

The Year in Review

In 2005, VIA re-established Canada's national passenger rail service as a leader in passenger transportation. With a strategic plan more precisely focused on customer service than ever before, the Corporation made dramatic improvements in ridership, revenues and cost-recovery over 2004, matching or exceeding growth in key markets and recapturing the year-over-year momentum that rail achieved in recent years. This once again allowed the Corporation to return exceptional value to Canadian taxpayers.

VIA's momentum was seriously undermined in 2003, when domestic and foreign travel in Canada declined significantly due to SARS and a series of natural disasters. Recovery for the travel industry as a whole was slow and sporadic at best in 2004, and attracting and retaining customers throughout the industry continues to be a very high priority. Nevertheless, in 2005, VIA fared well in all regions of the country.

While it achieved strong year-end performance, the Corporation entered 2005 facing major challenges. Revenues were lower than anticipated and there were jumps in key operating costs, such as fuel, that were beyond the Corporation's control. VIA also began the year with grave concerns about the capacity of the rail infrastructure to sustain efficient train service, and faced continuing uncertainty about capital investment, about operating funding, and about the long-term policy direction for operating the national passenger rail service.

MOVING FORWARD IN 2005

Early in 2005, VIA's President and senior executives met with employees to discuss these challenges, and to develop a clear strategy for moving forward. These discussions identified the need to focus on VIA's key strength in the marketplace – customer service – and to align every aspect of the Corporation's mission, vision and values with this focus on the customer.

Some 2,100 employees took part in meetings and discussions on VIA's new Strategic Plan, entitled *Moving Forward* (see page 3). The *Moving Forward* plan provides a renewed focus on customer service, drawing on the creative energy, innovation and passion of the entire organization.

Based on VIA's vision, mission and values, the plan identifies specific strategic goals with respect to safety, people, service, growth, entrepreneurship and the environment. These goals confirm VIA's commitment to the long-term sustainability of passenger rail, reinforcing its dedication to improving rail service and meeting measurable performance objectives.

Success in addressing each of these goals was critical to VIA's success in 2005.



Safety

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

Safety and security have become a primary concern for travellers. Heavy traffic and congestion on highways, especially surrounding urban areas, have heightened concerns about the risks of road travel, and many Canadians are exploring safer alternatives. World events have brought security to the forefront of public attention, as Canadians seek assurances that their personal security – and the transportation system itself – are well protected from the threat of terrorist or criminal activity.

Passenger rail is widely recognized as a very safe mode of public transportation. VIA and all its employees recognize a fundamental obligation to protect the safety and security of every customer and every community served by passenger rail.

WORKPLACE HEALTH AND SAFETY

VIA's commitment to safety is present everywhere in the organization.

Management, unions and employees work together to ensure that VIA provides all employees with a safe work environment. Health and Safety committees monitor safety issues and performance at all locations, inspecting facilities, identifying and addressing potential safety hazards, and maintaining a high level of safety awareness.

In 2005, VIA's Eastern Services Equipment Maintenance team marked a safety milestone that sets an example for the entire organization: eight years without a single work-related injury requiring time off from the job. VIA also addresses health concerns through national health initiatives. At the request of employees, VIA conducted an influenza immunization program in the fall of 2005, making flu shots universally available on a voluntary basis, free of charge.

VIA'S SAFETY MANAGEMENT SYSTEM

VIA developed and implemented a comprehensive Safety Management System in 2001. The System defines specific rules, procedures, and responsibilities for maintaining a safe work environment for employees, and a safe passenger service for customers. Since its inception, it has passed three audits by Transport Canada, confirming that the Corporation and its employees are following good safety management practices.

Employees at all levels were actively involved in reviewing the Safety Management System in 2005, providing essential feedback for continually monitoring and refining safety procedures. Safety targets and performance measures have been aligned with and integrated into VIA's business strategy. Health and Safety committees review annual safety reports and Safety Management System performance data to establish specific objectives for improving workplace safety, and to identify issues that require the attention of senior management.

In addition, VIA's management and unions have established two Safety Policy committees which provide a national safety perspective, reviewing and recommending action on all safety-related activities, national trends and concerns. These committees also help to develop and implement VIA's safety training and awareness programs throughout the Corporation.

As part of the Safety Management System, VIA developed a Hazard Assessment and Risk Control Strategy database, which is consulted by managers to identify, eliminate or mitigate situations involving risk to employees, customers or communities. This database system was thoroughly reviewed and redesigned in 2005. The new version will be launched in 2006 and will provide quality assurance for various risk assessments, better reports and improved information-sharing throughout the Corporation. VIA has also developed a new training program for managers and for Health and Safety committees to support the new database.

PUBLIC SAFETY AWARENESS

VIA works regularly with the railway industry and communities to raise awareness of the need for caution around railway tracks and at level crossings.

In 2005, VIA collaborated with CN police to hold the Officer on Board program, in which a train equipped with track cameras carried new police recruits between Montreal and Quebec City, giving them a direct view of the kinds of situations locomotive engineers deal with and sensitizing these future police officers to rail safety issues. Through the Operation Lifesaver program, VIA's locomotive engineers and managers visited communities across the country, providing information to a wide variety of public interest groups, educational institutions and organizations concerning railway safety.

SECURING THE TRANSPORTATION SYSTEM

As tragic events in recent years have shown, transportation systems have been targets for terrorist activity in other parts of the world. While no incidents have taken place in Canada, public concern about transportation security remained high during 2005.

In working and coordinating with various law enforcement agencies, VIA has implemented a wide range of new and enhanced security measures since 2001. These include measures to tighten security at train stations, such as the use of closed-circuit television surveillance, more controlled access, and the use of police and canine patrols. Employee security training and awareness received particular emphasis in 2005, with information campaigns, posters and other tools reminding all employees to remain vigilant.

VIA's Keep an Eye Open program provides front line staff with techniques for identifying security risks, while the RCMP's Jetway program, used at Canadian airports, has been adapted with the RCMP's assistance to improve the observation skills and awareness of VIA employees.

VIA introduced regular security announcements warning passengers at stations not to leave baggage unattended, and to alert VIA staff if they should notice unattended baggage. In addition, a baggage inspection program has been implemented at all staffed passenger rail stations, and passengers are informed that their baggage may be inspected at any time.

To further enhance VIA's state of preparedness, a Security Management System review was undertaken in late 2005. Potential improvements were identified and are currently being developed and implemented, including a new Corporate Security Policy.

VIA's security program as a whole will be defined by its Corporate Security Plan. This Plan encompasses the new Corporate Security Policy and identifies the actions, rules and procedures employees need to follow to protect the Corporation and its customers. The Corporate Security Plan is under development. In 2006, VIA will integrate its Security Plan into the Emergency Measures Organization, to ensure that appropriate systems and procedures are in place to respond quickly to security incidents. The Security Plan will then be integrated into the Safety Management System, giving the Corporation a single, consistent framework for maintaining passenger rail safety and security.

VIA also developed and tested a new Business Continuity Plan in 2005, which will ensure that a potential disruption to the rail network and passenger services can be minimized in the event of a security or other disruptive incident.

Ongoing review of all security measures at VIA is carried out by the Strategic Security Planning Committee. Co-chaired by the President and the Chief Operating Officer, with representatives from all departments and all parts of the passenger rail network, the Committee monitors security issues, identifies opportunities to improve security, and works with partners in the transportation industry, law enforcement and intelligence authorities, and government departments.

VIA's president participated in a number of panels, convened by the Minister of Transport and including industry experts, to discuss security measures implemented by each service operator and the need for integrated, industry-wide collaboration in maintaining the security of transportation. Collaboration is particularly important to VIA, since most of its infrastructure, and many station facilities, are shared with others. Following a risk assessment of VIA security by counter-terrorism experts, VIA is discussing shared security issues with CN, GO Transit, Toronto Terminal Railways, and others.



People

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

The success of passenger rail is based on VIA's ability to provide customers with something more than transportation: a travel *experience* that sets rail apart. Every key goal for the Corporation – revenue growth, enhanced train services, improved cost-recovery, and continued progress towards financial self-sufficiency – depends on this ability. And that ability depends on creativity, innovation, and *caring* – the fundamental human talents that people bring to the job.

This is evident in VIA's success in 2005. Virtually every service improvement discussed in this annual report is the direct result of suggestions contributed by VIA employees.

In the future, efforts to engage, recognize, value and reward talent will become more critical than ever before. Throughout 2005, VIA took concrete steps to make these efforts a meaningful part of its business strategy, and an integral part of day-to-day business practices.

VALUING EMPLOYEE OPINIONS

A major step was the development of the *Moving Forward* plan itself. An unprecedented number of employees had the opportunity to influence the framework that will guide the Corporation into the future. When VIA's executives and senior management met with employees in 2005, the dedication of VIA's people was very clear. They are committed to excellence in passenger rail, to performing their jobs well, to improving rail services, and to the success of the Corporation. That commitment is reflected in the Strategic Plan.

The Corporation's effort to engage and listen to employees is also evident in the results of employee opinion surveys. For example, the 2005 survey showed that internal communications, especially between senior management and staff, had improved significantly. This reflects VIA's on-going efforts to discuss the Corporation's vision, mission and values, to keep employees informed about business challenges, and to provide better feedback on both individual and corporate performance.

Regular employee opinion surveys have proven to be a valuable tool to help create an environment where people feel empowered to influence the success of the Corporation. For example, the VIA uniform was fine-tuned in 2005 in direct response to employee feedback. New and modified garments and a more efficient allotment system are being implemented in 2006.

Departmental managers met with their staff to discuss the 2005 employee survey results, and each department developed action plans based on the feedback provided.

MANAGING VIA'S TALENT

VIA is transforming the role of people management within the organization to ensure a more strategic focus on developing the talent of VIA's people, and aligning that talent with the strategic goals of the Corporation.

The goal of this transformation is twofold. The first is to ensure that VIA has the people with the right knowledge, skills and experience to sustain the long-term success of the Corporation. VIA's involvement in an executive development program at McGill University attests to this commitment. Strategic talents are identified to participate in the Advanced Leadership Program, where as a group they make

concentrated progress on a complex issue identified as essential for the organization. VIA's customer focus philosophy was developed and implemented out of the enriched international working environment offered by this program.

The second major goal is to further strengthen VIA's human resources. Its people are the foundation for VIA's competitive advantage in the marketplace. The processes of hiring, training, promoting and rewarding talent are all being more precisely managed to create an organization where every individual can succeed by directing their creativity and innovation towards the success of passenger rail.

This realignment of people management is a long-term undertaking, and VIA made substantial progress in 2005. A range of new e-Learning tools have been developed, giving employees convenient access to well-designed learning modules, focusing on skills that are linked to corporate objectives. VIA also began to identify and define corporate competencies that are essential to the Corporation's business strategy. These will provide the basis for future training and career development programs, hiring practices, and succession planning.

VIA has developed and reviewed a comprehensive succession plan which identifies key talent gaps the Corporation will face in the future, as more employees approach retirement. Development plans are being prepared for individuals within the company to fill these gaps, and priorities established for bringing new talent into the organization.

REWARDING PERFORMANCE

VIA has realigned total compensation programs for management personnel to ensure that it is both competitive with industry standards and effective in achieving corporate objectives. Cash compensation programs are closely linked to performance, and a flexible benefits plan will be introduced in 2006 in order to better meet the needs of VIA's new and current workforce.

The performance management system, used by managers to set annual objectives, to measure progress and to reward performance, has also been refocused to ensure that individual and departmental objectives are always clearly aligned with the strategic goals of the Corporation. The performance management system will include a process for self-assessment against corporate competencies in 2006, to support the strategic development of VIA's talent.



Service

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

Customer service is at the very heart of passenger rail, and it is the heart of the *Moving Forward* plan. VIA's consistent success in the marketplace is the direct result of a commitment to continually refine passenger rail services to enhance the customer's experience, and to deliver that service efficiently, with care and attention to the needs of each customer.

Passenger services are developed and delivered by VIA's regional, cross-functional service teams in Western, Central and Eastern Canada. These teams work closely with the customers, businesses and communities they serve to ensure that VIA's operations reflect and respond to the unique needs of regions across the country.

As a federal institution, VIA plays an important role in promoting Canada's linguistic duality. VIA demonstrates daily its commitment to offer clients quality services, including in their preferred official language.

Regional service teams, and all VIA employees, have made service excellence a key focus of VIA's business strategy, and earned exceptionally high ratings from customers in 2005. In fact, 97 per cent of customers said that VIA met or exceeded their expectations during the year – 57 per cent said VIA met their expectations and, for the second consecutive year, 40 per cent said that VIA exceeded them.

IMPROVING SERVICE DELIVERY

A number of initiatives helped to strengthen VIA's focus on the customer and improve service delivery. Managers increased their on-board presence by riding the trains more frequently, and all employees were given the opportunity to experience VIA service themselves in order to gain a better understanding of the customer's perspective. A new monthly "Customer Focus" newsletter provides all employees with real life examples of service excellence and underscores the impact of good customer service on VIA's performance.

VIA has increased its emphasis on "soft skills" in serving customers. Department, communication, interpersonal skills, planning and organization are essential in shaping a positive travel experience for travellers. These are now more clearly identified and measured in employee performance reviews.

Self-service options for making travel arrangements and purchasing tickets continue to be very popular. In the last two years web sales have almost doubled, reaching \$68 million in 2005 and amounting to 27 per cent of VIA's sales revenues. VIA has begun a comprehensive review of its web site and online reservation systems to make the process even easier for customers. VIA is also reviewing the placement of its self-service ticketing kiosks in key locations throughout the Quebec City-Windsor corridor, to ensure that customers have the best possible access to this service.

REFINING WESTERN SERVICES

VIA's Western transcontinental train, the *Canadian*, celebrated 50 years of service in 2005. In addition to providing basic, year-round transportation between Toronto and Vancouver, the *Canadian* supports Canada's tourism industry by attracting high-yield travellers with its world-renowned *Silver & Blue*[™] class service.

In 2005, the Western Services carried out a complete review of *Silver & Blue* to identify ways to update, refine and improve the experience of customers. They identified 25 specific ways to enhance service, and implemented eight of these during the year, including adjustments to staff training, telephone confirmations of bookings and signage enhancements. Additional improvements will be introduced at the start of the 2006 summer peak season.

IMPROVED SCHEDULES IN THE CORRIDOR

VIA's Corridor-East and Southwestern Ontario Service Teams carried out extensive consultations with customers, communities and major employers to find the best way to fine-tune train departure and arrival times in the Quebec City-Windsor corridor.

For example, in the Corridor-East, morning trains between Montreal and Quebec City now depart earlier to accommodate customers travelling to attend business meetings, and some Montreal-Ottawa trains have been extended to Ottawa's suburban Fallowfield station, eliminating the need for many customers to travel into the city centre.

In Southwestern Ontario, both the morning and evening trains from Sarnia to Toronto now leave slightly later, providing better connections with trains at both London and Toronto. The late evening Toronto-Kitchener train now provides through-service to London. Based on numerous requests from students, VIA also launched an additional train, on Friday nights, from London to Toronto via Brantford.

SERVING MARITIME TRANSPORTATION AND TOURISM

In response to regional transportation and tourism partners' demand for high-quality services in Eastern Canada, VIA launched an enhanced seasonal product on the *Ocean*, which runs between Montreal and Halifax. The new *Easterly* class service was developed in consultation with customers, staff, local governments and the tourism industry throughout the region.

This authentic, interactive rail tour offers a complete *Maritime learning experience*, with customers participating in a variety of on-board activities. Entertainment and educational content is tied to regional culture, history and geography, and the dining experience reinforces the cultural connection, with regionally-inspired cuisine and animated personal service. Inclusive meals and themed cars add further value to this enhanced first-class experience.

Response to the new *Easterly* class after the first year of operation was extremely positive. Customer satisfaction ratings on this route improved significantly, reaching 8.4 out of 10, with the dining experience and the learning component receiving even higher marks. Interest in this product remained high throughout its first season, and an increase in traffic is expected in the year ahead.

In 2005, the new *Easterly* operated from June through October; in 2006, it will be available from May through October, with further enhancements under development.

After an initial adjustment period, customer reaction to the Renaissance cars on the *Ocean* has been positive. In response to customer feedback, a number of modifications are underway to improve heating systems, to provide more flexible seating arrangements in the coach cars, and to add additional luggage racks for customer use.

VIA's Eastern Service Team has been meeting with local associations to enhance the value of rail passenger service to the region. One initiative, spearheaded by Halifax and Moncton front-line employees, was a Remembrance Day train in November. Launched by an honour guard and greeted en route by crowds of well-wishers, the service brought veterans and their families from Halifax to Ottawa to take part in *Year of the Veteran* Remembrance Day ceremonies in the nation's capital.

ON-TIME PERFORMANCE

On-time performance – VIA’s ability to get customers to their destination at the scheduled time – is one of the most critical factors affecting customer satisfaction. In 2005, VIA raised on-time performance to 81 per cent, 11 percentage points higher than in 2004.

This follows a number of years in which performance was declining, due largely but not exclusively to the challenges of mixed passenger/freight operations on existing tracks. CN owns most of the track and infrastructure used by VIA’s passenger trains. In recent years freight traffic has increased, and freight trains have grown longer. Both developments impact VIA’s operations, limiting capacity for higher-speed passenger service and causing frequent delays for passenger trains.

VIA and CN executives maintain ongoing discussions to identify opportunities for improving on-time performance. The improvements achieved in 2005 are the result of joint efforts at various levels of both organizations. Train delays are tracked daily and reviewed every morning to identify the cause of delays. In some cases, VIA is able to solve the problem on its own. In other cases, delay issues are raised in weekly meetings with CN managers to identify causes and find solutions.

In 2005, VIA re-opened its Toronto Maintenance Centre service shop, which had been closed in 1997. This has improved equipment cycling efficiency for trains in the Corridor and will provide better support for on-time performance issues related to equipment maintenance.

While these efforts brought improvement, infrastructure challenges and limitations will need to be addressed to provide lasting solutions and to increase capacity and speed for passenger services in the future.



Growth

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

VIA is recapturing the momentum for growth in passenger rail achieved in the decade before 2003. Record increases in both ridership and passenger revenues were achieved in 2005.

Much of this success is due to the customer focus framed by the *Moving Forward* plan. Improved on-time performance alone has helped recapture customers who were frustrated with delays in the past. Service improvements, such as more responsive frequencies and schedules, have made rail travel a more attractive option for new customers. As just one example, the reorganization of departures on Toronto-Sarnia trains has increased ridership by six per cent, while revenue on this service has grown by 13 per cent.

In addition, VIA has focused on capturing new markets and customers through effective marketing and pricing strategies, marketing partnerships, and innovative products that distinguish passenger rail in the marketplace.

MORE FLEXIBLE FARE STRUCTURE

VIA introduced Flexi Fares to provide customers with a more flexible fare structure, to increase choices for customers, and to eliminate complex restrictions on booking discount fares. This new pricing structure is simpler to understand, resembles that offered by other passenger services, and responds to the growing trend among customers to book seats closer to their desired departure date.

In order to make rail travel more accessible to seniors, VIA offers the Seniors' Companion Fare during the shoulder and off-peak season on Western and Eastern services, whereby seniors can take advantage of the standard seniors' discount and get a free companion ticket in *Comfort* class. The Kids Travel Free program provides an attractive option for family travel. And in September, VIA introduced gift cards in fixed denominations of \$25, \$50 and \$100, as well as a flexible value gift card that is reloadable, encouraging reuse.

STRATEGIC PARTNERSHIPS

Strategic marketing and promotional partnerships with other service providers have been effective tools for increasing VIA's attractiveness and availability to new customers.

For example, the AIR MILES® Rewards Program now encourages its members to exchange their reward miles for VIA gift cards, which can be redeemed for rail travel. This program was launched in September 2005, and sales in the first four months exceeded expectations. Similar partnership opportunities are being explored with other programs and organizations. VIA's agreement with Expedia Canada, allowing customers to make hotel and rental car reservations directly from VIA's web site, continues to generate steadily increasing commission revenues for the Corporation.

Intermodal partnerships are another opportunity to attract new customers. VIA has partnered with WestJet to offer a seamless rail/air travel experience, and has integrated rail operations with bus services at its Halifax and Miramichi stations. The Corporation is currently exploring options with the City of Guelph to establish an inter-regional transportation centre at the Guelph passenger station.

NEW PRODUCTS AND SERVICES

In 2005, VIA completed a very encouraging pilot project offering Wi-Fi capabilities, or wireless Internet access, to *VIA 1* customers in the Quebec City-Windsor corridor. This kind of service enhancement attracts business customers who appreciate the opportunity to make productive use of their travel time, playing to the unique strengths of passenger rail in the marketplace. The project was a resounding success, and in 2006 Wi-Fi service will be expanded and offered on all trains and in select stations in the Corridor.

VIA offered customers the use of the *Glenfraser* lounge car on selected departures to Niagara Falls in 2005, and feedback on the experiment was enthusiastic. The Corporation is evaluating the potential revenue benefits of providing lounge car service on these trains, and between Montreal and Toronto, on a seasonal basis.

VIA is also exploring opportunities to increase ridership by re-deploying fleet capacity to key growth markets. For example, in 2005 VIA discontinued the seasonal *Bras d'Or*[™] tour service in Nova Scotia, which had been unable to recover from declining tourism since 2003, and also discontinued its overnight service between Montreal and Toronto. At the same time, VIA introduced a 13-week additional frequency for the Niagara Falls-Toronto service, and the service will be available for a 20-week period in 2006. VIA is now considering options for adding weekly, seasonal or special theme trains in other markets.



Entrepreneurship

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

Cost-recovery for passenger rail operations has improved dramatically – by more than 120 per cent – over the past 15 years. While results in 2003 and 2004 were less than satisfactory, cost-recovery rose back to 2002 levels in 2005. Revenue growth was a key component in this success, and efforts to increase productivity and develop new, cost-effective business partnerships have also played an essential role.

PRODUCTIVITY INITIATIVES

Employees at VIA have demonstrated their commitment to controlling costs, and recognize the importance of increasing the financial self-sufficiency of passenger rail operations. This goal has been newly incorporated into VIA's performance management and incentive programs, which are designed to encourage and reward good revenue performance and effective cost controls.

Technology has been an important tool for increasing productivity. Automated and online services have proven to be the most cost-effective way to manage reservations, and to provide customers with travel information. Self-service ticketing kiosks in the Quebec City-Windsor corridor, and customer self-service through VIA's web site, contributed significantly to reduced costs in 2005.

VIA is undertaking a comprehensive review and redesign process for its web site, to make it more convenient and efficient for customers to locate information and make travel reservations. And online booking tools are being developed to enable major corporate customers to administer their travel programs directly with VIA.

VIA also introduced automated billing and settlement for IATA-affiliated travel agencies, which has encouraged large numbers of agents to move their bookings online. More and more travel agencies are using the VIA Agency Web Portal to book train trips for their clients – sales through this portal increased from \$2.8 million in 2004 to \$9 million in 2005.

Technology is also helping to increase productivity at VIA's Telephone Sales Offices. An automated call monitoring and reporting system allows managers to measure agent performance against clearly defined objectives, analyze performance statistics, and devote more time for personal coaching and training of staff. A workforce management system has improved demand forecasting and performance management, and allowed for optimal, cost-effective staff scheduling.

Following improved telephone sales systems and online services, VIA closed its Toronto Telephone Sales Office in 2005. This has resulted in cost-savings, while consolidated operations in the Montreal and Moncton facilities will ensure continued, high-quality service.

PRODUCTIVE PARTNERSHIPS

Partnerships are an effective way to develop new or enhanced service for customers, while minimizing VIA's direct costs and associated business risks.

On-board wireless Internet access is a prime example. Wi-Fi service in *VIA 1* class is provided by Parsons Transportation Group, one of the world's largest engineering firms with transportation and communications expertise. Parsons recognized the potential for growth in this area and made a long-term commitment, assuming the risks and costs of providing the network and equipping VIA's trains with the technology. In return, the firm benefits through fees-for-use paid by the passenger. At the same time, VIA attracts and retains more customers, particularly business travellers, by offering them a popular service that adds considerable value to their travel time.

On selected train departures from Toronto to Niagara Falls, on-board activities, wine sampling and cheese tasting were offered to customers free of charge and at no cost to VIA. These activities were organized by partners to promote their own products and services, while enhancing the travel experience for VIA's customers.

Partnerships with tour operators, tourism agencies and associations remain an important means for VIA to help develop Canada's tourism industry, while sharing the development and marketing costs of reaching tourists overseas. For example, the Canadian tour operator Brewster provides VIA with marketing services in China, one of the biggest emerging markets for travel to Canada. VIA benefits from Brewster's international expertise, while gaining access to a key market at a reasonable cost.



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.

VIA is a transportation leader in environmental performance, and environmental goals have been integrated into VIA's business for a number of years. These goals continue to be a priority in the Corporation's *Moving Forward* plan. VIA's Environmental Policy, supported by the Environmental Management System, is ingrained in the company's day-to-day business practices.

Passenger rail is already recognized as one of the most environmentally sustainable modes of public transportation available today. VIA believes that there is enormous potential for enhancing rail's contribution to environmental protection in Canada, by continually improving current operations and by expanding rail services as an environmentally responsible travel choice for Canadians.

REDUCING GREENHOUSE GAS EMISSIONS

Greenhouse gas (GHG) emissions are a primary cause of global warming, and transportation is one of the major sources of these emissions. Since 1990, VIA has succeeded in reducing fuel consumption by 25 per cent per passenger-kilometre, thereby reducing GHG emissions by 13 per cent. This reduction is more than double Canada's commitment to the Kyoto target of six per cent by 2008-2012, using 1990 as a base year.

Significant reductions were achieved by modernizing VIA's transcontinental equipment in the 1990s, and through the purchase of 21 new cleaner-running locomotives in 2001. At the same time, VIA has continually worked to manage the entire fleet more efficiently, and increase its productivity. For example, while fuel consumption is down significantly, VIA has increased passenger-miles per train – quite literally, doing more with less.

Current emission reduction strategies focus on improving both the equipment and technology VIA uses, and VIA's efficiency in operating that equipment.

In 2005, VIA began work on a prototype for rebuilding the engines of its older F-40 General Motors locomotives in order to meet the highest North American environmental standards for rebuilt engines. Separate generators for on-board amenities will be installed to allow the main engine to operate more efficiently, and an electric engine heating system will be installed to allow engines to be shut down even in the coldest winter temperatures, where ground-based electric power is available. An automatic start-stop system will allow engines to shut down year-round where no trackside power is available, by automatically restarting when the engine temperature gets too low.

These new systems will reduce the time engines spend idling at stations, and allow for more energy efficient heating during layovers. VIA is also working with General Electric to equip the newer General Electric P-42 locomotives with the layover heating and start-stop systems.

VIA is planning to overhaul the electrical systems in our older LRC cars by converting to more efficient and longer-lasting LED lighting where possible, using new high-efficiency motors to operate doors and other systems, and installing new microprocessor controls for heating and cooling systems. Curtains will also be installed in all cars to reduce the need for air-conditioning in the summer.

GREEN BUSINESS PRACTICES

While train emissions are a major focus of VIA's environmental efforts, the Corporation is committed to operating all aspects of its business in an environmentally responsible manner, introducing reduce, reuse and recycling strategies throughout its operation. An on-board recycling program has been fully implemented on all trains in Western Canada and the Corridor, and will soon be implemented on Eastern services. In December 2005, VIA received the Environmental Protection Award from the Railway Association of Canada for a new component of this recycling program, VIA's textile recovery and recycling initiative. Under this initiative, VIA recovers old uniforms and damaged linen from its operations and donates these for reuse to charitable organizations.

The Corporation is also increasing its emphasis on purchasing environmentally friendly products and services when dealing with suppliers, and is currently working with suppliers to reduce waste generation from materials such as packaging. As an example, VIA's Annual Report and national timetables are printed on paper produced in an environmentally responsible manner.

VIA employees formed three new Green Teams in 2005, bringing the total to 10. Through voluntary participation in these Teams, employees develop environmental initiatives in their own workplaces and communities, while helping to educate Canadians about the environmental consequences of transportation and the advantages of rail. They are making a difference in the most direct way possible – through individual action.

VIA's Green Teams organized a wide range of activities in 2005, including Earth Day celebrations across the country, and VIA's participation in Car Free Day in Montreal. Employees were also invited to take part in Transport Canada's "One Tonne Challenge," which encouraged Canadians to reduce emissions generated by their personal activities by one tonne in 2005.

INCREASING AWARENESS AND CHOICE

VIA's most important contribution to environmental protection in Canada is to provide Canadians with an efficient and environmentally responsible choice in transportation.

A full 50 per cent of personal greenhouse gas emissions in Canada come from the use of private cars, and passenger rail is a mode of transportation with the capacity to divert significant travel away from cars. The potential to reduce total transportation emissions by increasing the use of passenger rail further in the future is significant. This depends on VIA's ability to provide faster, more frequent rail service, to make rail travel more convenient for people to use. And to a large extent, this requires new investment in equipment and infrastructure – equipment that can run faster, and infrastructure that can handle both higher speeds and more trains safely.

VIA is exploring investment options which would allow modest but significant improvements. The Corporation has prepared a medium-term investment plan for the Government's consideration, which could allow VIA to divert scores of car trips to passenger rail – considerably reducing annual overall transportation GHG emissions.

Corporate Governance

Following a year of transition in VIA's leadership, the Government of Canada appointed Mr. Paul Côté as President and Chief Executive Officer of the Corporation on February 1, 2005. The Government also filled many of the existing vacancies on VIA's Board of Directors, appointing nine new members to the Board in 2005. The Government has not yet named a new Chairman of the Board.

The Corporation and its Board of Directors are committed to principles of good governance within the framework of the governance program introduced in 2003 and fully implemented in 2004. Training and orientation for the new Board members began in 2005, focusing on their roles and responsibilities in directing a Crown Corporation. Additional orientation sessions will take place in 2006.

CODE OF CONDUCT

VIA implemented a clear Code of Conduct for all of its employees in 2005, in anticipation of federal legislation.

This Code of Conduct supports the Corporation's core values and confirms VIA's dedication to maintaining a work environment that fosters respect and integrity. It 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. All management and unionized employees are required to complete a training course related to the new Code.

VIA has also retained the services of an independent, third-party Compliance Officer, ensuring that VIA employees are free to raise concerns about VIA 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 2005. It should be read in conjunction with the Financial Statements, which follow.

OVERVIEW OF FINANCIAL RESULTS

VIA delivered exceptional financial results in 2005, continuing and surpassing its strong financial performance in 2004. Despite the pressures of turbulent travel markets and rising operating costs, the Corporation considerably reduced its net operating deficit, both as compared to budget and to 2004.

This exceptional performance reflects a significant increase in passenger revenues, and revenue from a one-time recognition of capital gains in VIA's Asset Renewal Fund investment portfolio. Total revenues in 2005 hit an all-time high of \$289.8 million. This is \$26.3 million (or 10 per cent) higher than budget and \$31 million (or 12 per cent) higher than 2004.

Higher revenues more than offset higher than expected operating expenses, enabling the Corporation to end its financial year with an operating deficit of \$175.9 million. This represents a substantial reduction of \$14.9 million (or eight per cent) compared to budget and \$9.2 million (or five per cent) compared to 2004.

Annual operating funding for passenger rail from the federal government has been frozen at \$169 million since 1999. The Corporation must use its internal resources (the Asset Renewal Fund) to make up the difference between government funding available and the actual funding required. Due to the excellent financial results, VIA was able to reduce its 2005 funding shortfall, and therefore the amount of funding required from the Asset Renewal Fund, to \$6.9 million. This is \$14.9 million (or 68 per cent) better than anticipated.

REVENUE AND RIDERSHIP

Both revenue and ridership exceeded budget targets in 2005. This growth is particularly significant given the uneven performance of the Canadian travel market as a whole, with some key international markets experiencing no growth during the year.

Following the JetsGo bankruptcy in March, VIA benefited from a surge in domestic market demand, including a high percentage of new rail users. Flexi Fares, introduced earlier in January, helped VIA to retain these new customers by offering simplified, more flexible purchase options. Flexi Fares also produced higher yields compared to 2004 and improved usage of capacity.

A fare adjustment introduced at mid-year, largely to offset higher energy costs, had no negative effect on demand, as airlines had already increased fares.

Overall, revenue per passenger-mile increased to 28.6 cents, over two per cent higher than 2004. Passenger revenues increased \$15 million over 2004, exceeding budget targets by over six per cent. Passenger-miles, at 888 million, grew over four per cent as a result of strong Corridor ridership and recovery of long-distance travel markets in Eastern and Western Canada. Ridership reached 4.1 million passenger trips in 2005, a record for the current passenger rail network.

While facing revenue challenges in the first part of the year, VIA met and exceeded targets as of mid-year. Beginning in September, passenger revenue growth accelerated significantly. Between September and December, passenger revenues increased by over nine per cent and passenger ridership grew by approximately six per cent as compared to 2004. *Comfort* class experienced both strong revenue and ridership growth in 2005. *VIA 1* and sleeper classes recorded revenue growth, but only minimal ridership increases.

OPERATING COSTS

Total operating costs in 2005 were influenced by a number of one-time and recurring factors, which caused expenses to exceed budget by \$11.5 million, or three per cent. Compared to 2004, total operating expenses increased by five per cent.

Rising fuel prices were a major source of increased costs. However, the negative effects on VIA's financial results were attenuated somewhat in 2005 by the use of fare adjustments and hedging techniques, which sheltered the Corporation from the full impact of increases in the price of oil.

Changing financial conditions affecting the pension plan for VIA's unionized employees also influenced operating costs, and will continue to do so in the years to come. As required by the *Income Tax Act*, the Corporation did not contribute to the unionized plan for a number of years. VIA resumed contributions in 2005 as a result of the deteriorating financial position of the plan. These unplanned contributions started during the second half of the year and totalled \$5 million.

In addition, accident costs and provisions for third party claims jumped in 2005, exceeding budget by \$4 million.

The overall increase in operating costs masks the impact of the Corporation's stringent control of costs. Despite rising fuel prices and cost increases associated with poor on-time performance on the Western and Eastern long-haul services, costs for train operations – including fuel, maintenance material, and station and property expenses – were below budget for 2005, but nearly \$10 million more than last year. Marketing and sales expenses, as well as on-train product costs, were up versus last year and higher than budget, but this is due to higher passenger volumes and revenues.

CAPITAL EXPENDITURES

At the present time, the government has approved no new capital funding for passenger rail. VIA is thus obliged to use the internal Asset Renewal Fund not only to satisfy its capital requirements but to cover operating funding shortfalls as well.

VIA originally planned to spend \$32.4 million on capital expenditures in 2005, funded almost entirely through the Asset Renewal Fund. Actual spending for 2005, however, totalled only \$21.2 million, which is \$11.2 million less than planned.

This under-spending is in part a reflection of VIA's prudent management of its scarce capital resources. The continued absence of an expected government decision to approve new capital funding for 2006 left VIA at risk of having no capital funding in that year. Therefore, VIA decided to revise its 2005 capital spending plans so as to reallocate some of its remaining Asset Renewal Funds to 2006 to provide for a minimal level of capital investment in that year. This involved the cancellation of planned projects to permit the transfer of \$5 million dollars of capital funding from 2005 to 2006.

ON-TIME PERFORMANCE

VIA achieved a substantial improvement in on-time performance for the first time in the last four years. Overall on-time performance reached 81 per cent for 2005, an 11 percentage point improvement over 2004. This is one of the best gains in VIA's history. Most notable were improvements achieved over the Christmas period and during the difficult winter months.

VIA tracks delay minutes and distinguishes between those caused by its own operations and those attributable to infrastructure owners or other third parties. As such, VIA addressed critical problems in areas under the Corporation's direct control, such as equipment maintenance and passenger handling. Equipment maintenance delays for the Quebec City-Windsor corridor decreased 18 per cent compared to 2004, and passengers experienced fewer service disruptions related to mechanical failures. Another factor contributing to improved performance was the efforts of the Customer Service department, which achieved a 31 per cent reduction of non-mechanical delay minutes compared to 2004.

The Western transcontinental service suffered a significant rise in CN-related delays for a second consecutive year. Delay minutes increased by 38 per cent over 2004, resulting from a combination of increased freight congestion and derailments. Some delays resulting from track congestion are due to a major undertaking by CN to increase the capacity of its sidings, which will continue into 2006. VIA is working closely with CN to minimize delays resulting from such work projects, which will ultimately improve on-time performance.

The Eastern transcontinental service faced challenges of its own. On-time performance fell eight percentage points from 2004. Shortline railway delays more than doubled during 2005 as result of a need for reduced speed.

OUTLOOK FOR 2006

VIA is confident that it will sustain and further improve a high level of performance for passenger rail in 2006. The Conference Board of Canada predicts that travel in Canada will grow by 2.6 per cent, roughly in line with industry growth during 2005. VIA expects to match or exceed this rate of growth, by continuing to focus on customer service and the key goals set out in the *Moving Forward* plan.

With the prospect of continued increases in basic operating expenses, VIA will maintain rigorous cost controls, explore new opportunities to improve productivity, and capitalize on new market opportunities. Efforts to enhance web-based marketing and sales options and other technologies will respond to growing demand from customers, while further reducing distribution costs. Efforts to increase ridership will focus on fine tuning existing services, managing capacity in off-peak periods, and exploring opportunities to re-deploy fleet capacity in markets that show long-term growth potential.

While VIA enters 2006 with confidence, the Corporation remains very concerned about the financial stability of Canada's passenger rail service, and prospects for maintaining a quality service in the longer-term. While operating costs are rising substantially, operating funding for the service remains frozen at 1999 levels, creating a significant funding shortfall. VIA has managed to cover this shortfall by using funds intended for capital investment, but those funds will be exhausted by the end of 2006.

Capital investment, in turn, has been postponed, pending decisions from the federal government with respect to the future role of passenger rail in national transportation. Indefinite delays in critical investment will affect the performance of passenger rail, and ultimately its viability as a service to Canadians.

VIA will make every effort to continue improving the on-time performance of passenger rail, which depends largely on the infrastructure owned by freight railways. Cooperation between VIA and CN to address capacity issues has achieved excellent results, and will continue. However, it is clear that long-term solutions with respect to infrastructure will require investment to increase capacity, and to improve infrastructure owned by shortline operators.

VIA will continue to work closely with the Government of Canada to explore a long-term vision for the future of passenger rail, and options for investing in that future. The Corporation is confident that, with a clear vision in place, passenger rail will continue to be a relevant and cost-effective transportation service for Canadians.