



## MESSAGE FROM THE PRESIDENT TO SHAREHOLDERS

### Leveraging the strong potential of the tourism market

During fiscal 2010, the foundations were laid for an economic recovery that has been slow getting off the ground and very unequal from one market to another. International tourism demand has nonetheless been restored following the downturn of 2009. For Transat, volumes remained solid, but as in past years, demand was in part driven by particularly attractive sale prices, which exerted downward pressure on our margins for the winter season and on the French market. The process-optimization and cost-reduction measures implemented over the last few years, however, helped us post results that, all in all, are satisfactory under the circumstances—further proof of the soundness of these measures.

The past year has been an atypical one. During the winter season, our results are strongly dependent on travel to sun destinations outbound from Canada. This market is extremely competitive, however, because for several years now, capacities offered at the start of the season have tended to largely exceed demand—even though the latter is particularly strong. In response, this past year we took the exceptional step of reducing our inventory at the start of winter, which led to significant disruptions in scheduling, operation and distribution. Unfortunately, the hoped-for benefits—higher prices and margins—failed to materialize, because our competitors quickly moved to fill the void we had left. As a result, we had a disappointing first six-month period. Then, in the second half of the year, with some predicting a difficult period on the transatlantic market, we had the best summer in our history, thanks especially to the outstanding performance of the teams responsible for this segment, including those at Transat Tours Canada, Vacances Transat (France) and Canadian Affair.

For fiscal 2010, we posted sales of \$3.5 billion, a 1% decrease from the previous year; a margin of \$127.6 million, versus \$93.4 million for 2009; and net income of \$65.6 million (\$1.74 per share), compared with \$61.8 million (\$1.86 per share) for 2009. Note that the results for both periods include non-cash and non-operating items. With these items excluded, our adjusted net income was \$53.7 million in 2010 (\$1.41 per share), a clear improvement over the 2009 result of \$33.7 million (\$1.01 per share). Note also that Transat's margin suffered by some \$4 million due to the disruptions to air traffic in the wake of the Eyjafjallajökull volcano eruption in Iceland.

As we begin 2011, the outlook seems bright, despite challenges that cannot be ignored, and uncertainties linked to ongoing changes affecting the industry. Forecasts by the UN World Tourism Organization and the Conference Board of Canada, among others, point to a trend of long-term growth for international tourism, propelled by factors such as demographic expansion. Transat possesses the right skills, resources and organizational structure to leverage this potential, and so we embark on this new year with our usual blend of caution and optimism.

## **The outgoing Canadian market**

Transat Tours Canada (TTC), which operates mainly under the brands Transat Holidays, Nolitours and Air Transat, had an arduous winter season. The decision to adjust inventory downward led to a slight decrease in passenger numbers, while oversupply remained, causing sales prices to plummet. We therefore posted a drop in sales and a loss, due also to the impact of our hedging operations. The cost-reduction initiatives rolled out over the past few years and at the start of the season, however, helped contain the damage. Results were much better in the second half, thanks to increased volumes, prices and margins in the transatlantic market. Indeed, Transat is by far the most active tour operator in that market, with an unmatched, powerful presence that is perfectly tailored to tourism: approximately 70 direct routes linking Canada to some 30 European cities.

In 2009, we entered into a five-year agreement with the Canadian-based carrier CanJet Airlines for chartering of Boeing Next Generation 737-800 narrow-body jets on sun destination routes. We began using those aircraft in summer 2009, but the operational break-in period truly began in the first quarter of 2010. Performance was unfortunately not up to our expectations, due in part to the scheduling changes imposed by Transat, but we have taken the necessary measures to improve the situation for winter 2011. Those difficulties notwithstanding, the agreement with CanJet Airlines has considerably strengthened TTC's position on the sun destinations market and had a positive impact on our 2010 results.

We continued implementing the Air Transat fleet renewal plan. A fifth Airbus A330 entered service in the fall of 2009, three more followed during 2010, and we have made arrangements to add three more aircraft of the same type by the fall of 2011. An initial Airbus A310 was withdrawn from the fleet in the fall of 2009, and another in the fall of 2010. The remainder will be withdrawn gradually, or may be retained as part of special agreements with the lessors, with application of substantially lower lease prices. Operating a fleet consisting mainly of a single aircraft type, the A330, will allow us to lower our operating costs as well as reduce per-passenger greenhouse gas emissions.

Air Transat recorded one of its best-ever years for flight on-time performance and reliability, with results again superior to the average. In-flight amenities, including meal service, were improved, and periodic customer satisfaction surveys continue to confirm the extremely high calibre of Air Transat's overall performance.

A relaunched Air Transat Cargo, which began offering expanded services in November, now transports cargo from Canada to all destinations served by Air Transat, but also to other destinations around the world, pursuant to agreements with some 30 air carriers and a network of representatives in 50 countries.

In Canada, more than 30% of our sales are made through our distribution network and our websites. Transat Distribution Canada (TDC) continues to assert its presence from coast to coast, and comprised 464 agencies, including 368 franchises, as of October 31, 2010. TDC posted excellent results in 2010.

## **The outgoing European market**

Outbound travel from France recovered after a difficult 2009, though the market remains somewhat depressed. Demand on long-haul routes, which had declined sharply and severely affected our results in 2009, rebounded. The medium-haul market, however, suffered from hesitant demand, despite the fact that it had fared remarkably well the year before, notably in the case of Look Voyages. The abundant supply in this market created an imbalance that led to lower prices and margins.

As for travel between the United Kingdom and Canada, a very important market for Transat, we logged excellent performance in both directions, consolidating our position as the leading tour operator, in the face of competition that came essentially from the air carriers.

In the wake of the 2009 creation of Transat France (a structure that groups our two tour operators' Finance, Legal, Information Systems, Human Resources and, as of 2010, Communications departments), we continued implementation of our distribution strategy. This included the sale, with satisfactory conditions, of 20 travel agencies, and the retention of 40 agencies, which now operate under the Look Voyages banner. In November 2009, Transat France became a partner of reference of AS Voyages, France's biggest travel distribution network with more than 1,200 agencies, including those of Look Voyages since January 2010.

In 2010, Transat entered into a three-year agreement with Transavia France, an air carrier founded by the Air France / KLM group, under which Transat France charters narrow-body Boeing 737-800 aircraft, mainly for its destinations in the Mediterranean Basin. With this agreement, Transavia France became the air-carrier partner of choice of Vacances Transat (France) and Look Voyages, which serve nearly 600,000 customers per year, a good percentage of whom board medium-haul flights to Mediterranean Basin destinations. The agreement will enhance and strengthen our offer, much like the agreement we reached with XL Airways, which uses one of Air Transat's aircraft to serve our France-based tour operators during the winter season.

### **A new outgoing market: Mexico**

During the year, Transat began activities in a new source market, setting up operations in Monterrey, Mexico, under the Eleva Travel banner. Since the summer of 2010, Eleva Travel has offered Mexican travellers a variety of package products within their country (Cancún, Puerto Vallarta, Acapulco) as well as in the United States (Las Vegas). Eleva Travel will gradually add other destinations, including Canada, which is a popular choice for Mexicans.

Mexican tourism demand is concentrated on domestic destinations, and is highest during summer. Cancún and Puerto Vallarta attract more than two million Mexican travellers, the majority of them between April and September. Transat was already present in the incoming tour market in Mexico, and had existing agreements and business relationships with several hoteliers in the two destinations.

The creation of Eleva Travel will, of course, allow us to diversify our revenue streams. But it will also have positive spinoffs for our outgoing tour operators in Canada, our incoming tour operator in Mexico, and our hotels along the Riviera Maya, bolstering our presence at destination.

## **Incoming markets and destination services**

Despite vigorous demand for international tourism in 2010, Canada experienced another difficult year as a destination country. Jonview Canada, the leading incoming tour operator in the country, nevertheless posted very good results last year after a challenging 2009: our business unit welcomed more than 236,000 passengers to Canada, an increase of 14.6%, and improved its profitability. The upturn was mainly attributable to the British and French markets. However, the strong Canadian dollar combined with the introduction of the harmonized sales tax in Ontario and British Columbia are now hampering development of tourism to Canada and compounding existing industry difficulties. In 2010, we made representations to the federal government, insisting on the need for changes to Canada's tax regime to improve the country's ability to compete with other destinations.

A major renovation project has been completed in one of our Mexico hotel complexes, and everything is in place for our establishments to benefit from the coming recovery, notably along the Riviera Maya.

## **Corporate responsibility**

Jointly with our employees and partners, we are continuing our efforts to make Transat one of the most responsible players in the mass tourism industry. We intend to build more dynamic relationships with stakeholders, and adopt forward-looking corporate responsibility practices while encouraging our partners to do the same, with a principal objective being to ensure the longevity of the assets essential to tourism development. This is in the common interest of shareholders, employees, customers, partners and communities.

In 2010, we developed and implemented a dashboard tool that will guide us in our approach to corporate responsibility by monitoring progress toward achievement of 10 objectives, with 52 related priorities and targets.

Transat is especially proud to have signed a partnership agreement with the Canadian-based NGO Beyond Borders to combat the sexual exploitation of children in tourism. Transat had previously made this issue one of its core concerns in June 2008, when we adopted our policy on sustainable tourism.

In November 2010, Transat received a World Travel Market Global Award in recognition of its efforts in sustainable development. This international recognition reflects on all of our employees, and especially on all those who have focused directly on this issue as part of their daily tasks. The award is an incentive to keep up the good work.

With regard to human resources, over the past year we continued our efforts at skills upgrading and implementing a dynamic succession, building on the solid foundations laid in recent years. For obvious reasons, we paid particular attention to training in the area of change management. The training program for front-line managers has been enriched with new modules. We also renewed a

finely targeted, accelerated training program built around a Web tool that promotes periodic interaction between executives and participants, with the goal of ensuring sustained, documented progress. Lastly, we revisited our incentive compensation and group insurance programs with an eye to enhancing the company's attractiveness as an employer and to build employee loyalty.

## Looking ahead to 2011 and beyond

While demand for tourism is showing very encouraging signs of progress over both the short and long terms, the market is still changing and regularly bringing new challenges. In the last two years, for example, scheduled carriers have sent signals that they could be in the tourism market for the long run, having long been content to make only sporadic incursions. The result is an industry where two distinct operating models rub shoulders: that of tour operators and that of airlines. This makes designing and implementing commercial strategies more complicated still. And, of course, the tenacity of the traditional competition shows no signs of abating.

There are other drivers of uncertainty at work. First, tourists' tastes and expectations continue to evolve and diversify. Second, consumers are becoming more powerful each day with new tools available to plan holidays, rate service providers' performance and share information among themselves. And the Internet doubtless holds yet more untapped possibilities that will become either challenges or opportunities for market players, depending on how much vision and imagination they are able to muster.

It is against this backdrop that we look ahead to 2011 with relative optimism, and are actively working in three areas to prepare Transat for the future.

- With regard to commercialization in the broadest sense, we will continue to move the organization forward with an eye to presenting a more flexible product offering. Steering this transformation will involve, among other things, a renewal of our product strategy as well as upgrading of our information-management systems, which has been underway for several years and is progressing as planned. In 2011, we plan to invest \$21 million in technology capital expenditures. We must also refine our marketing strategy, continue expansion of our distribution network and, of course, implement increasingly more effective business processes.
- In addition, we have begun a strategic rethinking of our brand and customer experience. The goal is to improve our potential for differentiation, enhance customer-experience quality, and channel the energies of our teams in a clearly defined direction so as to propel Transat into a class by itself on the worldwide leisure travel market.
- Finally, growth remains a priority, of course. This includes going the acquisition route, when interesting targets become available and conditions are propitious. Our main intentions are to diversify our source markets by penetrating other national markets, increase our market share in Ontario (Canada's largest regional market), and continue integration, strengthening our presence in the incoming segments of our principal markets (notably in southern Europe and northern Africa) and in the hotel sector.

As we enter 2011, Transat is well positioned, both strategically and financially. Our organization has made significant efficiency and flexibility gains, we are doing a good job of controlling our costs, and our financial structure is sound.

In June 2010, we announced the appointment of W. Brian Edwards as an independent director of the Company. Mr. Edwards is the founder of BCE Emergis, which has grown into one of North America's premier e-commerce companies, and is a seasoned administrator. His strong skills and recognized experience will be significant assets to Transat and its shareholders.

I express my gratitude to all members of our personnel, the management team and the Board of Directors for their contribution and their determination to make Transat into an exemplary company across the board. I also thank our shareholders for their continued confidence. We remain solidly on course for success, and I can assure you that, as we stand on the cusp of the year 2011, Transat has all the necessary assets to get there.

Jean-Marc Eustache  
Chairman of the Board  
President and Chief Executive Officer

December 15, 2010