



# Management's Discussion and Analysis

## First Quarter 2006

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*This document provides management's discussion and analysis (MD&A) of our financial condition and results of operations for the three month period ended March 31, 2006, compared to the corresponding period in 2005. The MD&A should be read in conjunction with our unaudited interim consolidated financial statements and accompanying notes as at and for the period ended March 31, 2006, and our December 31, 2005, audited consolidated financial statements and accompanying notes, and MD&A. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). All amounts in this MD&A are in millions of Canadian dollars, except where otherwise noted.*

*Throughout this MD&A, "we", "us", "our" and "Aliant" refer to Aliant Inc. or our Telecommunications and Information Technology segments.*

*Quarterly reports, annual reports and supplementary financial information, as well as annual information forms and information circulars, can be found under "financial reports" on our corporate website at [www.aliant.ca](http://www.aliant.ca). These and other continuous disclosure documents are also available at [www.sedar.com](http://www.sedar.com).*

*This MD&A is dated May 1, 2006, which is the date of filing in conjunction with our press release announcing our results for the first quarter of 2006. This document contains forward-looking statements, which are qualified by reference to, and should be read together with, the "Forward-looking statements" section. Disclosure contained in this MD&A is current to, and describes our expectations on, May 1, 2006, unless otherwise stated.*

## About our business

We are Atlantic Canada's leading information and communications technology (ICT) provider, complementing our telecommunications business with strengths in information technology to deliver complete customer solutions.

We have two business segments, telecommunications and information technology. Information technology is a reportable segment and during 2005, our telecommunications segment was sub-divided into two reportable segments, wireline and wireless. We continue to combine the strengths of our telecommunications and information technology business segments to be the provider of choice for all communications, information and entertainment services. We serve customers in several geographic markets and across many different industries.

Our telecommunications business segment operates primarily through Aliant Telecom Inc. (Aliant Telecom). We provide a wide range of innovative and traditional voice and data communications services including local, long distance, wireless, Internet and other services. We also provide complementary services, in knowledge-service applications, retail sales, telephone directory advertising and wholesale distribution of wireless handsets, accessories and other telecommunications products. Wireless operations constitute a reportable segment and the remaining operations are included in the wireline reportable segment.

The business of our information technology segment is carried out through Xwave Solutions Inc. (xwave). We provide clients with a complete range of information technology (IT) solutions through our consulting, infrastructure management and product fulfillment services.

### Creation of an income trust

On March 7, 2006, we jointly announced with BCE Inc. (BCE) our intention to create one of the largest regional telecommunications service providers in North America (the proposed transaction). We will combine our wireline telecommunications and related operations in Atlantic Canada with Bell Canada's wireline telecommunications operations in its regional territories in Ontario and Quebec, and its indirect 63.4 per cent interest in the Bell Nordiq partnerships, Telebec, Limited Partnership and NorthernTel, Limited Partnership, to form Bell Aliant Regional Communications Income Fund.

As part of the transaction, Bell Canada will also acquire our wireless telecommunications operation and our ownership interest in DownEast Ltd.

The transaction is subject to shareholder, court and regulatory approvals as well as favourable advance tax rulings by the Canada Revenue Agency. It is anticipated that required approvals will be received and the proposed transaction will close in the third quarter of 2006. We have called a meeting of our shareholders to consider, and if deemed advisable, to approve the proposed transaction. A management information circular, dated April 14, 2006 (the Circular), has been mailed in connection with this meeting.

This business combination provides many strategic advantages for us.

#### *Creates one of the largest North American regional telecommunications service providers*

By combining forces, we will create a much larger and more stable organization serving customers in six provinces. The combined business will be double the size of Aliant today and will be the third largest incumbent local exchange carrier (ILEC) in Canada. The greater scale is expected to improve operational efficiencies and financial flexibility. With its lower cost of capital and scaleable operations, following the completion of the proposed transaction, it is anticipated that the combined business will be in a favourable position to become a leading consolidator of North American regional telecommunications companies. In addition, it also creates a broadly contiguous footprint connecting Atlantic Canada with the Bell Canada regional territory, enabling potentially greater efficiencies in the future.

#### *Combines similar operations and markets*

Our current operations and Bell Canada's regional wireline operation are comprised principally of small- to medium-sized cities and geographically dispersed rural areas. The combined business will remain focused on the needs of regional customers, yet have the scale and geographic reach to enable operational efficiencies and to provide customers with access to the latest high-quality networks, products and services.

### *New structure provides growth opportunities*

It is anticipated that the additional operational scale of the combined business will enhance the stability and strength of cash flows, which are well suited to an income trust structure. We believe that conversion to an income trust will result in a higher valuation for the combined business in comparison to our current corporate structure, as the market places a premium on the valuation of income trusts. It is anticipated that this will position us for future growth opportunities, including additional wireline communications acquisitions in regions with relatively low population density, or other acquisitions that support our strategy and are accretive to distributable cash flows.

### *Our wireless telecommunications operation requires scale*

While our wireless telecommunications segment has enjoyed considerable success, the Atlantic Canadian market is becoming more competitive as national competitors expand their Atlantic Canada operations and exert increasing pressure on the market. We have recognized the lack of scale in our wireless telecommunications segment as an obstacle to further advancing the services provided to customers and therefore to future growth. Important commercial agreements between Bell Canada and the combined business will facilitate the continued seamless access by our customers to wireless products and services. Our customers will further benefit from greater and earlier access to new technologies, like Evolution Data Optimized (EVDO) and new wireless data applications.

### **Strategic direction for 2006 and beyond**

We remain committed to our strategy to be a leading ICT services provider to our business customers and to be the provider of choice for our consumers' information, communications and entertainment services. Operating our wireline and other businesses and the Bell Canada regional wireline business as a combined business will allow for an increased focus on serving the needs of our customers, as we will have the scale and geographic reach to enable operational efficiencies, while providing customers with access to the latest high-quality networks, products and services, including value added services (VAS), multimedia, broadband and Internet. In addition, the combined business will also benefit from the extension of our existing ICT strategy and xwave's expertise to serve over 85,000 business customers in Ontario and Quebec, providing them with leading edge business solutions.

### *Customer experience*

The combined business will provide best-in-class service to support customers through a highly trained and skilled workforce focusing on first call resolution. We will deliver enhanced self-service (e-service) tools and automated service activation to reduce manual processes and provide differentiated service to customers based on value. We will continue to improve service reliability and trouble rates through investment in service improvement programs and commit to consistent service experiences across all channels. We are committed to making the transition into an income trust structure seamless for customers by providing the same service, same bill and same brands.

### *Operating revenue growth*

The combined business intends to drive operating revenue growth by increasing the penetration of high-speed Internet and VAS, leveraging xwave's capabilities in Ontario and Quebec, continuing our emphasis on bundling strategies and introducing new products and services.

## Quarter at a glance

### Financial results

*For the period ended March 31*

*(millions of dollars, except per share amounts)*

	2006	2005	% change
Operating revenues	\$ 544.9	\$ 524.4	3.9
Expenses	448.6	437.7	2.5
Operating income	96.3	86.7	11.1
Other expenses	12.8	0.9	-
Interest charges	17.4	17.4	0.3
Income taxes	25.3	24.4	3.9
Non-controlling interest	0.6	0.4	38.2
Net income	\$ 40.2	\$ 43.6	(7.8)
Earnings per common share	\$0.30	\$0.31	(3.2)

Operating revenues for the first quarter of 2006 increased by 3.9 per cent over the same period last year, reflecting growth in all areas except traditional local and long distance.

- Wireless revenue grew 14.3 per cent over the first quarter of 2005 driven by a 12.9 per cent increase in our customer base and a 2.6 per cent increase in average revenue per customer (ARPC).
- Internet revenue grew 20.7 per cent in the first quarter, fuelled by high-speed Internet revenue growth of 42.2 per cent.
- IT fulfillment revenue grew 13.9 per cent, experiencing strong growth in public sector sales.
- External IT services revenues grew by 1.0 per cent in the first quarter, with growth being driven by new contracts or incremental growth in existing contracts.
- Revenues from our knowledge service applications subsidiary, Innovatia Inc. (Innovatia) were up 23.5 per cent in the first quarter, over the same period last year, due to expansion in documentation services.
- Revenues from our local and long distance services declined by a combined 3.9 per cent this quarter over the same period last year. This is due to competition, technology substitution and regulatory constraints. Lower residential average revenue per minute contributed to a decline in long distance revenue, however, residential long distance minutes increased during the quarter due to significant customer adoption of our value packages.

First quarter operating income increased by 11.1 per cent, or \$9.6 million, over the results for the same period in the prior year. Operating expense increases required to drive revenue growth are being contained through sound general expense management.

Net income decreased by 7.8 per cent in the first quarter of 2006, when compared to the first quarter of 2005, mainly as a result of a financial derivative loss of \$13.1 million, discussed further in the "Other financial arrangements" section.

We generated cash from operating activities of \$99.7 million, an increase of \$67.2 million over the same period last year. In the first quarter of 2005, we made \$60.0 million in voluntary contributions to address deficits in our defined benefit (DB) pension plans. Due to their voluntary nature, these payments did not recur in 2006. Financing and investing activities used cash of \$213.4 million, mainly comprised of \$76.9 million in common and preferred dividends, the redemption of \$50.0 million of first mortgage bonds, and \$80.9 million in capital investments.

## Progress on our strategic initiatives

During the first quarter of 2006, we advanced our growth strategy in residential, small- to medium-sized business (SMB) and enterprise markets and we progressed on our initiatives for productivity and cost structure improvements:

- We launched an innovative wireless fidelity (Wi-Fi) Internet service for businesses in our region. The service allows businesses to provide their customers with seamless wireless, or wired, Aliant high-speed Internet access while on their premises.
- We launched our Worldphone service. In partnership with Vodafone Group Plc, our customers will now be able to access wireless voice service and text messaging in many countries around the world that use the global system for mobile communications technology.
- We expanded our popular residential market PC purchase program to include a notebook package, which will allow customers to experience portable wireless online access along with the general flexibility that notebooks provide. In addition, we launched a business PC purchase program designed to meet the needs of small and home-based businesses. This program bundles our business Internet services with the purchase of a PC designed for small businesses and provides our customers with the ability to access advanced features, such as Aliant Anti-Virus, PC Back up, fax-to-email and around-the-clock toll-free technical support.
- We launched our innovative Internet protocol (IP)-based hosted contact centre solution. The solution is a network-hosted environment that delivers both voice-over Internet protocol (VoIP) and full contact centre functionality.
- We are advancing on our strategy to roll out our IP-based television service, Aliant TV. Customer adoption and satisfaction rates continue to be positive. Aliant TV is available in select areas of Halifax. We plan to roll out our fibre-to-the-node network, which enables Aliant TV, throughout Halifax and into other major urban centres in our region.
- We launched high-speed wireless service, based on third generation EVDO technology, in the Halifax area. This high-speed service provides customers access to wireless data at speeds up to five times faster than what was previously available. Faster speeds allow customers to experience applications, such as streaming video and TV clips, video messaging, web browsing, interactive gaming and remote access to office e-mail and data. The service will be rolled out in other urban centres throughout the region later this year. We estimate that this service will be available to approximately 60 per cent of customers in Atlantic Canada by the end of 2007.
- We signed a 15-year service agreement with Newfoundland and Labrador Hydro, under which we will build, own and operate a province-wide trunked mobile radio system in Newfoundland and Labrador. Upon completion of the system in early 2007, we will begin providing two-way radio communications to Newfoundland and Labrador Hydro, the Department of Transportation and Works, and the broader commercial market in Newfoundland and Labrador.
- We expanded self-serve opportunities for our residential customers by making available, for the first time, on-line management of landline account. Customers now have a simple vehicle by which to add, change or remove most of our landline products and services. Also in line with our customer service transformation strategy, we made significant updates to our consumer contact centre technology, which will align interactive voice response options and reduce internal call transfers.
- We continued to advance our strategy to restructure costs by reducing discretionary spending, renewing supplier contracts and accelerating outsourcing initiatives.

## Environmental update

### *Regulatory*

Significant regulatory developments that affected our telecommunications business during the first quarter and up to and including May 1, 2006, are:

- On February 16, 2006, the Canadian Radio-television and Telecommunications Commission (CRTC or the Commission) issued its decision regarding the application of the deferral account balances and allowable measures to reduce the accumulated deferral account balances:
  - The CRTC first directed each incumbent local exchange carrier (ILEC) to allocate a minimum of 5.0 per cent of the accumulated balance in its deferral account to improve access to telecommunications services for persons with disabilities; and
  - With respect to the remaining 95.0 per cent of the funds in the deferral account, the CRTC addressed both broadband service investments and subscriber rebates. The CRTC concluded that each ILEC could use funds in its deferral accounts for initiatives to expand broadband services to rural and remote communities. Those ILECs who choose to invest in broadband are required to file a proposal with the CRTC by June 30, 2006, for approval to draw down qualified expenditures from their deferral accounts. If an ILEC chooses not to invest in broadband expansion, or invests in such expansion but has money left over in its deferral account, the remaining funds will be rebated to the ILEC's residential local subscribers in non-high cost serving areas.

Amounts that will arise in the future on a recurring basis and would otherwise be added to the deferral account may be reduced through rate reductions for certain residential subscribers. We have been directed by the CRTC to file our rate proposal along with our updated deferral account balances by May 15, 2006. These rate changes, subject to CRTC approval, are to become effective on June 1, 2006, and may also be used to clear any additional annual deferral account obligation as a result of the extension of the second price cap period to May 31, 2007.

In its decision, the CRTC also estimated ILEC's deferral account amounts, on an accumulated balance and future annualized commitment basis. Our accumulated balance at May 31, 2006, was estimated to be \$21.8 million with an estimated annualized commitment of \$2.2 million. Due to the nature and number of uncertainties about the disposition of the accumulated deferral account, we are unable to estimate the impact of the CRTC's decision on our financial results.

- On March 22, 2006, the Telecommunications Policy Review Panel (the Panel) released its report on the first comprehensive review of Canadian telecommunications policy and regulation in over 30 years. The Panel concluded that it is time for significant changes to current regulatory and policy approaches, which will allow our industry to respond more rapidly to new technology and market developments.

The highlights of the report include:

- Competition in Canadian telecommunications markets has now evolved to a point where market forces should be relied upon as much as possible. For example, the Panel states that tariffs for bundles should not need prior approval before coming into effect, that win-back campaigns should not be restricted by the regulator and that the rules should be the same regardless of technology, whether the service provider is a telecommunications company or cable company.
- Deregulation should be accelerated to promote a more innovative and customer-responsive environment.
- A Telecommunications Competition Tribunal (TCT) should be established as a means to move to less regulation.
- The TCT would review economic regulation, if a need exists, while the CRTC's role would be limited to social and technical regulation and licensing.
- Government should lead the development and implementation of a national ICT strategy, to encourage ICT adoption by all Canadian businesses, especially the SMB market.

- A government funded infrastructure program should be developed to complete the build of broadband to all Canadians no later than 2010.

We will be working with other industry partners to encourage the Federal Government and Industry Canada to implement these recommendations.

- On April 6, 2006, the CRTC ruled on our April 2004 application for forbearance of local residential services in 32 exchanges in Nova Scotia and Prince Edward Island which, if approved, would have allowed for greater pricing flexibility and symmetrical competition. Instead, the Commission denied our application and set out a framework to be used for all future local phone service forbearance applications. We intend to appeal the decision and believe that it was contrary to the spirit of the Panel report.

As part of this decision, the Commission also reduced the win-back restriction from 12 months to three months, which will allow us to contact former customers sooner.

The VoIP appeal to the Governor in Council will be addressed by Cabinet during the second quarter of 2006. The timing of any CRTC decision on other issues, including our 2005 applications related to quality of service rebates, is unknown.

### *Competitive*

Parts of Atlantic Canada continue to experience the most intense local competition in the country as our competitors expand their coverage area and new competitors launch services. Local and national competitors continue to develop their infrastructure and expand their service offerings in all market segments. Our strategy is to focus on the needs of our customers by communicating with them directly, offering greater simplicity and value through competitively priced solutions, particularly through residential market value packages and business bundles, and building world class service through our continued investment in networks and people.

## Operating results

The following is our discussion and analysis of the significant components of our consolidated operating results for the three months ended March 31, 2006, in comparison to the same period in 2005.

### Operating revenues

*For the period ended March 31*

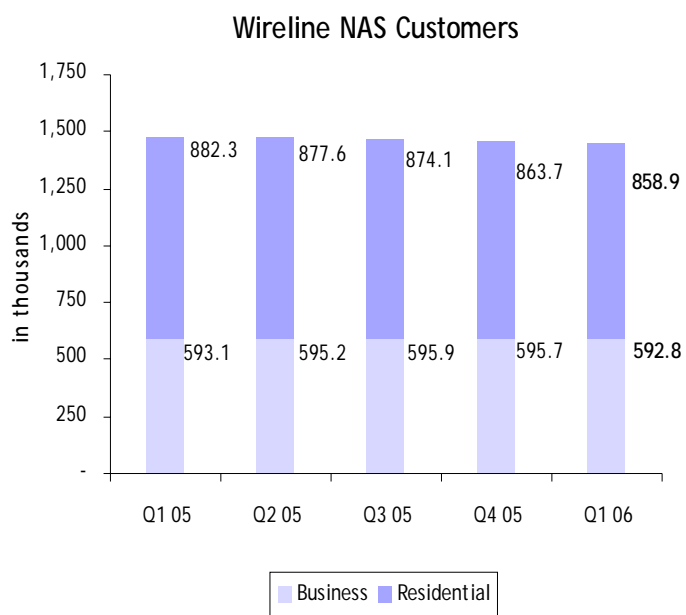
*(millions of dollars)*

	2006	2005	% change
Telecommunications			
Local	\$ 177.3	\$ 182.5	(2.8)
Long distance	74.7	79.7	(6.3)
Wireless	113.8	99.6	14.3
Internet	37.0	30.6	20.7
Other revenues	57.3	53.4	7.3
	460.1	445.8	3.2
Information Technology			
IT Services	42.8	50.9	(15.9)
Fulfillment	61.4	53.9	13.9
	104.2	104.8	(0.6)
Other and intercompany eliminations	(19.4)	(26.2)	(26.0)
Operating revenues	\$ 544.9	\$ 524.4	3.9

## Local revenue

Local revenue is earned through the provision of network access service (NAS), enhanced service features, data access, contribution payments, competitor payments, telephone set rentals, payphone usage and service charges.

Local revenue continued to decline in the first quarter of 2006, at a pace similar to that experienced during the same period in 2005, due to recent service area expansion by our competition, technology substitution and regulatory constraints. Revenue for the first quarter of 2006 is down 2.8 per cent over the same period in the prior year.

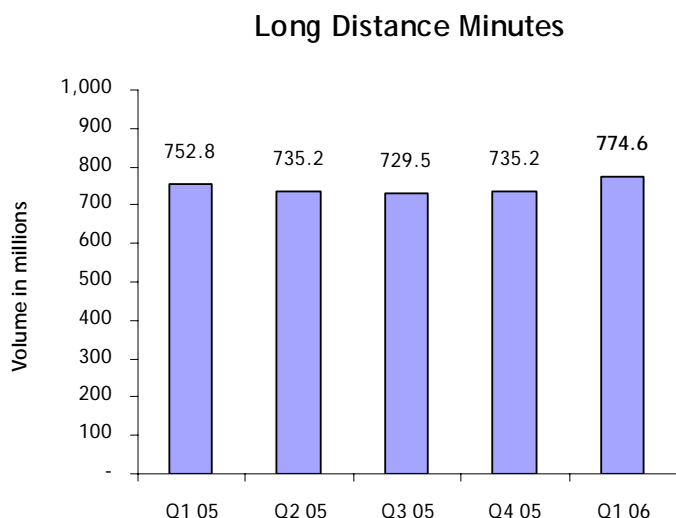


The majority of our local revenue is earned through the provision of NAS. NAS revenues declined 1.5 per cent compared to the first quarter of 2005, a direct result of the 1.6 per cent decline in our NAS customer base. Residential NAS revenue declined 2.7 per cent year over year, which reflects competitive losses, the reduction of second lines as dial Internet customers migrate to high-speed and the reduction in primary lines as customers adopt wireless and VoIP technologies. Our business NAS revenue has remained virtually unchanged from March 31, 2005, as our strong marketing programs in both the SMB and enterprise markets support customer retention.

Revenue from sources other than NAS declined by 5.0 per cent compared to the first quarter of 2005. Data access revenue was lower by 5.0 per cent as a result of the CRTC's Competitive Data Network decision, rendered in February 2005. In addition, terminal set rental revenue is 12.9 per cent lower, due to the continued erosion of the rental base, as customers are choosing to purchase rather than rent.

## Long distance revenue

Long distance revenue is earned through toll, data network and long distance terminating services.



Long distance revenue declined by \$5.0 million or 6.3 per cent compared to the first quarter of 2005, mainly as a result of lower per-minute and data circuit pricing.

In the residential market, long distance minutes in the first quarter of 2006 increased 5.4 per cent from the same period in 2005, due to a significant increase in the number of customers taking unlimited long distance plans in our value packages. Our success in marketing value packages has resulted in increased customer retention and enabled us to stabilize our customer base. Converting customers to our value packages contributed to a 14.7 per cent decline in the

residential average revenue per minute, but secures growing wireless and Internet revenues.

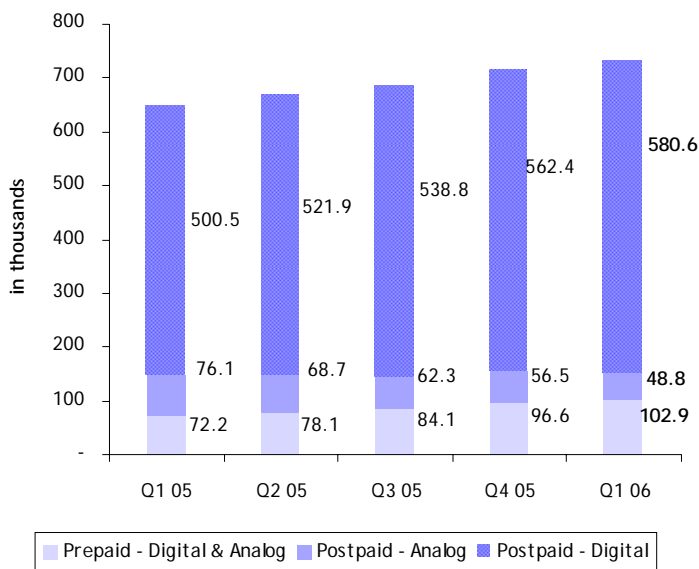
Business long distance revenues are declining due to competitive pricing pressures and contact centre minute usage reductions, as the contact centre industry continues to implement new technologies.

Data circuit revenues declined 6.0 per cent in the first quarter of 2006, reflective of lower prices in the enterprise market.

*Wireless revenue*

Wireless revenue is earned through the provision of cellular, paging and mobile radio services over our analog and digital wireless network. Cellular revenues consist primarily of monthly recurring charges and also include charges for airtime, long distance, roaming and enhanced service features, such as text and video messaging and web browsing.

**Cellular Customers**



Wireless revenue grew by 14.3 per cent in the first quarter of 2006, compared to the same period in the prior year, driven by strong customer growth, higher average revenues per customer (ARPC) and an increase in average minutes of use.

Our customer base grew 12.9 per cent, year over year, with net activations of 16,850, up by 83.2 per cent over the first quarter of 2005, as we continue to enhance our dealer network and offer broad product selection. Gross activations in the first quarter of 2006 were up by 13.5 per cent over the prior year and our customer turnover rate, or churn, improved by 20.5 per cent. Our churn rate remains very strong at 1.08 per cent, as a growing number of our customers are subscribing to value packages, business bundles and longer term contracts. The churn rate for postpaid customers was a notable 0.99 per cent for the first quarter of 2006. At March 31, 2006, approximately 90 per cent of Atlantic Canada’s population had access to our digital wireless network, up from approximately 89 per cent at the same time last year.

ARPC for postpaid customers grew by 5.0 per cent over the same period in 2005, reflecting increased average minutes of use and significantly higher data usage, driven by text messaging, Web browsing, Blackberry® and premium content downloads. Prepaid ARPC grew by 6.9 per cent, as more and more prepaid customers are subscribing to value-added services offered in some of our prepaid plans. Overall ARPC grew by 2.6 per cent over the same period in 2005; this lower overall growth being more reflective of a slightly higher proportion of prepaid customers in our base relative to 2005. Prepaid customers represent 14.1 per cent of the total customer base at March 31, 2006, compared to 11.1 per cent at March 31, 2005. The higher prepaid mix reflects our strategy of driving wireless growth through an increased focus on profitable growth of our prepaid customer base, while maintaining our solid postpaid performance.

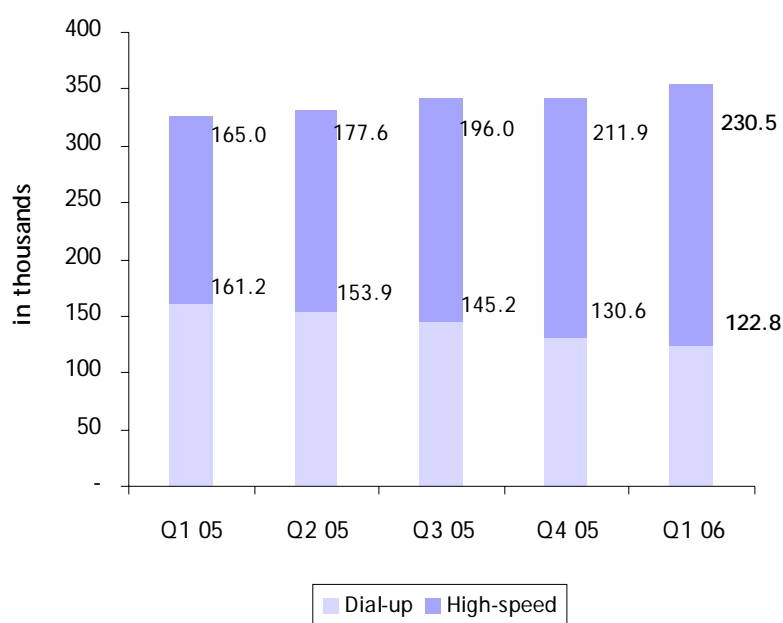
Wireless - statistics

For the period ended March 31	2006	2005	% change
Customers	732,343	648,860	12.9
Monthly - ARPC (dollars)			
Postpaid	\$ 56.94	\$ 54.24	5.0
Prepaid	\$ 11.52	\$ 10.78	6.9
Total	\$ 50.66	\$ 49.36	2.6
Gross activations	40,358	35,556	13.5
Deactivations	23,508	26,359	(10.8)
Net activations	16,850	9,197	83.2
Monthly - Average minutes of use per customer	278	264	5.3
Postpaid churn	0.99%	1.25%	(20.8)
Blended churn	1.08%	1.36%	(20.6)

Internet revenue

Internet revenue is earned through high-speed and dial-up service, enhanced services and applications such as TV on my PC™, security services, music download service and dial-up accelerator.

Internet Customers



Internet revenue for the first quarter of 2006 grew by 20.7 per cent over the same period in 2005, led by a 42.2 per cent growth in high-speed revenue. Revenue growth was driven by high-speed customer growth, lower use of promotional pricing and increased adoption of enhanced services.

Our high-speed customer base grew 39.7 per cent over the first quarter of 2005, contributing to total year-over-year Internet customer growth of 8.3 per cent. Net customer additions for high-speed service were 19.2 per cent higher than in the first quarter of 2005, largely due to competitive marketing offers, proactive management of dial migration, expansion of our service area, success in marketing our new home business Internet service and the continued popularity of the PC purchase program. The reduction in our dial-up customer base continues to reflect migration to high-speed service. At March 31, 2006, our high-speed Internet service passed 83 per cent of homes and 87

per cent of businesses in Atlantic Canada, up from 74 per cent and 80 per cent, respectively, at March 31, 2005.

Customer churn has been mitigated by our continued focus on customer retention and loyalty management programs, and through the continued success of value packages and business bundles that integrate Internet services with other products. Overall, our blended customer churn for the first quarter of 1.62 per cent was lower than the 1.78 per cent churn for the first quarter of 2005.

Consumer high-speed ARPC continued to increase and has shown strong growth over the first quarter of 2005, due to a move away from promotional pricing and increased penetration of ultra high-speed and value added services. Business high-speed ARPC declined, as expected, based on continued adoption of our home business high-speed Internet package introduced in 2005 as part of our strategic initiative to drive Internet growth in the SMB marketplace.

#### Internet - statistics

<i>For the period ended March 31</i>	2006	2005	% change
<b>Operating revenue (millions of dollars)</b>			
Dial-up	\$ 8.8	\$ 10.8	(18.8)
High-speed	\$ 28.2	\$ 19.8	42.2
Total	\$ 37.0	\$ 30.6	20.7
<b>Monthly - ARPC (dollars)</b>			
Consumer dial-up	\$ 21.20	\$ 19.90	6.5
Consumer high-speed	\$ 34.02	\$ 31.48	8.1
Business dial-up	\$ 46.51	\$ 46.77	(0.6)
Business high-speed	\$ 82.67	\$ 91.98	(10.1)
<b>Net additions</b>			
Dial-up	(7,808)	(6,951)	12.3
High-speed	18,600	15,599	19.2
Total	10,792	8,648	24.8
<b>Churn</b>			
Consumer high-speed	1.24%	1.27%	(2.4)
Business high-speed	1.79%	1.62%	10.5
Blended (high-speed and dial-up)	1.62%	1.78%	(9.0)

#### *Other revenues*

*For the period ended March 31*

<i>(millions of dollars)</i>	2006	2005	% change
Product	\$ 29.9	\$ 29.7	0.7
Directory	13.4	\$ 12.4	8.1
Innovatia	10.5	\$ 8.5	23.5
Miscellaneous	3.5	\$ 2.8	25.0
	\$ 57.3	\$ 53.4	7.3

Our directory business continues to experience growth in revenues through growth in its yellow pages advertising base. Also during the first quarter of 2006, Innovatia experienced growth in documentation services, as this area has expanded to take on additional work and provide more value added services to customers.

#### *IT services revenue*

IT services revenue is earned through systems integration, software engineering, business consulting and infrastructure services, such as data centre, help desk, security and technical support services.

IT services revenue declined \$8.1 million in the first quarter of 2006, compared to the same period in the prior year. Revenues from internal customers declined \$8.4 million, reflecting the 2005 organizational integration of the infrastructure services function of our information technology segment into our telecommunications segment, which involved the transfer of approximately 425 employees from xwave to Aliant Telecom. Approximately \$10 million of IT outsourcing revenue, charged to the telecommunications segment in the first quarter of 2005, is now performed directly by the telecommunications segment, reducing internal revenues. At the consolidated reporting level, these internal revenues are eliminated. IT services revenues from external customers grew by \$0.3 million in the first quarter, or 1.0 per cent, compared to the same period in the prior year. Growth was driven mainly by new contracts or incremental growth in existing contracts with external customers.

#### *Fulfillment revenue*

Fulfillment revenue is earned through the sale of computer hardware, accessories and packaged software.

Fulfillment revenue in the first quarter of 2006 grew 13.9 per cent over the same period in 2005, mainly due to growth in public sector sales.

### **Expenses**

*For the period ended March 31*

*(millions of dollars)*

	2006	2005	% change
<b>Expenses</b>			
<b>Operating expenses</b>			
Cost of operating revenues	\$ 89.0	\$ 83.0	7.2
Pension and other post-employment benefit costs	24.8	25.3	(2.0)
Other operating expenses	235.6	230.8	2.1
	<b>349.4</b>	<b>339.1</b>	<b>3.0</b>
Depreciation and amortization	98.9	98.6	0.3
Restructuring and other charges	0.3	-	-
	<b>\$ 448.6</b>	<b>\$ 437.7</b>	<b>2.5</b>

#### *Cost of operating revenues*

The cost of operating revenues increased by 7.2 per cent for the first quarter when compared with the same period in the prior year, primarily driven by a \$7.3 million increase in cost of goods sold associated with the increase in fulfillment revenue.

## *Pension and other post-employment benefit costs*

*For the period ended March 31*

*(millions of dollars)*

	2006	2005	% change
Defined benefit	\$ 20.2	\$ 18.3	10.4
Defined contribution	2.2	2.9	(24.1)
Other post-employment benefits	2.4	4.1	(41.5)
	\$ 24.8	\$ 25.3	(2.0)

Overall pension and other post-employment benefit costs declined 2.0 per cent in the first quarter of 2006, compared to the same period in 2005, reflecting the positive results of our efforts to bring a measure of stability to these costs over the last two years. While DB pension costs have increased, the DB pension plans were closed to new entrants as a result of plan amendments in 2004. Also, amendments to our OPEB plans made in the first quarter of 2006 have resulted in immediate cost reductions and will also lower our exposure to future growth in these costs.

The increase in DB pension cost for the first quarter of 2006 over the same period in 2005 was primarily due to the amortization of a larger balance of prior years' net actuarial losses. Net actuarial losses have increased due to a rise in the accrued benefit obligation, resulting from a lower interest rate used to discount the future obligations at the end of 2005. In the first quarter of 2006, we amortized \$2.7 million more accumulated losses through pension cost compared to the same period in the prior year.

Defined contribution (DC) pension cost represents the current service expense associated with our contributions to employees' retirement savings accounts. DC pension costs for the first quarter of 2006 were lower than for the same period last year due to fewer employee members in our DC pension plan. Pursuant to the 2004 plan amendments, certain eligible employees elected to convert their membership from a DC plan to a DB plan in the first quarter of 2005.

Other post-employment benefit (OPEB) costs were lower for the first quarter of 2006 when compared with the same period in 2005. Effective January 15, 2006, certain employees transferred participation from our existing defined benefit OPEB plans to a new plan having a maximum annual benefit that the employee may use to purchase group benefits upon retirement. As a result of these changes, a reduction in past service costs of \$44.9 million was recorded during the quarter and is being amortized on a straight-line basis over the expected average remaining service lives of employees. In addition, the plan changes result in lower interest costs and current service costs.

### *Other operating expenses*

Other operating expenses increased in the first quarter of 2006 by \$4.8 million, or 2.1 per cent, over the expenses incurred during the same period in the prior year. Increased costs of \$4.8 million associated with the growth in wireless operating revenues were contained through an effort to manage other operating expenses.

### **Other expenses**

#### *Other expenses*

During the first quarter of 2006, the exercise of an interest rate swaption derivative contract and the extinguishment of the associated unamortized premium income resulted in a financial derivative loss of \$13.1 million. Further details are discussed in the "Other financial arrangements" section.

#### *Interest charges*

Interest charges for the first quarter of 2006 were consistent with interest charges for the same period in 2005. Although our average long-term debt balance was slightly higher in the first quarter of 2006, we paid a slightly lower average interest rate due to refinancing completed in 2005.

## Income taxes

Income taxes for the first quarter of 2006 increased by 3.9 per cent over the same period in 2005, mainly as a result of higher operating income. Current tax expense increased \$7.7 million while future tax expense decreased by \$6.8 million. This shift to current tax expense from future tax expense occurs when there are lower deductions or higher additions to income calculated for tax purposes compared to reported income before tax. The decrease in future tax expense for the first quarter of 2006 is a result of lower capital investment related deductions taken for tax purposes in 2006 than in 2005, and settlement of an interest rate swaption in 2006 that did not occur in 2005, partially offset by higher deductions under our 2004 early retirement incentive program (ERIP) and utilization of loss carry-forwards.

## Financial and capital management

### Summary of cash flows

For the period ended March 31

<i>(millions of dollars)</i>	2006	2005	% change
Cash from (used in):			
Operating activities			
Net income	\$ 40.2	\$ 43.6	(7.8)
Adjustments to reconcile net income to cash from operating activities			
Net benefit plans cost	22.6	22.4	0.9
Funding of DB pension and OPEB plans	(23.0)	(80.1)	(71.3)
Financial derivative loss	13.1	-	-
Future income taxes	(6.4)	0.4	-
Change in operating assets and liabilities	(46.9)	(52.4)	(10.5)
Depreciation, amortization and other non-cash items	100.1	98.6	1.5
	99.7	32.5	206.8
Repurchase of common shares	\$ -	\$ (33.2)	-
Cash dividends paid on preferred and common shares	(76.9)	(40.1)	91.8
Repayment of long-term debt	(50.0)	(0.1)	-
Purchase of capital investments	(80.9)	(81.7)	(1.0)
Other financing and investing activities	(5.6)	(2.7)	107.4
Net use of cash	(113.7)	(125.3)	(9.3)

### Operating activities

During the first quarter of 2006, we generated \$99.7 million in cash from operating activities, an increase of \$67.2 million over the same period in 2005.

### Funding of DB pension and OPEB plans

In the first quarter of 2005, we made \$60.0 million in additional voluntary funding contributions to our DB pension plans. During the fourth quarter of 2005, \$17.3 million of these voluntary contributions were reallocated to required contributions. The voluntary funding completed in 2005 gives us greater flexibility to reduce the future cash required to fund the DB pension plans.

In 2006, we anticipate having to make required contributions to our DB pension plans in the range of \$120 million to \$130 million, and we are making regular contributions to our pension plans based on this estimate, net of a further reallocation of the 2005 voluntary contributions. This estimate is subject to change based on the results of

December 31, 2005, actuarial valuations, which are currently under way and are expected to be completed by June 30, 2006. In the first quarter we contributed \$21.4 million to our DB pension plans.

We expect 2006 funding requirements of our OPEB plans to be in the range of \$5 million to \$7 million. These plans required \$1.7 million of cash funding in the first quarter of 2006.

#### *Financial derivative loss*

During the first quarter of 2006, the exercise of an interest rate swaption derivative contract and the extinguishment of the associated unamortized premium resulted in a non-cash financial derivative loss of \$13.1 million. Further details are discussed in the "Other financial arrangements" section.

#### *Future income taxes*

The \$6.8 million decrease in future tax expense compared to the first quarter of 2005 is further discussed in the "Income taxes" section.

#### *Change in operating assets and liabilities*

*For the period ended March 31*

<i>(millions of dollars)</i>	2006	2005	% change
Accounts receivable	\$ 2.6	\$ 2.4	8.3
Prepayments	(2.4)	(6.9)	(65.2)
Inventory	3.4	0.2	-
Deferred charges and credits	(6.3)	0.6	-
Payables and accruals	4.2	(48.5)	-
Income taxes receivable and payable	(48.4)	(0.2)	-
<b>Change in operating assets and liabilities</b>	<b>\$ (46.9)</b>	<b>\$ (52.4)</b>	<b>(10.5)</b>

During the first quarter of 2006, the change in operating assets and liabilities used cash of \$46.9 million, 10.5 per cent less than the first quarter of 2005. The reduction in payables and accruals during the first quarter of 2005 was a result of \$32.8 million in payments related to our 2004 ERIP as well as higher supplier payments related to our capital program. Income taxes paid in the first quarter of 2006 were greater than those paid in the first quarter of 2005 as a result of a higher balance owing for prior years' taxes, due to a combination of higher taxable income and lower tax installments paid in 2005 as compared to 2004.

#### *Repurchase of common shares*

We commenced a normal course issuer bid (NCIB) on February 4, 2005, under which we were permitted to acquire 6,637,200 common shares prior to its expiry on February 3, 2006. For the three months ended March 31, 2006, no shares were purchased for cancellation and we have not renewed the NCIB. We plan to apply for a renewal of the NCIB in 2006 now that the Circular has been filed, and its purpose will be solely to offset the dilutive effects of share issuances under our employee stock option plan or dividend reinvestment plan. For the three months ended March 31, 2005, we purchased 1,151,188 shares for cancellation for an aggregate price of \$33.2 million.

Further details about the NCIB are provided in note 6 to our unaudited interim consolidated financial statements for the period ended March 31, 2006.

On May 1, 2006, we announced a new NCIB that will commence on May 3, 2006, and end on the earlier of the closing of the proposed transaction and April 30, 2007. Under this NCIB, we may acquire from time to time, up to 3,000,000 of our outstanding common shares at the market price with cash through the facilities of the Toronto Stock Exchange, representing approximately 2.4 per cent of our issued and outstanding common shares as of April 26, 2006, being 127,447,012 common shares. Such shares will be acquired primarily to offset the dilutive effects

of the exercise of options currently outstanding under our stock option plan and the issuance of shares under our dividend reinvestment plan. All common shares purchased will be cancelled.

#### *Preferred and common share dividends*

Common share dividends declared in the first quarter of 2006 increased by 1.1 per cent. There was a 5.1 per cent increase in the quarterly dividend rate, which was significantly offset by fewer shares outstanding as a result of the NCIB that was active throughout most of 2005. Cash dividends paid during the first quarter of 2006 increased compared with the same period in the prior year, as the fourth quarter of 2005 payment that would normally have been paid on December 30, 2005, was deferred until January 3, 2006.

#### *Repayments of long-term debt*

On March 1, 2006, we redeemed, prior to maturity, \$50.0 million of outstanding 10.45 per cent first mortgage bonds, Series AD, due March 1, 2013.

#### *Capital investments*

Cash used for capital investments during the first quarter of 2006 decreased slightly over the same period in 2005. The decrease can be attributed to timing differences in our capital plan for 2006 compared with 2005.

### **Liquidity**

The proposed transaction announced on March 7, 2006, as discussed in the "Creation of an income trust" section, will require us to significantly alter our current capital structure. It is currently anticipated that \$835.0 million of long-term debt will be repaid and approximately \$2,600.0 million of long-term debt will eventually be required to be accessed through capital markets. To assist in completing the transaction, to provide for ongoing liquidity requirements, to fund required special deficit payments of our DB pension plans, and to bridge to the re-financing through the public markets, bank credit facilities totalling \$3,500.0 million have been arranged for the Bell Aliant Regional Communications Income Fund.

The formation of an income trust will require us to incur significant costs to complete the proposed transactions and will affect how we manage our cash requirements, as the emphasis will be on generating maximum possible stable, distributable cash flows for the income trust's unit holders.

As the proposed transaction is still subject to required approvals, the estimated effects on liquidity have not been disclosed in this MD&A, however, the "New Credit Facilities" section of the Circular contains this information for the proposed transaction.

#### *Cash requirements*

Our cash requirements until closing of the proposed transaction in 2006 will consist of investments in capital, dividend payments, required pension plan contributions and payments of other commitments. In particular these requirements will result in the use of cash as follows:

- Capital investments will be made as required to support our existing infrastructure and to advance our strategies of growth and transformation.
- Common share dividends at a rate of \$0.31 per share per quarter will be paid, totalling approximately \$40 million per quarter.
- Total funding of our DB pension plans for 2006 is anticipated to be in the range of \$120 million to \$130 million. We are contributing regularly to our pension plans based on this estimate and we do not plan to make any additional voluntary contributions in 2006. DB pension plan actuarial valuations for the year ended December 31, 2005, will be completed in the second quarter of 2006 and we will adjust our DB pension plan contributions, if necessary, based on the outcome of these valuations.

Funding of our OPEB plans for 2006 is expected to be \$5 million to \$7 million.

- Our accounts receivable securitization program expires in December 2006. Should we decide not to renew the program, we would be required to repurchase \$120.0 million of our accounts receivable. Our intention is to renew the program and possibly enlarge it for the income trust.
- Other commitments, such as operating leases and purchase commitments for equipment and other network infrastructure, and contingencies are disclosed in note 8 to our unaudited interim consolidated financial statements for the period ended March 31, 2006, and notes 19 and 22 to our audited consolidated financial statements for the year ended December 31, 2005.

### *Sources of liquidity*

We anticipate that we will be able to meet our cash requirements from cash on hand, the generation of cash from operating activities and through access to the capital markets and credit facilities.

### *Capital structure*

<i>(millions of dollars, except as otherwise noted)</i>	March 31, 2006		December 31, 2005			
Common equity	\$	1,245.2	54.5%	\$	1,239.6	53.1%
Preferred equity		172.3	7.5%		172.3	7.4%
Non-controlling interest		6.1	0.3%		5.6	0.2%
Long-term debt, including amount due within one year		858.8	37.6%		904.5	38.8%
Notes payable and bank advances		2.7	0.1%		11.2	0.5%
Total capital	\$	2,285.1	100.0%	\$	2,333.2	100.0%
Debt as a percentage of total capital			37.7%			39.3%

### *Common equity*

At April 28, 2006, we had the following outstanding shares and stock options:

#### Authorized

Unlimited number of preference shares, issuable in series.

Unlimited number of common shares, without par value.

#### Issued

*(millions of dollars, except as otherwise noted)*

	April 28, 2006	
	Number of shares	Value
Preference shares, series 2	7,000,000	\$ 172.3
Common shares	127,448,447	1,012.7
		\$ 1,185.0

	Number of options	Weighted average exercise price
Options outstanding	2,577,336	\$ 30.44
Options exercisable	2,145,138	\$ 30.49

### *Preferred equity*

As part of the income trust proposed transaction, we intend to redeem our preferred shares for par value of \$175.0 million plus accrued dividends, provided for in accordance with their terms, on June 30, 2006.

### *Debt*

As at March 31, 2006, we maintained committed and other operating lines of credit totalling \$686.0 million, unchanged from December 31, 2005. Further details on our existing credit arrangements are provided in note 9 to our audited consolidated financial statements for the year ended December 31, 2005.

Our NBTel AA Debentures totalling \$40.0 million are callable prior to their maturity, in July 2006. Given current interest rates, it is our expectation that this debt will be called at the first available date, should the call date occur prior to closing of the proposed transaction. Moreover, pursuant to the proposed transaction, we intend at this time to redeem and refinance all of our other existing public indebtedness.

### *Credit ratings*

Our current credit ratings are unchanged from December 31, 2005.

However, Dominion Bond Rating Service has placed us "under review with developing implications" and Standard and Poors has placed us on "credit watch with negative implications" pending the close of the proposed transaction.

### **Other financial arrangements**

#### *Contractual obligations*

We have various operating leases and purchase commitments for equipment and other network infrastructure. The amounts of estimated future payments under such arrangements are detailed in note 8 to our unaudited interim consolidated financial statements for the period ended March 31, 2006, and described in our MD&A for the year ended December 31, 2005.

#### *Accounts receivable securitization*

Under a purchase and sale agreement, we sell certain accounts receivable to a securitization trust. There were no changes to this arrangement during the first quarter of 2006. Further details of this arrangement are described in notes 1 and 2 to our audited consolidated financial statements for the year ended December 31, 2005.

#### *Use of derivative financial instruments*

We use derivative financial instruments periodically in the management of interest rate and foreign currency exposures associated with our long-term debt or specific firm commitments. Details of our use of derivative financial instruments and accounting policies we follow are provided in notes 1 and 18 to our audited consolidated financial statements for the year ended December 31, 2005.

Effective March 2, 2006, an outstanding interest rate swaption related to the call option on our series AD first mortgage bonds was exercised by the counterparty. As a result, we were placed into an interest rate swap agreement, whereby we pay a fixed interest rate of 10.45 per cent and receive the three-month Bankers' Acceptance floating rate on a notional principal amount of \$50.0 million. On March 2, 2006, the fair value of the swap was \$17.9 million in favour of the counterparty, and was recorded as a deferred derivative liability. An unamortized premium amount of \$4.7 million related to the swaption was also extinguished and the resulting net charge to other expense was \$13.2 million. The fair value of the swap at March 31, 2006, was \$17.8 million. The change in fair value was also charged to other expense.

Given current interest rate levels, we anticipate the financial institution counterparty will exercise the remaining interest rate swaption agreement upon its July 19, 2006, expiry date. The exercise of this swaption will also cause us to be placed into a fixed-floating interest rate swap until maturity in 2013. We will pay fixed interest payments of 11.125 per cent on a notional principal of \$40.0 million and, in return, we will receive floating interest payments related to the three-month Bankers' Acceptance rates. At March 31, 2006, the fair value of this agreement is \$15.4 million in favour of the counterparty. The fair value, less unamortized premium income of \$2.5

million results in a \$12.9 million deferred derivative liability that is not recorded in our financial statements due to the application of hedge accounting treatment to this transaction. The actual derivative loss that will be recorded on this swaption will depend on the interest rate in effect on the exercise dates in July 2006.

## **Related party transactions**

Our only significant related party continues to be our majority shareholder, Bell Canada, which is owned 100.0 per cent by BCE. The nature of our relationship and our related party transactions remained substantially unchanged during the first quarter of 2006. For greater detail on our related party transactions refer to note 20 of our audited consolidated financial statements for the year ended December 31, 2005.

The proposed transaction will increase BCE and Bell Canada's percentage ownership in the income trust and will significantly affect the nature and extent of our related party transactions as we and BCE work together to create and operate the income trust. As the proposed transaction is still subject to required approvals, the estimated effects on related party transactions have not been disclosed in this MD&A, however, the Circular contains disclosure concerning related party transactions under the proposed transaction.

## **Significant accounting policies and critical accounting estimates**

Our unaudited interim consolidated financial statements as at March 31, 2006, have been prepared in accordance with Canadian GAAP. Our accounting policies and methods and critical accounting estimates and assumptions are consistent with those as described in note 1 to our audited consolidated financial statements for the year ended December 31, 2005.

The proposed transaction may require the adoption of new or a change to existing significant accounting policies and critical accounting estimates to ensure consistency among the combined businesses. As the proposed transaction is still subject to required approvals, the estimated effects on significant accounting policies and critical accounting estimates have not been disclosed in this MD&A.

### **Accounting policy developments**

We constantly monitor changes in accounting standards and guidelines to ensure that we continue to adhere with Canadian GAAP.

Changes in accounting standards or guidelines issued to date have not resulted in changes to our accounting in the first three months of 2006.

## **Risk and risk management**

Management is confident about our long-term prospects, but we recognize that we are exposed to a number of risks in the normal course of business that could have a negative effect on our financial condition or results of operations. We identified significant risks that we were aware of for the year ended December 31, 2005, as presented in our MD&A for the year ended December 31, 2005.

To date in 2006, we have not identified significant changes to the nature of the risks that we are exposed to in our current business. We have provided updates to our regulatory and competitive environments in the "Environmental update" section.

The proposed transaction will cause us to be exposed to a new set of specific risks relating to the income trust structure that will result upon the closing of the proposed transaction. As the proposed transaction is still subject to required approvals, the new risks have not been disclosed in this MD&A, however, the risks related to the proposed transaction are highlighted in the "Risk Factors" section of the Circular.

### **Legal and other contingencies**

We described certain legal proceedings and other contingencies that involved us in note 22 to our audited consolidated financial statements for the year ended December 31, 2005.

On February 16, 2006, the CRTC issued its decision regarding application of the deferral account balances and allowable cost mitigation features, as discussed in the "Environmental update" section. Our deferral account balance was estimated by the CRTC to be \$21.8 million.

There have been no significant changes in the legal proceedings involving us that would affect our financial position.

## Supplementary financial information

The accompanying table shows selected consolidated financial data for the most recent eight quarters. This quarterly information has been prepared on the same basis as the consolidated financial statements.

### Quarterly financial information (unaudited)

*For the eight quarters ended March 31, 2006*

<i>(millions of dollars, except for per share amounts)</i>	2004			2005				2006
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Total operating revenues	\$ 508.7	\$ 499.3	\$ 509.9	\$ 524.4	\$ 517.3	\$ 520.1	\$ 534.9	\$ 544.9
Net income	\$ 40.2	\$ 37.0	\$ 7.5	\$ 43.6	\$ 49.8	\$ 50.8	\$ 55.2	\$ 40.2
Preferred share dividends	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Common share dividends	\$ 36.5	\$ 36.3	\$ 36.9	\$ 39.0	\$ 38.5	\$ 38.1	\$ 37.6	\$ 39.5
Basic and diluted earnings per common share	\$ 0.28	\$ 0.26	\$ 0.04	\$ 0.31	\$ 0.36	\$ 0.37	\$ 0.41	\$ 0.30

Our 2004 results were affected by a labour disruption, which commenced on April 23 and concluded on September 20, and by the provision of an ERIP in October. The ERIP reduced net income in the fourth quarter of 2004 by \$42.3 million. In 2005, our business returned to normal following the labour disruption. Net income for the first quarter of 2006 was negatively affected by a \$13.1 million financial derivative loss related to the exercise of an interest rate swaption contract and the extinguishment of the associated unamortized premium, \$8.3 million after income taxes. Further details are discussed in the "Other financial arrangements" section.

The comparability of our operating results is also affected by the timing of telecommunications product sales and IT fulfillment sales that are typically large and sporadic in nature.

## Forward-looking statements

This MD&A contains forward-looking statements related to our future financial condition and results of operations. These statements are based on current expectations and estimates about the markets in which we operate and management's beliefs and assumptions regarding these markets. In some cases, forward-looking statements may be identified by words such as "anticipate", "believe", "could", "expect", "plan", "seek", "may", "intend", "will" and similar expressions. These statements are subject to important risks and uncertainties, which are difficult to predict, and assumptions, which may prove to be inaccurate. Some of the factors that could cause results or events to differ materially from current expectations include but are not limited to: general economic conditions; stock market volatility; market or business conditions; changing competitive environment; changing regulatory conditions or requirements; changing technology; changing discount rates and market returns on pension plan investments; our ability to achieve strategies and plans; and our success in implementing productivity initiatives. Some of these factors are largely beyond our control. Should any factor affect us in an unexpected manner, or should assumptions underlying the forward-looking statements prove incorrect, the actual results or events may differ materially from the results or events predicted. For more information concerning these risk factors and assumptions, please refer to our MD&A for the year ended December 31, 2005, including those sections entitled "Critical accounting estimates and assumptions" and "Risk and risk management". All of the forward-looking statements made in this document and the documents referred to within are qualified by these cautionary statements, and there can be no assurance that the results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences for us. Readers should not place undue reliance on any forward-looking statements.