrification Administration (REA) debt. The new debt proceeds were used to repay interim borrowings from TU's majority shareholder and provide funding of plant which had been constructed with internally generated funds.

The 1981 construction program of approximately \$39,000,000 will be financed primarily with internally-generated funds. In addition, the Company will receive additional funds from the REA in approximately the same magnitude as 1980. Any additional requirements will be funded through advances from the majority shareholder.

Management's opinion is that the Company's capital resources are adequate to provide for its liquidity needs and allow completion of its 1981 construction program.

The Company

Telephone Utilities, Inc. is a telephone holding company whose subsidiary operating companies serve 205,004 telephones located principally in Washington, Montana and Oregon and to a lesser extent in Alaska, Idaho, Nevada and California. Included in our wide geographic area are suburbs of Seattle, Tacoma, Spokane and Portland and much of southeastern Alaska. The areas in which the subsidiaries provide service include rapidly developing resort communities, diversified agricultural areas and areas which include integrated forest product manufacturers

as well as a cross-section of light industrial activities. In addition, our Alaska, Oregon and Washington coastal properties serve fishery and seafood processing facilities of some magnitude. All of the operating companies are subject to the jurisdiction of regulatory agencies of 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, substantially exceeded the national average for the industry. In addition,

the Company continues to experience substantial increases in toll usage. Although competition continues its attempt to provide equipment and service to our customers, the Company, through its customer-service oriented marketing program, has suffered very few losses in the terminal equipment market or other areas of our business.

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

As a result of continued growth and the need to pursue the modernization of our system, a construction budget of approximately \$39,000,000 is planned for 1981. Gross construction expenditures (including reuse of equipment and cost of removal) for 1980 totaled \$36,700,000. Conversion of our central offices to electronic switching continues to receive high priority in the construction program. During 1980 an additional five electronic central offices were placed in service, thereby bringing to one-third the number of subscribers served by electronic switching. These high technology digital electronic switching systems provide sophisticated calling

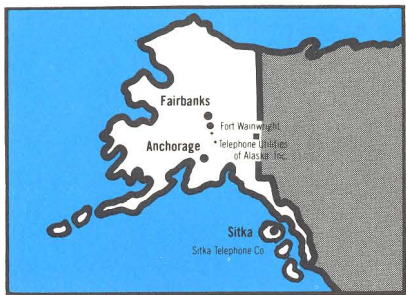
features, are readily expandable, have relatively low maintenance requirements, and require modest building space. In addition, significant cost savings in outside plant facilities can be achieved through replacement of small electromechanical central offices with remote switching units and the application of electronic transmission techniques.

Service demands which require plant construction remain at significant levels in spite of a general slowing of growth, 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 \$39,000,000 1981 construction program, we will generate a major portion of our construction funds internally. However, under a program of this size, outside financing is necessary. The budgeted expenditures are subject to continuing review and modification, and in light of the current high interest rates, 1981's actual expenditures will probably be less than the amounts budgeted. 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



EASTERN WASHINGTON DIVISION

Cheney — Headquarters

Amber	Kettle Falls	Winthrop
Spangle	Connell	
Medical Lake	Mesa	IDAHO
Reardan	Basin City	Grandview
Davenport	Eltopia	Bruneau
Creston	Mathews Corner	Richfield
Hunters	Kahlotus	NEVADA
Valley	Washtucna	Owyhee
Chewelah	Twisp	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	Pilot Rock	Aurora
Brownsville	Boardman	Depoe Bay
Yoncalla	Ukiah	Glenden Beach
Creswell	Lakeview	Maupin
Spray	Paisley	Wamic
Long Creek	Chiloquin	Tygh Valley
Mitchell	Fort Klamath	Pine Grove
Monument	Chemult	Knappa
Paulina	Rocky Point	Scappoose
Fossil	Sprague River	

MONTANA DIVISION

Kalispell — Headquarters

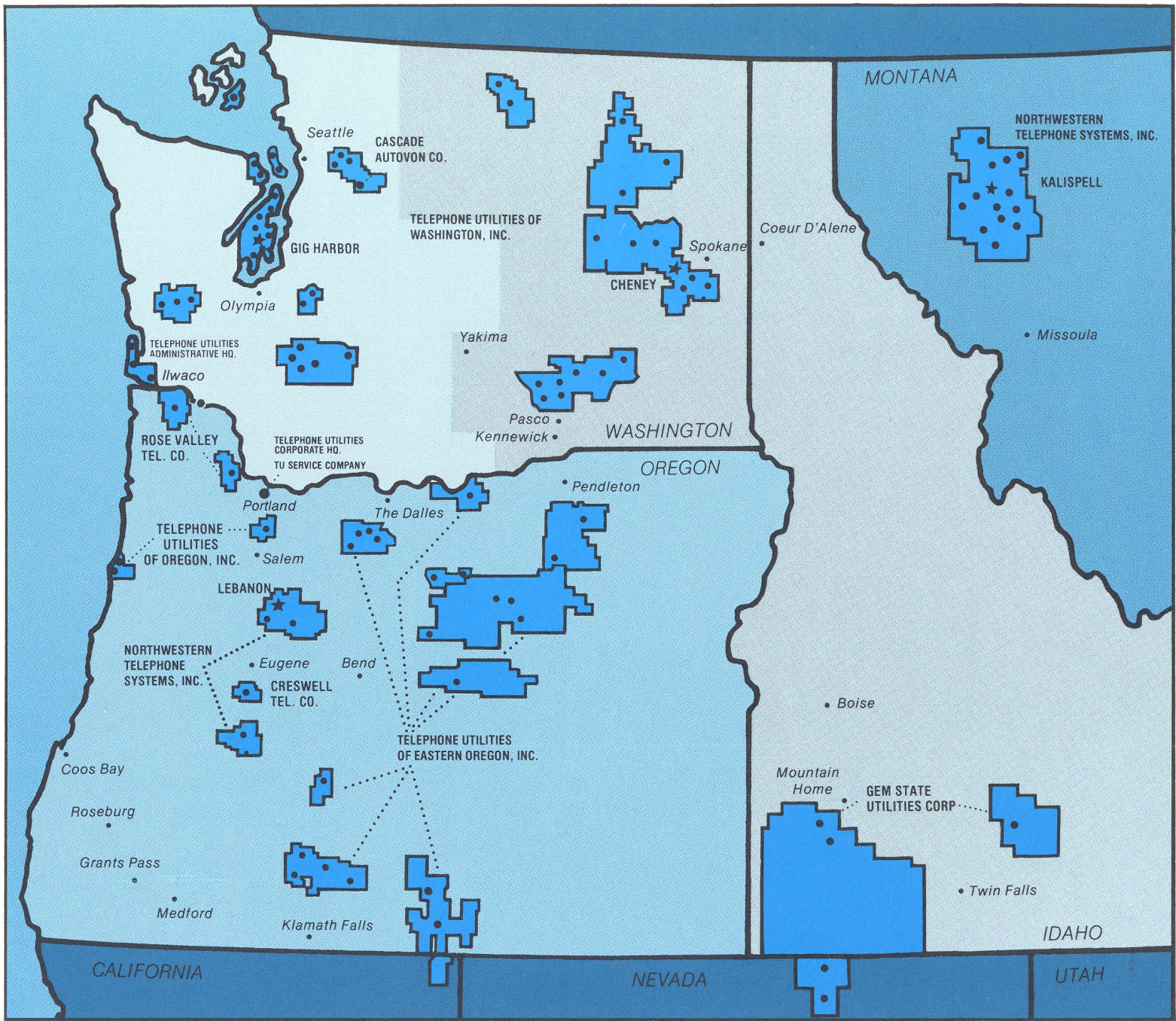
Whitefish	Finley Point	Olney
Columbia Falls	Hungry Horse	Somers
Polson	Lakeside	Swan Lake
Big Fork	Marion	Yellow Bay
Elmo	McGregor Lake	

ALASKA

Sitka	Hoonah	Pelican
Mt. Edgecumbe	Kake	Thorne Bay
Angoon	Klawock	Yakutat
Gustavus	Northway	Ft. Wainwright

CASCADE AUTOVON COMPANY

T U SERVICE COMPANY



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

Revenue and Rate Activities

The 1980 operating results allowed the Company to earn rates of return sufficient to permit completion of the year without applying for general rate relief. Based on present projections, any needed 1981 rate increase applications are expected to have minimal impact on 1981 operating results.

Reflecting the strong economic

health of our growing service area, the Company experienced an 11% increase in originating toll messages during 1980 compared to an increase of 12% in 1979 and 19% in 1978. This rate of growth continues to exceed our growth rate for main stations (number of customers) even though

our main station gains continue at healthy levels.

This growth in toll usage and customers provided significant revenue increases. These increases are reflected in the excellent revenue year set forth in the accompanying financial statements.

Organization

The Company provided full-time employment for 996 people at December 31, 1980 compared with 877 at the prior year-end. This increase includes 60 employees in the newly-acquired companies, and the remaining increase in employees was necessary to meet our growth in customers and maintain our expanded plant facilities. Approximately 60 percent of our employees are covered by seven different bargaining units, six of which are represented by either the International Brotherhood of Electrical Workers or the Communications Workers of America, both AFL-CIO affiliates. Four of these agreements

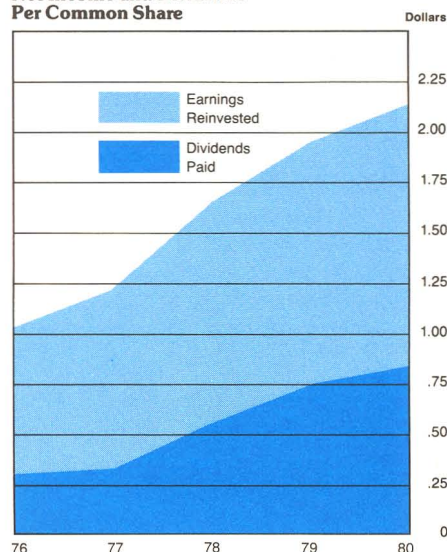
were renegotiated during 1980. A fifth agreement is currently under negotiation; the sixth agreement expires during 1981 and the seventh in 1982. The wage and benefit increases granted in settling the 1980 contract expirations closely parallel those of the major companies in our industry, thereby allowing us to continue to attract competent telephone personnel.

During 1980 a number of management changes occurred reflecting the creation of an overall management group to provide staff support services to both the Company and the other telephone holdings of our majority stockholder. The creation of

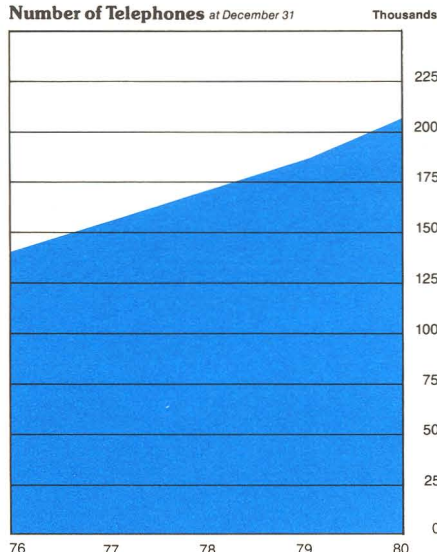
the group allowed us to pull together a highly competent management team to provide continued strong management direction to the Company while minimizing costs by sharing time and talent with our affiliated companies. Please turn to the last page in this report for a list of individuals and assignments involved.

Our work force projections for 1981 reflect a need to modestly increase the labor force to keep abreast of our internal growth and needed marketing effort.

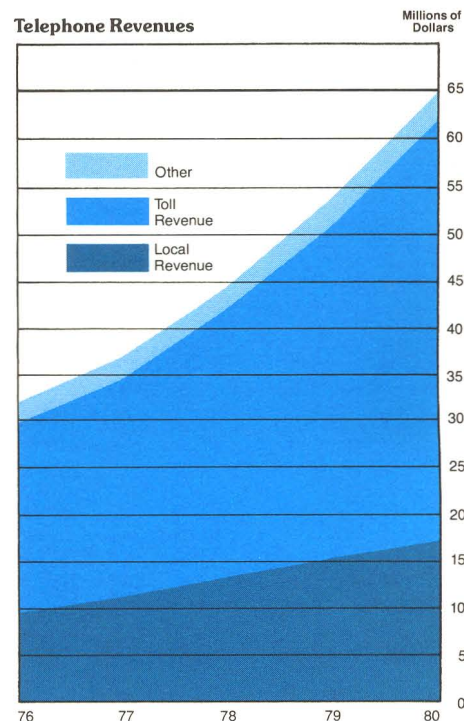
Net Income and Dividends Per Common Share



Number of Telephones at December 31



Telephone Revenues



Telephone Utilities, Inc.

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31—

1980

1979

1978

Operating revenues:

Local service	\$16,847,226	\$15,203,413	\$13,346,499
Toll service	44,987,589	36,192,977	28,782,295
Government communication service	894,853	841,255	915,202
Miscellaneous	2,252,571	1,932,391	1,654,128
Total operating revenues	64,982,239	54,170,036	44,698,124

Operating expenses:

Maintenance	13,871,956	11,160,738	8,440,743
Depreciation (Note 1)	10,609,457	8,505,172	6,966,763
Traffic	1,091,266	982,555	880,882
Commercial, administrative and other	10,835,906	8,095,387	7,012,283
Taxes, other than federal income taxes	4,851,739	4,677,035	3,868,005
Federal income taxes (Notes 2 and 6)	4,414,700	4,120,650	4,541,250
Deferred federal income taxes (Notes 1 and 6)	2,082,000	1,789,000	1,403,000
Deferred investment tax credit, net (Notes 1 and 6)	2,239,000	2,226,000	1,011,500
Total operating expenses	49,996,024	41,556,537	34,124,426

Operating income	14,986,215	12,613,499	10,573,698
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Other income (expense):

Allowance for funds used during construction (Note 1)	—	—	232,673
Other, net	5,958	(6,211)	20,288

	5,958	(6,211)	252,961
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Interest expense—principally on long-term debt	3,588,670	2,563,586	2,669,375
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Minority interest in net income and preferred stock dividends of subsidiaries	29,053	33,666	43,967
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Income from telephone operations	11,374,450	10,010,036	8,113,317
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Parent operations—interest, expenses and taxes, net (Note 5)	1,465,338	874,984	295,759
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Net income	9,909,112	9,135,052	7,817,558
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Preferred stock dividends	30,172	30,172	30,172
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Net income applicable to common stock	\$ 9,878,940	\$ 9,104,880	\$ 7,787,386
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Net income per common share (Note 1)	\$2.12	\$1.95	\$1.65
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See accompanying notes.

Telephone Utilities, Inc.
CONSOLIDATED BALANCE SHEETS

December 31—	1980	1979
Assets		
Telephone plant:		
Telephone plant in service (Notes 1 and 3)	\$191,753,863	\$156,002,186
Less accumulated depreciation	42,102,183	34,394,245
	149,651,680	121,607,941
Construction work in progress	6,797,183	4,657,326
Net telephone plant	156,448,863	126,265,267
 Cost of acquisitions in excess of equity in net assets of subsidiaries (Note 1)	12,645,014	10,779,111
 Current assets:		
Cash	526,126	268,093
Accounts receivable	9,518,780	5,802,648
Material and supplies (Note 1)	5,015,401	7,249,260
Prepayments	187,647	239,044
Total current assets	15,247,954	13,559,045
 Unamortized debt expense and other deferred charges	331,515	279,336
	<u>\$184,673,346</u>	<u>\$150,882,759</u>

See accompanying notes.

	1980	1979
Capitalization and Liabilities		
Shareholders' equity:		
Common stock, \$1 par value, 12,000,000 shares authorized, 4,728,079 shares issued	\$ 4,728,079	\$ 4,728,079
Preferred stock, \$25 par value, 6% cumulative, 152,000 shares authorized, 23,628 shares issued	590,700	590,700
Capital in excess of par value	26,782,317	26,782,317
Retained earnings (Note 3)	38,051,179	32,047,219
	70,152,275	64,148,315
Less treasury stock (at cost) common stock—634 shares in 1980 and 57,134 shares in 1979; preferred stock —3,513 shares in 1980 and 1979	93,416	761,923
Total shareholders' equity	70,058,859	63,386,392
Minority interest in subsidiaries	220,438	208,580
Long-term debt (Note 3)	66,537,920	29,404,211
Current liabilities:		
Notes payable—affiliates (Note 2)	5,000,000	13,700,000
Accounts payable	11,498,265	7,139,650
Income taxes payable	2,815,719	2,903,866
Accrued liabilities	2,517,443	2,342,813
Advance billings	963,926	1,265,893
Current maturities on long-term debt (Note 3)	1,923,275	12,709,844
Total current liabilities	24,718,628	40,062,066
Deferred income taxes (Notes 1 and 6)	11,878,585	9,548,372
Unamortized investment tax credit (Notes 1 and 6)	9,715,831	7,092,012
Other deferred credits	1,543,085	1,181,126
Commitments (Note 7)		
	<u>\$184,673,346</u>	<u>\$150,882,759</u>

See accompanying notes.

Telephone Utilities, Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31—	1980	1979	1978
Sources of working capital:			
From operations:			
Net income	\$ 9,909,112	\$ 9,135,052	\$ 7,817,558
Items not requiring working capital:			
Depreciation and amortization	11,122,327	8,943,978	7,356,853
Allowance for funds used during construction	—	—	(232,673)
Deferred income taxes and investment tax credit, net ...	4,474,000	4,203,000	2,428,000
Total from operations	25,505,439	22,282,030	17,369,738
Long-term debt issued	35,890,000	491,712	—
Long-term debt assumed in connection with acquisition of subsidiaries	2,950,001	—	—
Issue of common stock held as treasury shares	1,421,757	—	—
Salvage from plant and equipment retired	986,492	681,135	837,194
	<u>\$66,753,689</u>	<u>\$ 23,454,877</u>	<u>\$18,206,932</u>
Applications of working capital:			
Property, plant and equipment:			
Additions to telephone plant in service	\$33,302,292	\$ 28,294,224	\$15,254,096
Net change in construction work in progress	2,139,857	363,811	2,081,214
	35,442,149	28,658,035	17,335,310
Allowance for funds used during construction	—	—	(232,673)
	35,442,149	28,658,035	17,102,637
Net plant added through acquisition of subsidiaries	6,258,149	—	—
	41,700,298	28,658,035	17,102,637
Cost of removal of plant and equipment	547,423	366,772	313,101
Reduction of long-term debt	1,706,292	12,748,154	1,779,930
Dividends	3,905,152	3,533,380	2,581,188
Additions to cost in excess of equity in net assets of subsidiaries	1,910,000	—	—
Acquisition of common stock as treasury shares	753,250	601,091	—
Other—net	(801,073)	(296,987)	(258,987)
Increase (decrease) in working capital	17,032,347	(22,155,568)	(3,310,937)
	<u>\$66,753,689</u>	<u>\$ 23,454,877</u>	<u>\$18,206,932</u>
Increase (decrease) in the elements of working capital:			
Cash and temporary cash investments	\$ 258,033	\$ (2,362,851)	\$ (1,216,796)
Accounts receivable	3,716,132	583,835	761,335
Material and supplies	(2,233,859)	2,988,307	2,167,976
Other current assets	(51,397)	26,733	(45,359)
Notes payable—affiliates	8,700,000	(13,700,000)	—
Accounts payable	(4,358,615)	610,733	(1,294,218)
Income taxes payable	88,147	1,145,010	(3,109,782)
Current maturities on long-term debt	10,786,569	(10,868,680)	(107,015)
Other current liabilities	127,337	(578,655)	(467,078)
	<u>\$17,032,347</u>	<u>\$(22,155,568)</u>	<u>\$ (3,310,937)</u>

See accompanying notes.

Telephone Utilities, Inc.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended December 31—	1980	1979	1978
Balance at beginning of year	\$32,047,219	\$26,373,115	\$21,136,745
Net income	9,909,112	9,135,052	7,817,558
	41,956,331	35,508,167	28,954,303
Miscellaneous credits, per regulatory authority	—	72,432	—
	41,956,331	35,580,599	28,954,303
Deduct:			
Cash dividends:			
Common stock (1980—\$.83; 1979—\$.75; 1978—\$.54 per share)	3,874,980	3,503,208	2,551,016
Preferred stock	30,172	30,172	30,172
	3,905,152	3,533,380	2,581,188
Balance at end of year (Note 3)	\$38,051,179	\$32,047,219	\$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 the AFUDC be capitalized only on long-term construction projects (one year or more in duration). Because none of the Company's construction projects which were in process during 1980 and 1979 had a construction period of one year or more, the Company did not capitalize any of the related financing costs.

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 6.6% in 1980, 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, 1980, TU's investment in subsidiaries includes \$12,645,014 of cost in excess of the carrying value of net assets of purchased subsidiaries including excess costs associated with the acquisition of two subsidiaries during 1980 (Note 8). Of the total, \$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 \$3,406,179 and \$1,540,276 at December 31, 1980 and 1979, respectively.

(e) *Material and supplies* — Material and supplies are stated at average cost.

(f) *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.

The reduction in federal income taxes associated with the utilization of investment tax credit (\$2,909,000 in 1980, \$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.

(g) *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, 1980 and 1979, 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 \$243,000 in 1980, \$182,000 in 1979 and \$170,000 in 1978.

(b) *Notes payable-affiliates* — At December 31, 1980 and 1979, notes payable-affiliates represented \$5,000,000 and \$13,700,000 respectively of short-term advances from Pacific. These transactions were made under an agreement providing for temporary cash investment or advances at the prime commercial rate of interest. The daily weighted average balance of advances from Pacific was \$10,311,000 in 1980 and \$5,399,000 in 1979. The weighted average interest rate on these advances was 15% during 1980 and 14% during 1979. The maximum amount outstanding was \$17,600,000 during 1980 and \$13,700,000 during 1979.

(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, 1980 and 1979, consisted of the following:

	1980	1979
Parent Company—		
8%-9.75% Unsecured notes	\$ 9,817,217	\$10,021,867
Unsecured note, due in 1983, variable interest rate (12.99% at December 31, 1980)*	15,000,000	—
Subsidiaries—		
2%-8% First Mortgage notes payable to Rural Electrification Administration and Rural Telephone Bank, maturities through 2015	6,881,049	2,110,154
5.1%-15.8% First Mortgage notes and bonds, maturities through 1998	17,381,478	15,567,848
7.75% Second Mortgage note, due 1980*	—	11,000,000
5.75%-9.75% Unsecured notes, maturities through 2007	3,381,451	3,414,186
Unsecured notes, due in 1983, variable interest rate (17.31% at December 31, 1980)*	16,000,000	—
Total long-term debt	68,461,195	42,114,055
Less current maturities	1,923,275	12,709,844
	<u>\$66,537,920</u>	<u>\$29,404,211</u>

*On March 19, 1980, the Company refinanced a subsidiary's \$11,000,000 second mortgage note until March 1981. This agreement was replaced during September, 1980 by a three year, unsecured loan agreement. In addition, the Company and another subsidiary borrowed additional funds under like agreements. All three loans are unsecured, and bear interest based, at the option of the borrower, on either the prime interest rate or based on the interest rates of certificate of deposit obligations of the lender, and are renewable at the option of the borrowers through September, 1983.

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. Accordingly, consolidated retained earnings available for dividends and other distributions at December 31, 1980 was \$20,600,000 of which \$19,600,000 was available from the retained earnings of subsidiaries.

Total long-term debt maturing annually within each of the four years subsequent to 1981, is as follows:

1982	\$ 1,483,000	1984	\$1,774,000
1983	\$32,659,000	1985	\$1,880,000

4. Pension Plan

Substantially all employees are covered under the pension plan of the Company. Pension costs were \$823,000 in 1980, \$779,000 in 1979 and \$626,000 in 1978 including amortization of past service costs over a ten-year period. Pension costs are funded as accrued. As of January 1, 1980, the date of the most recent actuarial report, the present value of accumulated vested and nonvested plan benefits were \$4,307,000 and \$1,055,000, respectively. A 5% assumed rate of return was used in determining the actuarial present value of accumulated plan benefits, and the plan net assets available for benefits totaled \$4,472,000.

5. Parent operations

Parent operations of TU are summarized as follows:

	1980	1979	1978
Interest income:			
From subsidiaries	\$ 210,910	\$ 10,783	\$ 34,442
From temporary cash investments (Note 2)	29,150	59,173	404,460
	<u>240,060</u>	<u>69,956</u>	<u>438,902</u>
Interest expense:			
To subsidiaries	—	604	18,100
On long-term debt	1,482,865	842,577	864,794
On notes payable—affiliates (Note 2)	1,575,702	756,585	11,853
	<u>3,058,567</u>	<u>1,599,766</u>	<u>894,747</u>
Federal income tax (credit):			
Federal income taxes	(1,222,000)	(768,000)	(266,000)
Deferred federal income taxes	(24,000)	15,000	15,000
Deferred investment tax credit, net	16,000	19,000	(1,500)
	<u>(1,230,000)</u>	<u>(734,000)</u>	<u>(252,500)</u>
Other (income) expense—net	(123,169)	79,174	92,414
	<u>\$ 1,465,338</u>	<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:

	1980	1979	1978
Excess of tax over book depreciation	\$1,814,000	\$1,642,000	\$1,173,000
Cost of removal of retired assets deducted for tax purposes	243,000	162,000	245,000
	<u>\$2,057,000</u>	<u>\$1,804,000</u>	<u>\$1,418,000</u>

The Company's effective combined state and federal income tax rate was 45.1% in 1980, 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 1980 and 1979 and 48% in 1978 is attributable to the following:

	1980	1979	1978
Interest, taxes and pensions capitalized, net	(.3)%	.1 %	(.8)%
Amortization of investment tax credit	(3.6)	(2.7)	(2.3)
State income taxes, net of federal tax benefit	1.9	2.3	1.8
Other	1.1	1.3	1.2
	<u>(.9)%</u>	<u>1.0 %</u>	<u>(.1)%</u>

7. Commitments

Expenditures in connection with the Company's construction program will approximate \$39,000,000 in 1981.

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

8. Subsidiary Acquisitions

Effective August 1, 1980, a subsidiary of TU acquired Greatland Telephone Company which serves Ft. Wainwright, Alaska. The acquisition, which was accomplished through the issuance of 122,000 shares of TU's common stock with an assigned value of \$1,422,000 and \$147,000 in cash, has been accounted for as a purchase. The \$400,000 cost in excess of net assets acquired will be amortized over a forty-year period. The acquired company's operating results subsequent to the date of acquisition are included in the statements. Pro forma operating results, assuming acquisition of this subsidiary at the beginning of 1978, would not significantly change from previously-reported results.

Effective December 31, 1980, TU, for a cash payment of \$2,801,000, acquired Sitka Telephone Company which provides service to approximately 7,300 telephones throughout southeastern Alaska. The acquisition was accounted for as a purchase and the \$1,510,000 of cost in excess of net assets acquired will be amortized over a forty-year period. The accompanying financial statements do not include operating results from this acquisition. Had this subsidiary been acquired at the beginning of 1978, the pro forma results of operations would have been as follows:

	1980	1979	1978
Total operating revenues	\$67,700,000	\$56,414,000	\$46,418,000
Net income	\$10,102,000	\$ 9,215,000	\$ 7,901,000
Earnings per share	<u>\$2.16</u>	<u>\$1.97</u>	<u>\$1.67</u>

9. Quarterly financial data (Unaudited)

Summarized quarterly financial data for 1980 and 1979 is as follows:

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
1980				
Operating revenues	\$14,626,651	\$15,850,459	\$16,457,762	\$18,047,367
Operating income	\$ 3,049,206	\$ 3,682,950	\$ 3,696,978	\$ 4,557,081
Net income	\$ 1,993,924	\$ 2,162,316	\$ 2,560,785	\$ 3,192,087
Net income per common share	<u>\$.43</u>	<u>\$.47</u>	<u>\$.55</u>	<u>\$.67</u>
1979				
Operating revenues	\$12,438,208	\$13,207,988	\$13,527,842	\$14,995,998
Operating income	\$ 2,687,420	\$ 2,905,811	\$ 3,202,164	\$ 3,818,104
Net income	\$ 1,949,167	\$ 2,047,351	\$ 2,260,405	\$ 2,878,129
Net income per common share	<u>\$.41</u>	<u>\$.44</u>	<u>\$.48</u>	<u>\$.62</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 accounts.

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 and current cost 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 its 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, 1980

	As Recorded (Conventional Historical Cost)	As Adjusted for General Inflation (Constant Dollar)	As Adjusted for Changes in Specific Prices (Current Cost)
Operating revenues	\$64,982,239	\$64,982,239	\$64,982,239
Maintenance	13,871,956	13,871,956	13,871,956
Depreciation	10,609,457	17,220,480	17,950,198
Traffic	1,091,266	1,091,266	1,091,266
Commercial, administrative and other	10,835,906	10,835,906	10,835,906
Taxes other than federal income taxes	4,851,739	4,851,739	4,851,739
Federal income taxes	8,735,700	8,735,700	8,735,700
Other income, parent operations, etc. — net	1,488,433	1,488,433	1,488,433
Interest charges	3,588,670	3,588,670	3,588,670
	<u>55,073,127</u>	<u>61,684,150</u>	<u>62,413,868</u>
Income from continuing operations (excluding reduction to net recoverable cost)	<u>\$ 9,909,112</u>	<u>\$ 3,298,089*</u>	<u>\$ 2,568,371</u>
Increase in specific prices (current cost) of property, plant and equipment held during the year			\$18,842,401
Reduction to net recoverable cost		\$(9,251,936)	(2,198,483)
Effect of increase in general price level			<u>(25,166,136)</u>
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost			(8,522,218)
Gain from decline in purchasing power of net amounts owed		<u>10,412,931</u>	<u>10,412,931</u>
Net		<u>\$ 1,160,995</u>	<u>\$ 1,890,713</u>

*Including the reduction to net recoverable cost, the 1980 income on a constant dollar basis would have been a loss of \$5,953,847. At December 31, 1980, current cost of property, plant and equipment, net of accumulated depreciation was \$243,446,762, while historical cost or net cost recoverable through depreciation was \$156,448,863.

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

	Average 1980 Dollars				
	1980	1979	1978	1977	1976
Historical cost information adjusted for general inflation:					
Operating revenues	\$64,982,239	\$61,495,699	\$56,455,972	\$50,523,106	\$46,679,021
Income from continuing operations	3,298,089	4,928,194			
Income from continuing operations per common share71	1.05			
Reduction of plant to net recoverable cost	9,251,936	11,009,758			
Net assets (shareholders' equity) at year-end	66,913,802	68,045,940			
Current cost information:					
Income from continuing operations	2,568,371	4,119,965			
Income from continuing operations per common share55	.88			
Excess of increase in general price level of plant held during the year over changes in specific prices after reduction to net recoverable cost ...	8,522,218	10,201,518			
Net assets (shareholders' equity) at year-end	66,913,802	68,045,940			
Other information:					
Purchasing power gain on net monetary items held during the year	10,412,931	9,320,495			
Cash dividends declared per common share	\$.83	\$.86	\$.68	\$.35	\$.42
Market price per common share at year-end	\$11.94	\$12.61	\$14.29	\$11.60	\$ 8.85
Average Consumer Price Index	246.8	217.4	195.4	181.5	170.5

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, 1980 and 1979 and the related consolidated statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1980. 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, 1980 and 1979 and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1980, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins & Sells

Portland, Oregon
January 26, 1981

Officers

A. M. GLEASON
President and Chief
Executive Officer

C. E. PETERSON
Senior Vice President
and General Manager

VERN K. DUNHAM
Senior Vice President
Revenue Requirements

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

GEORGE P. ROBERTS
Senior Vice President
Engineering

JAMES P. BEST
Vice President—Controller

JOHN H. GEIGER
Vice President

MICHAEL E. HOLMSTROM
Vice President
Financial and Business Planning

JOHN E. MCGILL
Vice President
Regulatory Affairs

DIANA E. SNOWDEN
Vice President
Industrial Relations

BRIAN M. WIRKKALA
Vice President
and Secretary-Treasurer

JOHN DETJENS III
Assistant Secretary

MARGARET WANN
Assistant Secretary

MARVA J. WIRKKALA
Assistant Treasurer

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

RUSSELL A. HARTMAN
Director, Planning and Budgeting Services
Eastern Washington University
Cheney, Washington

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

ROBERT A. SNEDDON
Plant Manager, Anaconda
Aluminum Company, a Division
of The Anaconda Company,
Columbia Falls, Montana

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

Common Stock Telephone Utilities, Inc.

Range of Bid and Asked Prices for Quarters Ended
(Source: NASD OTC Quote System)

	Bid		Asked	
	High	Low	High	Low
March 31, 1979	14½	11	16	11¾
June 30, 1979	14¼	13¼	15¼	13¼
September 30, 1979	14¼	13¾	15¼	14¾
December 31, 1979	13¾	10	14¾	11
March 31, 1980	11¾	9½	12¾	11
June 30, 1980	11¾	9½	13¾	11
September 30, 1980	14½	11¾	15½	13
December 31, 1980	13¾	11¾	14½	12¾

Cash dividend payable dates

Per Share		Per Share	
March 3, 1980	\$.20	March 5, 1979	\$.15
June 2, 1980	\$.20	June 4, 1979	\$.20
September 2, 1980	\$.20	September 4, 1979	\$.20
December 8, 1980	\$.23	December 3, 1979	\$.20

See Note 3 of Notes to Consolidated Financial Statements for restriction as to payment of dividends.

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

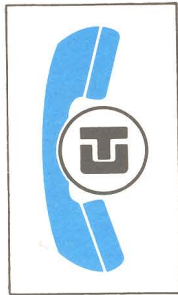
Deloitte Haskins & Sells
Portland, Oregon

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, Telephone Utilities, Inc., 1221 Southwest Yamhill Street, Suite 200, Portland, Oregon 97205.

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 27, 1981 at the Company's offices, 1221 Southwest Yamhill Street, Suite 200, Portland, Oregon 97205.



**TELEPHONE
UTILITIES, INC.**
