MANAGEMENT DISCUSSION & ANALYSIS

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This is a review of VIA Rail Canada's operations, performance and financial position for the quarter and year to date ended June 30, 2011, compared with the quarter and year to date ended June 30, 2010. It should be read in conjunction with the unaudited financial statements and notes.

The financial statements are prepared in accordance with international financial reporting standards (IFRS). Figures for 2010 have been adjusted and converted to international financial reporting standards (IFRS), as the annual report for 2010 presented financial statements under Canadian Generally Accepted Accounting Standards (Canadian GAAP).

1. FINANCIAL HIGHLIGHTS

	Quarter ended June 30				Semester ended June 30			
In Millions of Canadian dollars	2011	2010	Var $	Var %	2011	2010	Var $	Var %
Passenger revenues	64.5	62.5	2.0	3.2%	121.6	116.1	5.5	4.7%
Total revenues	69.1	66.4	2.7	4.1%	130.8	124.1	6.7	5.4%
Operating expenses	141.0	140.0	1.0	0.7%	283.7	282.0	1.7	0.6%
Operating defecit before funding from Government of Canada and corporate taxes	(71.9)	(73.6)	(1.7)	-2.3%	(152.9)	(157.9)	(5.0)	-3.2%
Operating funding from Government of Canada	75.7	80.0	(4.3)	-5.4%	137.4	136.0	1.4	1.0%
Amortization of deferred capital funding	9.7	11.6	(1.9)	-16.4	21.0	22.8	(1.8)	-7.9%
Corporate tax expense (Recovery)	(3.8)	0.1	3.9	n/a	(3.7)	0.2	3.9	n/a
Net income and comprehensive income for the quartar	17.3	17.9	(0.6)	-3.4%	9.2	0.7	8.5	n/a

After six months completed in 2011, revenues have increased by 5.4% compared to last year; passenger-miles have grown by 1.3% combined with higher fares achieved through the Corporation's revenue management program, especially in the Quebec City-Windsor Corridor and Western Longhaul routes.

Operating expenses rose by $1.7M, the increase strictly due to higher pension costs ($9.7M), other expenses have decreased by $8.0M.

As a result, the Corporation has reduced its Operating deficit before funding from the Government of Canada and Corporate taxes by $5.0M (3.2%).

HIGHLIGHTS OF THE QUARTER

Compared with the quarter ended June 30, 2010:

- Revenues have grown by 4.1% and total $69.1M for the quarter.
- Operating expenses have increased by 0.7% and amount to $141.0M for the quarter.
- Funding from Government of Canada decreased by 5.4% to $75.7M for the quarter.
- There is a net profit of $17.3M for the quarter, compared to a profit of $17.9M for the same quarter of 2010.

HIGHLIGHTS OF THE SIX MONTHS ENDED JUNE 30, 2011

Compared with the semester ended June 30, 2010:

- Revenues have grown by 5.4% and total $130.8M for the period.
- Operating expenses have increased by 0.6% and amount to $283.7M for the period.
- Funding from Government of Canada increased by 1.0% to $137.4M for the period.
- There is a net profit of $9.2M for the semester, compared to a profit of $0.7M for the same semester in 2010.

2. HIGHLIGHTS OF OPERATING RESULTS

a) Passenger Revenues

	Revenues (in '000 000$)							
	Quarter ended June 30				Semester ended June 30			
	2011	2010	Var $	Var %	2011	2010	Var $	Var %
Corridor East	$37.6	$36.2	$1.4	3.9%	$74.9	$71.5	$3.4	4.8%
SWO	$10.6	$10.0	$0.6	6.0%	$22.4	$21.0	$1.4	6.7%
Ocean	$2.9	$2.9	$0.0	0.0%	$5.5	$5.4	$0.1	1.9%
Canadian	$11.5	$11.0	$0.5	4.5%	$15.2	$14.3	$0.9	6.3%
Mandatory Services	$1.6	$1.8	($0.2)	-11.1%	$2.8	$3.0	($0.2)	-6.7%
Other	$0.3	$0.6	($0.3)	-50.0%	$0.8	$0.9	($0.1)	-11.1%
Total	$64.5	$62.5	$2.0	3.2%	$121.6	$116.1	$5.5	4.7%

	Passenger miles (in '000 000)							
	Quarter ended June 30				Semester ended June 30			
	2011	2010	Var	Var %	2011	2010	Var	Var %
Corridor East	120.8	120.2	0.6	0.5%	237.5	232.9	4.6	2.0%
SWO	29.6	29.9	(0.3)	-1.0%	62.6	61.4	1.2	1.9%
Ocean	13.7	14.6	(0.9)	-6.0%	25.9	26.7	(0.8)	-3.0%
Canadian	35.1	35.7	(0.6)	-1.6%	50.5	49.6	0.9	1.9%
Mandatory Services	7.0	8.0	(1.0)	-12.5%	12.7	13.8	(1.1)	-7.8%
Other	-	-	-	-	-	-	-	-
Total	206.2	208.4	(2.2)	-1.0%	389.2	384.4	4.8	1.3%

Passenger revenues have increased by 3.2% and total $64.5M for the quarter. On a cumulative basis, they have grown by 4.7% and amount to $121.6M. The performance of the quarter is explained by the increase in yields (revenues per passenger-mile), partly offset by a reduction in ridership.

The new MOT (Montreal-Ottawa-Toronto) service was introduced in April 2011 to provide additional frequencies between Montreal and Toronto (via Ottawa). Major infrastructure work will be completed in 2012 and additional trains added on the Toronto-Ottawa line.

On a cumulative basis, the increase stems from higher yields, ridership remaining stable compared to last year. Passenger-miles have grown reflecting the longer average trip lengths made by passengers.

For the quarter:

- Corridor East revenues are 3.9% higher than those of the previous year, and result mainly from the higher yields (3.2% vs last year). Passenger miles have grown slightly (+0.5%).
- Revenues in SWO have increased by 6.0% as a result of higher yields (+6%). Passenger levels are similar, but passenger-miles have decreased by 1.0% reflecting shorter trip lengths.
- Revenues on the Eastern service have remained stable compared to the last year, ridership has decreased (6.0% less passenger-miles) but yields have increased.
- Revenues on the Canadian have grown by 4.5% over the previous year. The performance stems from higher yields (+6.3%). Ridership also increased but passengers travelled on shorter distances, as reflected in the passenger-miles which have decreased by 1.6% compared to the same quarter last year.
- Mandatory Services have generated lower revenues, and the situation is directly attributable to the interruption of the Victoria-Courtenay service since April 2011 (busing service offered until the end of June 2011).

For the semester:

- Corridor East revenues have grown by 4.8%, resulting mostly increased yields (+2.7%). Ridership is similar to last year, but passenger-miles increased (+2.0%) reflecting the growth on end-to-end markets.
- Revenues in SWO have increased by 6.7% also as a result of higher yields (+4.9%) and passenger levels.
- Eastern Longhaul revenues have grown by 1.9% due to the increased yields (+5.7%), partly offset by the decline in ridership, reflected in the decrease of 3.0% in passenger-miles compared to last year.
- Revenues on the Canadian are 6.3% above last year's levels, due to the combination of yields (+3.9%) and ridership.
- Mandatory Services have generated lower revenues, a direct impact of the interruption of the Victoria-Courtenay service since April 2011 (busing service offered until the end of June 2011).

2. HIGHLIGHTS OF OPERATING RESULTS
b) Operating Expenses

	For the quarter ended June 30				For the semester ended June 30			
In Millions of Canadian dollars	2011	2010	Var $	Var %	2011	2010	Var $	Var %
Compensation & Benefits	47.8	49.8	(2.0)	-4.0%	102.2	105.9	(3.7)	-3.5%
Train Operations & Fuel	31.3	28.8	2.5	8.7%	60.7	57.4	3.3	5.7%
Other operating expenses	50.1	51.8	(1.7)	-3.3%	102.2	103.3	(1.1)	-1.1%
Unrealized loss (gain) on derivative financial instruments	3.7	0.7	3.0	n/a	(0.3)	(0.1)	0.2	200.0%
Realized loss (gain) on derivative financial instruments	(1.6)	1.7	(3.3)	-194.1%	(2.8)	3.5	(6.3)	-180.0%
Total Operating expenses before pension costs, amortization of deferred capital funding & Corporate Tax expense	131.3	132.8	(1.5)	-1.1%	262.0	270.0	8.0	-3.0%
Pension Costs - Employer contributions	9.7	7.2	2.5	34.7%	21.7	12.0	9.7	80.8%
Total Operating expenses before amortization of deferred capital funding & Corporate Tax expense	141.0	140.0	1.0	0.7%	283.7	282.0	1.7	0.6%
Corporate Taxes	(3.8)	0.1	(3.9)	n/a	(3.7)	0.2	(3.9)	n/a
Total Operating expenses before amortization of deferred capital funding	137.2	140.1	(2.9)	-2.1%	280.0	282.2	(2.2)	-0.8%

For the quarter:

- Operating expenses before pension contributions, amortization of deferred capital funding & Corporate tax expense decreased by $1.5M and total $131.3M for the quarter, mainly due to reductions in compensation and benefit costs, the gain realized on derivative financial instruments and other operating expenses including employee future benefits and maintenance material costs. These reductions were partly offset by increases in train operations and fuel expenses, as well as to an unrealized loss on derivative financial instruments.
- Fuel prices increased versus the previous year but the increase was offset by the gains realized on derivative financial instruments purchased through the Corporation's hedging policy. The Corporation realized a gain of $1.6M for the quarter, compared to a loss of $1.7M for the same period last year.
- The Corporation generated a credit of $3.8M in Corporate taxes, compared to an expense of $0.1M for the second quarter of 2010. The credit stems from a tax refund received for prior years' taxes.

For the semester:

- Operating expenses before pension contributions, amortization of deferred capital funding & Corporate tax expense decreased by $8.0M and amount to $262.0M. The decrease results primarily from reductions in compensation and benefits costs, maintenance material costs as well as the gains realized on derivative financial instruments. They are partly offset by increases in train operations and fuel expenses.
- Fuel prices increased versus the previous year but the increase was offset by the gains realized on derivative financial instruments purchased through the Corporation's hedging policy. Gains of $2.8M were realized during the semester, compared to a loss of $3.5M incurred in the same period last year.
- The Corporation generated a credit of $3.7M in Corporate taxes, as compared to an expense of $0.2M for the second quarter of 2010. The credit stems mainly from a tax refund received for prior years' taxes.

3. CAPITAL INVESTMENTS

Fixed assets (net of accumulated depreciation) amount to $1,051.5M, up $86.2M compared to the balance as at December 31, 2010. Capital investments for the quarter totaled $54.5M, and $110.3M for the semester.

- Investments of $33.0M were made in major infrastructure projects, mostly on the CN Kingston subdivision between Toronto and Brockville. On a year to date basis, investments total $59.5M. Work is done to add sections of a third track between Toronto and Brockville to minimize congestion.
- A total of $15.3M was invested in major equipment projects, including $4.7M for the LRC car fleet rebuild project, and $6.6M for the F40 locomotive fleet rebuild project. After 6 months completed this year, a total of $37.3M was invested in major equipment projects.
- Investments of $3.3M were also made in Information Technology projects during the quarter, bringing the cumulative investments to $6.0M for the semester.

4. CASH FLOW AND FINANCIAL POSITION

For the quarter:
Cash position increased by $0.8M in the second quarter of 2011 versus and increase of $20.5M for the same period in 2010 due mainly to the investment in Property, Plan and Equipment.

For the semester:
Cash position decreased by $59.2M in the first semester of 2011 versus and increase of $18.4M for the same period in 2010 due mainly to a reduction in Deferred Government Funding of $51M and to the investment in Property, Plan and Equipment of $29M.

The reduction in cash position since December 31, 2010 stems from the investments made in property, plant and equipment ($137.0M), and cash used for operating activities ($48.7M), partly offset by the funding received. The Corporation received $110.3M of capital funding from the Government of Canada during the semester.

5. RISK ANALYSIS

A) OPERATING FUNDING

VIA continues to face operational funding challenges. The Corporation is pursuing the development and the implementation of a range of initiatives to reduce its deficit by reducing costs and increasing revenues. Furthermore, VIA continues to work with Transport Canada to address the challenge of operating loss and develop sustainable funding solutions.

B) CAPITAL FUNDING

VIA will need to continue investing in equipment, stations, maintenance systems, facilities and information technology after 2011, when the current investment program is completed. The Corporation is working with Transport Canada to address ongoing capital funding requirements, and to ensure that VIA has the capital funding it requires to deliver on its mandate.

C) CROSSING INCIDENTS

VIA's trains operate through many protected and unprotected level road crossings where vehicles can cross and where incidents/accidents could occur. VIA's managers have developed a crossing protection/fences and closure program and work actively with communities and owners of the land where there are crossings. The objectives of the program are to close crossings where possible and to increase public awareness about the potential dangers they represent.

D) PENSION PLANS

Pension plans liabilities continue to represent a significant risk to the Corporation due to their size ($1.6B). Adverse investment returns and changes in interest rates can materially impact the funding status of the plans, and directly amplify the volatility in annual funding requirements. In recent years, the Corporation has implemented measures to mitigate this risk such as adjusting certain management practices and by aggressively reducing pension administrative expenses. The Corporation continues to explore means of further reducing this significant corporate risk.

E) RETIREMENT OF LOCOMOTIVE ENGINEERS

VIA is dependant on the specialized set of skills of the engineers who operate its locomotives. More than half of VIA's locomotive engineers could retire by the end of the year 2015, and if VIA were to experience a substantial turnover in its locomotive engineer group, its business could be adversely affected. The Corporation therefore launched, in December 2010, a training program for new locomotive engineers, with the first class scheduled to graduate in 2012. Two additional classes will start in 2012, for graduations in 2012 and 2013.

F) PASSENGER REVENUES

Following a sharp decline in travel markets in 2008, growth in ridership and revenues slowed compared to previous years. VIA continues to implement initiatives to mitigate the impact of slow growth in passenger revenues. These include optimizing train services between Montreal, Ottawa and Toronto, and generating additional revenues from real estate projects and through information technology improvements that support revenue management initiatives.

G) FUEL COST FLUCTUATIONS

Fuel is a major cost for passenger rail operations, and fuel costs could vary significantly from VIA's estimates due to the uncertainty and volatility of fuel prices. VIA's proven hedging strategy adds certainty to future fuel costs and can delay the impact of fuel price fluctuations. Given that contracts used to hedge fuel prices are denominated in U.S. dollars, VIA also hedges against foreign exchange risks.

H) CAPITAL INVESTMENT PROJECTS

Major delays in infrastructure or equipment projects, or an increase in project costs would adversely affect VIA's financial performance. VIA's managers monitor the progress of all projects closely in order to mitigate this risk, adjusting production timelines as needed to keep projects on track. In addition, VIA's Executive Capital Steering Committee meets regularly to discuss the status of all capital investment projects.

I) RE-PROFILING OF CAPITAL FUNDS

In 2007, Treasury Board approved a capital investment program of $516 million which was later re-profiled within the 2007-2013 government fiscal years. If major delays were experienced in the infrastructure or equipment projects and completion date was beyond 2013, re-profiling of capital funds allocated to these projects would be required. Historically, re-profiling of funds which were justified were approved, and VIA's Executive Capital Steering Committee meets regularly to monitor and discuss the status of all capital project.

6. OUTLOOK

VIA's Corporate Plan expressed confidence in achieving revenue growth and higher productivity in 2011. The results of the second quarter indicate that the corporation is on track to achieving these goals, as well as showing a return to growth in ridership.

VIA remains committed to the goals set out in the Corporate Plan for 2011. Marketing strategies will continue to focus on maintaining and building on ridership gains achieved this year. Lean management initiatives and a focus on productivity throughout the organization will help to ensure continuous improvements in efficiency.

As capital investment projects are completed in the coming months and in 2012, VIA will ensure that passenger rail delivers better value, to more Canadian travellers, while maintaining rigorous control over operating costs.