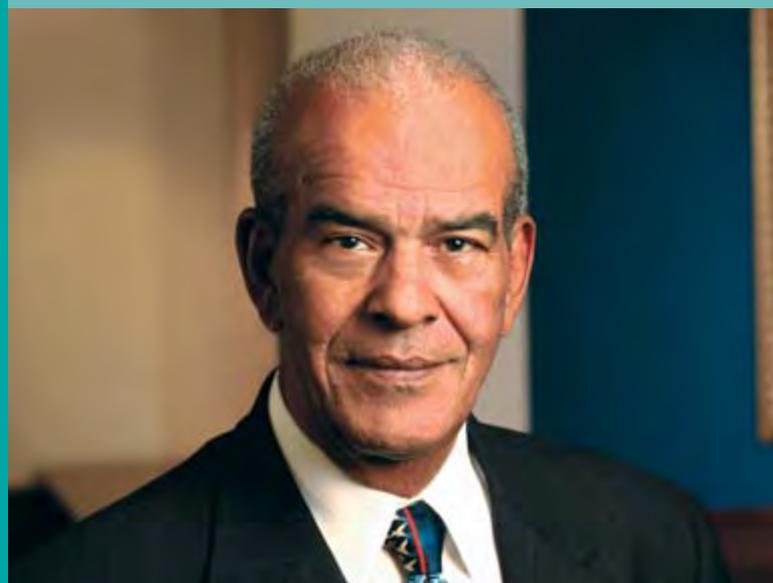


ANNUAL REPORT 2006



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CHAIRMAN'S REPORT

On behalf of your Board of Directors, I am pleased to report that the KeyTech Group of Companies concluded the last fiscal year with a Net Income of \$11.7M, a return that is 16% over the prior year. Total cash dividend payments for the year were \$0.60 per common share. When taking into consideration the many challenges that arose in the marketplace last year, this return attests to the strength of our resolve to remain focused on our primary goal, which is to increase shareholder value.

The Telecommunications industry world-wide continues to be a very competitive and dynamic one, yet I believe that our corporate strategy and the strengths of this Group will continue to serve us well in meeting the needs of our customers and allowing us to provide you with an acceptable rate of return on your investment.

Our Management Team has done a good job of executing their operating plans and on behalf of the Board, I extend congratulations and thanks to them and all of the staff on their success. I particularly want to thank the Chief Executive Officer of KeyTech Limited, Ms. Sheila Manderson who retires at the end of July after four and a half years of outstanding leadership of the Company. Sheila joined KeyTech in January 2002 as its first employee and during her tenure has developed a solid management team with whom she has worked to build the Company that we have today. She has set high standards for business integrity and work performance and we are indebted to her for her diligence and commitment to the success of this Company. The entire Board joins me in extending our thanks and very best wishes to Sheila on her retirement.

Following the Senior Management Succession Plan, the Board has appointed Ms. Sheila Lines as the new Chief Executive Officer of KeyTech Limited, effective August 1, 2006. Ms. Lines has held the position of Chief Financial Officer of KeyTech Limited for the past four and a half years and has worked closely with the CEO in successfully guiding the financial affairs of the Company. She has an undergraduate degree in Law and is a Chartered Accountant and Associate Corporate Treasurer. This year she completed the Senior Executive Program at the London Business School.

Board membership has remained stable this past year and I would like to take this opportunity to thank the Directors for their time and continued commitment to the affairs of the Company.

On behalf of the Board I extend sincere thanks and appreciation to you, our shareholders, for your continued loyalty and support. We will continue to work to ensure that the governance and prosperity of the Company are maintained.



James A.C. King, MD, FRCS (C), FACS, JP
Chairman of the Board

CHIEF EXECUTIVE OFFICER'S REPORT

OUR RESULTS

Following another year of intense competition, I am pleased to report that the KeyTech Group of Companies has delivered a Net Income of \$11.7M for the fiscal year ending March 31st, 2006, an increase of 16% over the prior year's return. Basic and fully diluted Earnings per Share were \$0.97, up 13.5 cents or 16% over the prior year.

Our focus on operational efficiency this past year has served us well. Total operating revenues were \$98.9M up \$1.6M over the previous year with growth in wireless, consulting and directory revenues exceeding the decreased revenue from residential Internet services due to price reductions. Total expenses decreased to \$86.2M down \$4M from the prior year, primarily due to a decrease of \$3.4M in amortisation expenses. Prior year amortisation included a \$1.8M adjustment to reflect M3 Wireless's transition from TDMA to GSM cellular technology. Included in general and administration expenses for the current year is a \$1.3M adjustment made to reflect the cumulative impact of the irregularities discovered in October 2005 within the Banking and Cashiering sections of the BTC Finance Department.

Losses in Affiliates were up by \$0.3M as a result of timing delays in building out signal coverage for WestTel in Cayman and in expansion of infrastructure for QuoVadis. Losses from discontinued operations in the current year of \$1.6M arose due to the discontinuance of operations by Bahamas Data & Media Limited. These losses are offset, however, through additional income of \$1.7M realised in April 2005 from the sale of KeyTech's interest in Packet Exchange (Ireland) Limited.

Income from continuing operations for the current year was \$13.3M. Excluding the one time gain made on the sale of our investment in Packet Exchange and the adjustment made to reflect the cumulative impact of the banking and cashiering irregularities, income from continuing operations for the current year was \$12.9M.

OUR OPERATIONS

In an ever changing industry, our challenge has been to continue to position our companies to maintain and grow market share. The diversification within the Group has supported our efforts in this regard but it has also been equally important to develop flexibility and agility in responding to change.

We have focused on product development and explored opportunities to grow and provide state of the art products and services to our clients. One of the outcomes of this process, I am pleased to share, will be the offer of a new island-wide wireless data service called, "easyConnect" in July of this year.

Recognising that the sustainability of our businesses in the marketplace is directly related to the skills and abilities of our people, much emphasis has been placed on ensuring that the right people are in the right positions and on the development and support of capable staff for future management and leadership roles in our businesses. Performance Management and Succession Planning have been high priorities for our Human Resource staff who have worked diligently in developing the support necessary to accomplish this.



THE BERMUDA TELEPHONE COMPANY LIMITED. (BTC)

Building on improvements made the previous year, the Bermuda Telephone Company has made good progress in refining its organisational structure and achieving operational efficiencies. Their financial target for the year was met. This, during a time when an increasing number of options are available to the consumers for voice and data services and in a period which the Telecommunications Commission reduced the Local Access Charges payable to the Company to three cents, representing a decrease of approximately \$2M in revenue on an annualised basis. BTC appealed to the Minister of Telecommunications for a reversal of this directive and was turned down. BTC is considering its options in relation to this matter.

Growth in the DSL service has continued to be strong. This has helped to offset the decline in call revenue and access lines, a phenomenon which is occurring with telephone companies in most jurisdictions as a result of increased cell phone usage. A significant investment was made in upgrading the transport network and the system used to deliver DSL services, and it is expected that customers will experience an even faster and more reliable system going forward.

It was during the process of implementing tighter controls last October when Management discovered irregular activity that had been carried out over a period of years by some long-term employees. The subsequent investigation and review by an external forensic auditor resulted in the implementation of an internal control framework designed to mitigate the risk of any recurrence of such an event in the future. The staff involved were dismissed and additional follow-up to this incident has afforded Management the opportunity to strengthen the anti-fraud environment by reviewing controls in all Subsidiaries, and re-emphasising the Company's core values and policy regarding zero tolerance for fraud.

LOGIC COMMUNICATIONS LTD.

Last year Logic set the market standard for low cost Internet and Long Distance pricing and the positive growth in market share in these areas has been encouraging. Sales for Consulting Services were 19% higher than the previous year and would have been higher were it not for the constraints of recruiting additional professional staff.

Cheaper prices have meant lower revenues than projected, however the shortfall has been offset by lower than projected operating and amortisation expenses.

Special focus has been placed on product development with a dedicated resource allocated for the purposes of initiating and developing better tools to assist clients in network monitoring and security. A new service to be launched shortly will also provide customers with house calls, personal one-on-one assistance in their homes provided by certified technicians.

The Company has invested in upgrading its network by implementing MPLS (MultiProtocol Label Switching), a method of speeding up IP based data communication, and continues to focus on its strong core asset of providing added value to their clients through full-service offerings and practical, timely and convenient solutions. Customer satisfaction with services grew to an all-time high this past year and efforts to sustain this trend will continue.

M3 WIRELESS LTD.

The past year has been one of great progress for M3 Wireless as many positive changes were accomplished. The Company formerly known as Mobility, was restructured, renamed and rebranded to reflect the new direction and service offerings.

Improvement in signal coverage island-wide was completed, and international voice and data roaming agreements were expanded considerably. After two years of concerted effort, the Company was granted a license by RIM to provide the Blackberry offering and is now in the position to provide multiple options for data services to their clients. The retail store was revitalised and upgraded to a more progressive look and agreement was reached for expansion of retail presence in the new P-Tech Phoenix store on Reid Street. Most importantly, staff have been trained to work within the vastly improved customer service processes and systems that have been put in place.

In keeping with our strategy for growth and expansion, M3 Wireless has explored new technology and as a result of this process, a new wireless data offering "easyConnect" will be made available in July of this year. M3 has achieved profitability for the first time in two years and we expect that trend to continue.

BERMUDA YELLOW PAGES LIMITED.

We are pleased with the success that the Bermuda Yellow Pages (BYP) has achieved year over year. Through innovation and delivering provable value to customers, they have been able to grow the business in this competitive finite market. Some of the new products introduced last year included an 80-page map booklet, an advanced platform CD ROM version of the Directory, revised Education and Transportation sections and a cost-effective way for local small and medium-sized enterprises to have a web presence with relevant traffic through an online ePage.

Sales increased for the print Directory and there was solid growth online from both advertisers and users. Traffic to www.bermudayp.com increased 90% year over year. During the month of March 2006, the site registered 343,000 page views.

The success of this business is directly attributable to the dedicated team at BYP who are constantly working to deliver a high return on investment to advertisers and we are pleased with their accomplishments. Earlier in the year the Company achieved the Department of Immigration's Good Corporate Citizen designation. Additionally, at their first annual award presentation in 2006, the Commission for Unity and Racial Equality (CURE) awarded BYP First Place Overall for Excellence in Equality of Opportunity. We look forward to their continued success.

AFFILIATES

Although limited by the constraints of tower capacity, **WestTel**, our affiliate in the Cayman Islands, experienced steady growth in sales over the past year with annualised sales at March 2006 of \$4.5M, increased from \$1.5M at March 2005. Residential data and voice averaged 10% growth month over month and business data sales grew by 20%. While the delay in tower roll-outs has hampered their ability to achieve projected revenue targets for the year, it is expected that with the resolution of the capacity issues over the next six months, followed by the implementation of a major marketing campaign, the Company will be well positioned to gain additional significant market share.

Having completed its roll-out of digital services in Bermuda, **Cablevision** is now experiencing positive cash flows and has focused its attention on improving customer service and encouraging the remaining analog subscribers to convert to the digital service. The use of the digital network to provide high speed Internet services has been announced.

QuoVadis continued to increase sales in the Digital Certificate and the Disaster Recovery/Business Continuity space. They have expanded their business offerings to Switzerland and New Zealand and have met the requirements for official CA accreditation from the Swiss Government, making it one of only two companies to achieve the Swiss Government Certificate Authority in that country. Significant investment was made this past year in expanding their infrastructure to support a Disaster Recovery offering and it is expected that revenue growth experienced to date will continue.

As previously reported to shareholders in our 2005 Six Month Report, KeyTech had invested in **The Bahamas Data and Media Limited**, a competitive hard copy and online directory business in the Bahamas. While of superior quality, the directory failed to meet financial targets over the past three years and cumulative sales for the Year/06 directory were significantly below forecast. This, together with our inability to obtain long-term work permits for key staff, made it less likely that full recoverability of the investment within a reasonable time frame could be achieved and the business has been discontinued.



Sheila Lines

OUR COMMUNITY INVOLVEMENT

Our Group of Companies remains committed to the support of the many Bermudian organisations and individuals who are working to improve quality of life in the community. Last year, many requests were granted, both monetarily and in service-in-kind, to deserving organisations in support of the Arts, Sports, Education, Social Services and the Environment.

OUR OUTLOOK FOR 2006/07

Our focus has been on improving the performance of our businesses, on gaining operational efficiencies, on minimising risks, on leveraging our resources and continuing to invest in our people. Our success continues to be assured by the diversity of our resources, and our ability to respond to change with agility. I would like to take the opportunity to thank the managers and staff of all of our Subsidiaries and Affiliates for a job well done. The dynamics that characterise the telecommunications industry today, of converging technology, regulatory uncertainty and increased competition will be ongoing considerations as the KeyTech Group moves forward. I believe that the foundation has been laid and the Company is well positioned to successfully manage and thrive under such conditions.

As the Chairman has stated, the latter half of the 2006/07 Fiscal Year will be one of transition as I retire from the position as the Chief Executive Officer of the Company on July 31, 2006. In accordance with our succession plans, the Board has approved the appointment of Ms. Sheila Lines as the new Chief Executive Officer. Sheila joined me at KeyTech as Chief Financial Officer shortly after I began over four and a half years ago. We have worked together as a team and I can think of no one who is better suited and prepared to take the Company forward to the next level. The transition should be a seamless one.

In closing, I will state that I have thoroughly enjoyed my tenure with KeyTech Limited. Leading an organisation involved in one of the most dynamic and competitive industries has been a challenging, exciting and rewarding experience. I am pleased with the progress that has been made and am most appreciative of the opportunity and support given to me by the Chairman and members of the Board. Many thanks are extended as well to the Senior Team, the KeyTech staff and the Chief Executive Officers of our Subsidiaries, all of whom I have had the privilege of appointing. They are an impressive group of professionals and I extend my most sincere appreciation to them for their support, diligence and hard work in helping to create a Group of Companies of which we can all be proud.



Sheila Manderson
Chief Executive Officer

FINANCIAL HIGHLIGHTS 2006

| | 2006 | 2005 |
|--|---------------|---------------|
| Revenues | \$ 98,899,022 | \$ 97,292,392 |
| Total expenses | (86,244,851) | (90,217,058) |
| Equity loss in affiliates | (1,651,636) | (1,335,602) |
| Investment income and realised gains | 629,355 | 489,699 |
| Other income | 1,677,275 | 5,008,000 |
| Discontinued operations | (1,631,962) | (1,184,154) |
| Net Income | 11,677,203 | 10,053,277 |
| | | |
| Earnings per common share, basic and fully diluted | 0.970 | 0.835 |
| | | |
| Shareholders' equity per common share, basic and fully diluted | 11.32 | 10.95 |
| | | |
| Capital expenditures | 16,675,139 | 16,171,299 |

FIVE YEAR FINANCIAL AND STATISTICAL SUMMARY

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|--|---------|---------|---------|---------|---------|
| Revenue and Expense Items | | | | | |
| (\$000's) | | | | | |
| Operating revenues | 98,899 | 97,292 | 93,845 | 87,444 | 89,529 |
| Total expenses excluding amortisation | 67,669 | 68,233 | 63,071 | 57,420 | 55,705 |
| Amortisation | 18,575 | 21,984 | 19,332 | 18,300 | 24,167 |
| Net earnings | 11,677 | 10,053 | 10,430 | 10,162 | 15,098 |
| Cash dividends declared on common shares | 7,222 | 6,735 | 6,341 | 4,415 | 4,289 |
| Balance Sheet Items | | | | | |
| (\$000's, except number of shares) | | | | | |
| Total assets | 159,068 | 155,073 | 153,687 | 152,388 | 151,418 |
| Long-term debt | 0 | 0 | 0 | 0 | 26,134 |
| Shareholders' equity | 136,280 | 131,825 | 128,507 | 129,947 | 106,227 |
| Number of common shares | 12,037 | 12,037 | 10,943 | 8,574 | 8,572 |
| Number of preferred shares | 0 | 0 | 0 | 1,922 | 0 |
| Per Common Share | | | | | |
| (\$'s) | | | | | |
| Net Earnings - Basic | 0.970 | 0.835 | 0.863 | 0.905 | 1.455 |
| Cash dividend | 0.600 | 0.600 | 0.590 | 0.515 | 0.500 |
| Net assets - Basic | 11.32 | 10.95 | 11.07 | 12.53 | 10.25 |
| Items of Interest | | | | | |
| Capital expenditures (\$000's) | 16,675 | 16,171 | 18,831 | 25,034 | 15,489 |
| Number of employees (full-time) | 408 | 423 | 454 | 476 | 456 |

AUDITOR'S REPORT



PricewaterhouseCoopers

Chartered Accountants
Dorchester House
7 Church Street
Hamilton
Bermuda HM 11
Telephone +1 (441) 295 2000
Facsimile +1 (441) 295 1242

Auditors' Report to the Shareholders of KeyTech Limited

We have audited the consolidated balance sheet of KeyTech Limited as at 31st March 2006 and the consolidated statements of earnings, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in Bermuda and Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at 31st March 2006, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in Bermuda and Canada.

A stylized, handwritten signature of the PricewaterhouseCoopers firm.

Chartered Accountants
15th June 2006

A list of partners can be obtained from the above address
PricewaterhouseCoopers refers to the members of the worldwide PricewaterhouseCoopers organisation

CONSOLIDATED BALANCE SHEET

As at 31st March 2006

| | Notes | 2006 | 2005 |
|---|-------|-----------------------|-----------------------|
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents | 17 | \$ 18,971,583 | \$ 14,105,723 |
| Accounts receivable | 17 | 9,370,363 | 9,252,778 |
| Merchandise, materials and supplies | | 4,616,588 | 4,509,624 |
| Prepaid expenses and other assets | | 2,555,199 | 3,393,057 |
| Total current assets | | 35,513,733 | 31,261,182 |
| Marketable securities | 17 | 15,765,617 | 15,838,340 |
| Investments | 5 | 16,436,879 | 14,662,577 |
| Capital assets, net | 7 | 84,388,465 | 85,570,734 |
| Intangible assets, net | 8 | 5,305,351 | 6,023,324 |
| Goodwill | 9 | 991,412 | 991,412 |
| Deferred pension asset | 10 | 667,000 | 725,000 |
| Total assets | | \$ 159,068,457 | \$ 155,072,569 |
| Liabilities | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | | \$ 8,948,884 | \$ 9,798,298 |
| Long-term debt redemption amounts unclaimed | 11 | 601,860 | 610,860 |
| Preferred share redemption amounts unclaimed | 12 | 1,299,793 | 1,378,721 |
| Dividends payable | | 1,805,543 | 1,805,543 |
| Deferred income | | 1,343,537 | 988,416 |
| Liability on acquisition of intangible assets | 8 | 312,500 | 312,500 |
| Total current liabilities | 17 | 14,312,117 | 14,894,338 |
| Deferred investment gain | 5 | 1,493,527 | 1,742,449 |
| Accrued post-retirement medical benefits | 10 | 6,983,210 | 6,611,210 |
| Total liabilities | | 22,788,854 | 23,247,997 |
| Shareholders' equity | | | |
| Share capital | 12 | 3,009,238 | 3,009,238 |
| Share premium | 12 | 45,940,651 | 45,940,651 |
| Contributed surplus | | 20,920,454 | 20,920,454 |
| Retained earnings | | 66,409,260 | 61,954,229 |
| Total shareholders' equity | | 136,279,603 | 131,824,572 |
| Total liabilities and shareholders' equity | | \$ 159,068,457 | \$ 155,072,569 |

Approved by the Board of Directors

Director



Director



The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF EARNINGS

For the year ended 31st March 2006

| | Notes | 2006 | 2005 |
|---|---------|---------------|---------------|
| Revenues and other income | | | |
| Wireline revenues | | 57,965,941 | 58,155,019 |
| Wireless revenues | | 13,800,174 | 11,683,994 |
| International long distance and network revenues | | 10,977,159 | 12,199,042 |
| Other revenues | | 16,155,748 | 15,254,337 |
| Total operating revenues | 4 | \$ 98,899,022 | \$ 97,292,392 |
| Expenses | | | |
| Salaries and employee benefit expenses | 3 | 34,735,617 | 38,970,362 |
| Maintenance expenses | | 12,373,622 | 12,076,846 |
| General and administration expenses | 3 | 14,573,117 | 11,316,513 |
| Government taxes, fees and levies | | 5,987,113 | 5,869,338 |
| Amortisation | 7, 8, 9 | 18,575,382 | 21,983,999 |
| Total expenses | | 86,244,851 | 90,217,058 |
| Net income before under noted items | | 12,654,171 | 7,075,334 |
| Equity loss in affiliates | 5 | (1,651,636) | (1,335,602) |
| Investment income and realised gains | | 629,355 | 489,699 |
| Other income | 13 | 1,677,275 | 5,008,000 |
| Net income before discontinued operations | | \$ 13,309,165 | \$ 11,237,431 |
| Discontinued operations | 6 | (1,631,962) | (1,184,154) |
| Net income after discontinued operations | | \$ 11,677,203 | \$ 10,053,277 |
| Earnings per common share before discontinued operations | | | |
| basic and fully diluted | | \$ 1.106 | \$ 0.933 |
| Loss per common share from discontinued operations | | | |
| basic and fully diluted | | \$ (0.136) | \$ (0.098) |
| Earnings per common share | | | |
| basic and fully diluted | 14 | \$ 0.970 | \$ 0.835 |

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

For the year ended 31st March 2006

| | Notes | 2006 | 2005 |
|--|-------|---------------|---------------|
| Retained earnings – Beginning of year | | \$ 61,954,229 | \$ 70,668,342 |
| Net income | | 11,677,203 | 10,053,277 |
| Dividends declared | | 73,631,432 | 80,721,619 |
| Cash – common shares | | (7,222,172) | (6,735,293) |
| Shares – common shares | | – | (12,032,097) |
| | | (7,222,172) | (18,767,390) |
| Retained earnings – End of year | | \$ 66,409,260 | \$ 61,954,229 |

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31st March 2006

| | 2006 | 2005 |
|---|---------------|---------------|
| Cash flows from operating activities | | |
| Net income for year | \$ 11,677,203 | \$ 10,053,277 |
| Items not affecting cash | | |
| Amortisation | 18,575,382 | 21,983,999 |
| Amortisation from discontinued operations | – | 262,302 |
| Net realised gain on marketable securities | (253,234) | (413,755) |
| Equity loss in affiliates | 1,651,636 | 1,335,602 |
| Provisions for discounted operations | 865,644 | 911,097 |
| Post-retirement benefits expense in excess of amounts received (paid) | 430,000 | 1,073,000 |
| | 32,946,631 | 35,205,522 |
| Decrease (increase) in non-cash working capital | 119,015 | (2,686,042) |
| Cash provided by operating activities | 33,065,646 | 32,519,480 |
| Cash flows from investing activities | | |
| Investments, net | (4,540,504) | (9,416,204) |
| Sale of marketable securities, net | 325,957 | 1,493,719 |
| Acquisition of capital assets | (16,675,139) | (16,171,299) |
| Cash used for investing activities | (20,889,686) | (24,093,784) |
| Cash flows from financing activities | | |
| Redemption of notes payable | (9,000) | (142,469) |
| Cash paid on share dividend | – | (5,343) |
| Redemption of preferred shares | (78,928) | (374,983) |
| Dividends paid on common shares | (7,222,172) | (6,565,876) |
| Cash used for financing activities | (7,310,100) | (7,088,671) |
| Increase in cash and cash equivalents | 4,865,860 | 1,337,025 |
| Cash and cash equivalents – Beginning of year | 14,105,723 | 12,768,698 |
| Cash and cash equivalents – End of year | \$ 18,971,583 | \$ 14,105,723 |

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

1. The Company

KeyTech Limited (the "Company") is incorporated in Bermuda with limited liability under the Companies Act 1981. KeyTech Limited, through its subsidiaries, is a major supplier of telecommunications services, providing a wide range of voice, data, wireless and Internet products and services.

2. Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Bermuda and Canada. The following are the significant accounting policies adopted by the Company:

(a) Consolidation

The consolidated financial statements include the financial statements of the Company and subsidiaries. All significant inter-company balances and transactions have been eliminated on consolidation.

(b) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates.

(c) Capital assets

Capital assets purchased, including intangible assets, are reported at cost and amortised on the straight-line basis over their estimated useful lives. Gains and losses resulting from the retirement of capital assets are included in net earnings for the year.

Land and a building acquired under a capital lease arrangement are reported at the amount of the lease payments paid in advance which is equal to the fair value of the asset on the date the lease was entered into. As lease payments were paid in advance there is no offsetting lease obligation. The asset is amortised on the straight-line basis over its estimated useful life.

Costs incurred relating to plant under construction are capitalised and held unamortised within plant under construction until such time as the asset is substantially complete, at which time the asset is transferred into plant and facilities and amortised over its useful life.

(d) Investments

The Company accounts for its investments in affiliated companies over which it has significant influence on the equity basis of accounting, whereby the investments are initially recorded at cost, adjusted to recognise the Company's share of earnings or losses of the investee companies and reduced by dividends received. Where appropriate additional provisions are made to reduce the carrying value to fair value when such declines are considered to be other than temporary.

Effective 1st April 2005, the Company adopted the Canadian Institute of Chartered Accountants Accounting Guidelines AcG-15 Consolidation of Variable Interest Entities ("AcG-15"). In applying AcG-15 the Company determined that Bahamas Data & Media ("BD&M") is a variable interest entity and that the Company is the primary beneficiary. In accordance with AcG-15 BD&M is consolidated in these consolidated financial statements.

Portfolio investments are accounted for on the cost basis. Declines in fair value below cost are recognised when such declines are considered to be other than temporary.

(e) Marketable securities

Marketable securities represent investments in mutual funds, bonds and equities. Marketable securities classified as current assets are carried at lower of cost and fair value.

Marketable securities classified as long term are carried as long term assets and are accounted for on the cost basis. Declines in fair value below cost of individual securities are recognised when such declines are considered to be other than temporary.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

(f) Deferred costs

During the year ended 31st March 2003, the Company decided to publish the annual telephone directory internally.

i) Deferred pre-operating costs

The costs incurred by the subsidiary prior to the commencement of operations have been deferred and are amortised using the straight-line basis over a three-year period representing the period of expected future benefit of the costs incurred. Unamortised deferred costs at 31st March 2006 of \$Nil (2005 – \$106,655) are included in prepaid expenses and other assets in the balance sheet.

ii) Deferred production costs

Costs incurred directly relating to the publication of the annual directory are deferred and recognised in income at the date of publication. Deferred production costs of \$1,681,332 (2005 – \$1,873,600) are included in prepaid expenses and other assets in the balance sheet.

(g) Deferred income

Amounts received in advance of publication of the annual telephone directory for advertising sold are shown as deferred income in the balance sheet and are recognised as income at the date of publication.

(h) Merchandise, materials and supplies

Merchandise, materials and supplies are recorded at lower of average cost and net realisable value. The cost of merchandise and materials sold are shown as a deduction from operating revenues.

(i) Goodwill and other intangible assets

Goodwill represents the excess, at the date of acquisition, of the cost over the fair value of the net tangible assets of subsidiary companies acquired and was previously amortised on a straight-line basis over its estimated life. Intangibles acquired in a business combination are distinguished and separately valued from goodwill. Goodwill and intangibles with indefinite useful lives are evaluated for potential impairment annually using estimates of future net cash flows and are no longer amortised. Intangible assets with definite useful lives are initially recorded at cost and amortised over their useful economic lives to their estimated residual values and reviewed for impairment when indications of impairment exist. Any permanent impairment of the value is charged to earnings in the year the impairment is recognised.

(j) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Bermuda dollars at rates of exchange prevailing at the balance sheet date. Non-monetary assets, including marketable securities, and transactions denominated in foreign currencies are translated at rates of exchange prevailing at the transaction dates. Exchange gains and losses are included in net earnings for the year.

(k) Pension and post retirement benefits

As described in note 10, some of the Company's subsidiaries maintain defined contribution pension plans for their employees. In addition, the Company has a residual non-contributory defined benefit pension plan and offers post-retirement medical benefits for the benefit of certain employees and retirees of certain of its subsidiaries. The cost to provide pension benefits under the defined benefit pension plan and post-retirement medical benefits is accrued and charged to earnings so as to reflect the manner in which the service giving rise to the benefits is rendered. The cost of providing benefits under the defined contribution plans is charged to earnings in the year.

The Company recognises actuarial gains and losses relating to its defined benefit pension plan in income immediately. Actuarial gains and losses relating to post-retirement medical benefits are amortised to income over the expected average remaining service life of the covered employees.

(l) Earnings per share

Earnings per share is calculated based on the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated on the weighted average number of shares outstanding during the year combined with the weighted average number of shares that would have been issued during the year had all existing dilutive conversion rights been exercised. There existed no dilutive conversion rights in the years ended 31st March 2006 and 31st March 2005.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

(m) Cash and cash equivalents

Cash and cash equivalents include highly liquid money market instruments, which can be redeemed on demand.

(n) Deferred investment gain

Under the corporate restructuring of Bermuda CableVision Limited (BCL) (see note 5) there was both an amount in excess of the tangible assets acquired and a deferred investment gain that arose. The Company determined that the excess amount over tangible assets acquired was an intangible asset representing BCL's installed customer base. Further the Company determined that this intangible has a life of ten years being BCL's current licence period. Commencing 1st April 2002, the underlying intangible asset and the associated deferred investment gain are being amortised over ten years. Amortisation of these amounts is included as a component of equity loss in affiliates in the statement of earnings.

(o) Rate regulated entities

Effective 1st April 2005, the Company adopted the Canadian Institute of Chartered Accountants Accounting Guidelines AcG-19 Disclosures by Entities Subject to Rate Regulation ("AcG-19"). The Bermuda Telephone Company Limited ("BTC"), a principal operating subsidiary of the Company, and Bermuda CableVision Limited ("BCL") an affiliate of the Company, are subject to rate regulation. Changes to BTC's rates for telecommunications services and BCL's rates for services require the approval of the Bermuda Telecommunications Commission.

(p) Revenue recognition

The Company recognises revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility of the sales price is reasonably assured. In addition to these general revenue recognition criteria, the following specific revenue recognition policies are followed:

For product and equipment sales, delivery generally does not occur until the products or equipment have been shipped, risk of loss has transferred to the customer, and objective evidence exists that customer acceptance provisions have been met.

Revenues derived from local telephone, long-distance and data services are recognised when services are provided. This is based upon either usage (e.g. minutes of traffic processed), period of time (e.g. monthly service fees) or other established fee schedules.

Revenues and expenses related to publishing the print directory are recognised at the time publication of the directory is completed (see notes 2(f) and 2(g) above). Revenues and expenses related to the Internet directory services are recognised on a pro rata basis over the life of the contract.

Revenue for other services is generally recognised as services are performed.

3. Expenses

During the year ended 31st March 2005 BTC undertook major organisational restructuring changes to increase operating efficiency and improve customer service. Forty-one long-term employees chose voluntary separation and early retirement packages at a total expense of \$3,634,113, which is included in salaries and employee benefit expenses in the statement of earnings in the prior year.

In October 2005 BTC discovered financial irregularities within the Banking Administration and Cashiering sections of its Finance Department. As a result of the investigation BTC has reduced its reported cash and cash equivalents amount by \$1,314,497 being the cumulative impact of the irregularities over a period of years. The adjustment is included in general and administration expenses in the statement of earnings in the current year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

4. Segmented information

Reportable segments correspond to the Company's internal organisational structure rather than the industry and geographic areas of operation. The Company operates the following reportable segments which are managed as separate business units as they operate in different industries and require different market strategies and technologies. The Company evaluates each segment's performance based on its contribution to consolidated net income. The accounting policies of the reportable segments are the same as those described in note 2.

The Bermuda Telephone Company Limited ("BTC") – provides a wide range of voice, data and wireline services.

M3 Wireless Ltd. ("M3") – provides wireless services.

Logic Communications Limited ("Logic") – provides a wide range of Internet products and services, as well as selling computer hardware, software and consulting services.

Bermuda Yellow Pages Limited ("BYP") – provides printed and on-line directory services.

Segment information

| | BTC | | M3 | | Logic | | BYP | | Total | |
|-----------------------------------|-----|------------|----|-------------|-------|------------|-----|-----------|-------|-------------|
| Year ended 31st March 2006 | | | | | | | | | | |
| Revenues from external customers | \$ | 63,140,399 | \$ | 14,223,480 | \$ | 16,536,288 | \$ | 4,853,436 | \$ | 98,753,603 |
| Revenues from internal customers | | 2,350,136 | | 399,142 | | 534,718 | | 200,165 | | 3,484,161 |
| Amortisation | | 13,485,922 | | 3,461,389 | | 1,391,021 | | 131,566 | | 18,469,898 |
| Operating expenses | | 40,011,672 | | 10,183,186 | | 14,310,151 | | 3,649,157 | | 68,154,166 |
| Interest expense | | 800,730 | | 444,360 | | – | | – | | 1,245,090 |
| Segment income | | 11,192,211 | | 533,687 | | 1,369,834 | | 1,272,878 | | 14,368,610 |
| Segment assets | | 86,975,781 | | 19,943,374 | | 11,622,037 | | 4,154,768 | | 122,695,960 |
| Year ended 31st March 2005 | | | | | | | | | | |
| Revenues from external customers | \$ | 63,715,529 | \$ | 12,276,574 | \$ | 16,957,981 | \$ | 4,237,000 | \$ | 97,187,084 |
| Revenues from internal customers | | 2,017,658 | | 346,373 | | 471,566 | | 174,950 | | 3,010,547 |
| Amortisation | | 14,380,047 | | 5,641,489 | | 1,730,829 | | 88,957 | | 21,841,322 |
| Operating expenses | | 42,905,987 | | 10,234,577 | | 12,796,084 | | 2,994,066 | | 68,930,714 |
| Interest expense | | 885,787 | | 444,360 | | – | | – | | 1,330,147 |
| Segment income (loss) | | 7,561,366 | | (3,697,479) | | 2,902,634 | | 1,328,927 | | 8,095,448 |
| Segment assets | | 84,382,595 | | 18,502,220 | | 12,112,356 | | 4,082,232 | | 119,079,403 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

Revenues by service

| | 2006 | 2005 |
|--|---------------|---------------|
| Domestic wireline services | \$ 53,700,259 | \$ 52,742,708 |
| International long distance and network services | 10,977,159 | 12,199,042 |
| Domestic wireless services | 13,800,174 | 11,683,994 |
| International interconnection fees | 4,265,682 | 5,412,311 |
| Hardware and software sales and rental | 4,567,765 | 4,712,119 |
| Directory services | 4,853,436 | 4,237,000 |
| Consulting services | 4,549,302 | 3,837,704 |
| Other services | 2,185,245 | 2,467,514 |
| | \$ 98,899,022 | \$ 97,292,392 |

Hardware and software sales and rental revenues are shown net of the related cost of goods sold. Amortisation of assets rented is included in amortisation expense in the statement of earnings. Cost of goods sold for the current year were \$4,639,487 (2005 – \$5,517,150).

Reconciliations

Revenues from external customers

| | 2006 | 2005 |
|--|---------------|---------------|
| Total segment revenues from external customers | \$ 98,753,603 | \$ 97,187,084 |
| Non-segment other revenue | 145,419 | 105,308 |
| | \$ 98,899,022 | \$ 97,292,392 |

Amortisation

| | 2006 | 2005 |
|----------------------------|---------------|---------------|
| Total segment amortisation | \$ 18,469,898 | \$ 21,841,322 |
| Non-segment amortisation | 105,484 | 142,677 |
| | \$ 18,575,382 | \$ 21,983,999 |

Operating expenses

| | 2006 | 2005 |
|--------------------------------------|---------------|---------------|
| Total segment operating expenses | \$ 68,154,166 | \$ 68,930,714 |
| Non-segment operating expenses | 2,848,580 | 2,380,350 |
| Elimination of inter-company amounts | (3,333,277) | (3,078,005) |
| | \$ 67,669,469 | \$ 68,233,059 |

Interest expense

| | 2006 | 2005 |
|--------------------------------------|--------------|--------------|
| Total segment interest expense | \$ 1,245,090 | \$ 1,330,147 |
| Elimination of inter-company amounts | (1,245,090) | (1,330,147) |
| | \$ – | \$ – |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

| Net income | 2006 | 2005 |
|--------------------------------------|----------------------|----------------------|
| Total income for reportable segments | \$ 14,368,610 | \$ 8,095,448 |
| Non-segment other income | 3,697,139 | 6,933,102 |
| Equity loss in affiliates | (1,651,636) | (1,335,602) |
| Non-segment administrative expenses | (2,848,580) | (2,380,350) |
| Non-segment amortisation | (105,484) | (142,677) |
| Loss from discontinued operations | (1,631,962) | (1,184,154) |
| Elimination of inter-company amounts | (150,884) | 67,510 |
| | <u>\$ 11,677,203</u> | <u>\$ 10,053,277</u> |

| Total assets | 2006 | 2005 |
|--------------------------------------|-----------------------|-----------------------|
| Total assets for reportable segments | \$ 122,695,960 | \$ 119,079,403 |
| Goodwill | 991,412 | 991,412 |
| Non-segment assets | 60,607,445 | 62,213,072 |
| Discontinued operations assets | 88,970 | 96,702 |
| Elimination of inter-company amounts | (25,315,330) | (27,308,020) |
| | <u>\$ 159,068,457</u> | <u>\$ 155,072,569</u> |

5. Investments

| | 2006 | 2005 |
|--|----------------------|----------------------|
| Investment in CableVision Holdings Ltd. | | |
| Promissory notes and accrued interest thereon | \$ 7,473,119 | \$ 7,049,517 |
| Interest in equity | (2,092,496) | (1,860,919) |
| | <u>5,380,623</u> | <u>5,188,598</u> |
| Investment in WestTel Ltd. | | |
| Loan and promissory note | 6,908,329 | 4,709,353 |
| Interest in equity | 441,418 | 35,946 |
| | <u>7,349,747</u> | <u>4,745,299</u> |
| Investment in QuoVadis Holdings Ltd. | | |
| Loan and accrued interest thereon | 507,329 | - |
| Interest in equity | 3,199,180 | 3,863,036 |
| | <u>3,706,509</u> | <u>3,863,036</u> |
| Investment in PacketExchange (net of losses and provision of \$1,053,796; 2005 – \$1,053,796) | - | - |
| Loan to Bahamas Data & Media (net of provision of \$3,231,298; 2005 – \$2,365,354) | - | 865,644 |
| | <u>\$ 16,436,879</u> | <u>\$ 14,662,577</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

Bermuda CableVision Limited

During the year ended 31st March 2000, the Company entered into a corporate restructuring agreement with a minority shareholder of Bermuda CableVision Limited ("BCL"). This restructuring agreement resulted in the Company gaining significant influence over BCL and exchanging its shares of BCL for 40% of the outstanding shares of a new holding company, CableVision Holdings Ltd. ("CHL"), \$7,000,000 in cash and a \$4,000,000 promissory note. The promissory note is unsecured, has no set terms of repayment and bears interest at 9% per annum. Interest relating to the note is included as a component of equity loss in affiliates in the statement of earnings. The above transaction resulted in a gain of \$3,697,862, net of restructuring expenses, which was deferred and was being amortised into income over a period of seven years. The period of amortisation of the deferred gain was adjusted to ten years from 1st April 2002 to reflect the Company's current estimate of the useful life of the underlying intangible assets acquired on restructuring. The amortisation of the deferred gain is included as a component of equity loss in affiliates in the statement of earnings.

During the year ended 31st March 2005 the Company loaned BCL \$300,000 under a promissory note. During the year ended 31st March 2004 the Company loaned BCL \$750,000 under a promissory note. Both promissory notes are unsecured and bear interest at 8% per annum. During the year ended 31st March 2006 the Company exchanged the two promissory notes from BCL, plus accrued interest thereon, in exchange for a promissory note from CHL for \$1,200,000 and \$23,398 in cash. The promissory note from CHL is unsecured and bears interest at 8% per annum. Interest relating to the notes are included as a component of equity loss in affiliates in the statement of earnings.

WestTel Limited

During the year ended 31st March 2004, the Company purchased a 40% equity interest in WestTel Limited ("WestTel"), a company registered in the Cayman Islands for \$1,041,909. WestTel is licensed to provide data and telephony services in the Cayman Islands. The Company is amortising the intangible assets acquired on purchase of this equity interest over periods of five to fifteen years. Subsequent to the purchase of the equity interest in WestTel, the Company subscribed \$378,486 for additional shares. Other shareholders of WestTel also subscribed for further equity, and therefore the Company's proportionate interest after the issuance of these additional shares remained at 40%. The Company provided a loan facility of \$3,621,515 to WestTel. WestTel fully utilised the loan facility during the year to 31st March 2005. Advances under the loan facility bear interest at US Libor plus 150 basis points and are secured on the fixed and floating assets of WestTel. Advances under the loan facility will be converted to a term loan repayable over five years after WestTel has reported positive operating cashflow for three consecutive months. During the year ended 31st March 2005 the operations of WestTel were severely disrupted by Hurricane Ivan, which impacted the Cayman Islands in September 2004. As a result, the Company provided a further loan facility of \$2,400,000 under a promissory note which is secured and bears interest of 6% per annum. The balance outstanding under the promissory note at 31st March 2006 is \$2,400,000. Other amounts receivable from WestTel at 31st March 2006 were \$311,385. During the year ended 31st March 2006 the Company subscribed \$2,217,845 for additional shares in WestTel. Other shareholders of WestTel also subscribed for further equity. The Company's proportionate interest after issuance of these shares increased to 48% at 31st March 2006. Other shareholders of WestTel have the right to purchase from the Company 8% of the shares in WestTel within six months of issue to the Company. The Company has also entered into a five year agreement to provide technical and advisory consulting services to WestTel in return for a fee based on a percentage of WestTel's gross revenues ranging from 4% to 6%. Amortisation of the intangible assets acquired, interest on the loan facility and promissory note and revenues for consulting services provided to WestTel are included as a component of equity loss in affiliates in the statement of earnings.

QuoVadis Holdings Limited

During the year ended 31st March 2005, the Company purchased a 20% equity interest in QuoVadis Holdings Limited ("QuoVadis"), a company registered in Bermuda for \$1,009,513. QuoVadis is a provider of managed security services. The Company is amortising 78% the intangible assets acquired on purchase of this equity interest over a period of five years and 22% over a period of sixteen years. Immediately subsequent to the purchase of the equity interest in QuoVadis, the Company subscribed \$3,028,538 for additional shares. The Company's proportionate interest after the issuance of these additional shares increased to 30%. The Company has provided a loan facility of \$1,000,000 to QuoVadis. During the year ended 31st March 2006 \$500,000 was advanced under this facility. Advances under the loan facility bear interest at 5% and are secured on the fixed and floating assets of QuoVadis. Advances under the loan facility will be converted to a term loan repayable over five years after QuoVadis has reported positive operating cashflow for three consecutive months. If the loan is not drawn in its entirety by 24th December 2007 the obligation of the Company to make the loan or any part thereof available to QuoVadis shall expire. Amortisation of the intangible assets acquired and interest on the loan are included as a component of equity loss in affiliates in the statement of earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

PacketExchange (Ireland) Limited

The Company sold its investment in PacketExchange (Ireland) Limited ("PacketExchange") for net proceeds of \$1,735,275 during the year ended 31st March 2006. Proceeds from the sale of the investment are included in other income in the statement of earnings.

Bahamas Data and Media Limited

Included in other investments at 31st March 2005 was a loan to Bahamas Data and Media Limited ("BD&M") of \$865,644. BD&M has established a competitive hard copy and on-line directory business in the Bahamas under the trade name of Bahamas Golden Pages. As described in note 2(d) effective 1st April 2005, the Company adopted the Canadian Institute of Chartered Accountants Accounting Guidelines AcG-15 Consolidation of Variable Interest Entities ("AcG-15"). In applying AcG-15 the Company determined that Bahamas Data & Media ("BD&M") is a variable interest entity and that the Company is the primary beneficiary. In accordance with AcG-15 BD&M is consolidated in these consolidated financial statements as at 31st March 2006 and is no longer included in investments.

6. Discontinued operations

In the year ended 31st March 2004, Genespidernet Caribbean Inc. ("GSN"), a subsidiary company established and licensed to provide telecommunications services to residents of Curacao entered voluntary liquidation. Accordingly the losses of GSN, excluding intercompany expenses, were classified as discontinued operations in the prior year. Prior year losses of GSN includes losses on the sale of assets of \$239,350. Remaining GSN net assets of \$20,310 are included in the Company's balance sheet at 31st March 2006.

Due to the inability to obtain work permits for key members of BD&M staff and the negative impact on the sales campaign during the year ended 31st March 2006 the Company decided to discontinue funding BD&M. Results for BD&M for the year ended 31st March 2006 and the provision in full against the \$865,644 loan to BD&M included in investments in the prior year are classified as discontinued operations in the consolidated statement of earnings for the current year. The provision against the loan to BD&M and funding provided in the prior year have been reclassified to discontinued operations in the comparative amounts in the consolidated statement of earnings to conform to the current year's presentation. Remaining BD&M net assets of \$57,424 are included in the Company's balance sheet at 31st March 2006.

7. Capital assets

| | Range of amortisation rates | 2006 | 2005 |
|---------------------------------------|-----------------------------------|----------------------|----------------------|
| Capital assets, at cost | | | |
| Land | | \$ 3,752,442 | \$ 3,752,442 |
| Land leased under capital lease | | 1,000,000 | 1,000,000 |
| Buildings and fixtures | | 37,094,650 | 36,272,940 |
| Buildings leased under capital lease | | 831,398 | 831,398 |
| Plant and facilities | | 204,114,943 | 197,496,919 |
| Machinery and equipment | | 25,625,576 | 24,154,163 |
| Total | | 272,419,009 | 263,507,862 |
| Less: Accumulated amortisation | | | |
| Buildings and fixtures | 2% – 10% | 19,437,471 | 17,350,054 |
| Buildings leased under capital lease | 2% | 41,577 | 24,945 |
| Plant and facilities | 6% – 25% | 155,592,983 | 142,901,637 |
| Machinery and equipment | 20% – 33% | 21,105,387 | 19,091,680 |
| | | 196,177,418 | 179,368,316 |
| Net capital assets in service | | 76,241,591 | 84,139,546 |
| Plant under construction | | 8,146,874 | 1,431,188 |
| Capital assets, net | | \$ 84,388,465 | \$ 85,570,734 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

During the year ended 31st March 2005 the Company recognised an impairment of the carrying value of M3's TDMA cellular system due to the migration of customers to its GSM cellular system. As a result additional amortisation expense of \$1,820,129 is included in amortisation expense in the statement of earnings in the prior year.

Amortisation on capital assets for the current year was \$17,686,604 (2005 – \$20,800,379).

8. Intangible assets

| | Amortisation rates | 2006 | 2005 |
|------------------------------------|--------------------|---------------------|---------------------|
| Intangible assets, at cost | | | |
| Leased telecommunications capacity | | \$ 10,114,763 | \$ 10,114,763 |
| Other intangibles | | 1,660,630 | 1,489,826 |
| Total | | 11,775,393 | 11,604,589 |
| Less: Accumulated amortisation | | | |
| Leased telecommunications capacity | 7% | 4,962,110 | 4,275,098 |
| Other intangibles | 20% – 33% | 1,507,932 | 1,306,167 |
| | | 6,470,042 | 5,581,265 |
| Intangible assets, net | | \$ 5,305,351 | \$ 6,023,324 |

During the year ended 31st March 2004 the Company acquired further leased telecommunications capacity and as part of this transaction acquired an option to purchase additional leased telecommunications capacity in the future. If the Company does not exercise its option a fee of \$312,500 is payable and is shown as a liability on acquisition of intangible assets in the balance sheet.

Amortisation on intangible assets for the current year was \$888,778 (2005 – \$1,183,620).

9. Goodwill

The goodwill arising on the Logic acquisition in 1998 is evaluated for potential impairment on an annual basis using estimates of future net cash flows and is no longer amortised. The unamortised goodwill of \$991,412 did not require an impairment provision in the fiscal years ended 31st March 2006 and 2005.

10. Pensions and post-retirement medical benefits

During the year ended 31st March 2000, with the coming into force of the National Pension Scheme (Occupational Pension) Act 1998 (the "Act"), the Company initiated a new defined contribution pension plan for the benefit of employees of certain subsidiaries in order to provide benefits for current and future service in compliance with the Act.

As a result of the initiation of the defined contribution plan above, the Company's non-contributory defined benefit plan (the "former plan") was amended in the year ended 31st March 2000 to substantially cease accruing benefits for future service as such service now accrues benefits under the new defined contribution plan (the "current plan"). In addition, certain other amendments were made to the former plan in order to make the provisions more consistent with similar provisions in the current plan. Employees were permitted to elect to surrender the benefits due under the former plan and transfer an amount of cash to their account in the current plan based on an actuarial estimate of the benefits surrendered. The former plan remains on a run-off basis to provide benefits to existing retirees and benefits earned to date and payable on retirement to those employees who so elected. As a result of these various transactions, there was a net increase in the net assets of the former plan. Further, as required by generally accepted accounting principles (see note 2(k)), the Company remeasured the assets and liabilities of the former plan resulting in an increase to the net assets for accounting purposes as at 1st April 2000. The Company established a valuation allowance as at 1st April 2000 to reduce the amount of the increase recorded in these financial statements to the amount that can be realised.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

During the prior year, the Company requested the Trustees of the plan to return to the Company a portion of the surplus in excess of the amount required to fund the benefits under the former plan. The Company, after consultation with their independent actuaries determined that, after providing an appropriate reserve for possible adverse investment and actuarial experience in the future, they could request \$5,788,000 of the then approximately \$30,358,000 surplus available. The Company received this amount prior to 31st March 2005.

Subsidiaries of the Company offer post-retirement medical benefits for substantially all retired employees. The Company adjusted its accounting policy for post-retirement medical benefits for employees as required under generally accepted accounting principles (see note 2(k)).

The following table provides summaries of the post-retirement medical benefits and the defined benefit pension plans' estimated financial position as of 31st March:

| | Defined benefit pension plan | | Post-retirement medical benefits | |
|--|------------------------------|---------------------|----------------------------------|--------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Accrued benefit obligation | | | | |
| Balance – Beginning of year | \$ (55,560,000) | \$ (48,383,000) | \$ (6,991,210) | \$ (6,516,210) |
| Current service cost | – | (218,000) | (206,000) | (176,000) |
| Interest cost | (3,094,000) | (2,834,000) | (371,000) | (353,000) |
| Net actuarial gain (loss) on plan liability | 4,266,000 | (7,014,000) | 653,000 | (182,000) |
| Benefits paid, net | 3,494,000 | 3,027,000 | 205,000 | 133,000 |
| Curtailment (loss) gain arising on corporate restructuring | – | (138,000) | – | 103,000 |
| Balance – End of year | (50,894,000) | (55,560,000) | (6,710,210) | (6,991,210) |
| Plan assets | | | | |
| Fair value – Beginning of year | 74,687,000 | 82,162,000 | – | – |
| Actual return on plan assets | 16,399,000 | 1,340,000 | – | – |
| Return excess employer contributions | – | (5,788,000) | – | – |
| Benefits paid, net | (3,494,000) | (3,027,000) | – | – |
| Fair value – End of year | 87,592,000 | 74,687,000 | – | – |
| Defined benefit pension plan assets consist of: | | | | |
| Equity securities | 76% | 77% | | |
| Debt securities | 22% | 22% | | |
| Other | 2% | 1% | | |
| | 100% | 100% | | |

On 31st March 2006 10% (2005 – 10%) of plan assets were invested in common shares of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

| | Defined benefit pension plan | | Post-retirement medical benefits | |
|---|------------------------------|-------------------|----------------------------------|-----------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Status of plan | | | | |
| Funded status – plan surplus (deficit) | 36,698,000 | 19,127,000 | (6,710,210) | (6,991,210) |
| unamortised net actuarial loss on plan liability | – | – | (273,000) | 380,000 |
| unamortised past service cost | 667,000 | 725,000 | – | – |
| Valuation allowance against accrued benefit asset | (36,698,000) | (19,127,000) | – | – |
| Accrued benefit asset (liability) | \$ 667,000 | \$ 725,000 | \$ (6,983,210) | \$ (6,611,210) |

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations as at 31st March are as follows:

| | Defined benefit pension plan | | Post-retirement medical benefits | |
|--|------------------------------|-------|----------------------------------|--------|
| | 2006 | 2005 | 2006 | 2005 |
| Discount rate | 6.00% | 5.75% | 6.00% | 5.75% |
| Expected long-term rate of return on plan assets | 8.50% | 8.50% | N/A | N/A |
| Rate of compensation increase | 3.55% | 4.75% | N/A | N/A |
| Assumed initial health care cost trend rate | N/A | N/A | 9.00% | 10.00% |
| Assumed ultimate health care cost trend rate | N/A | N/A | 4.75% | 4.75% |
| Year ultimate rate is reached | N/A | N/A | 2012 | 2011 |
| Remaining service life (in years) | N/A | N/A | 6 | 7 |

For the year ended 31st March, 2006, the effect of a one percentage point increase or decrease in the assumed ultimate health care cost trend rate on the aggregate of service and interest costs is a \$108,000 increase and \$87,000 decrease, respectively, and on the benefit obligation a \$923,000 increase and a \$769,000 decrease, respectively.

The Company's net benefit plan expense is as follows:

| | Defined benefit pension plan | | Post-retirement medical benefits | |
|---|------------------------------|-----------------------|----------------------------------|-------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Amortisation of past service cost | \$ 58,000 | \$ 58,000 | \$ – | \$ – |
| Amortisation of net actuarial gains | – | – | – | – |
| Current service cost | – | 218,000 | 206,000 | 176,000 |
| Interest cost | 3,094,000 | 2,834,000 | 371,000 | 353,000 |
| Actual return on plan assets | (16,399,000) | (1,340,000) | – | – |
| Curtailments arising on corporate restructuring | – | 643,000 | – | (103,000) |
| Actuarial (gain) loss on plan liability | (4,266,000) | 7,014,000 | – | – |
| Change in valuation allowance against accrued benefit asset | 17,571,000 | (14,435,000) | – | – |
| Net benefit plan expense (income) | \$ 58,000 | \$ (5,008,000) | \$ 577,000 | \$ 426,000 |

Contributions relating to the Company's defined contribution pension plans during the year ended 31st March 2006 amounted to approximately \$1,456,000 (2005 – \$1,382,000) and were expensed during the year.

The Company classifies the expense relating to the defined contribution pension plan and the post-retirement medical benefits plan as part of operating expenses in the statement of earnings. Income and expense relating to the defined benefit pension plan are included in other income in the statement of earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

11. Long-term debt redemption amounts unclaimed

During the year ended 31st March 2003, the Company offered the holders of the 7-3/4% notes the option to receive three 8% cumulative redeemable convertible preferred shares of the Company in exchange for every two \$15 notes held. The Company subsequently exercised its right to redeem the remaining notes effective 15th December 2002, extinguishing the Company's long-term debt. As at 31st March 2006 and 2005, not all notes redeemed had been presented to the Company in exchange for cash. The notes remaining outstanding valued at \$601,860 (2005 – \$610,860) are included in long-term debt redemption amounts unclaimed on the balance sheet and do not accrue interest beyond the redemption date.

12. Share capital

| | 2006 | 2005 |
|--|--------------|--------------|
| Authorised – 21,546,220 (2005 – 21,546,220) common shares of par value \$0.25 each | | |
| Authorised – 2,615,445 (2005 – 2,615,445) preferred shares of par value \$1 each | | |
| Issued and outstanding 12,036,954 (2005 – 12,036,954) common shares | \$ 3,009,238 | \$ 3,009,238 |
| Issued and outstanding nil (2005 – nil) preferred shares | \$ – | \$ – |

The Company issued 1,923,833 preferred shares during the year to 31st March 2003 in exchange for 7-3/4% notes of the Company. The Company exercised its right to redeem the preferred shares effective 15th November 2003. As a result no preferred shares are now in issue. As at 31st March 2006, not all preferred shares had been presented to the Company in exchange for cash. The preferred shares remaining outstanding valued at \$1,299,793 (2005 – \$1,378,721) are included in preferred share redemption amounts unclaimed on the balance sheet and do not accrue dividends beyond the redemption date.

On 31st January 2005, the Company declared a stock dividend to shareholders of record whereby they received one common share for each ten shares held. This dividend resulted in the issuance of 1,093,827 shares on 31st January 2005 and the payment of cash amounting to \$5,343 to those shareholders entitled to fractional shares. As a result of this transaction, \$12,032,097 was recorded as the stock dividend with \$11,758,641 being credited to share premium and \$273,456 being credited to share capital. The balance of \$5,343 was charged as a cash dividend.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

13. Other income

| | 2006 | 2005 |
|---|--------------|--------------|
| Pension (expense) income defined benefit pension plan (note 10) | \$ (58,000) | \$ 5,008,000 |
| Proceeds from the sale of Packet Exchange (note 5) | \$ 1,735,275 | \$ - |
| | \$ 1,677,275 | \$ 5,008,000 |

14. Earnings per share

The following sets forth the computation of basic and diluted earnings per share for the years ended 31st March 2006 and 2005.

| | Income (numerator) | Average weighted shares (denominator) | 2006 Per share amount | Income (numerator) | Average weighted shares (denominator) | 2005 Per share amount |
|-----------------------------------|-----------------------|--|-----------------------------|-----------------------|--|-----------------------------|
| Net income | \$ 11,677,203 | | | \$ 10,053,277 | | |
| Basic earnings per share | | | | | | |
| Income available to common shares | 11,677,203 | 12,036,954 | 0.970 | 10,053,277 | 12,036,954 | \$ 0.835 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

15. Government license fee

Certain subsidiaries of the Company are required to pay to the Government of Bermuda a license fee based on 3% of certain revenues. The license fee for the year ended 31st March 2006 was approximately \$2,739,000 (2005 – \$2,548,000).

16. Commitments

The Company has entered into operating lease agreements for its premises and telecommunications capacity. Minimum lease commitments pursuant to these leases over the next five years are as follows:

| | |
|------------|--------------|
| 2007 | \$ 1,408,060 |
| 2008 | \$ 1,162,141 |
| 2009 | \$ 665,452 |
| 2010 | \$ 424,318 |
| 2011 | \$ 424,318 |
| Thereafter | \$ 848,636 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31st March 2006

17. Financial assets and liabilities

Fair values approximate amounts at which financial assets and liabilities could be exchanged between willing parties and are determined using judgment and after consideration of uncertainties. Therefore, the aggregate fair value amounts should not be interpreted as being realisable in an immediate settlement of the instruments.

| | 2006 | | 2005 | |
|---------------------------|----------------|---------------|----------------|---------------|
| | Carrying value | Fair value | Carrying value | Fair value |
| Cash and cash equivalents | \$ 18,971,583 | \$ 18,971,000 | \$ 14,105,723 | \$ 14,106,000 |
| Accounts receivable | 9,370,363 | 9,370,000 | 9,252,778 | 9,253,000 |
| Marketable securities: | | | | |
| Mutual funds | 5,829,740 | 6,593,000 | 5,689,394 | 5,290,000 |
| Bonds | 5,942,111 | 5,654,000 | 5,531,062 | 5,411,000 |
| Equities | 3,993,766 | 5,544,000 | 4,617,884 | 5,026,000 |
| | 15,765,617 | 17,791,000 | 15,838,340 | 15,727,000 |
| Current liabilities | 14,312,117 | 14,312,000 | 14,894,338 | 14,894,000 |

The following are the significant financial risks associated with each significant class of financial assets and liabilities and the methods and assumptions used to estimate fair value:

(a) Cash and cash equivalents

Cash and cash equivalents included deposits held by one United States bank and one Bermuda bank and a Bermuda subsidiary of an international bank as well as money market funds. The fair value of deposits with banks approximates their carrying value. The fair value of Money Market Funds approximate carrying value as they are readily realisable at this amount.

(b) Accounts receivable

The fair value of accounts receivable approximates carrying value, which is net of an allowance for doubtful accounts. The allowance for doubtful accounts is established based on the judgment of management after consideration of historical trends and expectations of future developments. As the allowance is an estimate, there is the risk that actual results may differ from the estimate.

(c) Marketable securities

The fair value of marketable securities is determined by reference to their quoted market prices. Approximately 37% (2005 – 36%) of marketable securities represent Bermuda incorporated international bond and equity mutual funds. It is the Company's opinion that there are no unusual interest rate or credit risks associated with marketable securities.

(d) Current liabilities

The fair value of current liabilities approximates carrying value due to their relatively short-term nature.

18. Comparative figures

Certain comparative amounts have been reclassified to conform to the current year's presentation.

DIRECTORS AND OFFICERS

BOARD OF DIRECTORS

Chairman **James A.C. King, M.D., F.R.C.S.(C.), F.A.C.S.**
Chairman,
The Bank of N.T. Butterfield & Son Limited.
Chairman,
Argus Insurance Company Limited.
Director since 1979

Deputy Chairman **Mr. Roderick A. Ferguson III, MBA, J.P.**
Chairman,
Gorham's Limited.
Director,
The Bank of N.T. Butterfield & Son Limited.
Chairman,
Purvis Ltd.
Director since 1988

Mrs. Jeanne J. Atherden, C.A., J.P.
Director since 1988

Ms. Fiona E. Beck
President & Chief Executive Officer,
Southern Cross Cable Network.
Director since 2003

Mr. Peter C. Durhager
Chief Administrative Officer,
RenaissanceRe Holdings Ltd.
President,
RenaissanceRe Services Ltd.
Director,
BELCO Holdings Ltd.
Director since 2000

Mr. Michael J. Mello, Q.C., J.P.
Senior Partner,
Mello Jones & Martin.
Director since 1993

Mr. Gary L. Phillips
Retired Director of Tourism.
Director since 2000

Mr. Glen C. Smith, J.P.
Consultant,
International Bonded Couriers of Bermuda Ltd.
Director,
LOM Holdings Limited.
Director since 2004

Mr. S. Sean Tucker, LL.B.
Attorney,
King & Associates.
Barristers & Attorneys.
Director since 2001

Mr. Colin V. K. Williams
Director,
PacketExchange (Ireland) Limited
Director since 1997

COMPANY OFFICERS

Mr. John C. R. Collis
Secretary,
Barrister & Attorney,
Partner,
Conyers Dill & Pearman.

Ms. Dawna L. Ferguson
Assistant Secretary,
Conyers Dill & Pearman.

KEYTECH EXECUTIVE MANAGEMENT

Mrs. Sheila G. Manderson
Chief Executive Officer,
Director,
The Bank of N.T. Butterfield & Son Limited.

Mrs. Sheila A. Lines
Chief Financial Officer

Common shares held by Directors – 375,141.

Common shares held by KeyTech Executive Management – 14,193.

No rights to subscribe to shares or debt securities in the Company have been granted to, or exercised by, any Director, Officer or member of KeyTech Executive Management.

There are no service contracts in existence for Directors.

There are no contracts of significance subsisting during or at the end of the period in which a Director was materially interested either directly or indirectly, with the exception noted below.

During the current year the Company sold its interest in PacketExchange (Ireland) Limited ("PEIRL") to an unrelated third party for net proceeds of \$1,735,275. Simultaneously the same unrelated third party purchased equity interests from other shareholders unrelated to the Company, and who subsequent to the sale had no continuing interest in PEIRL, for \$1,825,785 and subscribed \$2,119,000 for additional equity in PEIRL. At the time of the transaction Mr. Colin V. K. Williams controlled 10.8% of the equity of PEIRL. As provided in the Company's bye-laws Mr. Colin V.K. Williams did not vote as a Director of the Company on this transaction.

