ANNUAL
REPORT

PEOPLE MOVING PEOPLE

06

VIA Rail Canada

LETTER TO THE MINISTER OF TRANSPORT, INFRASTRUCTURE AND COMMUNITIES

The Honourable Lawrence Cannon
Minister of Transport, Infrastructure and Communities, Ottawa

Dear Minister:

In accordance with the provisions of the *Financial Administration Act*, I am pleased to submit VIA Rail Canada Inc.'s Annual Report for the year ending December 31, 2006.

DA Wright

Donald A. Wright
Chairman of the Board

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The Year at a Glance

The following key financial indicators and operating statistics summarize the performance of the Corporation for the year 2006 with comparative data for the years 2002 to 2005. They exclude the financial results of the variable interest entity.

	2006	2005	2004	2003	2002
Key financial indicators (IN MILLIONS OF DOLLARS)					
Total revenue	**297.1**	289.8	258.7	250.3	270.8
Cash operating expenses (1)	**475.5**	465.7	443.8	431.4	424.2
Operating deficit (1)	**178.4**	175.9	185.1	181.1	153.4
Capital expenditures	**14.5**	21.2	20.2	77.4	98.4
Government funding:					
Operating	**169.0**	169.0	177.4	181.1	153.7
Capital	**0.0**	0.7	20.2	82.4	103.4
Total Government funding (2)	**169.0**	169.7	197.6	263.5	257.1
Key operating statistics (3)					
Revenue/Cash operating expenses ratio (%) (1)	**62.8**	62.4	58.8	58.5	64.5
Total passengers carried (IN THOUSANDS)	**4,091**	4,097	3,887	3,789	3,981
Total passenger-miles (IN MILLIONS)	**874**	888	851	857	948
Government operating funding per passenger-mile (IN CENTS)	**19.3**	19.0	20.8	21.1	16.2
Yield (CENTS PER PASSENGER-MILE)	**30.3**	28.6	28.0	26.8	26.6
Train-miles operated (IN THOUSANDS)	**6,665**	6,740	6,771	6,780	6,770
Car-miles operated (IN THOUSANDS)	**47,625**	48,614	48,396	48,682	48,262
Average passenger load factor (%)	**55**	55	53	53	57
Average number of passenger-miles per train-mile	**131**	132	126	126	140
On-time performance (%)	**84**	81	70	73	84
Number of employees at year-end	**3,003**	3,059	3,027	3,051	3,054

1. Cash operating expenses used in the calculation of the Revenue/Cash operating expenses ratio, exclude amortization of Property, plant and equipment, reorganization charges, accounting accrual for compensation, unrealized gains on derivative financial instruments, pension and employee future benefits.
2. Excludes internal funding from the Asset Renewal Fund of $23.9 million in 2006, $27.4 million in 2005 and $7.7 million in 2004 and includes a capital funding contribution to the Asset Renewal Fund of $5.0 million in 2001, 2002 and 2003.
3. Key operating statistics are unaudited.

Corporate Overview

VIA Rail operates Canada's national passenger rail service on behalf of the Government of Canada. An independent Crown corporation established in 1977, we provide safe, efficient and environmentally responsible passenger rail service from coast to coast. We operate up to 492 trains weekly on 12,500 kilometres of track, connecting over 450 Canadian communities. With approximately 3,000 employees, VIA carried almost 4.1 million passengers in 2006.

OUR VISION

At VIA, we will be the Canadian leader of service excellence in passenger transportation.

OUR MISSION

We will work together to provide travel experiences that anticipate the needs and exceed the expectations of our customers.

OUR VALUES

Customer Focus
We appreciate and listen to our customers, and we innovate to provide the best passenger transportation experience at the best value for money.

Respect
We are human – people who respond with integrity to the needs of our customers, to each other and to the people and communities we serve.

Passion
We are passionate about passenger rail and the role that it can play in the social, economic, and environmental development of Canada.

OUR SERVICES

In Western Canada, we provide year-round, all-weather intercity transportation, including service to remote communities. The legendary Western transcontinental train the *Canadian*® provides service thrice weekly between Toronto and Vancouver.

In the Quebec City-Windsor corridor, our trains provide intercity passengers with fast, convenient, comfortable and affordable service, downtown-to-downtown, between Canada's largest business centres.

In Eastern Canada, the *Ocean*™ runs six times a week between Montreal and Halifax, offering its friendly *Easterly*™ class service during the peak season. The *Chaleur*™ makes three trips each week from Montreal through the Gaspé Peninsula.

In rural and remote areas, we operate services designated by the government to meet regional transportation needs.

Message from the Chairman

VIA Rail retained its position as a Canadian leader in passenger transportation in 2006, combining responsible management of its resources with efficient, responsive service to customers and communities across the country.

This success is especially impressive given the budgetary constraints of the Corporation. With discussions regarding capital and operating funding ongoing, VIA entered the year in a difficult position – facing a highly competitive and unstable travel market, rising costs, and a projected funding shortfall.

By refining its focus on the customer, the Corporation responded quickly to changing travel patterns and markets with innovative services and marketing – maintaining and slightly improving on the revenue gains achieved in 2005. Prudent management of resources and new entrepreneurial initiatives helped to contain rising costs, keeping cost recovery on an upward trend. Together, strong revenues and efficient cost management allowed VIA to complete the year within the limits of available funding. This is in itself no small achievement.

At the same time, VIA maintained a high quality of service to Canadians. On-time performance improved, despite aging equipment and infrastructure. Customer satisfaction ratings remain the highest in the industry. And VIA Rail continues to enjoy a corporate reputation as one of the most trusted transportation companies in Canada.[1]

The Board of Directors recognizes that this success would have been impossible without the loyalty and support of VIA's customers, the communities VIA serves, and VIA's people, who demonstrate their dedication to Canada's national passenger rail service every day.

Although I joined VIA Rail's Board late in the year, the quality of VIA's people became evident very quickly. To everyone at VIA, I offer my appreciation and congratulations for a job well done in 2006.

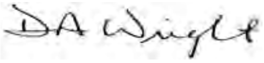
I must also commend the members of the Board for their dedicated work on behalf of passenger rail in Canada. We share a commitment to demonstrate integrity in providing oversight of the Corporation, and foresight in managing the strategic direction of the national passenger rail service.

1 Leger and Leger Corporate Reputation Study, 2006.

To this end, I am pleased that the Board adopted a clearly articulated code of ethics for Directors in 2006, and I fully support our continued efforts to refine Board operations through an examination of best practices in corporate governance. The Board joins me in welcoming and supporting the renewed emphasis on transparency and integrity for Crown corporations set out in the *Accountability Act*, which received Royal assent in December 2006.

A responsibly managed passenger rail service, responding to the changing needs of Canadian travellers, plays an important role in the social, economic and environmental development of Canada. VIA is working with the Government of Canada to clarify that role for the future, to develop a long-term vision for the service, and to assess the funding requirements to achieve that vision.

Encouraged by excellent working relationships between the Corporation and the Departments of Transport and Finance, the Treasury Board, and other agencies, I am confident that a realistic and sustainable vision will ensure the continued success of Canada's national passenger rail service.



Donald A. Wright
Chairman of the Board

Message from the President

The core of VIA's business strategy – and the heart and soul of VIA as a corporation – is our customer focus. Our success as a customer-intimate organization depends on listening to, understanding and anticipating passenger needs, developing a service that meets those needs, and then going a step further to deliver a service that exceeds all expectations.

Our goal is to grow our base of loyal customers, and to make every customer an advocate for choosing passenger rail.

This central focus on the customer builds on what sets rail apart in the marketplace, and our single most important competitive advantage: the way we treat the people who travel with us. And since many of VIA's traditional markets have seen little growth for several years, this focus was the key to meeting the challenges of 2006. By keeping the customer at the centre of everything we do, we succeeded in increasing revenues, productivity and cost-recovery. We also managed limited resources to considerably reduce a projected funding shortfall, all while providing a service that remains responsive to changing needs.

Early in the year we completed a major realignment of the Corporation, to better reflect what we need to do to succeed. This new organization aligns all activities, resources and people which affect customer service into a single branch, to deliver a consistent, high-value travel experience to our customers. At the same time, it aligns all operational activities to ensure the best possible support of that customer experience.

In 2006 we improved our cross-functional approach and communications throughout the Corporation, and developed new tools to identify and respond to customer needs. We developed new marketing and sales strategies to attract more customers, and to provide better access to our services. We further refined our existing services, such as the *Easterly* class to Halifax, and prepared to meet emerging market needs with new services like the Snow Train Express. We also launched a complete review of services throughout the Quebec City-Windsor corridor, to identify future needs and market opportunities.

And we continued to refine our focus on the talents and expertise of our people, with better ways to recognize and celebrate performance on the job, better ways to identify the skills we need, and better opportunities for training and career advancement.

As a result, we held on to the record ridership levels achieved in 2005, and once again we improved our yield – the revenue earned per passenger-mile. We reduced the funding gap, despite steadily rising operating costs that are outside of our control. And we raised customer satisfaction ratings to 98 per cent. In fact, the proportion of customers who say we not only satisfied but exceeded their expectations has climbed from 32 per cent in 2000 to 40 per cent in 2006.

The results, as always, are a credit to the people of VIA Rail, who made a tremendous effort to keep passenger rail moving forward in 2006. They have made VIA a recognized leader in passenger service excellence in Canada.

Their extraordinary talent – their creativity, innovation, and integrity – are the key to meeting the challenges we face as we continue to move forward. Together, we are building a Corporation in touch with the customer, aligned with the changing marketplace, and ready for the future.

Paul Côté

Paul Côté
President and Chief Executive Officer

The Year in Review

MOVING FORWARD IN 2006

VIA has a strong track record managing Canada's passenger rail service. Between 1990 and 2006, the Corporation reduced operating funding requirements for the service by 59 per cent, while absorbing cost increases over the period. This reduction was achieved through vigorous revenue growth (up 108 per cent), and rigorous control of operating costs (down 14 per cent). The cost to the public for operating passenger rail has dropped significantly, and the quality of service across the country has improved.

Like many other businesses, VIA has faced new challenges in recent years, including increased operating expenses, particularly fuel. Some of these challenges have been more specific to passenger rail, including shifts in travel markets and demand, and rising costs resulting from aging equipment and infrastructure.

In 2005 VIA launched *Moving Forward*, a new business strategy to meet these challenges. The results were dramatic: VIA carried a record number of passengers during the year, and achieved a record increase in revenues. This plan will be reviewed in 2007.

Moving Forward makes the customer the cornerstone of VIA's mission, vision and values, and defines six key corporate goals for the Corporation. These goals provide a customer-focused framework for managing VIA's people and resources, adapting to new realities in the marketplace, and responding to the customers and communities VIA serves.

MOVING FORWARD – CORPORATE GOALS

> Safety
We will provide a safe and secure environment for our customers, ourselves and the general public.

> People
We will work together to create an environment that promotes a passionate commitment to realizing our vision and to VIA's business success.

> Service
We will consistently provide our customers with excellent travel experiences that exceed their expectations.

> Growth
We will seize opportunities to offer innovative products and services in all markets that we serve.

> Entrepreneurship
We will become increasingly self-sufficient by continually improving productivity and increasing the revenue/cost ratio on all train services.

> Environment
We will actively structure our operations to meet the needs of our customers in an environmentally sustainable and responsible manner, while contributing to Canada's commitment to the Kyoto accord.

Moving forward

Responding to Change

Canadian travel markets, and the travel industry as a whole, have changed in recent years. During the 1990s markets expanded rapidly, and VIA matched or exceeded that growth every year. In 2003 a number of uncontrollable events, including SARS, the war in Iraq, and the depreciation of the U.S. dollar, had a negative effect on travel markets. While domestic markets are in a recovery period and are now returning to 2002 levels, financial pressures have caused a number of bankruptcies, major restructuring and consolidations of services throughout the industry.

At the same time, travel patterns changed, with increased competition from other countries as destinations for international travel, a drop in overall travel into Canada from the U.S., and declines in long-distance travel in favour of shorter trips. Customer purchasing patterns have also changed, largely as a result of online technologies. Consumers continue to shift away from making purchases through traditional travel intermediaries, in favour of web-based tools which offer convenient, personalized travel planning and booking options.

VIA performed well during this period. Following a year-over-year drop in revenues in 2003, the Corporation responded quickly to shifts in the marketplace, with growth in both revenues and ridership. Despite intense competition, VIA maintained its performance in 2006. This was accomplished by continually refining marketing strategies and tools to acquire new passengers and build customer loyalty, all while identifying opportunities to provide enhanced, value-added services in key markets.

ALIGNING RESOURCES WITH THE CUSTOMER

In February of 2006, VIA restructured its organization to bring its resources more precisely in line with the core focus of meeting our customers' needs and exceeding their expectations. The new Customer function clearly identifies responsibilities and activities that contribute directly to the customer experience. A unified Operations branch brings new energy to the drive for operational excellence – aligning all resources involved in running passenger trains, including train operations, maintenance, safety and security.

The new Customer function integrates the process of developing and delivering services to VIA's customers, from market research, product and service design, sales and marketing, through to service delivery on board trains, in VIA's stations, in telephone sales offices and on the web. With more direct links between customer expectations, product development and service delivery, VIA has sharpened its business focus – and is better able to ensure consistency between what the customer expects, and what the customer actually experiences.

While the new structure clarifies roles and accountabilities for related activities, VIA continues to emphasize the value of cross-functional teams – working groups which bring together people from different departments and functions.

VIA first introduced the concept of cross-functional teams in 2001, when four regional service teams became responsible for VIA's operations in the East, the West, Southwestern Ontario, and the area east of Toronto to Quebec City. These teams are responsible for all results related to the services and products they manage, including cost-recovery, on-time performance and customer satisfaction ratings. They provide a foundation for the collaboration and teamwork necessary in a passenger service, and because of their proximity to their markets they are able to anticipate the needs and exceed the expectations of customers.

Moving Forward

> Customer Focus

We appreciate and listen to our customers, and we innovate to provide the best passenger transportation experience at the best value for money.

The cross-functional approach embodied in service teams is also vitally important when managing issues which cut across organizational boundaries, and require collaboration between all parts of the Corporation. In addition to the four service teams, there are 14 cross-functional teams at VIA today, including two created in 2006 – the Accessibility Review Committee and the Risk Management Committee. These groups bring together the perspectives and skills necessary to identify problems and opportunities, explore solutions and new ideas, and take action quickly – with a clear understanding of the impact their decisions will have on the customer.

BUILDING STRONG CUSTOMER RELATIONSHIPS

VIA's customer reward program, VIA Préférence, celebrated its 10th anniversary in 2006. Designed to build customer loyalty, the program allows members to accumulate points toward free train travel, as well as periodic special offers. VIA Préférence has close to half a million members and is still growing steadily.

With customer loyalty becoming a key focus for the Corporation, VIA is building on VIA Préférence to strengthen and manage its relationship with customers. In November, VIA launched the first phase of a new customer profile technology using information from the VIA Préférence customer database, as well as information gathered through RESERVIA, VIA's online booking system. The technology gives telephone and counter sales agents instant access to customer information when making a booking – helping them to understand individual customers' needs, and provide a more personalized service, such as offering products tailored to individual travel habits and preferences. VIA's sales agents were also given extensive technology upgrades and improved network and telecommunications services in 2006, allowing them to respond to customers more quickly and efficiently.

Moving Forward

> Service

We will consistently provide our customers with excellent travel experiences that exceed their expectations.

Customer profile technology is part of a corporate strategy designed to help VIA become a customer-intimate organization – an organization that builds a more human bond with customers and strives to understand and respond to the specific needs of individual customers.

On a broader scale, this is a major focus of the new Customer function, integrating all aspects of service design, marketing and delivery to provide customers with a consistent, unique and high-value travel experience. Efforts to attract, train and develop people with the right talents – VIA's core competencies as a customer-focused organization – are vital to this approach, and key to maintaining and strengthening relationships with customers.

NEW SALES STRATEGIES AND TOOLS

With limited opportunities to expand under currently defined network and service levels, VIA must depend on increased sales – particularly sales of high-yield products and services – to maintain and improve revenues.

Telephone sales offices developed a more proactive sales strategy in 2006 – taking better advantage of contact with customers to offer higher value services, and to encourage customers to travel with VIA more frequently. VIA is also actively pursuing growth through business-to-business marketing, increasing sales to corporate customers, and through partnerships with tour operators and travel agencies.

For both individual and corporate customers, web-based access to information, bookings and reservations is becoming essential. VIA has been a pioneer in providing online tools for customers, and web-based sales now account for a record 33 per cent of total sales.

Recognizing that the online experience is now a significant part of the total customer experience, VIA began a comprehensive review of its web site in 2006, and will begin work on an enhanced web site in 2007. VIA also introduced new online payment options – including "virtual credit cards" and INTERAC bank transfers – to make online transactions more efficient, convenient and secure for customers.

ENHANCED SERVICES

VIA continues to explore opportunities to enhance the value of existing train services, and to develop new services that would help to increase revenues.

Wireless Internet access for customers, offered on a trial basis in 2005, was launched on all Corridor trains in 2006. This is the first commercial deployment of Wi-Fi on passenger trains in North America. Developed on a partnership basis with the technology service provider Parsons, Wi-Fi is an example of VIA's commitment to exceed customer expectations with a service that makes their trip more enjoyable, relaxing and productive.

In the Corridor, new schedules were introduced in response to customer feedback, providing for more convenient service from Montreal to Quebec City, and adding a new round trip between Montreal and Ottawa's Fallowfield station. Operation of the peak season Toronto-Niagara Falls train was extended in 2006, and, in partnership with Fallsview Casino Resort and Peller Estates Winery, VIA added an additional train with a special "learn to play" Casino car – the first of its kind in Canada. The car offered customers the opportunity to relax and enjoy a complimentary Peller Estate wine sampling, while learning to play poker or blackjack from a professional Fallsview Casino Resort croupier.

Moving Forward

> Growth

We will seize opportunities to offer innovative products and services in all markets that we serve.

In Atlantic Canada, *Easterly* class service on board the *Ocean* – designed as a "Maritime Learning Experience", complete with educational activities and regional cuisine – received high customer approval ratings during its first season in 2005. The service was improved and refined for its second year, operating for an extended peak season between Montreal and Halifax.

The Western Service team used 2006 to plan for a new summer tourism product on the Winnipeg-Churchill train, modeled on the *Canadian*'s successful *Silver & Blue* class service and scheduled to begin in 2007. The Western team also established a new winter service between Edmonton and Jasper, to operate for 15 weeks beginning in January 2007. Developed in partnership with Marmot Basin and the Town of Jasper, the Snow Train Express will provide weekend getaways for skiers, snowboarders and outdoor enthusiasts, thus helping to support the winter tourism economy in the region.

LISTENING TO CUSTOMERS IN THE CORRIDOR

2006 marked the 150th anniversary of passenger rail service in central Canada. What began in 1856 with a 14-hour train trip between Toronto and Montreal has grown to become VIA's busiest market, with some 400 trains operating in the Quebec City-Windsor corridor every week.

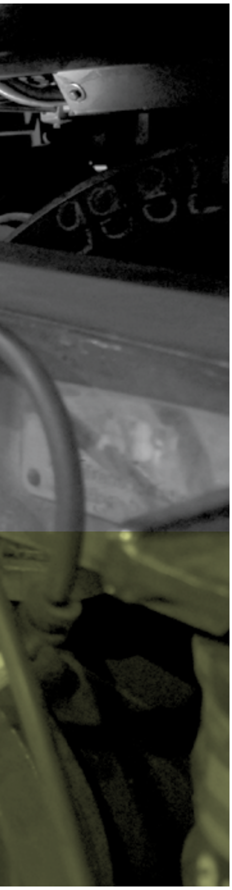
To ensure that passenger rail continues to evolve and offer the best possible value to travellers in the Corridor, VIA undertook a close examination in 2006 of those features of rail service most important to customer satisfaction. In addition to on-time performance and the quality of on-board services, value for money was singled out as one of the most important benefits to Corridor customers. Based in part on this research, VIA introduced new pricing strategies for services between Montreal and Quebec City, between Montreal and Toronto, and between Toronto and Ottawa. Leading to a significant increase in ridership, this proved to be one of the most successful growth initiatives of 2006.

Following the success of this initiative, VIA launched the first steps in a comprehensive review of all Corridor services. This review will include a complete forward-looking assessment to determine how passenger rail must evolve to meet the changing needs of customers in the Corridor, and how it can serve more customers.

The review will be supported by a number of innovative tools for conducting market research, including a pilot project that proposes to use online technology to gather consumer feedback. New tools will engage online panels in providing feedback to market researchers, while simplifying the process of conducting surveys, collecting data, and analysing results. Experimenting with this new approach will give VIA insights into the value of using this new technology, and how it could be integrated into the Corporation's overall market research strategy.

In 2006, VIA maintained and slightly improved upon the high level of customer satisfaction achieved in recent years. Overall satisfaction has remained at 96 per cent or higher since 2000, reaching a high of 98 per cent in 2006. The proportion of those satisfied customers who say that VIA exceeded their expectations has also been steadily increasing since 2000.

Responsible Management



Aligning people, talents, and goals

VIA's Moving Forward plan depends on the understanding, talents, and creativity that people bring to the job, and the opportunities they have to make a real contribution to VIA's success.

VIA has made dialogue with people a priority – engaging employees in meaningful discussions about the Corporation's vision, mission, values and goals, keeping everyone informed about business challenges, and providing honest feedback on both individual and corporate performance. Throughout 2006 VIA continued to improve the way it consults with employees through surveys, "town hall" meetings and informal discussions. The Corporation also asked employees to identify what kind of information they wanted to see, and how it could be best presented. As a result, VIA completed a comprehensive redesign of the tools used to communicate with employees, such as the employee newsletter, bulletins and memos from senior management.

VIA also strengthened its employee recognition program in 2006, and a new recognition program – emphasizing employee contributions to VIA's success as a customer-focused organization – is currently being developed.

VIA began changing the way it manages human resources in 2004, shifting the HR function from a largely administrative role to a more strategic one, developing the talent of VIA's people, and aligning that talent with the goals of the Corporation. The process of hiring, training, promoting and rewarding talent is being rigorously managed – to create an organization where people succeed by directing their creativity and innovation towards the success of passenger rail.

Moving Forward

> People

We will work together to create an environment that promotes a passionate commitment to realizing our vision, and to VIA's business success.

As part of this emphasis on managing talent, VIA identified eleven core competencies in 2006. Each competency – such as empathy and listening, teamwork, and creative problem-solving – combines knowledge, attitudes and skills that the Corporation needs to succeed as a customer-focused business. They also provide a valuable framework for people pursuing their own career growth and development at VIA Rail.

The core competencies have been integrated into VIA's hiring practices, training and development programs, career and succession planning, and performance management. Management employees completed a self-assessment exercise on the competencies, which in turn was incorporated into the process for year-end evaluations. In 2007, all management employees will create personal development plans reflecting these evaluations.

Course modules on the competencies are now included in the growing number of learning tools available to employees online – either from their home computers or through well-equipped e-Learning classrooms.

VIA has also developed e-Careers, an online recruitment and career development service accessible to both employees and outside job applicants. E-Careers is an important tool that supports VIA's efforts to attract new people, new ideas and new energy to the Corporation -- encouraging the recruitment and development of people with the right talents and skills for VIA's future.

In the spring of 2006, VIA introduced a flexible benefits program for management employees. The initiative allowed the Corporation to offer a highly competitive benefits program best suited to employees' personal needs, while at the same time containing the ever-growing costs associated with group benefits.

CONTROLLING COSTS

Despite rising costs for key operating expenses, VIA maintained – and slightly improved – the high level of cost-recovery achieved in 2005. At 63 per cent, the revenue/expense ratio for passenger rail has improved by more than 117 per cent over the past 16 years.

Employees throughout the Corporation helped to maintain this performance by controlling costs and increasing productivity in all aspects of VIA's operations. Continuing a practice introduced in 2005, VIA's performance management and incentive programs encouraged and rewarded management employees for demonstrating effective cost controls, and for contributing to revenue performance.

Technology is proving particularly effective in controlling costs. Internet-based booking and reservation technologies have helped VIA reduce costs significantly, while making access to rail services more convenient and efficient for VIA's customers and partners. In 2006, VIA developed a web-based distribution platform for consumers and travel partners. All travel agencies in the U.S. have migrated to this platform, and most Canadian travel agencies will soon follow. This improvement is expected to save the Corporation more than $1 million annually.

Building strategic alliances is an important part of the newly realigned organization, allowing VIA to share the costs of developing and improving services, and expanding its marketing efforts, with its partners. For example, VIA completed implementation of wireless Internet service for customers on board all Corridor trains in 2006, with the service provider assuming the costs for implementing the technology. The service has provided extra convenience and value to customers without increasing VIA's operating costs.

Strategic partnerships with tour operators, travel agencies and associations are also valuable tools to control costs, and continued to be important in 2006. Through VIA's partnership with Brewster Transportation, VIA has established a marketing presence in China, one of the biggest emerging markets for travel to Canada. VIA continues to work with the Canadian Tourism Commission, regional and local tourism associations, as well as local chambers of commerce and boards of trade. These partnerships allow VIA to share the expertise and resources required to reach and develop new markets, while helping to support the Canadian tourism industry as a whole.

Moving Forward

> Entrepreneurship

We will become increasingly self-sufficient by continually improving productivity and increasing the revenue/cost ratio on all train services.

Another strategy – fuel hedging – has been an important tool to control costs in recent years. Diesel fuel is central to VIA's operations and accounts for 93 per cent of VIA's total energy consumption. For more than a decade the Corporation has employed a hedging strategy involving agreements with financial institutions about price levels for this important commodity. This risk management strategy provides protection against extreme fluctuations in price, and has also resulted in considerable savings for the company – $27 million since 1996, and more than $4 million in 2006 alone.

MANAGING THE FLEET

VIA is using its limited capital funds to maintain an efficient and reliable passenger service. At the same time, VIA is taking the necessary steps to prepare for the future, identifying and planning for the equipment renewal and improvements needed to maintain service in the years ahead, and which will require significant capital investment.

VIA completed assembly and modifications to the final Renaissance train set, on schedule and in time for the busy summer season. The Renaissance fleet was purchased in 2000. With the final set modified, the *Ocean* between Montreal and Halifax now operates entirely with Renaissance equipment in the peak season – ensuring a uniform and consistent travel experience in Atlantic Canada.

The new equipment replaced a 21-car train set, which was redeployed for use in the West on the *Canadian*. This extra train set in Vancouver has helped to ensure on-time departures on VIA's flagship transcontinental train.

VIA is also developing plans for a comprehensive interior rebuild of the stainless steel fleet used on the Western transcontinental service. A competitive design process begun in 2005 has resulted in a full-sized, semi-functional mock-up of a redesigned sleeper bedroom. The design incorporates many customer advantages, including forward facing seats, heating and air conditioning controls, larger windows, and includes plans that would allow for a wheelchair accessible bedroom in every car. The project, which requires capital funding to proceed, would include all sleepers and Park cars in this fleet.

While funds for improving existing equipment are extremely limited, VIA was able to undertake a $2.3 million overhaul of the stainless steel equipment used in the Quebec City-Windsor corridor. In 2006, the interiors of ten *VIA 1* cars from this fleet were modified to match the more spacious and comfortable *VIA 1* cars from the Light Rapid Comfortable (LRC) fleet, also used in the Corridor. The result is a more consistent service to all first class travellers in the Corridor. In 2007 VIA plans to overhaul ten *Comfort* class cars from the stainless steel fleet, to upgrade interiors and improve seating for customers.

Because the LRC fleet is also aging – leading to lower reliability and increased maintenance costs – VIA has also been taking the necessary preparatory steps for future renewal. VIA plans to undertake a major rebuilding project which will extend the life of this equipment by another 15 to 20 years, at a lower cost than buying new equipment. A prototype was completed in 2006, and will be tested in service in 2007. Further progress on this project will require capital funding.

A prototype for rebuilding VIA's General Motors F-40 locomotives was also completed in 2006. One of the company's oldest locomotives, in service since the 1980s, was completely stripped down and rebuilt from the ground up, incorporating state-of-the-art technology and components. The completely rebuilt engine provides 200 additional horsepower and lower fuel consumption, at half the cost of purchasing a new locomotive. The prototype will be tested in service in 2007. Rebuilding the remaining 53 F-40 locomotives will require capital funding.

CREATING A RISK-SMART CULTURE

VIA Rail is strengthening its approach to risk management, emphasizing the need to embed a risk management focus into all management processes across the Corporation. In an increasingly complex and rapidly changing business environment, it is vital for the Corporation to identify potential events or issues that might affect the reliability of its services, and to ensure that appropriate measures are in place to minimize the risks involved. Such events might include deterioration of the rail infrastructure, limiting VIA's ability to deliver reliable on-time performance, or sudden surges in fuel prices, significantly raising VIA's operating costs.

At the level of the Board of Directors, risk management is addressed by the Audit and Risk Committee, which monitors the procedures to identify principal business risks, and assesses steps undertaken to manage and mitigate them.

In 2006, VIA created a cross-functional team to enhance this risk management focus and to ensure that it becomes integral to all management activities – including strategic and budget planning processes, internal and external audit procedures, and key processes such as safety and security planning, environmental management activities, and capital project planning. The new Risk Management Committee will enhance and sustain the level of awareness and sensitivity amongst VIA's management team on the subject of risk management – providing an updated, corporate-wide risk assessment review annually, performing a gap analysis on major risks to determine if new actions should be taken, and monitoring all risk management initiatives.

The 2006 realignment also saw the merger of those groups responsible for health and safety, the environment, and quality control. The new Integrated Risk Management group is charged with helping employees develop a systematic awareness and approach to managing operational risk in their day-to-day work activities.

A Responsible Service

Managing passenger rail responsibly means managing the bottom line. It also means much more.

Since its beginnings, passenger rail has made vital contributions to Canadian society – to the growth and development of communities, to the economic infrastructure of the country, to the well-being and quality of life of Canadians. And it continues to play a role in the life of Canadians, communities and society that goes beyond the income statement.

With this unique role comes great responsibility. VIA embraces this responsibility, and acts on it every day.

VIA's activities – like those of any corporation – have an impact on the life not only of customers, but a broad range of people, communities and interest groups. Responsible management means recognizing that VIA Rail does not operate in a vacuum. VIA is connected to the society it serves, and strives to be a good corporate citizen – taking its impact on others into account in management decisions, and responding with integrity and respect to all stakeholders who are affected by its activities.

Moving Forward

> Passion

We are passionate about passenger rail and the role that it can play in the social, economic and environmental development of Canada.

RESPONDING TO COMMUNITIES

Viewed by Canadians as a national icon, VIA is committed to providing a service that reflects and responds to all facets of Canada's diverse, multicultural society.

As a federal institution, VIA plays an important role in promoting Canada's linguistic duality. The Corporation is committed to serving passengers in the official language of their choice, and to using both French and English in all internal and external communications, as well as in business practices. In 2006, when VIA carried 4.1 million passengers, just six complaints were filed with the Office of the Commissioner of Official Languages. All were investigated and corrective measures were taken, to ensure that VIA continues to provide quality service in both official languages.

In responding to people and communities in difficult circumstances, VIA also fulfills needs that passenger rail is uniquely positioned to address. In 2006, VIA worked closely with both the federal and provincial governments to help Canadians fleeing violence in Lebanon. As flights carrying returning Canadians arrived in Toronto and Montreal, VIA provided complimentary transportation to individuals and families to complete the final leg of their journey home. VIA's employees received recognition from many, including the Red Cross and the Government of Ontario, for their extraordinary efforts during the crisis.

Moving Forward

> Respect

We are human – people who respond with integrity to the needs of our customers, to each other, and to the people and communities we serve.

VIA is also recognized as an industry leader working with people with disabilities to provide accessible transportation services. In 2006, VIA created a new cross-functional Accessibility Committee, drawing together resources and expertise throughout the company to ensure that VIA continues to provide a responsive, accessible service. One of the first priorities for the Committee was to establish an external advisory group, helping VIA to engage in a dialogue with concerned groups of customers with special needs.

On many occasions throughout its history, VIA has provided special services to groups and communities who deserve recognition in Canada. In June 2006, VIA operated the Chinese Redress Express – a train bringing Canadian Chinese Head Tax payers, their families and descendents from Vancouver to Ottawa. The purpose of their journey was to witness an historic apology in the House of Commons.

Finally, in November of 2006, VIA operated two unique trains linked to Remembrance Day. Between 1942 and 1948 some 40,000 war brides and 20,000 children came to Canada from Britain and Europe, first touching Canadian soil in Halifax. The War Bride Train brought hundreds of surviving war brides and family members from across the country back to Halifax to take part in special reunion celebrations. Following those celebrations, the Troop Train honoured Canadian veterans, bringing them with their families from Halifax to Ottawa for Remembrance Day ceremonies in the capital.

ENSURING SAFETY AND SECURITY

All VIA employees recognize that safety and security are the top priority for travellers – and that safety can never be taken for granted. VIA Rail has one of the best safety records in the business, a testament to our continual efforts to improve safety procedures and to remain vigilant with respect to security.

VIA developed and implemented a comprehensive safety management system in 2001, integrating rules, procedures and responsibilities for safety and making safety a top priority for every employee. This system is regularly audited by Transport Canada, and employees continue to review the system on an ongoing basis to provide essential feedback and suggest improvements. As in 2005, safety targets and performance measures were aligned with and integrated into VIA's business strategy for 2006. In addition, safety performance is continually monitored by Health and Safety committees at all major VIA locations across Canada. These committees review annual safety reports and ongoing safety performance data to establish specific objectives for improving workplace safety, and to identify issues that require the attention of senior management.

Moving Forward

> Safety

We will provide a safe and secure environment for our customers, ourselves and the general public.

An integral part of the safety management system is the Hazardous Assessment and Risk Control Strategies database, which was reviewed and updated early in 2006. This database is consulted by managers to identify and mitigate situations involving risk to customers, communities or employees. VIA developed a new hazard protection program using the database, along with a new training program for employees and VIA's Health and Safety committees.

At the request of employees, VIA introduced an influenza immunization program in the fall of 2005. VIA continued the program in the fall of 2006, making flu shots universally available to employees on a voluntary basis, free of charge. At the same time, the Pandemic Planning Committee, newly created in 2006, focussed on developing and monitoring a proactive approach for mitigating the risks for VIA of a potential pandemic influenza outbreak in Canada, and ensuring that a rapid response plan is in place should one occur.

A cross-functional team is responsible for reviewing security policies and procedures at VIA Rail. The Strategic Security Planning Committee, chaired by the president with representatives from all departments and all parts of the passenger rail network, works with regulators and industry partners to enhance VIA's security standards, and ensure that the best possible facility and operations security procedures are implemented at VIA. This committee oversaw further refinements and improvements to VIA's security practices and procedures in 2006, following an analysis of VIA's security systems by an outside consultant in late 2005.

As part of this continuing emphasis on efficient and effective security for passenger rail, VIA's Board of Directors approved a Corporate Security Policy in 2006. New security standards are currently being developed for VIA's facilities, operations, and the Corporation as a whole.

AN ENVIRONMENTALLY RESPONSIBLE PASSENGER SERVICE

Passenger rail is considered one of the safest modes of public transportation available today, and one of the most environmentally sustainable. For VIA, managing passenger rail responsibly means operating the safest possible service, while continually reducing the environmental impact of this mode of transportation.

VIA's Environmental Policy commits the company to operating all aspects of its business in an environmentally responsible manner. This policy is distributed to all employees and shared with contractors, and provides the foundation for VIA's environmental management system.

Moving Forward

> Environment

We will actively structure our operations to meet the needs of our customers in an environmentally sustainable and responsible manner.

A new e-Learning module explaining the company's environmental commitment and encouraging "green" work practices was launched in 2006. This training is supported by on-going efforts to raise environmental awareness both inside and outside the Corporation by the new Integrated Risk Management group, and by voluntary groups of employees known as Green Teams. In 2006, Green Teams participated with other associations and agencies in activities such as Earth Day, Car Free Day, Clean Air Day, and the International Youth Summit on Sustainable Urban Transportation.

In 2004 VIA enacted a Green Procurement Guide, which sets guidelines for purchasing environmentally-friendly products and services, and in recent years the Corporation has sourced recycled paper for a variety of publications and supplies, including napkins, timetables and newsletters. Recycling of plastic, cans, glass and newspapers occurs on board and in offices across the network, while used linens and uniforms are also repurposed or recycled, with proceeds going to a variety of Canadian charities. This year, in an effort to reduce waste, VIA introduced a reusable coffee mug for sale to passengers.

One of VIA's primary environmental goals is the continued reduction of greenhouse gas emissions through reduced fuel consumption. VIA has succeeded in significantly decreasing emissions since 1990, even as the volume of its operations has grown. Compared to 1990, VIA operates 20 per cent more trains and carries 18 per cent more passengers; in the same period, VIA reduced greenhouse gas emissions by 15 per cent.

In 2006, improvements were made to the air conditioning of Renaissance sleeper cars and the windows of P-42 locomotives to improve their energy efficiency, which will in turn have an impact on fuel efficiency. The proposed rebuild of a fleet of 20-year-old locomotives and a fleet of 25-year-old passenger cars will result in further improvements in fuel efficiency.

As a transportation choice, passenger rail is recognized as one of the most environmentally sustainable options for Canadian travellers. In 2004, rail transportation accounted for less than one per cent of Canada's total greenhouse gas emissions, or 6,000 kilotons of CO_2e.[1] Of that total, VIA's operations accounted for 0.03 per cent, or 194 kilotons.

A PARTNER IN THE GLOBAL COMMUNITY

While VIA's operations are based in Canada, the Corporation recognizes that Canada is part of a global community, and that the Corporation's actions can affect people in other parts of the world.

In 2006 VIA became the first major transportation company in Canada to serve only fair trade certified coffee to its customers. Through cooperation with TransFair Canada, an independent, not-for-profit certification body for fair trade products, VIA is able to guarantee that the coffee served on its trains has been grown according to strict environmental standards, and that the farmers and workers who produce the coffee have been paid a fair price for the product. VIA hopes that its commitment to fair trade will set an example for others, helping to improve the living conditions of farmers and workers in other countries.

VIA also had the opportunity to take the lead in exchanging views, expertise and solutions with the international community. In June 2006 VIA hosted the annual meeting of the International Union of Railways – the first time this event has been hosted outside of Europe – and the 7th World Congress on Railway Research. Also in June, VIA was a partner of the International Economic Forum of the Americas. The theme of the Forum – Growing Through Partnership: From Risk to Reward – covered a wide range of issues, among them sustainable development.

International dialogue with communities around the world provides VIA with an opportunity to share information specific to Canada's approach to passenger rail, while fostering an open and in-depth discussion of the most important economic, social and cultural issues facing society today.

1 Source: Canada's GHG Inventory, Environment Canada, 2004. CO_2e, or carbon dioxide equivalent, is the quantity of a given greenhouse gas multiplied by its global warming potential. This is the standard unit for comparing the degree of harm caused by different greenhouse gasses.

Corporate Governance

In October 2006, the Government of Canada appointed Mr. Donald A. Wright as VIA's Chairman of the Board for a period of three years. The appointment of a permanent Chairman is an important step forward for VIA, and Mr. Wright's extensive business experience will be a valuable asset to the Corporation in the challenging years ahead.

The Corporation and its Board of Directors are committed to principles of good governance, and have fully implemented a new governance program over the past few years, including a governance "matrix" that clearly defines the Board's roles with respect to strategic planning and direction of the Corporation, performance management of executives and directors, succession planning, risk management and financial oversight. Training and orientation programs for new Board members continue to play an important role in supporting good governance.

In 2006 the Board worked with an independent consultant to complete an assessment of Board activities, including an evaluation of relations between the Board, VIA management, and the shareholder, of the Board's focus on governance, and of the Board's effectiveness overall. The exercise was very successful, with Board members quickly reaching a consensus on the findings of the review. The results will help the Board continue to maintain the highest standards in governance for the Corporation.

The Board also completed the development of a new code of ethics for Directors, and all members have signed this code. The code reflects the spirit and intent of the new *Accountability Act*, which sets out new standards of transparency and accountability for the officers of Crown corporations.

WORKPLACE ETHICS

VIA Rail fully implemented a Code of Conduct for all employees and executive officers of the Corporation in 2005. The Code of Conduct is a formal statement of VIA's values and business practices, and a promise to serve Canadians with the highest standards in ethical behaviour and customer service. It reflects the Corporation's dedication to responsible management and governance, and a work environment that fosters respect and integrity at all levels of the organization. A revised online Code of Conduct training module for employees was developed in 2006, and the first annual review of compliance with the Code was completed by the end of the year.

In 2005 VIA retained the services of an independent, third-party compliance officer, ensuring that employees are free to raise concerns about VIA's operations with the assurance that those concerns will be recognized and resolved fairly.

Management Discussion and Analysis

This discussion and analysis presents data and comments on the Corporation's financial position and results of operations for the year 2006. It should be read in conjunction with the consolidated financial statements, which follow, as well as the Year at a Glance on page 1.

In April 2006, as part of its mandate to provide passenger rail service in Canada, the Corporation entered into an operating agreement with the Keewatin Railway Company ("KRC") to provide a financial contribution to KRC for the purposes of operating passenger rail services and essential freight to the communities in Northern Manitoba served by KRC. KRC is a Variable Interest Entity (VIE) to the Corporation given that the Corporation is the primary beneficiary exposed to a majority of the risk of loss from KRC's activities. The Corporation has therefore consolidated the financial statements of KRC. In 2006, the financial contribution provided by the Corporation to KRC amounted to \$2.0 million. (See note 11 in the consolidated financial statements.)

OVERVIEW OF FINANCIAL RESULTS

EXCLUDING THE FINANCIAL RESULTS OF THE VARIABLE INTEREST ENTITY.

Following two consecutive years of exceptional financial performance, VIA once again generated impressive financial results in 2006. Bottom line figures reflect a solid increase in revenues, organization-wide efforts to reduce costs, and several one-time events. Despite the pressures of turbulent travel markets and rising operating costs, the Corporation reduced its net operating deficit substantially compared to budget. There was a modest increase in the operating deficit as compared to last year.

VIA began 2006 with the knowledge that, in the absence of other sources of funding, it would be necessary to draw on internal resources to meet operational and minimal capital requirements for the year. This challenge was met through a solid increase in passenger revenues versus 2005, combined with revenue from a one-time recognition of capital gains in VIA's Asset Renewal Fund investment port-folio, which brought total revenues in 2006 to an all-time high of \$297.1 million. This is \$11.3 million (or 4 per cent) higher than budget and \$7.3 million (or 3 per cent) higher than last year.

These higher revenues were matched with lower than projected operating expenses due to careful management of costs across the organization. This enabled the Corporation to end its financial year with an operating deficit of \$178.4 million – an increase of \$2.5 million (or 1 per cent) compared to last year, but a reduction of \$14.2 million (or 7 per cent) compared to budget.

Annual operating funding for passenger rail from the federal government has ranged from \$181 million to \$154 million since 1999. In recent years the Corporation has had to use the Asset Renewal Fund to make up the difference between government operating funding available and the actual operating funding required. In 2006, due to the significant one-time revenues and rigorous cost controls, VIA was able to reduce the funding shortfall and therefore the amount of funding required from the Asset Renewal Fund, to \$9.4 million. This is \$14.2 million (or 60 per cent) better than anticipated.

REVENUE AND RIDERSHIP

Passenger revenue continued to grow in 2006, even though growth was constrained by a slight decline in ridership in a weak and highly competitive travel market. Early in the year, Canadians' winter travel patterns had begun to shift to destinations outside the country. Later, faced with rising costs of Canadian destinations due in part to the strong Canadian dollar, U.S. and overseas travellers began redirecting their vacation trips elsewhere, leaving capacity unfilled during summer months.

To offset this situation, VIA concentrated on managing yield to stimulate domestic travel, realigning fares to better match market conditions. A more flexible *VIA 1* Corridor fare plan was introduced in the spring, building on the simplified *Comfort* class fares introduced in 2005. The market responded positively to this initiative, producing an immediate increase in ridership which continued through the rest of the year. Western Canada tourism also began to recover in August, reversing in part earlier losses in VIA's long distance markets.

Overall, revenue per passenger-mile increased to 30.3 cents, almost 6 per cent higher than 2005. Total passenger revenues increased $11 million over 2005 to reach $266.6 million, a 4 per cent increase that, while substantial, fell 2 per cent short of budget targets. Passenger ridership slipped back slightly from the 4.1 million trips recorded last year, while passenger-miles, at 874 million, fell 1 per cent as a result of the weak demand for long distance travel – with particularly acute declines in Eastern Canada throughout the year.

VIA's success in maintaining revenue growth throughout 2006 reflects its strong customer focus – supported by the creative application of technology to communicate with our customers and simplify their travel planning. As more of the travel trade moves online, VIA is enhancing its web site to attract both consumers and business users: customers can register and create personalized travel profiles; and travel agents are able to book space directly, rather than making more costly arrangements through third-parties. As a result of the features introduced during 2006, VIA's online sales increased for the fifth consecutive year – growing by 30 per cent, reaching close to $90 million and accounting for about one third of total sales.

OPERATING COSTS

EXCLUDING THE FINANCIAL RESULTS OF THE VARIABLE INTEREST ENTITY.

Total operating costs in 2006 were favourably influenced by a number of one-time factors, and by a concerted effort to contain costs across the organization. These factors resulted in expenses that were under budget by $3.0 million, or 1 per cent. As a result, total operating expenses increased by only 2 per cent, or $9.8 million, compared to 2005.

Train operating costs (particularly fuel) and compensation were the major source of increased costs versus 2005. The effects of higher fuel prices were significantly attenuated by the use of hedging techniques, which sheltered the Corporation from the full impact of increases in the price of fuel.

Changing financial conditions affecting the pension plan for VIA's unionized employees also influenced operating costs. As required by the *Income Tax Act*, the Corporation did not contribute to the unionized plan for a number of years. However, given a modest deterioration in the financial position of the plan, VIA elected to resume contributions in the second half of 2005. In 2006, the contribution to the unionized pension plan was $13.5 million for the full year (versus $5 million in 2005 for a partial year).

VIA benefited from two unbudgeted recoveries of prior year expenses in 2006: a recovery of prior year capital taxes and a recovery of accident costs incurred in 2005. Together, these served to reduce 2006 operating costs by $6.7 million.

The modest year-over-year increase in overall operating costs also demonstrates the impact of the Corporation's stringent control of costs. VIA faced rising fuel prices, and inflation induced increases in labour, utilities, and other areas. Despite these pressures, expenses for compensation and train operations, including fuel and station and property expenses, were below budget in 2006.

Marketing and sales expenses, as well as on-train product costs, increased over last year and were higher than budget. Increased marketing and sales expenses were due to higher spending on advertising and promotion, necessary to address intense competition, especially in the Corridor. In addition to inflation, increased *VIA 1* passenger traffic in the Corridor drove up product delivery costs, as food and beverages are included in the price of these first class tickets.

CAPITAL EXPENDITURES

EXCLUDING THE FINANCIAL RESULTS OF THE VARIABLE INTEREST ENTITY.

No new capital or operating funding was approved for passenger rail in 2006. A significant portion of the revenues from the Asset Renewal Fund were thus required to address operating funding shortfalls, with the rest dedicated to a modest capital program.

VIA spent $14.5 million on capital expenditures in 2006 (funded entirely through the Asset Renewal Fund), which is $3.5 million less than planned. Slightly more than half of this year's capital spending was devoted to equipment-related projects. These included the prototypes of the rebuilt F-40 locomotive and the rebuilt LRC car that will serve as the basis for a planned future program to rebuild these two fleets. The balance of the 2006 spending was largely devoted to information technology projects (26 per cent) and station upgrading projects (19 per cent).

VIA will carry the $3.5 million of unspent capital funding forward to 2007 to fund the expenditures deferred from 2006, as well as new capital projects.

ON-TIME PERFORMANCE

2006 saw improvements in on-time performance for the second year in a row. Overall on-time performance reached 84 per cent for 2006, a 3 percentage point improvement over 2005.

VIA tracks delay minutes and distinguishes between those caused by its own operations, and those attributable to infrastructure owners or other third parties. The Corporation has substantially reduced those delays under its direct control. In 2006, equipment maintenance delays in the Quebec City-Windsor corridor dropped 28 per cent lower than in 2005, and passengers experienced fewer service disruptions related to mechanical failures. In addition, VIA's Customer Experience and Operations teams achieved a 13 per cent reduction in non-mechanical delay minutes compared to 2005.

The Western transcontinental service achieved an improvement in delay minutes, which decreased by 15 per cent compared to 2005, thanks to close cooperation with other railroad companies in controlling the impact of increased freight congestion on passenger train operations.

Overall on-time performance on the Eastern transcontinental service improved by 15 percentage points from 2005, reaching 74 per cent. Delay minutes improved by 38 per cent, due largely to good weather conditions, fewer slow orders, and reduced freight traffic. The best performance was achieved in the eastern half of the Corridor (between Toronto and Quebec City), where on-time performance reached 90 per cent.

However, this year over year improvement disguises the fact that in 2005 VIA added time to its Corridor schedules to accommodate work programs. Longer trips have the potential to undermine customer satisfaction and loyalty in VIA's busiest region, where travellers are especially time sensitive. Slower trains and erratic on-time performance pose a serious challenge as VIA faces competition from other modes.

OUTLOOK FOR 2007

VIA's *Moving Forward* plan, with its clear focus on the customer, has helped the national passenger rail service adapt to changing market conditions and achieve strong financial results over the past three years. VIA will continue to achieve strong results in 2007 by maintaining this focus, striving to be the Canadian leader of service excellence in passenger transportation – anticipating, meeting and exceeding the needs of its customers.

Success will depend on responding to future shifts in market demand, particularly in Central and Eastern Canada, a volatile marketplace characterized by aggressive price competition. Domestic travel markets will be the key to revenue growth in 2007. Forecasts from the Canadian Tourism Commission and the Conference Board of Canada suggest that 2007 will see a modest increase in domestic travel, particularly business travel, while travel demand from the U.S. and overseas markets will continue to be weak – with a decline in travellers from the U.S.

To meet these challenges, VIA will further refine its service delivery, marketing and pricing strategies, ensuring that they remain responsive to customer needs and opportunities for growth.

The corporate realignment undertaken in 2006, which integrated all aspects of service design, development, marketing and delivery in order to enhance value to the customer, will provide the framework for re-energizing VIA's entire organization in 2007. New teams and fresh ideas will help to marshal the company's resources, and enable its people to develop more innovative products and services. Creativity and flexibility will be critical to ensure that VIA continues to offer the right kind of service and the highest possible value to Canadian travellers.

At the same time, VIA must continue to address the pressure of rising costs. Rigorous cost controls will continue to reduce expenses, while efforts to increase productivity will focus on enhancing the talents of VIA's people, developing innovative applications of technology, and exploring new entrepreneurial initiatives to further increase the Corporation's level of self-sufficiency.

Without investment to overhaul equipment and to upgrade the rail infrastructure and other assets, there is a significant risk that customer satisfaction and ridership will deteriorate. This risk remains a primary concern for VIA Rail in 2007. The Corporation is working closely with the Government of Canada to develop a plan that will address both operating and capital funding needs of passenger rail for the future. This plan will ensure that Canada's national passenger rail service can continue to meet the needs of Canadian travellers in the future.






Consolidated Financial Statements

Management's Responsibility Statement

YEAR ENDED DECEMBER 31, 2006

Management of the Corporation is responsible for the preparation and integrity of the consolidated financial statements contained in the Annual Report. These consolidated statements have been prepared in accordance with Canadian generally accepted accounting principles and necessarily include certain amounts that are based on management's best estimates and judgement. Financial information contained throughout the Annual Report is consistent with that in the consolidated financial statements. Management considers that the consolidated statements present fairly the financial position of the Corporation, the results of its operations and its cash flows.

To fulfill its responsibility, the Corporation maintains systems of internal controls, policies and procedures to ensure the reliability of financial information and the safeguarding of assets. The internal control systems are subject to periodic reviews by Samson Bélair/Deloitte & Touche, s.e.n.c.r.l., as internal auditors. The external auditors, the Auditor General of Canada and Ernst & Young LLP, have audited the Corporation's consolidated financial statements for the year ended December 31, 2006, and their report indicates the scope of their audit and their opinion on the consolidated financial statements.

The Audit and Risk Committee of the Board of Directors, consisting primarily of independent Directors, meets periodically with the internal and external auditors and with management, to review the scope of their audits and to assess reports on audit work performed. The consolidated financial statements have been reviewed and approved by the Board of Directors on the recommendation of the Audit and Risk Committee.

Paul Côté

Paul Côté
President and Chief Executive Officer

Robert St-Jean

Robert St-Jean
Chief Financial and Administration Officer

MONTREAL, CANADA
FEBRUARY 8, 2007

Auditors' Report

TO THE MINISTER OF TRANSPORT, INFRASTRUCTURE AND COMMUNITIES

We have audited the consolidated balance sheet of VIA Rail Canada Inc. as at December 31, 2006 and the consolidated statements of operations and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. 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 Corporation as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Corporation that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with Part X of the *Financial Administration Act* and regulations, the *Canada Business Corporations Act* and articles and the by-laws of the Corporation.

Ernst & Young LLP
Chartered Accountants

Sheila Fraser, FCA
Auditor General of Canada

MONTREAL, CANADA
FEBRUARY 8, 2007

CONSOLIDATED BALANCE SHEET

AS AT DECEMBER 31
IN THOUSANDS

	2006	2005
Current Assets		
Cash and cash equivalents	**$ 4,250**	$ 2,621
Accounts receivable, trade	**5,805**	6,723
Accounts receivable, prepaid and other	**2,080**	1,514
Derivative financial instruments (NOTE 12)	**5,759**	5,678
Materials	**19,968**	16,105
Asset Renewal Fund (NOTE 4)	**22,000**	37,700
	59,862	70,341
Long-term assets		
Property, plant and equipement (NOTE 3)	**533,123**	571,012
Asset Renewal Fund (NOTE 4)	**55,141**	68,489
Accrued benefit asset (NOTE 6)	**230,878**	177,245
Derivative financial instruments (NOTE 12)	**1,206**	6,587
Other	**220**	986
	820,568	824,319
	$ 880,430	$ 894,660
Current liabilities		
Account payable and accrued liabilities (NOTE 5 AND 12)	**$ 94,687**	$ 99,207
Deferred revenues	**11,524**	9,473
	106,211	108,680
Long-term liabilities		
Accrued benefit liability (NOTE 6)	**24,477**	21,805
Future corporate taxes (NOTE 7)	**35,871**	35,408
Deferred investment tax credits	**2,292**	2,639
Other	**778**	568
	63,418	60,420
Deferred capital funding (NOTE 8)	**530,242**	578,733
Shareholder's equity		
Share capital (NOTE 9)	**9,300**	9,300
Contributed surplus	**4,963**	4,963
Retained earnings	**166,296**	132,564
	180,559	146,827
	$ 880,430	$ 894,660

Commitments and Contingencies (Note 10 and 16 respectively)

See accompanying notes to consolidated financial statements

On behalf of the Board,

Kenneth Savage, CA, CFP
Director and Chairman of the Audit and Risk Committee

Donald A. Wright
Director and Chairman of the Board

CONSOLIDATED STATEMENT OF OPERATIONS AND RETAINED EARNINGS

YEAR ENDED DECEMBER 31
IN THOUSANDS

	2006	2005
Revenues		
Passenger	**$ 266,609**	$ 255,593
Investment income	**17,987**	22,017
Other	**13,219**	12,150
	297,815	289,760
Expenses		
Compensation and benefits	**213,877**	210,825
Train operations and fuel (NOTE 12)	**118,033**	97,091
Stations and property	**28,533**	27,818
Marketing and sales	**28,398**	27,120
Maintenance material	**23,551**	23,964
On-train product costs	**17,969**	17,359
Operating taxes	**6,159**	11,394
Employee future benefits (NOTE 6)	**(29,594)**	(14,043)
Amortization and losses on write-down and disposal of property, plant and equipement	**58,956**	59,599
Other	**22,590**	31,025
	488,472	492,152
Operating loss before funding from the Government of Canada and corporate taxes	**190,657**	202,392
Operating funding from the Government of Canada	**169,001**	169,001
Amotization of deferred capital funding (NOTE 8)	**55,851**	57,633
Income before corporate taxes	**34,195**	24,242
Corporate tax expense (NOTE 7)	**463**	1,983
Net income for the year	**33,732**	22,259
Retained earnings, beginning of year	**132,564**	110,305
Retained earnings, end of year	**$ 166,296**	$ 132,564

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31
IN THOUSANDS

	2006	2005
Operating activities		
Net income for the year	**$ 33,732**	$ 22,259
Non-cash items relating to operations:		
Amortization of property, plant and equipment	**58,956**	59,336
Losses on write-down and disposal of property, plant and equipment	**347**	610
Gain on disposal of Asset Renewal Fund investments	**(13,645)**	(7,073)
Amortization of premium and discount on purchase of bonds in the Asset Renewal Fund	**23**	187
Amortization of invesment tax credits	**(347)**	(347)
Amortization of deferred capital funding	**(55,851)**	(57,633)
Future corporate taxes	**463**	1,576
Unrealized net loss (gain) on derivative financial instruments	**4,429**	(5,827)
Change in non-cash working capital related to operations	**(5,326)**	13,720
Change in other long-term assets	**766**	3,766
Change in accrued benefit asset	**(53,633)**	(31,317)
Change in accrued benefit liability	**2,672**	2,460
Change in other long-term liabilities	**427**	(67)
	(26,987)	1,650
Financing activities		
Capital funding	**7,360**	700
	7,360	700
Investing activities		
Acquisition of investments in the Asset Renewal Fund	**(636,575)**	(307,660)
Proceeds from sale and maturity of investments in the Asset Renewal Fund	**679,245**	319,063
Acquisition of property, plant and equipment	**(22,012)**	(21,198)
Proceeds from disposal of property, plant equipment	**598**	252
	21,256	(9,543)
Cash and cash equivalents		
Increase (decrease) during the year	1,629	(7,193)
Balance, beginning of year	2,621	9,814
Balance, end of year	$ 4,250	$ 2,621
Represented by:		
Cash	$ 393	$ 126
Short-term investments, 4.30%, maturing in January 2007 (2005: 3.28%)	3,857	2,495
	$ 4,250	$ 2,621

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

AS AT DECEMBER 31, 2006

1. AUTHORITY AND OBJECTIVES

VIA Rail Canada Inc. is a Crown corporation named in Part I of Schedule III to the *Financial Administration Act*. It was incorporated in 1977, under the *Canada Business Corporations Act*. The Corporation's vision is to be the Canadian leader in service excellence in passenger transportation with a mission to work together to provide travel experiences that anticipate the needs and exceed the expectations of our customers. The Corporation uses the roadway infrastructure of other railway companies and relies on them to control train operations.

The Corporation is not an agent of Her Majesty and is subject to income taxes.

The Corporation has one operating segment, passenger transportation and related services.

2. ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies followed by the Corporation are summarized as follows:

A | VARIABLE INTEREST ENTITIES

These consolidated financial statements include the financial statements of the Corporation and as required by Accounting Guideline 15 "Consolidation of Variable Interest Entities" ("AcG-15"), the financial statements of the Keewatin Railway Company ("KRC"), a variable interest entity (VIE). AcG-15 requires the consolidation of VIEs if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is exposed to a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party is exposed to a majority of the VIE's losses), or both (the primary beneficiary). Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interests at fair value at the date the enterprise became the primary beneficiary (See note 11). The Corporation revises its initial determination of the accounting for VIEs when certain events occur, such as changes in governing documents or contractual arrangements.

B | FUNDING FROM THE GOVERNMENT OF CANADA

Operating funding, which pertains to services, activities and other undertakings of the Corporation for the management and operation of railway passenger services in Canada, is recorded as a reduction of the operating loss. The amounts are determined on the basis of operating expenses less commercial revenues excluding unrealized gains and losses on derivative financial instruments, employee future benefits and non-cash transactions relating to property, plant and equipment and future corporate taxes, and are based on the operating budget approved by the Government of Canada for each year.

Funding for depreciable property, plant and equipment is recorded as deferred capital funding on the Consolidated Balance Sheet and is amortized from the acquisition date on the same basis and over the same periods as the related property, plant and equipment. Upon disposition of the funded depreciable property, plant and equipment, the Corporation recognizes into income all remaining deferred capital funding related to the property, plant and equipment. Funding for non-depreciable property, plant and equipment is recorded as contributed surplus.

C | CASH EQUIVALENTS

Cash equivalents include highly liquid investments purchased three months or less from maturity and are carried at lower of cost or market value.

D | ASSET RENEWAL FUND

Short-term investments are carried at the lower of cost or market value, determined on an aggregate basis.

The other investments in the Asset Renewal Fund are carried at cost. The carrying value of each of these investments is assessed periodically to determine if there has been an other than temporary decline in value. A charge to income is recorded during the period in which such a decline in value is determined.

E | REVENUE RECOGNITION

Revenues earned from passenger transportation are recorded as services are rendered. Amounts received for train travel not yet rendered are included in current liabilities as deferred revenues. Investment income and other revenues which includes third party revenues are recorded as they are earned.

F | FOREIGN CURRENCY TRANSLATION

Accounts in foreign currencies are translated using the temporal method. Under this method, monetary Balance Sheet items are translated at the exchange rates in effect at year-end. Gains and losses resulting from the changes in exchange rates are reflected in the Consolidated Statement of Operations and Retained Earnings.

Non-monetary Balance Sheet items as well as foreign currency revenues and expenses are translated at the exchange rate in effect on the dates of the related transactions.

G | MATERIALS

Materials, consisting primarily of items used for the maintenance of rolling stock, are valued at the lower of weighted average cost and replacement cost, and at net realizable value for obsolete materials.

H | PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment acquired from Canadian National Railway and Canadian Pacific Limited at the start of operations in 1978 were recorded at their net transfer values while subsequent acquisitions, including those acquired under capital leases, are recorded at cost.

The costs of refurbishing and rebuilding rolling stock and costs associated with other upgrading of property, plant and equipment are capitalized if they are incurred to improve the service value or extend the useful lives of the property, plant and equipment concerned; otherwise, such costs are expensed as incurred.

Retired property, plant and equipment are written down to their net realizable value.

Amortization of property, plant and equipment is calculated on a straight-line basis at rates sufficient to amortize the cost of property, plant and equipment, less their residual value, over their estimated useful lives, as follows:

Rolling stock	12 to 30 years
Maintenance buildings	25 years
Stations and facilities	20 years
Infrastructure improvements	5 to 40 years
Leasehold improvements	2 to 20 years
Machinery and equipment	4 to 15 years
Information systems	3 to 7 years
Other property, plant and equipment	3 to 10 years

No amortization is provided for projects in progress and retired property, plant and equipment.

I | CORPORATE TAXES

The Corporation utilizes the liability method of accounting for corporate taxes under which future corporate tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future corporate tax assets and liabilities are measured using substantively enacted rates that are expected to apply for the year in which those temporary differences are expected to be recovered or settled. The effect on future corporate tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date. Future corporate tax assets are recognized to the extent that realization is considered more likely than not.

J | INVESTMENT TAX CREDITS

Investment tax credits are recognized when qualifying expenditures have been made, provided there is reasonable assurance that the credits will be realized. They are amortized over the estimated useful lives of the related property, plant and equipment. The amortization of deferred investment tax credits is recorded as a reduction of the amortization of property, plant and equipment. These credits are included in other long-term liabilities.

K | EMPLOYEE FUTURE BENEFITS

The Corporation accrues obligations under its employee future benefit plans.

The cost of pension and other employee future benefits earned by employees is actuarially determined using the projected benefit method prorated on services and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

For the purpose of calculating the expected return on plan assets, those assets are valued at market value.

On January 1, 2000, the Corporation adopted the new accounting standard on employee future benefits using the prospective application method. The Corporation is amortizing the transitional asset on a straight-line basis over 13 to 14 years, which was the average remaining service lives of the active employee groups at the time.

Past service costs are amortized on a straight-line basis over the expected average remaining service lives of the active employee groups which was, in most cases, estimated to be 11 years at the time.

For the pension plans, the excess of the accumulated net actuarial gain or loss over 10 per cent of the greater of the accumulated benefit obligation and the fair value of plan assets is amortized on a straight-line basis over the average remaining service lives of the active employee groups which is, in most cases, estimated to be 12 years.

The Corporation's obligations for worker's compensation benefits are based on known awarded disability and survivor pensions and other potential future awards with respect to accidents that occurred up to the fiscal year-end. The Corporation is self-insured. The actuarial determination of these accrued benefit obligations uses the projected benefit method. This method incorporates management's best estimate of cost escalation as well as demographic and other financial assumptions. Management's best estimate also takes into account the experience and assumptions of provincial workers' compensation boards. The actuarial gains or losses are amortized over a seven-year period, the average duration of these obligations.

L | DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments such as swaps, call options and forward foreign exchange contracts, are utilized by the Corporation in the management of its exposure to changes in fuel prices for up to 80 per cent of its consumption. The Corporation does not enter into derivative financial instruments for trading or speculative purposes. The Corporation does not currently apply hedge accounting on these derivative financial instruments.

Derivative financial instruments are recognized on the Consolidated Balance Sheet at inception and removed when they expire or are terminated. On the inception, each derivative is recognized at fair value as either an asset or a liability on the Consolidated Balance Sheet and changes in fair value are recognized in the train operations and fuel expenses. Derivative financial instruments with a positive fair value are reported as derivative financial instrument assets and derivatives with a negative fair value are reported as part of accounts payable and accrued liabilities or other long-term liabilities.

M | MEASUREMENT UNCERTAINTY

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as revenues and expenses and the disclosure of contingent assets and liabilities. The most significant estimates involve the recognition of liabilities and other claims against the Corporation, the fair value of financial instruments, employee future benefits, future corporate taxes as well as the useful life of property, plant and equipment. Actual results could differ from these estimates and such differences could be material.

N | VIA PRÉFÉRENCE PROGRAM

The incremental costs of providing travel awards under the Corporation's VIA Préférence frequent traveller reward program are accrued as the entitlements to such awards are earned and are included in accounts payable and accrued liabilities.

O | NON-MONETARY TRANSACTIONS

Non-monetary transactions are recorded at the estimated fair value of the goods or services received or the estimated fair value of the services given, whichever is more reliably determinable. Revenues from non-monetary transactions are recognized when the related services are rendered. Expenses resulting from non-monetary transactions are recognized during the period when goods or services are provided by third parties.

3. PROPERTY, PLANT AND EQUIPMENT

IN MILLIONS OF DOLLARS

	2006			2005		
	COST	ACCUMULATED AMORTIZATION	NET	COST	ACCUMULATED AMORTIZATION	NET
Land	**5.7**	**-**	**5.7**	5.0	-	5.0
Rolling stock	**772.0**	**448.5**	**323.5**	746.9	413.4	333.5
Maintenance buildings	**181.8**	**133.0**	**48.8**	181.8	124.6	57.2
Stations and facilities	**45.1**	**28.6**	**16.5**	44.2	26.6	17.6
Infrastructure improvements	**147.8**	**53.9**	**93.9**	141.4	50.1	91.3
Leasehold improvements	**114.2**	**90.2**	**24.0**	113.0	87.4	25.6
Machinery and equipment	**35.5**	**29.5**	**6.0**	34.2	28.5	5.7
Information systems	**46.2**	**43.0**	**3.2**	44.1	39.9	4.2
Other property, plant and equipment	**20.4**	**19.4**	**1.0**	20.2	19.3	0.9
	1,368.7	**846.1**	**522.6**	1,330.8	789.8	541.0
Projects in progress			**10.1**			28.7
Retired property, plant and equipment (AT NET REALIZABLE VALUE)			**0.4**			1.3
			533.1			571.0

Projects in progress as at December 31, 2006, primarily consist of rolling stock for $4.0 million (2005: $23.4 million) and improvements to infrastructure and information systems for $4.7 million (2005: $3.1 million).

4. ASSET RENEWAL FUND

The Corporation has been authorized by the Treasury Board of the Government of Canada to segregate proceeds from the sale or lease of surplus assets as well as up to $5 million of annual funding approved but not expended during the fiscal year to 2006.

The Asset Renewal Fund includes the following investment instruments:

IN MILLIONS OF DOLLARS

	2006		2005	
	COST	MARKET VALUE	COST	MARKET VALUE
Government of Canada bonds	-	-	18.2	25.0
Other Canadian bonds and debentures	-	-	16.1	17.6
Pooled equity unit trust	-	-	58.4	61.7
Cash and short-term investments	**77.1**	**77.1**	13.5	13.5
	77.1	**77.1**	106.2	117.8
Expected cash drawdown	**22.0**		37.7	
Long-term portion	**55.1**		68.5	

During the year ended December 31, 2006, the Treasury Board approved the use of the Asset Renewal Fund to fund $9.4 million of the 2006 operating deficit and $14.5 million of the 2006 capital expenditures.

The short-term portion of the Asset Renewal Fund presented as Current Assets represents the amount of cash that the Corporation expects to draw from the fund in 2007 for operating expenses and capital expenditures.

The weighted average effective rate of return on short-term investments as at December 31, 2006, was 4.38 per cent (2005: 5.10 per cent) and the weighted average term to maturity as at December 31, 2006, is one month (2005: 7 years).

The market value of short-term investments is based on the current bid price at the Consolidated Balance Sheet date.

The Asset Renewal Fund is invested in 21 short-term money market funds that have a rating of "R-1 low" or higher. The diversification in short term securities is provided by limiting to 10 per cent or less the percentage of the market value of the Asset Renewal Fund assets invested in securities of a single issuer.

The Corporation is subject to credit risk from its holdings of the Asset Renewal Fund. The Corporation minimizes its credit risks by adhering to the *Minister of Finance of Canada Financial Risk Management Guidelines for Crown Corporations* and the Corporate Investment Policy and by investing in high quality financial instruments.

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The Accounts payable and accrued liabilities include the following:

IN MILLIONS OF DOLLARS

	2006	2005
Accrued liabilites	**27.8**	31.9
Wages payable and accrued	**31.9**	31.7
Trade payables	**25.5**	25.0
Capital tax, income tax and other taxes payable	**8.2**	7.6
Derivative financial instruments	**0.5**	1.2
Current portion of network restructuring and reorganization accrual	**0.6**	1.7
Other	**0.2**	0.1
	94.7	99.2

6. EMPLOYEE FUTURE BENEFITS

The Corporation provides a number of funded defined benefit pension plans as well as unfunded post retirement and post-employment benefits that include life insurance, health coverage and self insured Workers' Compensation benefits, to all its permanent employees. The actuarial valuations for employee future benefits are carried out by external actuaries who are members of the Canadian Institute of Actuaries.

The defined benefit pension plans are based on years of service and final average salary.

Pension benefits increase annually by 50 per cent of the increase in the Consumer Price Index in the 12 months ending in December subject to a maximum increase of 3 per cent in any year.

The latest actuarial valuation for the post-retirement unfunded plan was carried out as at July 31, 2004. The next actuarial valuation will be carried out as at July 31, 2007.

The latest actuarial valuation for the post-employment unfunded plan was carried out as at August 31, 2004. The next actuarial valuation will be carried out as at August 31, 2007.

The latest actuarial valuation for the self-insured workers' compensation benefits was carried out as at January 1, 2004. The next actuarial valuation will be carried out as at January 1, 2007, and will be available in September 2007.

The latest actuarial valuations of the pension plans were carried out as at December 31, 2004. The next actuarial valuation will be carried out as at December 31, 2007, and will be available in June 2008.

The actuarial valuation of the Supplemental Executive Retirement Plan is carried out annually. The last actuarial valuation was carried out as at December 31, 2006.

Based on these actuarial valuations and projections to December 31, the summary of the principal valuation results, in aggregate, is as follows:

IN MILLIONS OF DOLLARS

	PENSION PLANS		OTHER BENEFIT PLANS	
	2006	2005	**2006**	2005
Accrued benefit obligation:				
Balance at beginning of year	**1,511.4**	1,351.6	**29.8**	27.5
Current service cost	**26.0**	20.0	**4.7**	4.5
Employee contributions	**9.6**	9.8	**-**	-
Interest cost	**74.8**	76.3	**1.5**	1.6
Benefits paid	**(90.0)**	(79.8)	**(6.0)**	(5.8)
Net transfer in	**0.2**	-	**-**	-
Special termination benefits	**-**	1.8	**-**	0.1
Actuarial (gain) loss	**0.8**	131.7	**(0.3)**	1.9
Accrued benefit obligation at the end of year	**1,532.8**	1,511.4	**29.7**	29.8
Fair value of plan assets:				
Balance at beginning of year	**1,659.0**	1,465.2	**-**	-
Actual return on plan assets	**183.3**	256.3	**-**	-
Employer contributions	**15.1**	7.5	**6.0**	5.8
Employee contributions	**9.6**	9.8	**-**	-
Net transfer in	**0.2**	-	**-**	-
Benefits paid	**(90.0)**	(79.8)	**(6.0)**	(5.8)
Balance at end of year	**1,777.2**	1,659.0	**-**	-

The percentage of the fair value of the total pension plan assets by major category as at December 31 was as follows:

ASSET CATEGORIES:	2006	2005
Equity securities (public market)	**57.3%**	57.2%
Fixed income securities (public market)	**32.6%**	34.1%
Private equity, hedge funds and other	**10.0%**	7.5%
Real estate	**0.1%**	1.2%
	100.0%	100.0%

IN MILLIONS OF DOLLARS

	PENSION PLANS		OTHER BENEFIT PLANS	
	2006	2005	**2006**	2005
Reconciliation of the funded status:				
Fair value of plan assets	**1,777.2**	1,659.0	**-**	-
Accrued benefit obligation	**1,532.8**	1,511.4	**29.7**	29.8
Funded status of plans - surplus (deficit)	**244.4**	147.6	**(29.7)**	(29.8)
Unamortized net actuarial losses	**201.7**	276.8	**1.2**	1.6
Unamortized past service costs	**2.7**	3.1	**0.5**	0.5
Unamortized transitional (asset) obligation	**(217.9)**	(250.3)	**4.3**	6.8
	230.9	177.2	**(23.7)**	(20.9)
Network restructuring long-term liability	**-**	-	**(0.8)**	(0.9)
Accrued benefit asset (liability)	**230.9**	177.2	**(24.5)**	(21.8)

IN MILLIONS OF DOLLARS

	PENSION PLANS		OTHER BENEFIT PLANS	
	2006	2005	**2006**	2005
Elements of defined benefit costs recognized in the year:				
Current service cost	**26.0**	20.0	**4.7**	4.5
Interest cost	**74.8**	76.3	**1.5**	1.6
Actual return on plan assets	**(183.3)**	(256.3)	**-**	-
Actuarial losses (gains)	**0.8**	131.7	**(0.3)**	1.9
Special termination benefits	**-**	1.8	**-**	0.1
Elements of employee future benefits (income) costs before adjustment to recognize the long-term nature of these costs	**(81.7)**	(26.5)	**5.9**	8.1
Adjustments to recognize the long-term nature of employee future benefits costs:				
Differences between:				
▸ Expected return and actual return on plan assets for the year	**66.1**	153.1	**-**	-
▸ Actuarial loss (gain) recognized for the year and the actual actuarial loss on accrued benefit obligation for the year	**9.0**	(118.2)	**0.4**	(1.9)
▸ Amortization of past service costs for the year and the actual plan amendments for the year	**0.4**	0.4	**0.1**	0.1
▸ Amortization of transitional (asset) obligation	**(32.4)**	(32.5)	**2.4**	2.4
Defined benefit (income) costs recognized	**(38.6)**	(23.7)	**8.8**	8.7

The employee future benefits expense in the Consolidated Statement of Operations and Retained Earnings includes the pension plans net income, the other benefit plans net costs as well as the adjustment of Network restructuring and reorganization accrual of $0.1 million (2005: $1.0 million).

	PENSION PLANS		OTHER BENEFIT PLANS	
	2006	2005	**2006**	2005
Weighted-average of significant assumptions:				
Accrued benefit obligation as at December 31:				
Discount rate	**5.00%**	5.00%	**5.00%**	5.00%
Rate of compensation increase	**3.25%**	3.25%	**3.25%**	3.25%
Benefit costs for the year ended December 31:				
Discount rate	**5.00%**	5.75%	**5.00%**	5.75%
Expected long-term rate of return on plan assets	**7.25%**	7.25%	**-**	-
Rate of compensation increase	**3.25%**	3.25%	**3.25%**	3.25%
Assumed health care cost trend rates as at December 31:				
Initial health care cost trend rate	**-**	-	**5.88%**	6.50%
Cost trend rate declines to	**-**	-	**3.37%**	3.37%
Year ultimate rate is reached	**-**	-	**2011**	2011

SENSITIVITY ANALYSIS

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2006:

IN THOUSANDS OF DOLLARS

	INCREASE	DECREASE
Total service and interest cost	19	(18)
Accrued benefit obligation	235	(210)

7. CORPORATE TAXES

The corporate tax expense of the Corporation consists of the following:

IN MILLIONS OF DOLLARS

	2006	2005
Current tax expense	**-**	0.4
Future corporate tax expense	**0.5**	1.6
Corporate tax expense	**0.5**	2.0

Corporate tax expense on net income for the year differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rates of 32.4 per cent (2005: 32.3 per cent) to income before corporate taxes. The reasons for the differences are as follows:

IN MILLIONS OF DOLLARS

	2006	2005
Computed tax expense - statutory rates	**11.0**	7.8
Permanent differences:		
Large corporation tax expense	**-**	0.4
Non-taxable portion of capital and accounting gains	**(2.2)**	(3.5)
Non-taxable portion of dividends received	**-**	(0.2)
Adjustment to future corporate tax assets and liabilities for changes in tax laws and rates	**(3.9)**	-
Recognition of tax benefits previously not recognized	**(4.4)**	(2.7)
Other	**-**	0.2
	0.5	2.0

Future corporate income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the future corporate tax assets and liabilities of the Corporation are as follows:

IN MILLIONS OF DOLLARS

	2006	2005
Future corporate tax assets:		
Property, plant and equipment	**(19.2)**	(18.2)
Contingencies, other liabilities and net amounts	**(4.0)**	(5.0)
Accrued benefit liability	**(7.6)**	(7.1)
Loss carry-forward	**(11.9)**	(6.9)
	(42.7)	(37.2)
Less the valuation allowance	**7.8**	12.2
	(34.9)	(25.0)
Future corporate tax liabilities:		
Accrued benefit asset	**68.8**	58.5
Unrealized gain on derivative financial intruments	**2.0**	1.9
	70.8	60.4
Net future corporate tax liabilities	**35.9**	35.4

The Corporation has $40.8 million of unused federal non-capital tax losses carried forward and their related year of expiry are as follows:

IN MILLIONS OF DOLLARS

2007	**2.2**
2008	**4.0**
2010	**0.7**
2014	**3.3**
2015	**12.0**
2026	**18.6**
	40.8

8. DEFERRED CAPITAL FUNDING

Deferred capital funding represents the unamortized portion of the funding used to purchase property, plant and equipment.

IN MILLIONS OF DOLLARS

	2006	2005
Balance, beginning of year	**578.7**	635.6
Deferred capital funding consolidated from Keewatin Railway Co.	**7.3**	-
Government funding for depreciable property, plant and equipment	**-**	0.7
Amortization of deferred capital funding	**(55.8)**	(57.6)
Balance, end of year	**530.2**	578.7

9. SHARE CAPITAL

The authorized share capital of the Corporation is comprised of an unlimited number of common shares with no par value. As at December 31, 2006 and 2005, 93,000 shares at $100 per share are issued and fully paid.

10. COMMITMENTS

A | The future minimum payments relating to operating leases mainly for real estate, maintenance of way and computer equipment are as follows:

IN MILLIONS OF DOLLARS

2007	**17.5**
2008	**18.3**
2009	**11.7**
2010	**8.3**
2011	**8.3**
Subsequent years proportionately to 2049	**166.8**
	230.9

B | As at December 31, 2006, the Corporation has outstanding purchase commitments amounting to $5.6 million (2005: $5.7 million) consisting mainly of advertising as well as the maintenance and completion of rolling stock projects.

C | The Corporation has entered into train service agreements for the use of tracks and control of train operations expiring on December 31, 2008.

D | The Corporation has issued letters of credit totalling approximately $17.7 million (2005: $19.9 million) to various provincial government workers' compensation boards as security for future payment streams.

11. VARIABLE INTEREST ENTITIES

In April 2006, as part of its mandate to provide passenger rail service in Canada, the Corporation entered into an operating agreement with the Keewatin Railway Company ("KRC") to provide a financial contribution to KRC for the purposes of operating passenger rail services and essential freight to the communities in Northern Manitoba served by KRC. The Corporation will contribute an annual amount to KRC to fund a significant portion of KRC's operating expenditures and is at risk of increasing the level of contributions if net operating costs were to increase. KRC is a Variable Interest Entity (VIE) to the Corporation given that the Corporation is the primary beneficiary exposed to a majority of the risk of loss from KRC's activities.

In 2006, the financial contribution provided by the Corporation to KRC amounted to $2.0 million.

For the year ended December 31, 2006 KRC has received $7.4 million in Deferred Capital Funding. The liabilities recognized as a result of consolidating KRC do not represent additional claims on the Corporation's assets; rather, they represent claims against the specific assets of KRC. Conversely, assets having a net book value of $7.9 million recognized as a result of consolidating KRC do not represent additional assets that could be used to satisfy claims against the Corporation's assets. Additionally, the consolidation of the KRC VIE did not result in any change in the underlying tax, legal or credit exposure of the Corporation.

12. DERIVATIVE FINANCIAL INSTRUMENTS

The derivative financial instruments used by the Corporation include swaps which are typically a commodity or price swap where parties exchange payments in cash based on changes in the price of the commodity (heating oil) or a market index while fixing the price they effectively pay for fuel. The Corporation has also used call options that give the Corporation the right but not the obligation to buy a futures contract for a specified price within a specified period of time in exchange for premium payment. It obligates the seller of an option to sell the underlying futures contract at the designated price should the option be exercised at that price. These call options can no longer be exercised should the price of the commodity exceed a trigger level for more than a specified amount of time. The foreign exchange forwards and futures are contractual agreements to either buy or sell U.S. dollars at a specified price and date in the future.

At year-end, the Corporation had the following derivative financial instruments with positive fair values:

DESCRIPTION	MATURITY DATE	FIXED PRICE PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
				2006	2005
Crude swap	Dec. 31, 2006	1.560	2,016	**-**	572
Crude swap	Dec. 31, 2006	0.818	4,536	**-**	5,098
Crude swap	Dec. 31, 2007	0.800	4,536	**5,036**	5,085
Crude swap	Dec. 31, 2007	1.498	2,016	**648**	743
Crude swap	Dec. 31, 2007	1.780	1,008	**2**	64
Crude swap	Dec. 31, 2008	1.860	1,008	**39**	-
Crude swap	Dec. 31, 2008	1.799	1,008	**105**	**
Crude swap	Dec. 31, 2008	1.457	2,016	**952**	690
				6,782	12,252

** This financial instrument had a negative fair value in 2005.

DESCRIPTION	MATURITY DATE	FORWARD RATE CAD/USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
				2006	2005
Foreign Exchange	Monthly in 2006	1.148	824	**-**	8
Foreign Exchange	Monthly in 2007	1.148	1,794	**20**	-
Foreign Exchange	Monthly in 2007	1.147	1,859	**22**	5
Foreign Exchange	Monthly in 2007	1.142	1,885	**31**	-
Foreign Exchange	Monthly in 2008	1.110	2,936	**110**	-
				183	13
				6,965	12,265

At year-end, the Corporation had the following derivative financial instruments with negative fair values:

DESCRIPTION	MATURITY DATE	FORWARD RATE CAD/USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
				2006	2005
Foreign Exchange	Monthly in 2006	1.290	2,117	**-**	(273)
Foreign Exchange	Monthly in 2006	1.277	357	**-**	(42)
Foreign Exchange	Monthly in 2006	1.189	5,999	**-**	(182)
Foreign Exchange	Monthly in 2006	1.170	3,730	**-**	(46)
Foreign Exchange	Monthly in 2006	1.181	4,098	**-**	(94)
Foreign Exchange	Monthly in 2007	1.179	9,369	**(178)**	(254)
				(178)	(891)

DESCRIPTION	MATURITY DATE	FIXED PRICE PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
				2006	2005
Crude swap	Dec. 31, 2006	2.033	2,016	**-**	(507)
Crude swap	Dec. 31, 2006	1.850	2,016	**-**	(91)
Crude swap	Dec. 31, 2007	1.844	1,008	**(71)**	(6)
Crude swap	Dec. 31, 2007	1.870	1,008	**(101)**	-
Crude swap	Dec. 31, 2007	1.996	1,008	**(244)**	-
Crude swap	Dec. 31, 2008	1.799	1,008	**	(10)
Crude swap	Dec. 31, 2008	1.945	1,008	**(53)**	-
				(469)	(614)

** This financial instrument has a positive fair value in 2006

DESCRIPTION	MATURITY DATE	CAP PRICE PER U.S. GALLON (USD)	TRIGGER LEVEL PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
					2006	2005
Crude call option	Dec. 31, 2006	1.065	1.450	2,520	**-**	(13)
					(647)	(1,518)

The fair value of the positive balance of the above derivative financial instruments at December 31, 2006 is $7.0 million (2005: $12.3 million) of which $5.8 million is recorded as Current assets (2005: $5.7 million) and $1.2 million as Long-term assets (2005: $6.6 million). The negative balance is $0.6 million (2005: $1.5 million) of which $0.5 million (2005: $1.2 million) is included in "Account payable and accrued liabilities" as a short-term derivative financial instrument liability and $0.1 million (2005: $0.3 million) is included in "Other" as a long-term derivative financial instrument liability.

Included in the "Train operations and fuel" expense is a realized and unrealized net loss of $0.1 million (2005: net gain of $13.5 million) on these derivative financial instruments.

The Corporation is exposed to credit risk in the event of non-performance by the counterparty to its derivative financial instruments but does not expect such non-performance as the counterparty is of high credit quality.

13. FAIR VALUE OF OTHER FINANCIAL INSTRUMENTS

The estimated fair value of the recognized financial instruments other than derivative financial instruments approximates their carrying value due to their current nature.

14. RELATED PARTY TRANSACTIONS

The Corporation is related in terms of common ownership to all Government of Canada created departments and agencies. The Corporation enters into transactions with these entities in the normal course of business on trade terms applicable to all individuals and enterprises and these transactions are recorded at exchange value. Other than disclosed elsewhere in these consolidated financial statements, related party transactions are not significant.

15. NON-MONETARY TRANSACTIONS

The Corporation recorded a revenue from non-monetary transactions of approximately $1.6 million (2005: $1.0 million) as "Passenger revenue" in the accompanying consolidated statements of operations and retained earnings for the year ended December 31, 2006. The Corporation also recorded non-monetary expenses of $1.5 million (2005: $1.0 million) in the accompanying consolidated statement of operations and retained earnings, mainly as "Marketing and sales" and other expenses resulting from non-monetary transactions.

16. CONTINGENCIES

A | The Canadian Transportation Agency (CTA) rendered a decision in October 2003 against the Corporation in favour of the Council for Canadians with Disabilities (CCD). The Corporation was directed to re-design and re-construct its Renaissance rail cars to remove certain undue obstacles to persons with disabilities.

On March 2, 2005, the Corporation was successful in overturning the earlier CTA decision by a judgement of the Federal Court of Appeal. That appeal decision has been further appealed to the Supreme Court of Canada by the CCD. The Supreme Court heard the case on May 19, 2006. The decision is still pending.

If the CTA decision is finally upheld, the cost of modifying the Renaissance cars would be significant. Management is of the opinion that this could cost between $50 million and $100 million, an amount that would exceed funding approved by the Government of Canada for the Renaissance project. No provision has been made in the consolidated financial statements for a major modification of the cars.

B | The Corporation began a restructuring of its labour force in 1997 which resulted in the elimination of a number of positions. The changes became subject to various Canadian Industrial Relations Board (CIRB) decisions, mediations and arbitrations.

In May 2003, the CIRB rendered a decision directing the Corporation to pay back wages under certain circumstances to former conductors. The Supreme Court decided not to grant the Corporation leave to appeal a Federal Court of Appeal ruling supporting the decision of the CIRB.

The Corporation is waiting for the final ruling from the arbitrator.

The Corporation has made a provision in its consolidated financial statements.

C | The Corporation's operations are subject to numerous federal, provincial, and municipal environmental laws and regulations concerning among other things, the management of air emissions, wastewater, hazardous materials, wastes and soil contamination as well as the management and decommissioning of underground and aboveground storage tanks. A risk of environmental liability is inherent in railroad and related transportation operations, real estate ownership and other activities of the Corporation with respect to both current and past operations.

The Corporation has performed an assessment of all of its operations and of all of its sites and facilities at risk in order to determine the environmental risks. The sites and the facilities for which environmental risks were identified were the subject of thorough studies and corrective actions were taken if necessary in order to eliminate or to attenuate these risks. The continuous risk management process that is in place allows the Corporation to monitor its activities and properties under normal operating conditions as well as monitor accidents that occur. The activities or properties likely to be contaminated or to cause a contamination are addressed without delay, at the moment of their observation, by the development of an action plan according to the nature and the importance of the impact and the applicable requirements. As at December 31, 2006, the Corporation believes that no environmental provision is required.

The Corporation's ongoing efforts to identify potential environmental concerns that may be associated with its properties may lead to future environmental investigations, which may result in the identification of additional environmental costs and liabilities. The magnitude of such additional liabilities and the costs of complying with environmental laws and containing or remediating contamination cannot be reasonably estimated due to:

i) the lack of specific technical information available with respect to many sites;
ii) the absence of any third-party claims with respect to particular sites;
iii) the potential for new or changed laws and regulations and for development of new remediation technologies and uncertainty regarding the timing of the work with respect to particular sites;
iv) the ability to recover costs from any third parties with respect to particular sites;
v) the fact that the environmental responsibility has not been clearly attributed.

There can thus be no assurance that material liabilities or costs related to environmental matters will not be incurred in the future, or will not have a material adverse effect on the Corporation's financial position. Costs related to any future remediation will be accrued in the year in which they become known.

D | The Corporation is subject to claims and legal proceedings brought against it in the normal course of business. Such matters are subject to many uncertainties. Management believes that adequate provisions have been made in the accounts where required and the ultimate resolution of such contingencies are not expected to have a material adverse effect on the financial position of the Corporation.

17. ASSET RETIREMENT OBLIGATION

The Corporation has certain operating leases where the lessor could request that the land/structures or the other assets be returned in the same condition as they were originally leased or the lessor can retake control of these assets without any compensation for any additions or modifications made to the initial assets. Given the nature of the assets under contract, the fair value of the asset retirement obligation cannot be reasonably estimated. Accordingly, no liability has been recognized in the consolidated financial statements.

18. RECLASSIFICATION

The comparative financial statements have been reclassified from the statements previously presented to conform to the presentation of the 2006 consolidated financial statements.

Corporate Directory

AS AT DECEMBER 31, 2006

BOARD OF DIRECTORS

Paul Côté
President and Chief Executive Officer
Montreal, Quebec

Michel Crête
Montreal, Quebec

Steven Cummings
Montreal, Quebec

Angela Ferrante
Toronto, Ontario

Paul Fraser
Surrey, British Columbia

Jean-Louis Hamel
Montreal, Quebec

Wendy Kelly
Regina, Saskatchewan

Margaret MacInnis
Halifax, Nova Scotia

Lore Mirwaldt
Winnipeg, Manitoba

Donald Pettit
Vancouver, British Columbia

Timothy Reid
Toronto, Ontario

Charles Ross
London, Ontario

Kenneth Savage, CA, CFP
Fredericton, New Brunswick

Paul G. Smith
Calgary, Alberta

Louis Tremblay
Cornwall, Ontario

Donald A. Wright
Chairman of the Board
Toronto, Ontario

*The Board wishes to thank outgoing member **James J. Smith** for his important contribution.*

OFFICERS

Paul Côté
President and Chief Executive Officer

Steve Del Bosco
Chief Customer Officer

Christena Keon Sirsly
Chief Strategy Officer

Carole Mackaay
General Counsel and Secretary

John Marginson
Chief Operating Officer

Denis Pinsonneault
Chief People Officer

Robert St-Jean, CA
Chief Financial and
Administration Officer

Donald A. Wright, Chairman of the Board, *is an ex officio member of each Committee of the Board.*

Paul Côté, President and Chief Executive Officer, *is an ex officio member of each Committee of the Board except for the Audit & Risk Committee.*

COMMITTEES OF THE BOARD

Audit and Risk Committee

Kenneth Savage, CA,CFP, Chairman
Steven Cummings
Jean-Louis Hamel
Louis Tremblay

Human Resources Committee

Angela Ferrante, Chair
Michel Crête
Margaret MacInnis
Lore Mirwaldt
Donald Pettit
Timothy Reid

Investment Committee

Paul Fraser, Chairman
Steven Cummings
Jean-Louis Hamel
Kenneth Savage, CA, CFP
Paul G. Smith

Corporate Governance Committee

Jean-Louis Hamel, Chairman
Angela Ferrante
Wendy Kelly
Margaret MacInnis
Lore Mirwaldt
Charles Ross

Planning and Finance Committee

Vacant, Chairman
Michel Crête
Paul Fraser
Wendy Kelly
Timothy Reid
Charles Ross
Kenneth Savage, CA, CFP
Paul G. Smith
Louis Tremblay

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Photos: Caroline Bergeron, except pages 4, 6, 14 (left), and 35 (bottom center), Marc Dussault; page 3 (top right), 19, and 35 (top right), Jeff Chiang; page 35 (top centre), Roger Aziz.

Special thanks to all the VIA employees who agreed to appear in this annual report.

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