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 2004. It should be read in conjunction with the Financial Statements, which follow.

OVERVIEW OF FINANCIAL RESULTS

Despite the very difficult market conditions in 2004, and excluding the impact of the Canadian Industrial Relations Board (CIRB) ruling described below, VIA's financial performance has been nothing short of exceptional. Although total revenues of $259.5 million were short of budget by $14.5 million (or five per cent), the Corporation was able to reduce cash operating expenses, which resulted in a favourable variance versus budget that more than offset the revenue shortfall.

The year-end result was negatively impacted by a decision of the Supreme Court not to grant VIA leave to appeal a Federal Court of Appeal ruling supporting a decision of the CIRB. The CIRB ruling relates to a complaint filed by a group of ex-VIA conductors against their union, the Brotherhood of Locomotive Engineers (BLE), claiming unfair labour practices. VIA, as the employer, was added as an interested party. The dispute relates to an implementation agreement between the BLE and VIA, reached in 1997, regarding VIA's decision to merge the conductor's position with that of the locomotive engineer. Following generally accepted accounting principles, VIA has made provision for this expense in its 2004 financial results.

REVENUE AND RIDERSHIP

Both passenger revenues and ridership fell below budget in 2004, as travel markets continue to experience very low growth following the market drop in 2003. However, total revenues did increase $9.2 million over 2003. Significantly, revenues increased more than passenger volumes, reflecting VIA's focus on improving yield. Revenues per passenger-mile increased significantly to 28 cents over 26.8 cents in 2003.

Passenger-miles of 851 million were seven per cent short of budget and one per cent below last year, the result of traffic losses on the long-haul services and the relatively greater loss of longer distance first-class passengers.

The year ended on a very positive note, with December revenues posting a strong performance. Not only did December passenger revenues exceed forecast by $3.1 million (or 16.5 per cent), they also exceeded the monthly budget for the first time since January 2004. Other revenues, especially investment income, were also very strong in December and ended the year $2.4 million over budget.

OPERATING COSTS

As noted above, the CIRB ruling has significantly increased VIA's 2004 operating costs. In addition, VIA also experienced higher costs for legal services in 2004. However, during the year, the Corporation reversed $14 million of capital taxes related to prior years. This adjustment helped offset the negative effect of the CIRB settlement and the increased legal services costs. Total operating costs (cash operating expenses), excluding the CIRB settlement, were slightly less than last year.

Almost all areas of the Corporation contributed to this excellent result. The sources of expense savings (excluding the capital tax reversal) are diverse, as almost all expense categories were below budget. Major contributors include $6.4 million in lower maintenance material costs; $4.9 million in compensation savings through control of vacant positions and staffing levels; $1.3 million from train operations, mostly from reduced line-haul charges; $1.3 million from lower station and property expenses; and $1.2 million from lower marketing and sales expenses, including the benefits from new customer service technologies.

The reduction in operating expenses allowed the Corporation to end the year with a 58.9 per cent cost-recovery ratio, an improvement compared to the 58.5 per cent recorded last year.

CAPITAL EXPENDITURES

Capital expenditures totalled $20.2 million in 2004, slightly less than forecast and far below the planned level of $41.1 million, which reflects VIA's prudent management of its capital resources until a certain long-term investment strategy is more clearly articulated pursuant to the Minister's instructions. With the exception of administration projects, all capital programs underspent their budgets this year.

The most significant underspending occurred in equipment projects at $9.8 million, where significant delays in VIA's LRC and F-40 rebuild projects occurred. Other programs with significant underspending include station projects, mostly due to delays in project startups, infrastructure projects, where work was deferred for future consideration, and maintenance centre projects.

ON-TIME PERFORMANCE

VIA faced another difficult year in 2004 with on-time performance decreasing for a third year in a row. However, despite very challenging first quarter conditions when on-time performance averaged only 54 per cent, some recovery was seen in the remainder of the year to achieve a year-end result of 70 per cent of the trains arriving on time.

VIA recognizes that failing to meet operating schedules is a critical problem, with potentially disastrous effects on VIA's financial performance if the root cause of the problem is not addressed quickly. Deteriorating performance will lead to lost business, lower revenues, and possibly higher costs to government.

Of the train delays experienced in 2004, 18 per cent were directly under VIA's control, an improvement from 2003 of almost three percentage points. A significant portion of these delays was related to adjustments that had to be made to the introduction of new equipment as well as some equipment failures caused by an aging fleet.

VIA continues to closely monitor and seek ways to minimize the delays in its own operations, including changes in station practices to reduce station stand time, and improved baggage handling procedures to reduce delays en route. In addition, albeit slightly longer term, VIA has begun the process of rebuilding two of its older fleets of rolling stock.

However, the majority of train delays were caused by operating railways (69 per cent), with other parties accounting for another 11 per cent of delays. The significant volume of operator-related delays is due largely to insufficient infrastructure. VIA continues to work closely with all parties to resolve problems that cause delays, and is making progress in this regard.

Although the number of trains arriving late increased in 2004, the severity of delays from all sources was significantly less than in 2003 (average delay minutes 18 per cent down). Delay minutes under VIA's direct control decreased by almost 25 per cent in 2004, showing that VIA's continuous efforts to contain controlled delays is yielding results.

OUTLOOK FOR 2005

VIA looks forward to completing a transition in leadership in 2005, with the appointments of a new President and Chief Executive Officer and a new Chairman of the Board. With new leadership in place, VIA will continue to explore options with the Government of Canada concerning the future direction of passenger rail.

Although VIA's revenues and ridership showed signs of growth in the last quarter of 2004, markets are expected to be highly uncertain and unstable in 2005. VIA will continue to concentrate on finding innovative and creative ways to maintain above-average performance and maximize passenger revenues in growing markets. In order to return revenues to the upward trend established over the past decade, and to continue minimizing costs, VIA will:

- Continue to implement rigorous cost controls to eliminate unnecessary costs, without jeopardizing services.
- Promote its new simplified *Comfort*® class Flexi Fares to increase the convenience and flexibility of passenger rail travel as an attractive option in the marketplace.
- Improve and enhance access to VIA's services by expanding use of self-service ticketing kiosks for most products, and introducing special Web-based promotional initiatives to capitalize on the growth in online bookings to attract new customers, while retaining existing travel base.
- Improve and enhance service delivery to capitalize on its competitive edge over other modes of transportation.

On-time performance will remain a critical focus in 2005. Indeed, any optimism for the coming year must be tempered by grave concerns about limited infrastructure capacity, and the impact this is having on on-time performance. Many of the infrastructure and capacity problems experienced in 2003 and 2004 will continue, and increase, if they are not addressed quickly.

VIA is working closely with the freight railways and the federal government to examine options for resolving these issues. VIA is confident that viable options will be identified which, if implemented, would allow the Corporation to continue increasing revenues, thereby ensuring that the national passenger rail service will grow to meet Canada's transportation needs in the years ahead.