Annual Report

Transat A.T. Inc.

2006

Transat A.T. Inc. is an integrated international tour operator that specializes in holiday travel. It offers more than 60 destination countries and distributes products in approximately 50 countries. Transat owns an air carrier, offers destination services and operates an extensive distribution network. The Company has a dedicated team of thorough and efficient people who deliver quality vacation travel services at affordable prices to a broad customer base.

# Highlights

Revenues totalling $2.6 billion and net earnings of $65.8 million, compared with $2.4 billion and $55.4 million respectively in 2005.

Strengthening of our presence in Ontario and Western Canada with the acquisition of 191 travel agencies.

Entry into the outgoing British market with the acquisition of The Airline Seat Company (Canadian Affair) for a total cost of $43.7 million.

Increase in our French sales and financial recovery for Look Voyages in France, which posted a profit in 2006.

Repurchase of shares totalling $125 million and introduction of a quarterly dividend.

| (In thousands of dollars except amounts per share) | 2006 | 2005 |
|---|---|---|
| Revenues | 2,603,746 | 2,364,481 |
| Net income | 65,770 | 55,416 |
| Diluted earnings per share | 1.85 | 1.33 |
| Cash and cash equivalents | 214,887 | 293,495 |
| Cash flows relating to operating activities | 113,279 | 74,156 |

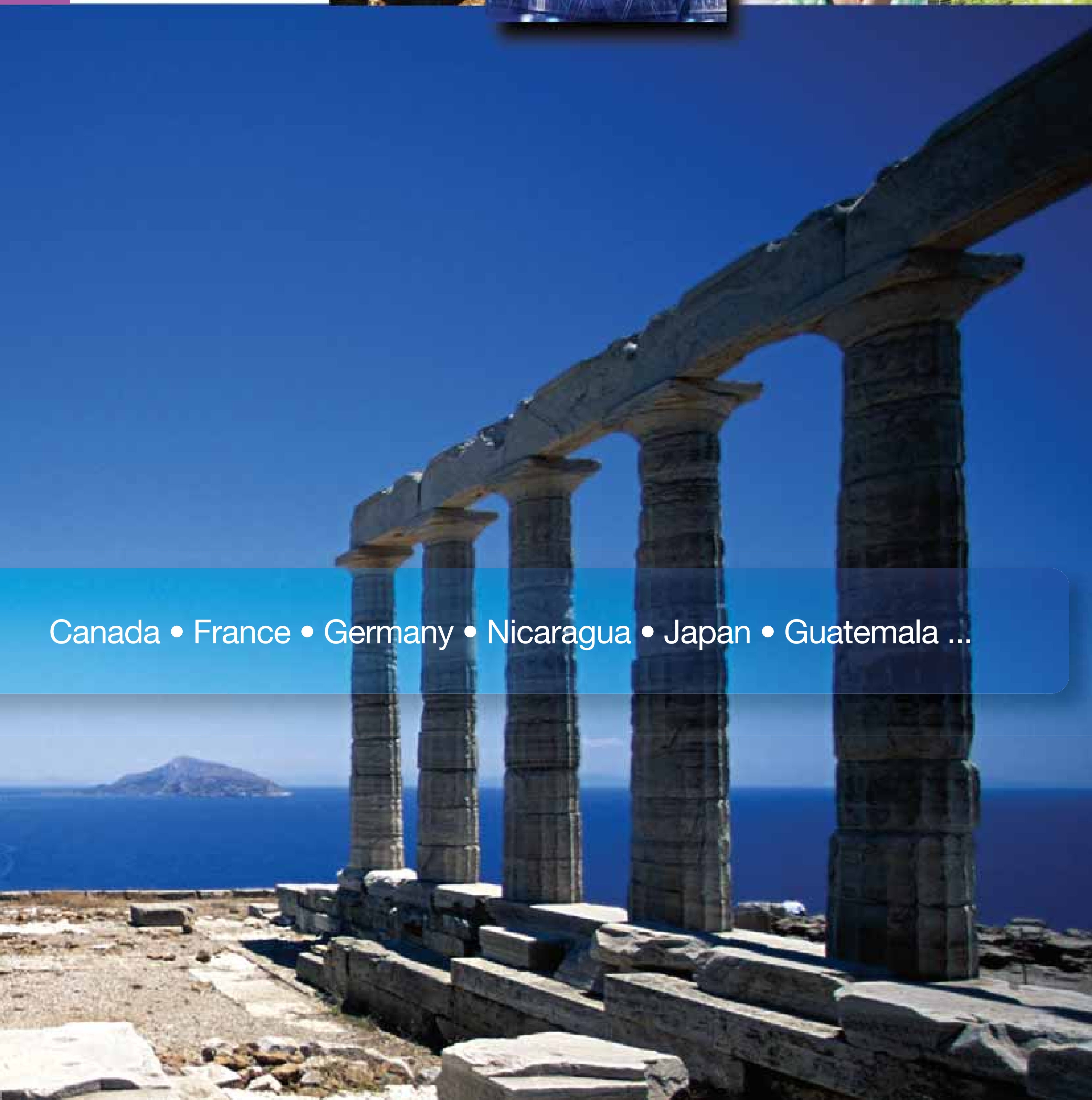
*In 2007, Transat turns 20. Established in 1987, it now ranks among the largest integrated tourism companies in the world. www.transat20.com.*

# there

*More than 60 countries for rest or discovery*



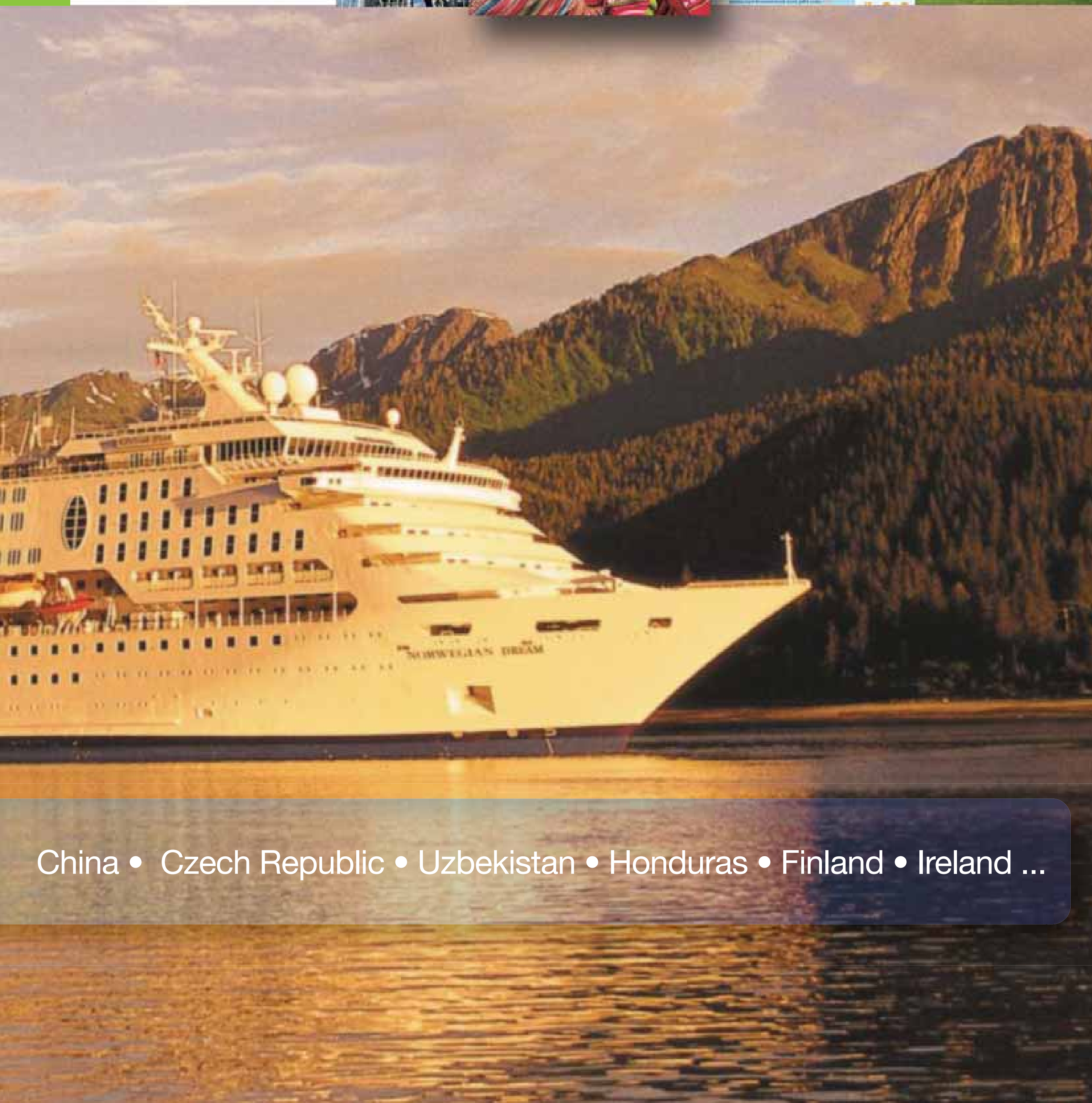



Canada • France • Germany • Nicaragua • Japan • Guatemala ...

# your way

*Cruises, individual or group tours, all-inclusive, air only...*

Austria • Thailand • Argentina • United Kingdom • Tanzania • Spain •


China • Czech Republic • Uzbekistan • Honduras • Finland • Ireland ...

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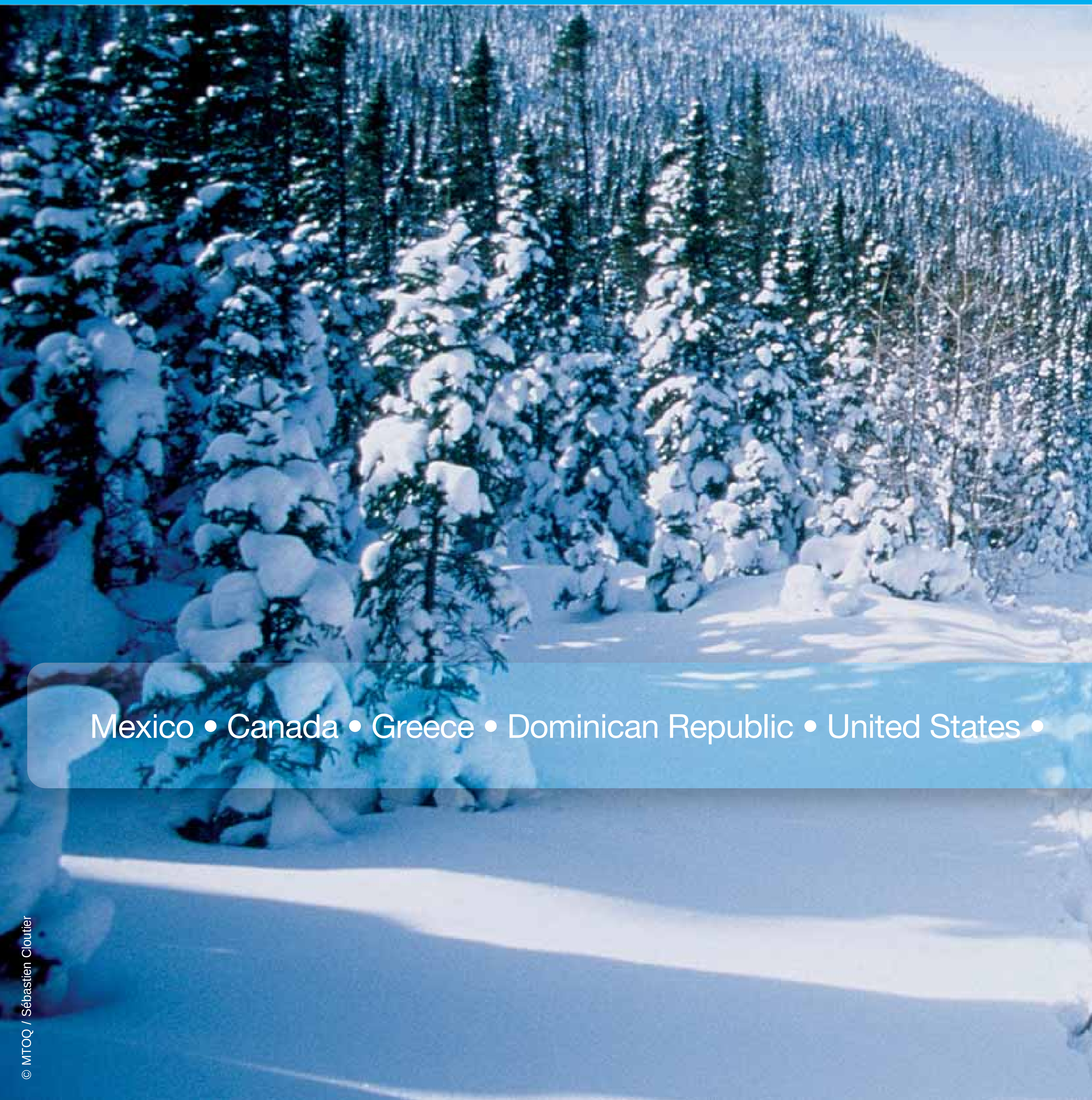
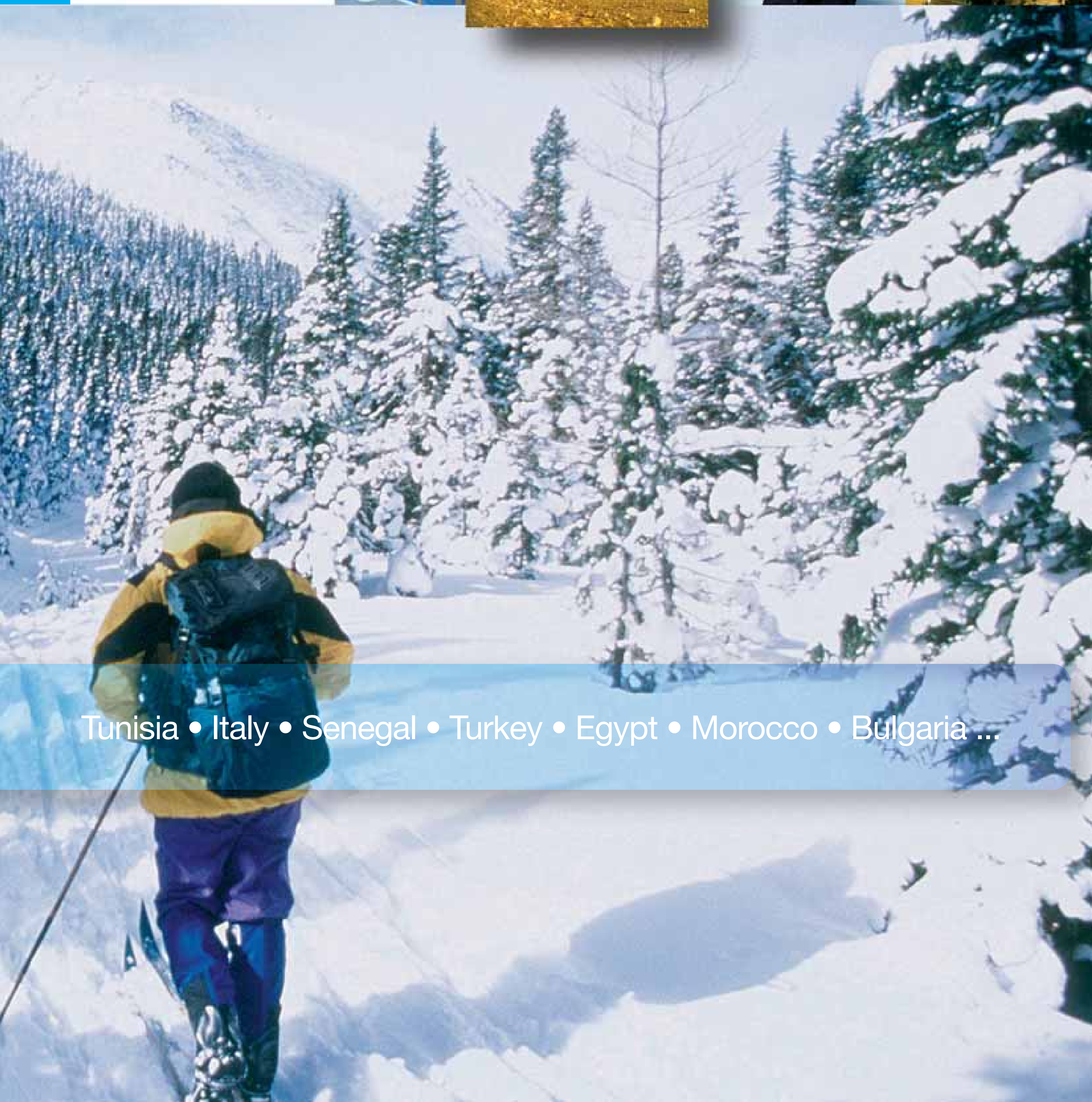
*For a memorable experience, you will find us in the field*




Tunisia • Italy • Senegal • Turkey • Egypt • Morocco • Bulgaria ...

# *Message to Shareholders*

## A year marked by growth and expansion in a vibrant market

Given the challenges that the industry has had to face, 2006 proved to be an excellent year for Transat. We grew our sales, turned in an enviable financial performance, made progress with the implementation of our strategic plan and increased our size. We are more focused than ever on holiday travel and offer packages, tours or flights to over 60 destination countries. We market products in approximately 50 countries, primarily in Canada, France and the United Kingdom.

The tourism market has remained buoyant in spite of certain unforeseen events, such as Hurricane Wilma, which considerably affected the winter season of travel from Canada and France to Cancùn, Mexico.

Travel is growing steadily; however, international tour operators, already dealing on a day-to-day basis with fierce competition, must also adapt to a changing landscape, as tourists originate from increasingly diversified countries, rely more and more on the Internet, wait until the last minute to book their trips and select ever-more-varied destinations.

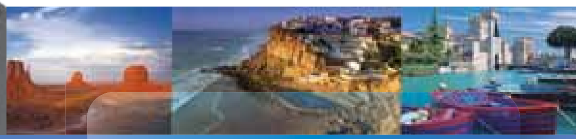
### Winter 2006 in the outgoing Canadian market

The outgoing Canadian market was active in winter 2006. Our two main tour operators, Transat Holidays and Nolitours, operated by Transat Tours Canada, generally increased their customer bases. Still avid sun-seekers, Canadians remained loyal to all-inclusive packages, by far our star product during the winter. In this respect, we maintained our leadership position with the most diversified range of products and services in Canada, not only in terms of destinations (more than 30 in approximately 15 countries) and hotels (over 300), but also in terms of gateways. In fact, the combined use of Air Transat’s wide-bodied aircraft and other carriers has enabled us to offer departures from 22 Canadian centres.

Transat Tours Canada's main brands represent distinct product ranges and tailored distribution strategies. Nolitours offers all-inclusive packages to sun destinations. Travel agents get lower commissions while Nolitours makes significant marketing efforts to reach consumers. Nolitours products can also be purchased on-line. Transat Holidays offers both all-inclusive South destinations as well as European destinations, with a focus on more exclusive and superior hotels. Transat Holidays also offers the finest cruise itineraries from the world’s leading cruise lines. Products are available through travel agency networks across Canada and product information can be found on-line.

In 2006, Transat Tours Canada implemented a regional sales structure and a national marketing organization working on an integrated basis for Transat Holidays and Nolitours. This new approach will help enhance our marketing efforts.

On a different front, we have introduced electronic tickets and other travel documents to replace paper copies. This move will help reduce costs and save time.



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

The most significant business factor remains the intensity of competition, primarily in Ontario, and the resulting pressure on margins. Although demand is on the rise, supply is also growing, due in part to weakening industry barriers to entry. Given these circumstances, tour operators have to remain very attentive and focused on the introduction of new destinations and exclusive hotels, prices, marketing, quality of service and customer satisfaction.

The cruise market, although smaller than the market for all-inclusive packages, is growing faster than the tourism market as a whole. The major shipowners with which we work are adapting rapidly and offer an increasingly diverse range of activities. Our distribution network and our air capacity between Canada and Florida, among other factors, have enabled us to become one of the leaders in this market in Canada.

### Summer 2006: the Canada-Europe transatlantic market

Although we are maintaining significant capacity between Canada and sun destinations, our direct flights between Canada and some 30 European destinations represent the bulk of our summer business. In Canada, we offer a wide range of packages, tours (both escorted and independent) and other travel services to people visiting Europe; our tour operators and partners in Europe market similar services for Canadian destinations. Our transatlantic customer base grew in 2006.

Canada-UK routes represent the largest Canada-Europe market segment, and competition is especially fierce. In August 2006, we acquired our main competitor on that market, the British tour operator The Airline Seat Company, better known under the Canadian Affair brand. This is the first time since 1987 that we are entering a new market as an established outgoing tour operator, and this acquisition, which represents a total cost of $43.7 million, is a direct outcome of our strategic plan adopted in 2005. The combined striking force of Transat and Canadian Affair represents a potential capacity of 400,000 seats between Canada and the United Kingdom, up by approximately 200,000. We are therefore better positioned to operate these highly coveted routes in the summer of 2007.

The acquisition of Canadian Affair is also strategic because it is enabling us to significantly upgrade our distribution network in the United Kingdom. Whereas for many years we relied exclusively on a single wholesaler to sell our products, we are now benefiting from a multi-channel system that will expand our reach by 2007: we will be able to market our seats through Canadian Affair (which has a remarkable 80% direct-sale rate, including 50% online), on our UK websites, directly to travel agencies thanks to our B2B Internet platform and the airline industry's global distribution systems (GDS), or through other tour operators under non-exclusive agreements.

In the summer of 2006, we introduced a new route to Spain (Madrid) from Toronto and Montreal with a complete program of escorted and independent tours, accommodation packages and excursions. This new destination proved to be as successful as expected and we will move forward with other new destinations, including in Spain.

As of 2007, our Canadian departures toward Europe will be marketed entirely by Transat Holidays; the objective of this move is to fully capitalize on growing awareness of our brand.

### Canadian distribution network

Although the vast majority of Canadian vacationers still prefer to deal with a travel agency, direct sales are up, as an increasing number of travellers are turning to call centres or websites. Sales on airtransat.com, for example, have increased significantly in 2006.

Transat is consequently developing an enhanced, multi-faceted approach to meet the preferences of all customers. We are entering an era of multi-channel distribution and the challenge is to ensure that many distribution strategies blend smoothly.

In accordance with our three-year strategic plan, we have significantly strengthened our presence on the Canadian market with the acquisition of 191 Marlin Travel and Thomas Cook travel agencies, primarily in Ontario and Western Canada, at a total cost of $8.3 million. We have thus become the largest network of travel agencies in Canada and increased the number of our outlets in Ontario—the largest regional market in the country—to close to 140, compared to fewer than 60 prior to the acquisition. The new travel agencies, about 20 of which offer foreign exchange services, will all operate under the Marlin Travel banner.

The acquisition, completed in May 2006, paved the way for the reshaping of our Canadian distribution network, now known as Transat Distribution Canada (TDC). Headed by Philippe Sureau, TDC is in charge of all retail distribution in the Canadian market. TDC's main objective in 2007 will be to increase the sale of Transat products through agencies. With this in mind, we launched a new Internet platform in fall 2006 aimed at customers of the Club Voyages banner. It cleverly combines a national website and sites specific to local travel agencies, and meets the expectations of both travellers and agencies.

In 2006, Transat Tours Canada introduced Agent Direct, a new Web-based platform geared toward travel agencies. This latest-generation B2B tool, which is highly user-friendly and efficient, enables our tour operators and all travel agencies that sell our products to work together online. The implementation work will continue in 2007 with the addition of new functions.

### Our air transportation subsidiaries: Air Transat and Handlex

On the Canada-Europe and Canada-sun destination routes, Transat fulfils approximately 85% of its airline seating requirements through its wholly owned subsidiary Air Transat, which is still the largest international charter specializing in holiday travel in Canada. Our tour operators rely on other carriers, primarily WestJet, with which we have an agreement valid until October 2007, to cater to the remaining 15%. In the summer of 2007, we will also be using Thomas Cook Airlines and My Travel Airways for flights between Canada and the United Kingdom, as both of these airlines are partners of Canadian Affair. In France, our tour operators use Air Transat and several European carriers.

At the end of 2006, Air Transat was operating 15 Airbus aircraft (4 A330s and 11 A310s). A 16th aircraft will join the fleet in 2007.

The performance of our carrier in 2006 was remarkable on all fronts. The company recorded on-time performance and fleet reliability rates among the best in the industry. Surveys indicate that customer satisfaction remains very high. Air Transat once again improved the scope of its services with the official launch of its Kids Club, which offers a range of services geared specifically toward families. In addition, the Air Transat team is recognized for being at the leading edge of safety-management.

Tight control over operating costs continued to yield results. Following an in-depth review initiated in 2003, Air Transat developed and implemented a fuel-management program that helped reduce consumption (by approximately 5%), costs and greenhouse gas emissions.

Like all airline companies, especially in Canada, Air Transat incurs additional costs stemming from the increase in fees payable for the use of airport facilities and the introduction of increasingly complex security measures. Like other carriers, it is therefore seeking additional sources of revenue, including through the sale of optional services to travellers.

Handlex provides logistical support to Air Transat and more than 20 other carriers in Canada. The services provided include passenger check-in, baggage-handling, cargo, aircraft cleaning and ramp services. In 2006, Handlex signed new contracts and opened a third base in Vancouver, in addition to those in Montreal and Toronto.

## Our outgoing and incoming European tour operators

Our two main tour operators in France—Look Voyages and Vacances Transat (France)—posted revenue increases in 2006. The rate of the increases, higher than the tourism-market average, indicates gains in market share. Vacances Transat (France) posted a less considerable increase in revenue due to the impact that Hurricane Wilma had on Cancùn, Mexico, and the difficulties that France experienced introducing the new biometric passports required for entry into the United States.

Vacances Transat (France) remains the leading French tour operator to Canada and the United States, and offers a diversified range of destinations, including countries in South America, Africa and Asia. The operations of Bennett Voyages, which specializes in packages and tours to Scandinavian countries, the United Kingdom and Eastern Europe, and which we acquired in 2005, have been integrated within Vacances Transat (France).

Look Voyages had an excellent year. With the sale of air-only a thing of the past, we can now focus on our core product: holiday packages. Look Voyages is now referenced by the two largest travel agency networks in France. It has increased its product range, with more departures from more cities. A first-tier international tour operator in France, Look Voyages continues to focus on its Lookéa clubs, which numbered 17 in summer 2006. These resort clubs offer French tourists all-inclusive packages in a francophone environment in Mexico, the Caribbean, Africa and Europe.

Tourgreece, in Athens, is our only European incoming tour operator. Its products are distributed internationally through Transat and other tour operators, including into the United States, where we saw spectacular growth in 2006.

We have 72 travel agencies in France—38 under the Look Voyages banner and 34 under that of Club Voyages. The integration of the approximately 20 agencies acquired in 2005 has now been completed.

## The incoming Canadian market

In the incoming sector, Transat and the Canadian tourism industry face a transition period. The main markets from which Canada attracted its customers in the past, namely the United States and Western Europe, are showing signs of maturity. According to the data available, in 2005 Canada was the only country in the Americas that saw its foreign tourist numbers decline. This is largely attributable to the marked decrease in U.S. tourists who, under normal circumstances, account for approximately 75% of foreign visitors in Canada. Although the drop would appear to be partly caused by a decline in the destination's attractiveness and the rise in the value of the Canadian dollar, it is also due to insufficient government-sponsored promotional efforts, at a time of rising investments by competing destinations.

Jonview Canada remains the largest incoming tour operator in Canada with nearly 240,000 customers in 2006—a 6% increase that is quite remarkable given the market decline. Jonview offers its products in some 50 countries, not only in Europe—which is its main stronghold—but also in a growing number of emerging markets. Its efforts have yielded positive results, primarily in Latin America. The World Tourism Organization expects international tourism to continue growing and to originate largely from these new markets, which are clearly in our sights.

## Financial position

For fiscal 2006, we posted revenues of $2.6 billion and a margin of $126.9 million. Net earnings stood at $65.8 million, or $1.85 per share (on a diluted basis). In 2005, revenues amounted to approximately $2.4 billion, the margin reached $120.6 million, and the net earnings totalled $55.4 million, or $1.33 per share (on a diluted basis). Excluding a gain on disposal of an equity interest and the reversal of restructuring charges, 2005 earnings were $48.7 million, or $1.17 per share (on a diluted basis).

Once again, the year was marked by very high aircraft fuel prices. Our bill for this essential commodity increased more than 90% in two years, rising from $128 million in 2004 to nearly $200 million in 2005 and nearly $248 million in 2006, while revenues rose only 18% during the same period. We successfully offset part of the rise through hedging, which we pursue actively, and surcharges. The effects of the latter are limited, however, due to pressures on selling prices.

Transat remains in a healthy financial position. As at October 31, 2006, our debt had decreased and our cash position reached $214.9 million. We bought back approximately 1.8 million shares at $19.40 each through a $125 million substantial issuer bid closed on January 3, 2006, and we introduced a quarterly dividend.

## The 2006-2008 three-year strategic plan

The year 2006 was the first of the three-year strategic plan adopted in 2005. As previously stated, we have achieved some of the major milestones of this plan, namely our entry into the outgoing UK market, the expansion of our Canadian retail distribution network (in particular in Ontario), the introduction of new destinations, the launch of new technological platforms and the integration of companies and travel agencies acquired in 2005. In addition, we succeeded in bringing Look Vacances back into the black within the anticipated timeframe. In brief, 2006 was marked by decisive advances.

Besides the acquisitions and implementation of new systems, it is important to highlight that we have an increasingly clear vision of the multichannel distribution system that we are seeking to introduce, and we have made significant progress in that regard. The foundations of such a network are in place in our three key markets—Canada, France and the United Kingdom—and we continue to fine-tune the model, which we expect will play a crucial role in our long-term growth.

We plan to stay the course in 2007, especially in Ontario where we are aiming to grow our market share. In addition, our three main priorities are to establish ourselves as a tour operator in the United States, to enter the hotel sector at our sun destinations and to introduce a new growth strategy in Europe. We have also set several key information technology projects in motion, for which we have earmarked adequate resources.

## The contribution of the Transat team

The contribution of our employees in all our offices worldwide is crucial. We currently employ approximately 6,000 people. In 2006, the total value of our payroll and benefits amounted to approximately $290 million. We will continue to work relentlessly to build and maintain an organization which, in spite of borders, remains united, focused and loyal to our basic values: efficiency, teamwork and customer focus. In that respect, we have three major priorities, namely communication, training and succession management. Programs have been developed for each priority area and are overseen directly by the President and Chief Executive Officer. As an example, the Académie Air Transat, a partnership between Air Transat and Université de Sherbrooke, in Quebec, enables groups of employees to take management courses during business hours in the Air Transat offices.

We continue to provide financial assistance to a large number of organizations that are involved primarily in healthcare, the fight against poverty, teaching and culture. We supported the Red Cross during the crisis in Lebanon. Air Transat and its employees continued their partnership with the Children's Wish Foundation of Canada. In 2006, the support we provided to two teaching institutions was formally recognized. The language laboratory of the Institut de tourisme et d'hôtellerie du Québec and the Chaire de tourisme at Université du Québec à Montréal now bear the Transat name.

I would like to thank all our employees. Each of them plays a significant role in enabling the organization to grow and deliver a world-class product to our customers. I would also like to thank all the members of the Board for their loyalty and contribution.

Jean-Marc Eustache

Chairman of the Board
President and Chief Executive Officer
January 18, 2007

## OUTGOING TOUR OPERATORS

**Transat Tours Canada (TTC)**

Transat Holidays
Caribbean, Latin America and Mexico from Canada, Canada-Europe market and cruises

Nolitours
Caribbean, Latin America, Mexico and Florida from Canada

**Look Voyages**
Mediterranean Basin, Africa, Asia, Caribbean, Mexico, etc. from France, and Lookéa clubs

**Vacances Transat (France)**
Americas, Caribbean, Asia, Africa from France.
Tours in Eastern Europe, Scandinavia, Scotland, Ireland under the Bennett brand

**Brokair**
Group tours from France

**Canadian Affair**
British tour operator specializing in travel to Canada

**Rêvatours**
Eastern Europe, Asia, North Africa, etc. from Canada

**Merika Tours**
North American destinations from Canada

**Air Consultants Europe (ACE)**
TTC's representative in Germany, the Netherlands, Belgium, Luxembourg and Austria

## INCOMING TOUR OPERATORS AND DESTINATION SERVICES

**Jonview Canada**
Tours and packages to Canada

**Tourgreece**
Tours and packages to Greece

**Trafic Tours**
Excursions and destination services in Mexico

**Turissimo**
Excursions and destination services in the Dominican Republic

**Transat Holidays USA**
Destination services and travel agency in Florida

## RETAIL DISTRIBUTION

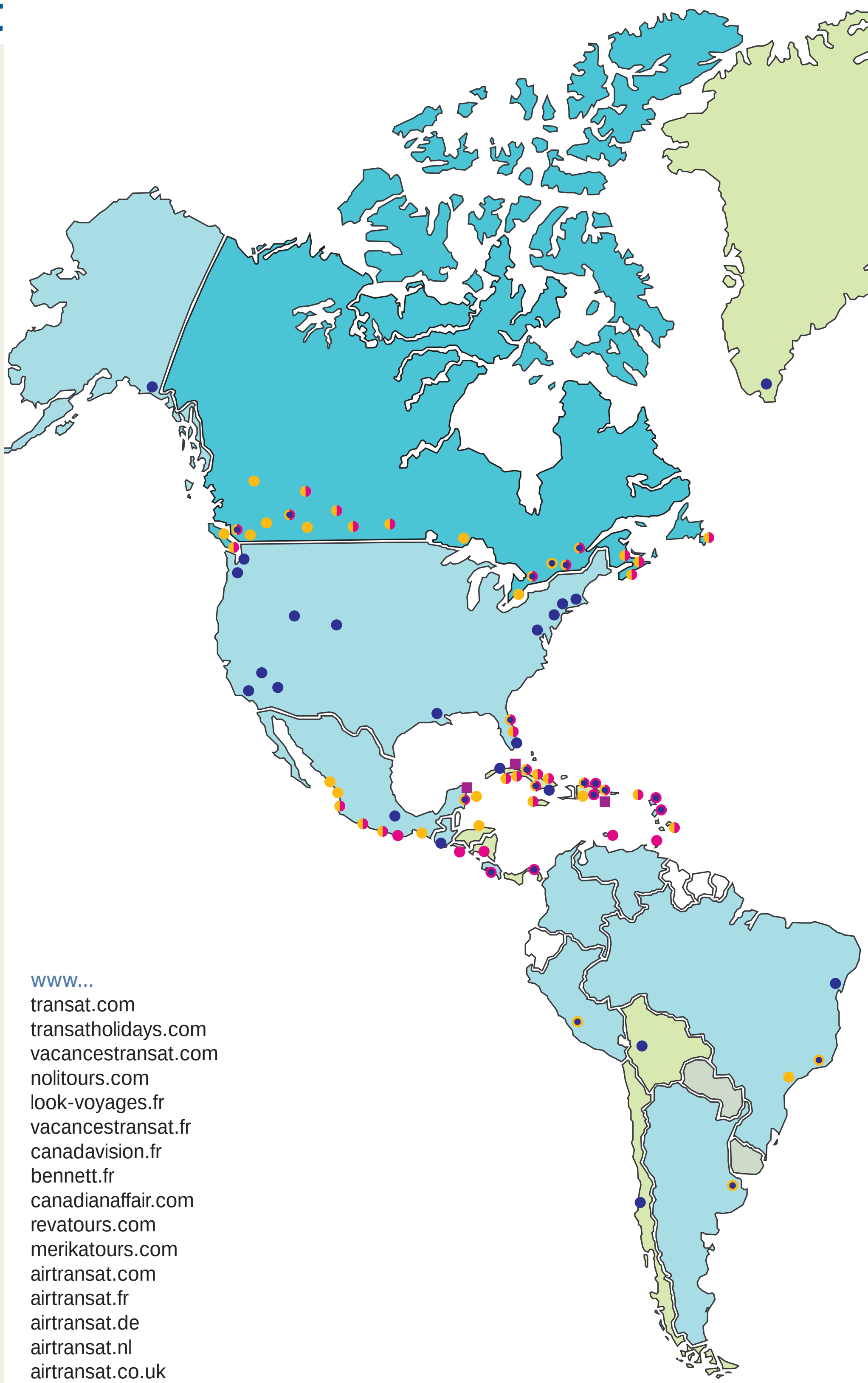
**Transat Distribution Canada**
More than 400 travel agencies in Canada (Marlin Travel, TravelPlus, tripcentral.ca, Club Voyages, Voyages en Liberté) and exitnow.ca

**Club Voyages (France)**
Network of 72 travel agencies in France (Club Voyages, Look Voyages)

## AIR TRANSPORTATION

**Air Transat**
Charter air carrier specializing in holiday travel

**Handlex**
Airport ground services in Montréal, Toronto and Vancouver



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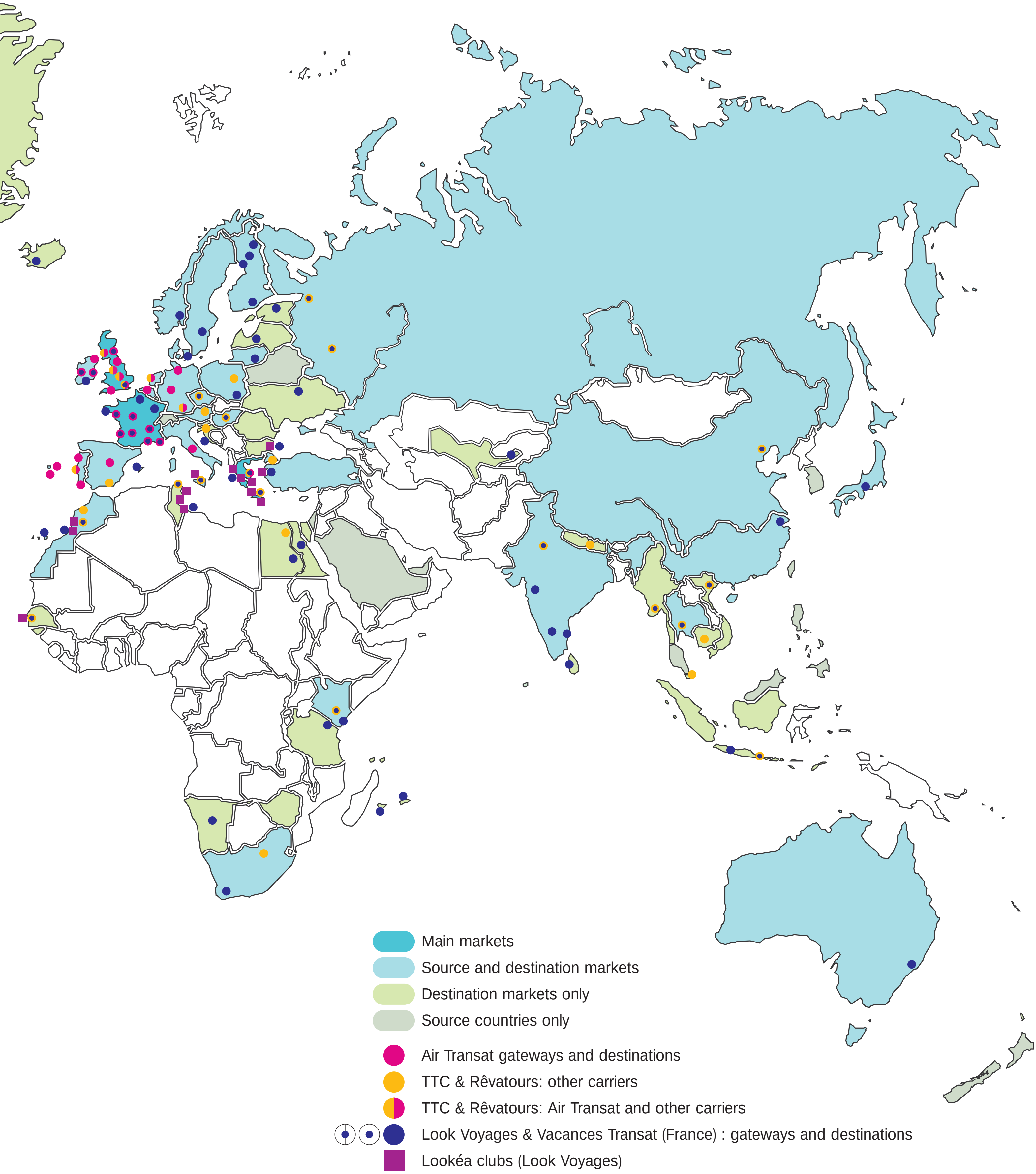
jonview.com
outbyview.com
tourgreecedmc.com
clubvoyages.com
marlintravel.ca
travelplus.ca
tripcentral.ca
exitnow.ca

## CRUISES

Transat Holidays and Look Voyages offer an extensive selection of cruises: in the Atlantic Ocean, Mediterranean and Baltic seas, South Pacific and Indian oceans; on the Nile and on Europe's major rivers; in Alaska, the Bahamas, Bermuda, Canada, the Caribbean, Hawaii, Mexico, to the Panama Canal and in South America.




Note 1: *This map reflects the situation as of summer 2006 as well as the planned program for the 2006-2007 winter season. Destinations offered and gateways may vary.*

Note 2: *"Source only" countries are those where we market Jonview Canada and/or Tourgreece products and to which we offer neither air service, packages or tours. We offer no products out of "destination only" countries.*

# Key Figures

## North America

(Revenues in thousands)

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| **Outgoing tour operators and air transportation** | | | |
| **Transat Tours Canada** (Transat Holidays, Nolitours and Air Transat) | | | |
| Revenues ($) | 1,912,000 | 1,777,000 | 1,570,000 |
| Employees | 2,667 | 2,616 | 2,500 |
| Passengers[1] | 2,625,000 | 2,504,000 | 2,394,500 |
| Travellers[2] | 1,200,000 | 1,140,000 | 1,017,500 |
| **Rêvatours** | | | |
| Revenues ($) | 18,400 | 19,600 | 19,000 |
| Employees | 26 | 27 | 26 |
| Travellers | 6,000 | 7,000 | 7,000 |
| **Incoming tour operators and destination services** | | | |
| **Jonview Canada** | | | |
| Revenues ($) | 118,000 | 117,300 | 108,000 |
| Employees | 286 | 169 | 156 |
| Travellers | 237,000 | 223,000 | 206,000 |
| **Other** | | | |
| Revenues ($) | 32,000 | 12,000 | 13,000 |
| Employees | 61 | 19 | 18 |
| **Retail distribution** | | | |
| **Transat Distribution Canada** (Club Voyages, Marlin Travel, TravelPlus, Voyages en Liberté and exitnow.ca) | | | |
| Revenues commissions and franchise ($) | 36,000 | 19,500 | 19,600 |
| Outlets owned | 110 | 21 | 22 |
| Employees | 597 | 210 | 203 |
| Outlets franchised | 315 | 190 | 173 |
| **Tripcentral.ca** | | | |
| Revenues commissions ($) | 7,700 | 2,800 | — |
| Employees | 99 | 103 | — |
| Outlets | 23 | 16 | — |
| **Other airline services** | | | |
| **Handlex** | | | |
| Revenues ($) | 41,000 | 37,000 | 29,000 |
| Employees | 1,108 | 1,024 | 857 |

## Europe

(Revenues in thousands)

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| **Outgoing tour operators** | | | |
| **Vacances Transat (France)** | | | |
| Revenues (€) | 167,000 | 139,000 | 133,000 |
| Employees | 193 | 213 | 177 |
| Travellers | 121,000 | 97,000 | 95,000 |
| **Look Voyages** | | | |
| Revenues (€) | 148,000 | 132,000 | 179,000 |
| Employees | 305 | 275 | 319 |
| Passengers | 3,000 | 65,000 | 465,000 |
| Travellers | 164,000 | 129,000 | 145,000 |
| **Brokair** | | | |
| Revenues (€) | 27,000 | 24,000 | 24,000 |
| Employees | 21 | 18 | 14 |
| **Canadian Affair** | | | |
| Revenues (£) | 30,000 | — | — |
| Employees | 63 | — | — |
| Travellers | 68,000 | — | — |
| **ACE** | | | |
| Revenues commissions (€) | 3,200 | 2,600 | — |
| Employees | 19 | 21 | — |
| Travellers | 45,000 | 43,000 | — |
| **Incoming tour operator and destination services** | | | |
| **Tourgreece** | | | |
| Revenues (€) | 19,700 | 19,000 | 10,400 |
| Employees | 35 | 27 | 20 |
| Travellers | 66,000 | 65,000 | 46,000 |
| **Retail distribution** | | | |
| **Club Voyages (France)** | | | |
| Revenues commissions (€) | 9,900 | 8,800 | 8,700 |
| Employees | 201 | 170 | 167 |
| Outlets | 72 | 52 | 59 |

All subsidiaries wholly owned, except:
Air Consultants Europe (70.0%)
Jonview Canada (80.07%)
Tourgreece (90.0%)
Trip Central (50.1%).

1 Airlines record flight segments in terms of passengers
2 Tour operators record round-trip travellers

# *Management's Discussion & Analysis*

This MD&A is comprised of the following sections



This Management's Discussion and Analysis (MD&A) provides a review of Transat A.T. Inc.'s operations, performance and financial position for the year ended October 31, 2006, compared with October 31, 2005, and should be read in conjunction with the audited Consolidated Financial Statements and notes thereto beginning on page 41. The information contained herein is dated as of January 15, 2007. You will find more information about us on Transat's website at www. transat. com and on SEDAR at www.sedar.com, including the Attest Reports for fiscal 2006 and Annual Information Form.

We prepare our financial statements in accordance with Canadian generally accepted accounting principles (GAAP). We will occasionally refer to non-GAAP financial measures in this MD&A. These non-GAAP financial measures have no meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures reported by other issuers. They provide additional information and should not be considered a substitute for measures of performance prepared in accordance with GAAP. All dollar figures are in Canadian dollars unless otherwise indicated. The terms "Transat," "we," "us," "our" and the "Corporation" mean Transat A.T. Inc. and its subsidiaries, unless otherwise indicated.

### Caution regarding forward-looking statements

*This MD&A contains certain forward-looking statements with respect to the Corporation. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by these forward-looking statements. We consider the assumptions on which these forward-looking statements are based to be reasonable, but caution the reader that these assumptions regarding future events, many of which are beyond our control, may ultimately prove to be incorrect since they are subject to risks and uncertainties that affect us. You will find elsewhere in this MD&A a discussion of certain risks and uncertainties affecting us. The Corporation disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by law.*

## *Financial Highlights*

(In thousands of dollars, except per share amounts)

| | 2006 $ | 2005 $ | 2004 $ | Variance 2006 % | Variance 2005 % |
|---|---|---|---|---|---|
| **Consolidated statements of income** | | | | | |
| Revenues | 2,603,746 | 2,364,481 | 2,199,822 | 10.1 | 7.5 |
| Margin[1] | 126,944 | 120,631 | 163,755 | 5.2 | (26.3) |
| Restructuring charge | — | (934) | 11,350 | 100.0 | (108.2) |
| Net income | 65,770 | 55,416 | 72,320 | 18.7 | (23.4) |
| Basic earnings per share | 1.88 | 1.43 | 2.07 | 31.5 | (30.9) |
| Diluted earnings per share | 1.85 | 1.33 | 1.76 | 39.1 | (24.4) |
| Dividend – Class A and B shares | 0.14 | — | — | n.a. | n.a. |
| **Consolidated balance sheets** | | | | | |
| Cash and cash equivalents | 214,887 | 293,495 | 310,875 | (26.8) | (5.6) |
| Cash and cash equivalents in trust or otherwise reserved | 203,613 | 182,268 | 157,678 | 11.7 | 15.6 |
| | 418,500 | 475,763 | 468,553 | (12.0) | 1.5 |
| Assets | 959,195 | 949,537 | 838,389 | 1.0 | 13.3 |
| Debt (short-term and long-term) | 87,404 | 106,769 | 33,214 | (18.1) | 221.5 |
| Total debt[1] | 407,741 | 463,382 | 536,746 | (12.0) | (13.7) |
| Net debt[1] | 192,854 | 169,887 | 225,871 | 13.5 | (24.8) |
| **Consolidated statements of cash flows** | | | | | |
| Operating activities | 113,279 | 74,156 | 184,321 | 52,8 | (59,8) |

1 NON-GAAP FINANCIAL MEASURES

The terms margin, operating cash flow, total debt and net debt have no standard definition prescribed by Canadian GAAP and are therefore unlikely to be comparable to similar measures reported by other issuers. However, these terms are presented on a consistent basis from period to period. These terms are included because management uses them to measure Transat's financial performance.

Margin is used by management to assess Transat's ongoing and recurring operational performance. This term is represented by revenues less operating expenses, according to the Consolidated Statements of Income.

Operating cash flows is used by management to assess Transat's operating performance and its capacity to meet its financial obligations. Operating cash flows is defined as cash flow from operating activities excluding the net change in non-cash working capital balances related to operations, net change in other liabilities and net change in deposits, expenses and provision for engine and airframe overhaul, according to the Consolidated Statements of Cash Flows.

Total debt is used by management to assess Transat's future cash requirements. It represents the combination of balance sheet debt (long-term debt and debentures) and off-balance sheet arrangements, excluding arrangements with suppliers presented on p. 33.

Net debt is used by management to assess Transat's cash position. It represents total debt (described above), less cash and cash equivalents not held in trust or otherwise reserved.

# OVERVIEW

## The holiday travel industry

The holiday travel industry is composed mainly of tour operators, travel agencies (traditional and online) and air carriers serving the holiday travel market through a combination of scheduled and charter air services. According to the World Tourism Organization, international tourist arrivals reached a record high of 806 million in 2005 and could reach one billion by 2010.

Tour operators specialized in outgoing services purchase the various components of a trip (including certain services purchased abroad) and sell them to consumers in their local markets, generally via travel agencies, either as travel packages or separately. 'Incoming' tour operators design travel packages or other travel products consisting of services they purchase in their local market for sale in foreign markets, generally through other tour operators or travel agencies. The companies providing destination services are based at destination and sell a range of products to travellers onsite for quick or immediate consumption.

Travel agencies are the intermediaries between tour operators and consumers. Travel agents meet with, advise and sell to consumers. Travel agencies sell holiday packages and plane tickets offered by tour operators, in addition to plane tickets sold directly by airline carriers and other travel products and services. Online travel agencies now offer a large range of travel products via transactional Internet Web sites. In both North America and Europe, online travel sales are now made up almost exclusively of air-only tickets, with only a small proportion consisting of packages (including airline tickets and hotels). Sales of online packages, however, are expected to grow.

Air carriers provide services to travel agencies and tour operators. These carriers are known as "scheduled" when they sell services directly to the public and travel agencies, and as "charter" when they sell seats in blocks to tour operators.

## Core business, vision and strategy

### Core business

Transat is one of the largest fully integrated world-class tour operators in North America. We conduct our activities in a single industry (holiday travel) and we mainly market our products in two geographic areas (North America and Europe). Transat's core business involves developing and marketing vacation travel services in package and air-only format, including airline seats. We operate as both an outgoing and incoming tour operator by bundling services bought in Canada and abroad and reselling them in Canada, France, the U.K. and elsewhere, mainly through travel agencies, some of which we own. Transat is also a major retail distributor with a total of approximately 500 travel agencies and a multi-channel distribution system that incorporates Web-based sales. Transat leverages on its subsidiary Air Transat, Canada's largest international charter air carrier, to meet a substantial portion of its airline seat needs. We also offer destination, hotel management and airport services.

### Vision

The international tourism market is growing, and international tourists have increasingly varied origin markets and travel destinations. Transat's vision is to maximize shareholder value by entering new markets, increasing our market share and maximizing the benefits of vertical integration. We maintain a leadership position in the Canadian market, where we operate as an outgoing and incoming tour operator; we are also the country's leading charter airline. We are also a well-established outgoing tour operator in France and the U.K. and incoming tour operator in Greece. We offer our customers a broad range of international destinations spanning some 60 countries. Over time, we aim to expand our business to other countries where we believe there is high growth potential for an integrated player specializing in holiday travel, particularly the U.S. and other European countries.

## Strategy

We completed a three-year strategic plan (2006-2008) focusing on growth and profitability. We anticipate that increased international tourism will speed our growth in North America and Europe. To this end, we will be making new acquisitions while pursuing an aggressive pace of internal growth. Our key strategic focuses are as follows:

- In Canada, Transat is the leader in all regions except Ontario. We plan to bolster our presence in Ontario by adding new destinations and expanding our distribution network to become and remain the market leader in all regions of the country.

- In Europe, Transat intends to grow its market share and continue its vertical integration in France and the U.K., building on its strong presence in these two high-potential markets. Transat will also continue its initiatives to expand into other European countries as a tour operator specializing in travel to Canada, among other destinations.

- Elsewhere, Transat will strive to invest in new markets and, in particular, to become a tour operator in the U.S., a strategic market it has been analyzing for some time. In addition, Transat will continue considering the possibility of penetrating other markets, including Asia and Latin America.

- Transat wishes to step up development of destination services and to assume a portion of its accommodation needs in order to gain better control over capacity and product quality and to boost margins. In practical terms, this may mean pursuing stakes or acquisitions in the hotel industry. Markets in which Transat has already reached critical mass will be reviewed first.

- In light of rapid change in the distribution industry and travellers' expectations, and given the importance of organizational responsiveness and productivity, our strategic plan will include our ongoing technology and training initiatives and investments. To this end, Transat will strive to introduce cutting-edge solutions via agencies and direct sales in order to adapt to new markets and to continue efficiency improvements.

Transat anticipates that implementing its strategic plan will require up to $300 million over three years, with funding from existing cash resources, future cash flows and external sources, as needed.

## Review of 2006-2007 objectives and achievements

(See two-page table, p. 22 to 25)

## Key performance drivers

The following key performance drivers are essential to the successful implementation of our strategy and to the achievement of our objectives:

Market share
Be the leader in Canada in all provinces and increase market share in Ontario, across the rest of the country and in Europe.

Revenue growth
To grow revenues by more than 5%, excluding acquisitions.

Margin
To generate margins higher than 5%.

## Ability to deliver on our objectives

Our ability to deliver on our objectives is dependent on our financial and non-financial resources, both of which have contributed to the success of our strategies and the achievement of our objectives in the past.

Our financial resources include:

Cash

Our cash balances not held in trust or otherwise reserved, totalling $214.9 million as at October 31, 2006, are strong. Our continued focus on expense reductions and margin increases should maintain our cash balances at healthy levels, taking into consideration the possible use of cash balances to acquire businesses.

Our non-financial resources include:

Brand

We have taken all necessary steps, including the use of a new corporate logo and an integrated branding platform, to create a unique, strong and visible identity across our main business units with a view to maximizing customer awareness in both the B2C and B2B markets, fully leveraging the contribution of all business units and creating value.

Structure

Our vertically integrated structure enables us to ensure a better quality control of our products and services.

Employees

In recent years, we have intensified our efforts to build a unified corporate culture based on a clear vision and shared values. As a result, our employees work together as a team and are committed to ensuring overall customer satisfaction and improving productivity. In addition, we believe we reap the benefits and expertise of strong leadership, since our founders are still at the helm.

Relationship with supplier

We have exclusive access to certain hotels at sunshine destinations as well as almost 20 years of privileged relationships with many hotels at these destinations and in Europe.

Transat has the resources it needs to meet its 2007 objectives and to continue building on its long-term strategies.

# CONSOLIDATED OPERATIONS

## Acquisitions

During the year ended October 31, 2006, the Corporation acquired several businesses. These acquisitions were recorded using the purchase method. The results of these businesses were included in the Corporation's results as of their respective dates of acquisition, unless otherwise indicated.

During the year ended October 31, 2006, the Corporation acquired the assets, via Travel Superstore Inc., of six travel agencies for a total consideration of $1.1 million. Of that amount, $0.5 million was paid in cash on the acquisition dates, with the $0.6 million balance payable in instalments over periods ranging from three to five years.

On December 1, 2005, the Corporation acquired the assets of 20 travel agencies operating in France from the Carlson Wagonlit Travel network, for a cash consideration of €3.1 million ($4.3 million). The results of these agencies were consolidated starting January 1, 2006.

On May 1, 2006, the Corporation acquired 100% of the issued and outstanding shares of the Thomas Cook Travel Limited (TCT) travel agency network, located in Canada, for a cash consideration of $8.3 million. TCT operates a network of 67 wholly owned agencies and 124 franchised agencies under the Thomas Cook and Marlin Travel banners. TCT also operates foreign exchange offices in 22 of its travel agencies.

On August 1, 2006, the Corporation acquired 100% of the issued and outstanding shares of British tour operator The Airline Seat Company, which operates under the Canadian Affair brand, for a cash consideration of £20.7 million ($43.7 million).

These transactions resulted in a $26.9 million increase in balance sheet goodwill. Note 17 to the audited Consolidated Financial Statements presents the purchase price allocation for the acquired businesses.

(Cont'd p.26)

| 2006 Objectives | Achievements or progress as at October 31, 2006 |
|---|---|
| **Increasing Transat's competitiveness in the Canadian and European markets.** We aim to refine our customer segmentation process and to ensure that our tour operators develop and implement separate customized marketing strategies, in line with the market. To this end, we will be upgrading our distribution system, which is based on three pillars: travel agencies; business-to-business (B2B) applications involving our tour operators and their retail network; and online business-to-consumer (B2C) distribution. Lastly, we will continue to integrate certain tour operators' activities in both France and Canada, with a view to reducing costs, particularly via synergies.<br><br>**Continuing to build on our "new" base in France.** At Look Voyages, we aim to achieve profitability beginning in the second half of 2006. In light of our new emphasis on holiday packages, we will be redefining the "Clubs Lookéa" concept and drawing up a strategic plan accordingly. Although tour operator Vacances Transat (France) remains strongly focused on Canada, this subsidiary's growing diversification will enable us to pursue growth in continental Europe and the long-haul market while improving the targeting of our offer. In France, we will be mobilizing our entire team to build on the solid base we have already established. | In Canada, we:<br><br>• Completed the sharing of products between Nolitours and Transat Holidays and continued capitalizing on our separate marketing strategies for each brand.<br><br>• Continued our initiatives to strongly establish the Nolitours brand among the public at large.<br><br>• Decided to focus Nolitours on southern destinations; European products will now be marketed exclusively by Transat Holidays.<br><br>• Implemented e-tickets and e-travel documents.<br><br>• Implemented a comprehensive B2B platform for flight and package sales.<br><br>• Enhanced efficiency by combining the sales and marketing operations of Transat Holidays and Nolitours.<br><br>• Grew our direct sales—particularly online—and innovated through the implementation of the Club Voyages sites, all of this part of a multi-channel distribution system.<br><br>• Acquired 191 travel agencies, including 81 in Ontario.<br><br>• Expanded our market share in Ontario in the segment of vacation packages to Mexico and the Caribbean during the winter season.<br><br>. |
| **Achieving growth via new markets.** Transat is already a leading outgoing tour operator in Canada and France. To achieve further growth, we intend to become a leader in other markets, particularly in European and North American markets. In 2006, we will be examining other opportunities, including the U.K., which is already an important market for us, and we will complete a U.S. market analysis to ensure proper timing of our entry in that market. | • We made a major acquisition, Canadian Affair, at a total cost of $43.7 million, making Transat an outgoing tour operator in the U.K. This acquisition considerably bolstered our sales network in the U.K., where we now have a multi-channel distribution system that has widened our outreach. |

## 2007 Objectives

In France, we:

- Achieved profitability at Look Voyages, which recorded a substantial increase in sales.
- Grew our direct sales and implemented a new Web site specializing in Canadian destinations (canadavision.fr).
- Completed the integration of Bennett Voyages, Brokair and Vacances Transat (France), with the pooling of purchasing and back office services, as well as certain technological exchanges.
- Strengthened the long-haul offering of Vacances Transat (France), with products spanning several continents.

### Enhance our competitiveness in Canada.

In Canada, where competition remains fierce, we intend to continue growing our Ontario market share, and maintain or increase our share elsewhere. We are stepping up capacity, adding new destinations, expanding the scope of our distribution network, which is increasingly efficient at combining all the channels the market expects, and pursuing initiatives to reduce costs and maximize revenue streams, particularly between Canada and the U.K. In addition, we are preparing the second stage in the initiative to renew our fleet of aircraft, whose structure remains a key competitiveness factor.

### Become more competitive and accelerate growth in Europe.

We will be developing a new European expansion plan based on growth in our tour operator and distribution operations, through internal growth and potentially acquisitions. We will focus on (i) expanding our multi-channel distribution system combining various distribution strategies, including direct sales; (ii) growing the Air Transat network; (iii) optimizing business processes to reduce costs at our European operations; and of course (iv) integrating Canadian Affair's operating and marketing functions and increasing our market share between Canada and the U.K.

- We actively pursued our search for acquisitions in the U.S. Key factors include complementary operations, a quality management team and financial performance.

### Tap into new outgoing markets.

After breaking into the British market in 2006, we continue to actively study the U.S. market in search of acquisitions, in order to gain a foothold in this market as an outgoing tour operator. We will achieve this goal via acquisitions, provided the opportunity meets our parameters.

| 2006 Objectives | Achievements or progress as at October 31, 2006 |
| --- | --- |
| **Emphasizing vertical integration of destination services.**<br>We intend to make additional investments in destination services through partnerships or acquisitions in the hotel and incoming tour operator sectors. | • We actively pursued our search for hotel partners. The primary targeted markets are Mexico, the Dominican Republic, the Caribbean and Latin America. |
| **Creating an environment to enable continuous knowledge acquisition, development and sharing.**<br>We aim to use the best tools to identify, promote and attract talented people, thereby building a strong and diversified team capable of assuming responsibility for our ongoing viability. We will also be developing personal development initiatives for high-potential employees as part of an aggressive business succession plan. | • All Transat subsidiaries have implemented a committee in charge of succession planning and skill sharing, and prepared and began implementing a work plan. |
| **Planning and implementing the next generation of information systems.**<br>We will be developing a long-term plan with a view to implementing the next generation of information systems – the central component of tour operators' activities. These are expected to include a centralized seat inventory management system, which will be integrated into the operating systems of Air Transat. In addition, we aim to refine our preferred B2B applications and online sales systems (B2C), both in Canada and France. Lastly, we will be developing the information systems used by our Canadian incoming tour operator, particularly as regards to multilingual capability and connectivity with customers and suppliers. | • We implemented B2B ("Agent Direct" – Nolitours and Transat Holidays) and B2C (Club Voyages) Internet platforms in Canada. There were similar developments in France, including the launch of the canadavision.fr site.<br><br>• We made progress in the selection process for a new seat and package inventory management system tool. |

## 2007 Objectives

- We set up Transat Destination, an umbrella organization for Trafic Tours (Mexico) and Turissimo (Dominican Republic).

**Further capitalize on vertical integration at destination.**

This initiative will be threefold: (i) increase the non-Transat sales of our incoming tour operators and destination service providers; (ii) target acquisitions in the incoming market; (iii) target acquisitions or partnerships in the hotel industry in our primary Southern markets to supply a portion of our room needs and benefit from the economic performance of this industry segment.

**Implement a knowledge management culture complete with the necessary processes to support our growth and continuity.**

Acknowledging the vital nature of the human contribution to realizing our mission statement and the necessity of anticipating our needs to drive growth, we will (i) improve our training and development programs; and (ii) ensure that all our subsidiaries develop or fine-tune their succession plans, such as through a high-potential employee development program.

- We completed the information system projects at Jonview Canada, providing greater connectivity. The number of system-to-system links with customers doubled and some fifty connection projects are underway.

**Develop and implement an integrated information management infrastructure that supports development and actively contributes to profitable growth.**

Taking into account special geographic considerations, we will continue developing our business-to-business (B2B) and business-to-consumer (B2C) platforms by adding new features to support greater product sales and tight price management, thereby enhancing the breadth and flexibility of our service offering. In addition, we will (i) actively continue the pooling of assets, investments and resources among our business units to either upgrade services, achieve greater harmonization or reduce costs; (ii) pursue our plan to adopt a more efficient centralized seat management system; (iii) and implement new analytical and decision-making support tools to lower our response time.

## Geographic Areas

### Revenues

We draw our revenues from outgoing tour operators, air transportation, travel agencies, distribution, incoming tour operators and services at travel destinations.

*Revenues per geographic areas*

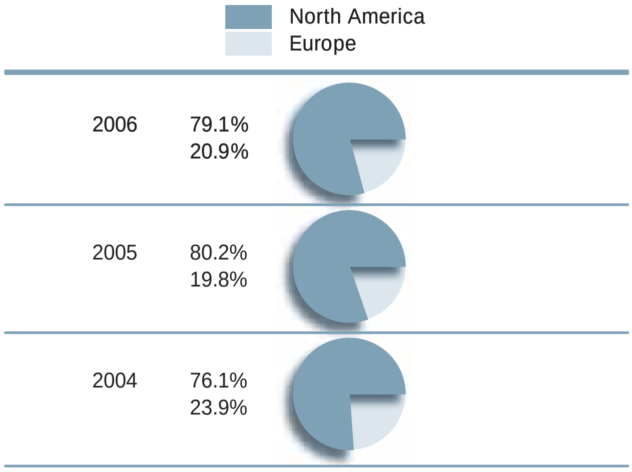
Years ended October 31 (in thousands of dollars)

| | 2006 $ | 2005 $ | 2004 $ | Variance 2006 % | Variance 2005 % |
|---|---|---|---|---|---|
| North America | 2,059,611 | 1,896,487 | 1,673,530 | 8.6 | 13.3 |
| Europe | 544,135 | 467,994 | 526,292 | 16.3 | (11.1) |
| Total | 2,603,746 | 2,364,481 | 2,199,822 | 10.1 | 7.5 |

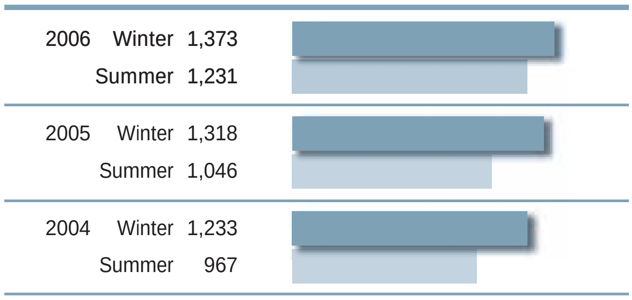
The overall increase was due to revenue growth of 8.6% in North America and 16.3% in Europe. The terms "travellers" and "passengers" will be used throughout the MD&A to explain these increases and decreases. Basically, tour operators record round-trips in terms of travellers and airlines record flight segments in terms of passengers. The key factor driving higher revenues was the number of travellers, which increased by 8.9% over 2005. This in turn resulted from a 7.3% increase in the number of North American travellers and a 17.6% improvement in Europe, excluding Canadian Affair travellers. The recent acquisition of Canadian Affair helped increase European revenues by 13.2% compared with 2005. Rising revenues from European operations was offset by the dollar's strength against the euro.

We expect that the total number of travellers in 2007 will be higher than in 2006. In light of this increased volume and our recent acquisitions, we also expect revenues to grow, compared with 2006.

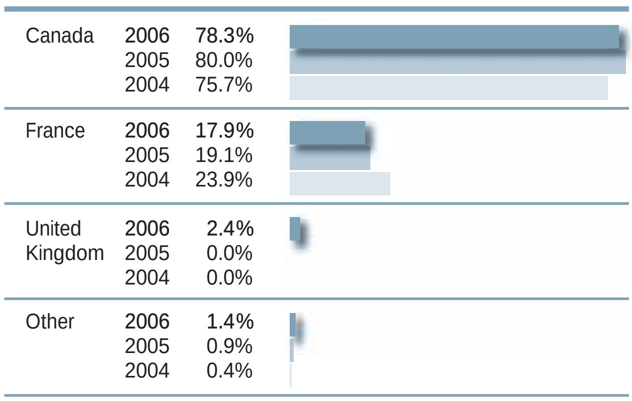
Geographic segmentation of revenues




Revenues by season
North America and Europe
(In millions of dollars)




Sources of revenues



## Operating expenses

Our operating expenses consist mainly of direct costs, salaries and employee benefits, aircraft fuel, aircraft maintenance, commissions, airport and navigation fees, and aircraft rent.

The overall growth in our operating expenses is due to a 9.2% increase in North America and a 14.8% increase in Europe. These fluctuations resulted primarily from the higher pace of business activity in both North America and Europe, rising fuel prices and the impact of our business acquisitions since 2005. Despite these increases, expenses as a percentage of revenues remained relatively steady at 95.1% compared with 94.9% in 2005.

Approximately 30% of our operating expenses are payable in U.S. dollars. We did not fully benefit from the rebounding Canadian dollar, however, due to our hedging program.

Direct costs include the costs of the various trip components sold to consumers via travel agencies and incurred by our tour operators. They also include hotel room costs and the costs of reserving blocks of seats or full flights with air carriers other than Air Transat. In 2006, these costs represented 50.2% of our revenues, compared with 49.4% in 2005. The dollar-figure increases were due to higher per-seat costs, caused in particular by growing fuel costs, business activity and hotel room costs.

Salaries and employee benefits were up 20.1% compared with fiscal 2005, due in part to our business acquisitions since November 1, 2004 and increased business activity.

Aircraft fuel costs rose 24.2%, or almost $48.3 million, during the year. This increase resulted primarily from high fuel prices during the year.

Commissions include the fees paid by tour operators to travel agencies for serving as intermediaries between tour operators and consumers. The 5.8% decline in commissions resulted mainly from reduced commission rates in North America.

Aircraft maintenance costs relate mainly to the engine and airframe maintenance expenses incurred by Air Transat. These expenses were down 11.6% compared with 2005 despite a higher pace of business activity. This decline was mainly due to the strength of our domestic currency against the U.S. dollar and the solid performance and reliability of our aircraft.

Airport and navigation fees relate mainly to fees charged by airports. The 5.7% growth in fees compared with the previous year resulted from an increase in business activity and the airport landing fees imposed by several airports.

Aircraft rent costs were down due to the strength of the Canadian dollar against its U.S. counterpart.

Other expenses were up 7.2% compared with 2005 but remained unchanged as a percentage of revenues. The increase was primarily due to greater business activity.

Despite our continued efforts to reduce and control costs, we expect total operating expenses to increase due to growth in business activity in 2007.

*Operating expenses*

Years ended October 31 (in thousands of dollars)

| | | | | As a % of revenues | | | Variance | |
|---|---|---|---|---|---|---|---|---|
| | 2006 $ | 2005 $ | 2004 $ | 2006 % | 2005 % | 2004 % | 2006 % | 2005 % |
| Direct costs | 1,307,732 | 1,168,612 | 1,075,861 | 50.2 | 49.4 | 48.9 | 11.9 | 8.6 |
| Salaries and employee benefits | 290,385 | 241,776 | 227,626 | 11.1 | 10.2 | 10.4 | 20.1 | 6.2 |
| Aircraft fuel | 247,697 | 199,376 | 128,112 | 9.5 | 8.4 | 5.8 | 24.2 | 55.6 |
| Commissions | 171,116 | 181,587 | 179,873 | 6.6 | 7.7 | 8.2 | (5.8) | 1.0 |
| Aircraft maintenance | 81,150 | 91,778 | 88,684 | 3.1 | 3.9 | 4.0 | (11.6) | 3.5 |
| Airport and navigation fees | 71,833 | 67,937 | 59,379 | 2.8 | 2.9 | 2.7 | 5.7 | 14.4 |
| Aircraft rent | 48,870 | 52,064 | 59,640 | 1.9 | 2.2 | 2.7 | (6.1) | (12.7) |
| Other | 258,019 | 240,720 | 216,892 | 9.9 | 10.2 | 9.9 | 7.2 | 11.0 |
| **Total** | 2,476,802 | 2,243,850 | 2,036,067 | 95.1 | 94.9 | 92.6 | 10.4 | 10.2 |

## North America

### Winter season

In North America, revenues were up 6.0% during the 2006 winter season, compared with the same period in 2005. This increase was mainly due to a 4.3% growth in total travellers compared with the same period in 2005. Competition was once again fierce last winter.

For the 2006 winter season, our margin decreased to 7.2%, compared with 7.7% during the 2005 winter season. The combined effect of price pressures and rising fuel costs narrowed margins during the 2006 winter season.

During the 2006 winter season, Air Transat served some 40 destinations in 18 countries, primarily southern or other sunshine destinations. During the summer months, Air Transat shifts most of its capacity to Europe, while maintaining some flights to southern destinations. In 2006, Air Transat offered direct flights to some 30 cities in ten European countries.

### Summer season

During the summer season, revenues were up 12.3%. This improvement resulted primarily from a 13.5% increase in travellers. The acquisition of TCT on May 1, 2006 also partly explains our higher revenues. Competition remained fierce, particularly for travel between Canada and the U.K. Both sunshine and European destinations were more popular with summer travellers. However, one must also factor in the string of hurricanes that occurred during the 2005 summer season.

As in the winter season, very high fuel prices continued to squeeze our margin, which declined from 4.3% in 2005 to 3.8% in 2006.

## Europe

### Winter season

In Europe, revenues and expenses increased in euro terms but decreased in Canadian dollar terms during the 2006 winter season, compared with the corresponding season of 2005. The strength of the Canadian dollar against the euro slowed the upswing in our revenues and expenses throughout the season. Moreover, we had to reduce prices for travel to Cancùn after Hurricane Wilma adversely affected demand for this region early in the season. Excluding passengers purchasing air-only flights from Look Voyages, winter travellers surged 25.8%.

We reported a negative margin of $2.7 million compared with a negative margin of $5.9 million in 2005. This improvement would have been more significant were it not for the aftermath of Hurricane Wilma.

*North America — Winter and summer results*

Years ended October 31 (in thousands of dollars)

| | Winter | | | Variance | | Summer | | | Variance | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 $ | 2005 $ | 2004 $ | 2006 % | 2005 % | 2006 $ | 2005 $ | 2004 $ | 2006 % | 2005 % |
| Revenues | 1,178,532 | 1,111,924 | 993,373 | 6.0 | 11.9 | 881,079 | 784,563 | 680,157 | 12.3 | 15.4 |
| Operating expenses | 1,093,342 | 1,026,033 | 884,185 | 6.6 | 16.0 | 847,474 | 750,778 | 611,786 | 12.9 | 22.7 |
| Margin | 85,190 | 85,891 | 109,188 | (0.8) | (21.3) | 33,605 | 33,785 | 68,371 | (0.5) | (50.6) |
| Margin (%) | 7.2 | 7.7 | 11.0 | (6.5) | (30.0) | 3.8 | 4.3 | 10.1 | (11.6) | (57.4) |

*Europe — Winter and summer results*

Years ended October 31 (in thousands of dollars)

| | Winter | | | Variance | | Summer | | | Variance | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 $ | 2005 $ | 2004 $ | 2006 % | 2005 % | 2006 $ | 2005 $ | 2004 $ | 2006 % | 2005 % |
| Revenues | 194,613 | 205,760 | 240,051 | (5.4) | (14.3) | 349,522 | 262,234 | 286,241 | 33.3 | (8.4) |
| Operating expenses | 197,286 | 211,614 | 252,953 | (6.8) | (16.3) | 338,700 | 255,425 | 287,143 | 32.6 | (11.0) |
| Margin | (2,673) | (5,854) | (12,902) | 54.3 | 54.6 | 10,822 | 6,809 | (902) | 58.9 | 854.9 |
| Margin (%) | (1.4) | (2.8) | (5.4) | 50.0 | 48.1 | 3.1 | 2.6 | (0.3) | 19.2 | 966.7 |

### Summer season

For the summer season, revenues were up 33.3%, primarily due to the recognition, as of August 1, 2006, of the revenues of The Airline Seat Company (Canadian Affair). Excluding the revenues of Canadian Affair, revenues from our European companies grew 10.0% whereas travellers increased 12.9%. As in the winter season, the strength of the Canadian dollar against the euro slowed the upswing in our revenues and expenses.

The main factor behind our improved European margins was a return to profitability at Look Voyages. The recent acquisition of Canadian Affair and the solid performance of our other European subsidiaries also contributed positively. However, the profitability of European operations was impacted by the dollar's strength against the euro, compared with the same season in 2005.

## Other expenses and revenues

Amortization is calculated on property, plant and equipment, intangible assets subject to amortization, deferred lease inducements and other assets, consisting mainly of development costs.

*Amortization*

Years ended October 31 (in thousands of dollars)

| | 2006 $ | 2005 $ | 2004 $ | Variance 2006 % | Variance 2005 % |
|---|---|---|---|---|---|
| Amortization | 39,360 | 37,558 | 33,027 | 4.8 | 13.7 |

Amortization expense was up 4.8%, mainly as a result of additions to property, plant and equipment made during the year.

## Restructuring charge (2004)

In July 2004, we unveiled a plan to reposition Look Voyages and to pursue our efforts to bring it back to profitability. The plan involved discontinuing certain operations considered non-strategic, namely the marketing and sale of air-only tickets. The plan called for Look Voyages to boost its holiday package business and to step up its use of Web-based technologies with a view to promote sales to travel agents and the general public. Approximately 90 jobs were eliminated, and Transat recorded an $11.4 million restructuring charge in the fourth quarter of 2004. This amount included $8.3 million in cash charges and $3.0 million in asset writedowns. In 2004, we forecast that the plan would reduce Look Voyages' losses by 50% in fiscal 2005 and that Look Voyages would return to profitability in late fiscal 2006. These two objectives were exceeded.

In 2005, our review of the measures implemented during the year ended October 31, 2004 resulted in a $0.9 million reversal of the provision, primarily due to employee training and reclassification expenses (as required under French law), lower-than-expected negotiation expenses related to the cancellation of contracts and earlier-than-expected employee departures.

No additional costs are anticipated under this plan.

## Restructuring charge (2003)

In 2003, we undertook to reduce our costs, while improving our operational efficiencies and ensuring that all products and services not generating targeted returns would be either remedied or eliminated. As part of these efforts, we developed a restructuring program in the second quarter of fiscal 2003. This program included changes to our management structure, as well as a fundamental restructuring of our operations in France and Canada. The war in Iraq and SARS, both of which drove down demand, accelerated the need for such a program. These events also significantly affected our fleet mix.

The 2003 restructuring program is substantially completed. No additional costs are anticipated under this plan. We expect to make the final disbursements related to this program, amounting to less than $0.9 million as at October 31, 2006, during fiscal 2008.

## Interest

*Interest expense and interest revenue*

Years ended October 31 (in thousands of dollars)

| | 2006 $ | 2005 $ | 2004 $ | Variance 2006 % | Variance 2005 % |
|---|---|---|---|---|---|
| Interest on long-term debt and debentures | 7,264 | 10,815 | 7,712 | (32.8) | 40.2 |
| Other interest and financial expenses | 1,484 | 1,708 | 1,907 | (13.1) | (10.4) |
| Interest income | (15,706) | (12,963) | (11,307) | 21.2 | 14.6 |

### Interest on long-term debt and debentures

The decline compared with 2005 was primarily attributable to the interest savings resulting from the repurchase on November 1, 2005 of a $10.0 million debenture and the early redemption on January 10, 2005 of debentures amounting to $21.9 million. This early redemption had led to a $1.7 million non-cash charge reflecting the difference between the debentures' face value amount and their book value at that time, in addition to a $0.8 million interest penalty.

### Other interest and financial expenses

Our other interest and financial expenses remained relatively consistent during the year, compared with the previous year. We do not expect that these expenses will vary significantly in 2007, compared with 2006.

### Interest income

Growth in interest income resulted primarily from higher interest rates. We expect our interest income to remain stable in 2007.

## Foreign exchange gain on long-term monetary items

For fiscal 2006, the Corporation recorded a foreign exchange gain on long-term monetary items due to the Canadian dollar's continuing appreciation against the U.S. dollar during the year. A stronger Canadian dollar reduces the value of our long-term monetary assets and liabilities. The foreign exchange gain on long-term monetary items was primarily due to the positive impact of exchange rates on our debt levels.

## Gain on disposal of investment

In June 2005, we signed an agreement that led to the sale of our 44.27% stake in Star Airlines S.A. (Star) for a total consideration of €4.5 million. This transaction resulted in a $5.7 million gain on disposal.

## Income taxes

Our income tax provision amounted to $32.0 million for the fiscal year ended October 31, 2006, compared with $36.3 million for fiscal 2005. Excluding the share in net income of companies subject to significant influence, the effective tax rates were 32.3% for the fiscal year ended October 31, 2006 and 39.1% for the preceding fiscal year.

Our lower tax rate was due in part to the decision to write down $5.6 million in future tax assets in 2005. This amount had been recorded based on the unused tax losses generated by our French operations up to July 31, 2004. This writedown was recorded based on our analysis (from an accounting perspective) of whether our unused tax losses related to our French operations could be used to realize future tax benefits. Excluding the writedown of future tax assets, however, our effective tax rate for fiscal 2005 would have been 33.5% if we had recorded tax recoveries on losses generated by our French operations.

## Net income

As a result of the items discussed in "Consolidated operations" of this MD&A, our net income was $65.8 million, or $1.88 per share, for fiscal 2006, compared with net income of $55.4 million, or $1.43 per share, for fiscal 2005. The weighted average number of outstanding shares used to compute per share amounts was 34,907,000 for the current year and 37,863,000 for fiscal 2005.

On a diluted per share basis, earnings per share for fiscal 2006 amounted to $1.85 per share, compared with $1.33 per share for fiscal 2005. The adjusted weighted average number of outstanding shares used to compute diluted earnings per share was 35,660,000 for the current year and 41,684,000 for 2005. The significant decrease in the weighted average number of shares in 2006 resulted mainly from the share repurchase of January 3, 2006.

Excluding the reversal of restructuring charges and the gain on disposal of our investment in Star, net income amounted to $48.7 million or $1.17 per fully diluted share in 2005.

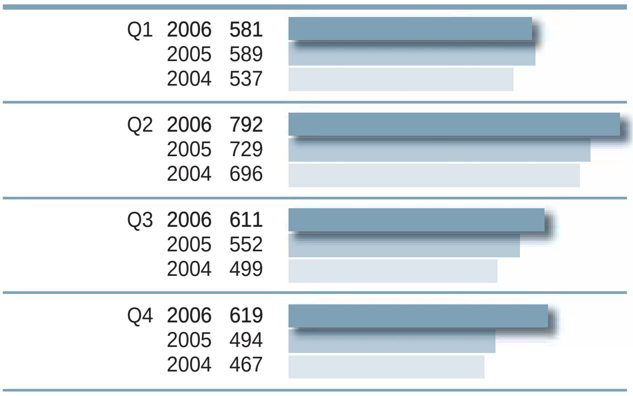
(See note 13 to the audited Consolidated Financial Statements.)

## Selected unaudited quarterly financial information

Overall, revenues in 2006 were up compared with 2005, primarily due to an increase in the number of travellers and to the acquisitions made since fiscal 2005.

Our margins fluctuated in fiscal 2006, compared with 2005. In general, they were under great pressure throughout the year from surging fuel prices and price competition.

Revenues by quarter
(In millions of dollars)




## Fourth-quarter highlights

In the fourth quarter of fiscal 2006, we recorded revenues of $619.5 million, compared with $493.9 million for the same period in 2005, representing an increase of $125.6 million, or 25.4%. This increase was mainly attributable to revenues generated by Canadian Affair and the higher revenues of our Canadian tour operators.

We generated a margin of $28.8 million, or 4.7%, during the quarter, compared with $23.4 million, or 4.7%, in 2005.

Net income for the quarter amounted to $13,6 million, or $0,39 per share on a fully diluted basis, compared with $18.0 million, or $0.44 per share on a fully diluted basis for the same period in 2005. Net of the reversal of certain restructuring charges and the gain on disposal of the investment in Star, 2005 quarterly net income amounted to $11.3 million, or $0.28 per share on a fully diluted basis.

*Selected unaudited quarterly financial information*

(In thousands of dollars, except per share data)

| | Q1 | | Q2 | | Q3 | | Q4 | |
|---|---|---|---|---|---|---|---|---|
| | 2006 $ | 2005 $ | 2006 $ | 2005 $ | 2006 $ | 2005 $ | 2006 $ | 2005 $ |
| Revenues | 581,576 | 588,740 | 791,569 | 728,944 | 611,107 | 552,897 | 619,494 | 493,900 |
| Margin | 14,030 | 13,833 | 68,487 | 66,204 | 15,606 | 17,214 | 28,821 | 23,380 |
| Net income (loss) | 5,168 | (1,800) | 42,845 | 38,400 | 4,205 | 794 | 13,552 | 18,022 |
| Earnings (loss) per share | 0.14 | (0.08) | 1.27 | 1.05 | 0.12 | 0.02 | 0.40 | 0.45 |
| Diluted earnings (loss) per share | 0.13 | (0.08) | 1.24 | 0.91 | 0.12 | 0.02 | 0.39 | 0.44 |

# LIQUIDITY AND CAPITAL RESOURCES

As at October 31, 2006, cash and cash equivalents amounted to $214.9 million, compared with $293.5 million in 2005. Cash and cash equivalents in trust or otherwise reserved were $203.6 million at the end of fiscal 2006, compared with $182.3 million in 2005. Our balance sheet included $97.6 million in working capital, or a ratio of 1.2, compared with $225.8 million in 2005, or a ratio of 1.6. With regard to our French operations, we also have access to unused lines of credit totalling €11.8 million ($16.9 million).

Total assets increased by $9.7 million, or 1.0%, to $959.2 million from $949.5 million as at October 31, 2005. Shareholders' equity amounted to $296.0 million as at October 31, 2006, down $66.3 million from $362.3 million as at October 31, 2005. This decrease resulted primarily from the share repurchases during the year, which totalled $132.4 million, which was offset by net income for the year in the amount of $65.8 million.

## Operating activities

Cash flows totalling $113.3 million were generated from operating activities, up $39.1 million from 2005. This increase resulted from an improvement in net income during the year, given that net income required fewer adjustments in respect of items not resulting in cash inflows. In 2005, these items included a gain on disposal of an investment and higher future income taxes than in 2006. In addition, the net change in working capital balances related to operations for 2006 was positive compared with 2005, primarily as a result of higher balances of accounts payable and accrued liabilities and income taxes payable than in 2005.

We expect to continue to generate positive cash flows from our operating activities in 2007.

## Investing activities

During the year, cash flows used for investing purposes decreased by $1.0 million to $42.2 million, compared with $43.2 million in 2005. During the year, the Corporation spent $47.6 million more than in 2005 on business acquisitions. However, this amount was offset by the cash and cash equivalents of the acquired businesses which exceeded $40.2 million over the businesses acquired in 2005. Compared with 2005, the net change in cash and cash equivalents in trust or otherwise reserved was favourable. Finally, additions to property, plant and equipment were lower than expected, down $4.8 million from the previous year. In 2007, we expect that additions to property, plant and equipment will total between $30.0 million and $35.0 million.

## Financing activities

During the year, cash flows totalling $152.0 million were used from financing activities, up $108.0 million compared with 2005. This increase resulted primarily from share repurchases during the year. These repurchases were more substantial than in 2005, up $109.9 million.

*Cash flows*

Years ended October 31 (in thousands of dollars)

| | 2006 $ | 2005 $ | 2004 $ | Variance 2006 % | Variance 2005 % |
|---|---|---|---|---|---|
| Cash flows – operating activities | 113,279 | 74,156 | 184,321 | 52.8 | (59.8) |
| Cash flows – investing activities | (42,173) | (43,190) | (84,475) | 2.4 | 48.9 |
| Cash flows – financing activities | (152,046) | (44,091) | (35,359) | (244.8) | (24.7) |
| Effect of exchange rate changes on cash and cash equivalents | 2,332 | (4,255) | 3,436 | 154.8 | (223.8) |
| Net change in cash and cash equivalents | (78,608) | (17,380) | 67,923 | (352.2) | (125.6) |

*The above table summarizes the cash flow activity and should be read in conjunction with the audited Consolidated Statements of Cash Flows.*

## Off-balance sheet arrangements and contractual obligations

In the normal course of business, Transat enters into arrangements and incurs obligations that will impact its future operations and cash flows. Some of these obligations are reflected as liabilities in the Corporation's Consolidated Financial Statements. Total debt obligations amounted to $87.4 million as at October 31, 2006 ($106.8 million in 2005). Obligations not reflected as liabilities are considered off-balance sheet arrangements. These contractual arrangements are entered into with non-consolidated entities and are made up of:

- Guarantees (see notes 9 and 22 to the audited Consolidated Financial Statements)
- Operating leases (see note 21 to the audited Consolidated Financial Statements)
- Agreements with suppliers (see note 21 to the audited Consolidated Financial Statements)

The 2006 off-balance sheet debt that can be estimated was approximately $550.8 million as at October 31, 2006 ($520.0 million in 2005) and is detailed as follows:

| (In thousands of dollars) | 2006 $ | 2005 $ |
|---|---|---|
| Guarantees | | |
| Irrevocable letters of credit *(notes 9 and 22)* | 5,751 | 17,238 |
| Security contracts *(note 22)* | 780 | 1,260 |
| Operating leases | | |
| Commitments under operating leases *(note 21)* | 313,806 | 338,115 |
| Agreements with suppliers *(note 21)* | 230,418 | 163,377 |
| Total | 550,755 | 519,990 |

In the normal course of business, guarantees are required in the travel industry to provide indemnification and guarantees to counterparties in transactions such as operating leases, irrevocable letters of credit and security contracts. Historically, Transat has not made any significant payments under such guarantees. Operating leases are entered into to enable the Corporation to lease certain items rather than acquire them. Agreements with suppliers are negotiated to reserve hotel rooms, blocks of seats and flights.

We believe that the Corporation will be able to meet its obligations with existing funds, operating cash flows and borrowings under existing credit facilities.

# OTHER

## Issuer bid

On November 14, 2005, the Corporation announced an issuer bid to repurchase and cancel its Class A Variable Voting Shares and Class B Voting Shares. A maximum of 7,142,857 shares, or approximately 18% of the Corporation's 40,156,450 issued and outstanding Class A Variable Voting Shares and Class B Voting Shares could have been repurchased at a price of not less than $17.50 per share and not more than $20.00 per share, for a total of $125 million. The issuer bid expired on December 22, 2005.

In accordance with its issuer bid, the Corporation repurchased, on January 3, 2006, a total of 6,443,299 voting shares, consisting of 1,780,797 Class A Variable Voting Shares and 4,662,502 Class B Voting Shares, for a cash consideration of $125,0 million.

*Contractual obligations — Payments due by period*

Years ended October 31 (in thousands of dollars)

| | 2007 $ | 2008 $ | 2009 $ | 2010 $ | 2011 $ | 2012 and thereafter $ | Total $ |
|---|---|---|---|---|---|---|---|
| Debentures | — | — | 3,156 | — | — | — | 3,156 |
| Long-term debt | 26,885 | 57,363 | — | — | — | — | 84,248 |
| Operating leases (aircraft) | 63,537 | 60,438 | 44,040 | 24,901 | 12,242 | 1,054 | 206,212 |
| Operating leases (other) | 19,028 | 14,109 | 10,702 | 6,454 | 3,194 | 54,107 | 107,594 |
| Agreements with suppliers | 165,629 | 41,884 | 20,973 | 966 | 966 | — | 230,418 |
| Total | 275,079 | 173,794 | 78,871 | 32,321 | 16,402 | 55,161 | 631,628 |

*The above table summarizes the Corporation's obligations and commitments to make future payments under contracts, including long-term debt, leases, debentures and agreements with suppliers. Additional information is contained in notes 10, 11 and 21 to the audited*

### Normal course issuer bid

On June 7, 2006, the Board of Directors of Transat filed a notice to extend the normal course issuer bid for a 12-month period; the bid was originally scheduled to expire on June 14, 2006. In the notice, the Corporation stated its intention to purchase for cancellation up to a maximum of 3,270,939 of its Class A Variable Voting Shares and Class B Voting Shares, representing 10% of the publicly held Class A Variable Voting Shares and Class B Voting Shares. As at June 2, 2006, there was a total of 33,768,158 Class A Variable Voting Shares and Class B Voting Shares issued and outstanding.

This program allows the Corporation to purchase Class A Variable Voting Shares and Class B Voting Shares in the normal course of business, i.e., when the Corporation believes that the Class A Variable Voting Shares and Class B Voting Shares are undervalued by the market.

These purchases are to be made via the Toronto Stock Exchange in accordance with its policy on normal course issuer bids. The price the Corporation will pay for any Class A Variable Voting Shares and Class B Voting Shares will be the market price at the time of acquisition, plus brokerage fees. Purchases began on June 15, 2004, and will terminate no later than June 14, 2007.

During the year, 287,000 voting shares, made up of Class A Variable Voting Shares and Class B Voting Shares, were purchased for cancellation for a cash consideration of $7.4 million.

### Dividend

On June 8, 2006, the Corporation announced that its Board of Directors had approved the introduction of a quarterly dividend of $0.07 per Class B Voting Share and Class A Variable Voting Share. During the year, the Corporation declared and paid dividends totalling $4.7 million.

### Shares issued and outstanding

As at October 31, 2006, the number of Class A Shares and Class B Shares amounted to 2,794,011 and 30,853,586 respectively.

## ACCOUNTING

### Financial instruments

In the normal course of business, the Corporation is exposed to risks related to exchange rate variations for certain currencies and fuel price variations. The corporation manages these risks through various financial instruments. Management is responsible for determining the acceptable level of risk and only uses financial instruments to hedge existing commitments or obligations and not to realize a profit on trading activities.

#### Credit risk related to financial instruments

The theoretical risk to which the Corporation is exposed in relation to financial instruments is limited to the replacement cost of contracts at market prices in the event of default by one of the parties. Management is of the opinion that the credit risk related to financial instruments is well controlled because the Corporation only enters into agreements with large financial institutions.

#### Management of fuel price and foreign exchange risks

The Corporation has entered into fuel forward contracts maturing in less than two years to manage fuel price fluctuation risks. To manage foreign exchange risks, it also entered into foreign exchange forward contracts, expiring in less than two years, for the purchase and sale of foreign currencies.

#### Credit risk

The Corporation believes it is not exposed to a significant concentration of credit risk. Cash and cash equivalents are invested on a diversified basis in investment-grade corporations. Accounts receivable generally arise from the sale of vacation packages to individuals through retail travel agencies and the sale of seats to tour operators, which are dispersed over a wide geographic area.

#### Fair value of financial instruments reported in the balance sheets

Due to the short-term nature of current financial assets and liabilities reported in the consolidated balance sheets, their carrying amount approximates their fair value.

Due to the nature of long-term debt reported in the consolidated balance sheets, its carrying amount approximates its fair value.

The fair value of the debentures could not be determined with sufficient reliability due to their specific nature.

Note 23 to the audited Consolidated Financial Statements for the year ended October 31, 2006 (included in this 2006 Annual Report) contains additional information on financial instruments.

## Related party transactions and balances

In the normal course of business, the Corporation enters into transactions with related companies. These transactions are measured at the exchange amount, which is the amount of consideration determined and agreed to by the related parties. Related party transactions and balances are not material.

## Critical accounting estimates

The preparation of financial statements in accordance with GAAP requires management to make certain estimates. We periodically review these estimates, which are based on historical experience, changes in the business environment and other factors that management considers reasonable under the circumstances. Our estimates involve judgements we make based on the information available to us. Actual results may differ materially from these estimates.

In the discussion below, we have identified a number of critical accounting estimates that required us to make assumptions about matters that were uncertain at the time the estimates were made. Our results, financial position and cash flows might be substantially different if we had used different estimates in the current period or if these estimates were likely to change in the future.

This discussion addresses only those estimates that we consider important based on the degree of uncertainty and the likelihood of a material impact if we had used different estimates. There are many other areas in which we use estimates about uncertain matters.

### Aircraft maintenance/Provision for engine and airframe overhaul

The Corporation provides for engine and airframe overhaul expenses for its aircraft based on an estimate of all such future expenses until the expiry of the leases for these aircraft, or on their estimated useful lives when owned by the Corporation. These expenses are amortized over the total number of engine cycles and the total number of estimated airframe hours over the same periods. These expenses are charged to income according to the number of cycles used or over the completed fiscal months, by a provision for future costs or the amortization of the capitalized overhaul costs, as the case may be. Any changes in demand for air travel or in the economy as a whole, or any additional actions by management, could alter the factors used to estimate this provision. This may result in charges that could materially affect our results, financial position and cash flows. In general, the main assumptions used to calculate this provision would have to be reduced by approximately 15%, resulting in additional charges that could have a material impact on our results, financial position and cash flows.

### Goodwill and intangible assets

We record material balance sheet amounts under goodwill and other intangible assets calculated using the historical cost method. We are required to measure goodwill and intangible assets that have indefinite lives, such as trademarks, each year, or more often if events or changes in circumstances indicate it is more likely than not that they might be impaired. Our review is based on an asset's ability to generate future cash flows. We carry out an analysis by estimating the discounted cash flows attributable to each asset. This analysis requires us to make a variety of judgements concerning our future operations. The cash flow forecasts used to determine asset values may change in the future due to market conditions, competition and other factors. Any changes may result in non-cash charges that could materially affect our results and financial position. In general, the main assumptions would have to be reduced by 30%-70% (depending on the operating unit), resulting in a significant loss in value for the operating unit and a material impact on our results and financial position. However, reducing these assumptions would only result in a non-cash charge and would not affect our cash flows.

### Property, plant and equipment

Property, plant and equipment in the balance sheet includes material amounts based on historical costs. These assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Our review is based on an asset's ability to generate future cash flows. We carry out an analysis by estimating the net undiscounted cash flows attributable to each asset. This analysis requires us to make a variety of judgements concerning our future operations. The cash flow forecasts used to determine asset values may change in the future due to market conditions or other factors. Any changes may result in non-cash charges that could materially affect our results and financial position. In general, the main assumptions would have to be reduced by 60%, resulting in a loss in value and a material impact on our results and financial position. However, reducing these assumptions would not result in cash outflows and would not affect our cash flows.

### Future accounting changes

On January 27, 2005, the CICA issued three new accounting standards: Section 1530 ("Comprehensive Income"), Section 3855 ("Financial Instruments — Recognition and Measurement") and Section 3865 ("Hedges"). These standards became effective November 1, 2006. We do not anticipate that these changes will have a significant impact on the Corporation's results.

#### Comprehensive income

This new standard describes how comprehensive income (and its components) should be presented. Comprehensive income corresponds to the variation in an enterprise's net assets resulting from transactions, events and circumstances from non-shareholder sources. The main components include unrealized currency translation adjustments arising from self-sustaining foreign operations and fair value adjustments of the effective portion of hedging instruments.

#### Financial Instruments — Recognition and Measurement

This new standard establishes the timing and method of accounting for financial instruments in the balance sheet. In some cases, fair value may be used; in other cases, a method based on the historical cost may apply. This standard also describes how gains and losses on financial instruments should be presented.

#### Hedges

Hedge accounting is discretionary. This standard makes it possible for entities to apply accounting treatments other than those set out in Section 3855 ("Financial Instruments — Recognition and Measurement") to eligible transactions that the entities choose to designate (for accounting purposes) as components of a hedging relationship. This new standard adds to Accounting Guideline no. 13 (AcG-13), *Hedging Relationships*, and Section 1650 ("Foreign Currency Translation") by specifying how hedge accounting may be applied and the related disclosure requirements.

## CONTROLS AND PROCEDURES

The implementation of the Canadian Securities Administrators Multilateral Instrument 52-109 represents a continuous improvement process, which has prompted the Corporation to formalize existing processes and control measures and introduce new ones. Transat has chosen to make this a corporate-wide project, which will result in operational improvements and better management.

In accordance with this instrument, the Corporation has filed certificates signed by the President and Chief Executive Officer and the Vice-President, Finance and Administration and Chief Financial Officer, that, among other things, report on the design and effectiveness of disclosure controls and procedures and the design of internal control over financial reporting.

Management has designed disclosure controls and procedures to provide reasonable assurance that material information relating to the Corporation is made known to the President and Chief Executive Officer and the Vice-President, Finance and Administration and Chief Financial Officer, particularly during the period in which the annual filings are being prepared.

These two certifying officers evaluated the effectiveness of the Corporation's disclosure controls and procedures as of October 31, 2006, and based on their evaluation, they have concluded that these controls and procedures are effective. This evaluation, among other things, took into consideration the Corporation's Corporate Disclosure Policy, the sub-certification process that has been implemented, and the functioning of its Disclosure Committee.

Management has also designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The President and Chief Executive Officer and the Vice-President, Finance and Administration and Chief Financial Officer have evaluated the design of the Corporation's internal controls and procedures over financial reporting as of the end of the period covered by the annual filings, and believe the design to be sufficient to provide such reasonable assurance.

On August 1, 2006, the Corporation purchased U.K.-based Canadian Affair, whose annual revenues represent approximately 5% of Transat's consolidated revenues. In the upcoming quarters, management will review internal control over financial reporting for this newly acquired subsidiary. At year-end, risks were mitigated, however, as Transat was fully apprised of any material events affecting this company. In addition, this subsidiary was integrated with regard to the aspects of internal control at the entity level.

Finally, other than additional formal policies and specific procedures, there has been no change in the Corporation's internal control over financial reporting that occurred during the fourth quarter of fiscal 2006 that materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## RISKS AND UNCERTAINTIES

### Economic and general factors

Economic factors such as a significant downturn in the economy, a recession or a decline in the employment rate in North America, Europe or key international markets could have a negative impact on our business and operating results by affecting demand for our products and services. Our operating results could also be adversely affected by more general factors, including the following: extreme weather conditions; war, political instability or terrorism, or any threat thereof; epidemics or disease outbreaks; consumer preferences and spending patterns; consumer perceptions of airline safety; demographic trends; disruptions to air traffic control systems; and costs of safety, security and environmental measures. Furthermore, our revenues are sensitive to events affecting domestic and international air travel as well as the level of car rentals and hotel and cruise reservations.

### Competition

We face many competitors in the holiday travel industry. Some of them are larger, with strong brand name recognition and an established presence in specific geographic areas, substantial financial resources and preferred relationships with travel suppliers. We also face competition from travel suppliers selling directly to travellers at preferential prices. These competitive pressures could adversely impact our revenues and margins since we would likely have to match competitors' prices.

### Fluctuations in foreign exchange and interest rates

We are exposed, due to our many arrangements with foreign-based suppliers, to fluctuations in exchange rates between the U.S. dollar, the Canadian dollar and the euro. These fluctuations could increase our operating costs. Changes in interest rates could also impact our interest income from our cash and cash equivalents and interest expense from variable-rate debt instruments, in turn affecting our earnings. We currently purchase derivative financial instruments to hedge against exchange-rate fluctuations affecting our long-term debt, our off-balance sheet financing obtained for aircraft and the revenues and operating expenses that the Corporation settles in foreign currencies.

### Fuel costs and supply

In particular, Transat is exposed to fluctuations in fuel costs. Due to competitive pressures in the industry, there can be no assurance that we would be able to pass along any increase in fuel prices to our customers by increasing fares, or that any fare increase would offset higher fuel costs, which could in turn adversely impact our business, financial position or operating results. We purchase futures contracts to hedge against fuel cost fluctuations. Furthermore, if there were a reduction in the supply of fuel, our operations could be adversely impacted.

## Changing industry dynamics: new distribution methods

The widespread popularity of the Internet has resulted in travellers being able to access information about travel products and services and to purchase such products and services directly from suppliers, thereby bypassing not only vacation providers such as Transat, but also retail travel agents through whom we generate a substantial portion of our revenues. For the time being, direct Internet sales remain limited in the vacation travel segment, shifts in industry dynamics in the distribution business occur rapidly and, in this respect, give rise to risks. In order to address this issue, Transat is in the process of developing and implementing a multi-channel distribution system to strike a harmonious balance between a variety of distribution strategies such as travel agencies, direct sales (including via Internet), third-party sales and the use of electronic booking systems.

In addition, the phenomenon of the gradual erosion of commissions paid by travel suppliers, particularly airlines, has weakened the financial position of many travel agents. Because we rely to some extent on retail travel agencies for access to travellers and revenues, any consumer shift away from travel agencies and toward direct purchases from travel suppliers could have an impact on our Corporation.

## Reliance on contracting travel suppliers

Despite being well positioned due to our vertical integration, we depend on third parties who supply us with certain components of our packages. We are dependent, for example, on non-group airlines and a large number of hotels. In general, these suppliers can terminate or modify existing agreements with us on relatively short notice. The potential inability to replace these agreements, to find similar suppliers, or to renegotiate agreements at reduced rates could have an adverse effect on our results. Furthermore, any decline in the quality of travel products or services provided by these suppliers, or any perception by travellers of such a decline, could adversely affect our reputation. Any loss of contracts, changes to our pricing agreements, access restrictions to travel suppliers' products and services or negative shifts in public opinion regarding certain travel suppliers resulting in lower demand for their products and services could have a significant effect on our results.

## Dependence on technology

Our business depends on our ability to access information, manage reservation systems (including handling high telephone call volumes on a daily basis) and distribute our products to retail travel agents and other travel intermediaries. To this end, we rely on a variety of information and telecommunications technologies. Rapid changes in these technologies could require higher-than-anticipated capital expenditures to improve customer service; this could impact our operating results. In addition, any systems failures or outages could adversely affect our business, customer relationships and operating results.

## Dependence on customer deposits and advance payments

Transat derives significant interest income from customer deposits and advance payments. In accordance with our investment policy, we are required to invest these deposits and advance payments exclusively in investment-grade securities. Any failure of these investment securities to perform at historical levels could reduce our interest income.

## Negative working capital

In the normal course of business, we receive customer deposits and advance payments. In the event that the flow of advance payments diminished and Transat were required to find alternative sources of capital, there can be no assurance that such sources would be available at terms and conditions acceptable to us. This could have a significant impact on our business.

## Fluctuations in financial results

The travel industry in general and our operations in particular are seasonal. As a result, our quarterly operating results are subject to fluctuations. In our view, quarter-to-quarter comparisons of our operating results are not necessarily meaningful and should not be relied on as indicators of future performance. Furthermore, due to the economic and general factors described above, our operating results in future periods could fall short of the expectations of securities analysts and investors, thus affecting the market price of our shares.

## Government regulation and taxation

Transat's future results may vary depending on the actions of government authorities with jurisdiction over our operations. These actions include the granting and timing of certain government approvals or licenses; the adoption of regulations impacting customer service standards (such as new passenger security standards); the adoption of more stringent noise restrictions or curfews; and the adoption of provincial regulations impacting the operations of retail and wholesale travel agencies. In addition, the adoption of new regulatory frameworks (or amendments thereto) or tax policy changes could affect our operations, particularly as regards hotel taxes, car rental taxes, airline excise taxes and airport taxes and fees.

## Future capital requirementsl

Transat may need to raise additional funds in the future to capitalize on growth opportunities or in response to competitive pressures. There can be no assurance that additional financing will be available on terms and conditions acceptable to us. This could adversely affect our business.

## Interruption of operations

If our operations are interrupted for any reason (including aircraft unavailability due to mechanical troubles), the loss of associated revenues could have an impact on our business, financial position and operating results.

## Insurance coverage

In the wake of the terrorist attacks of September 11, 2001, the airline insurance market gave notice that it intended to cancel all aircraft third-party liability coverage for risks associated with war and terrorist acts. Although this notice was subsequently rescinded, the limit on third-party civil liability coverage for bodily injury and property damage was reduced to US$50 million per incident.

Over the past few years, a commercial market has become available to cover these risks. However, the reasonableness of the terms and conditions has been a subject of some discussion, and some insurers are not licensed to transact business in Canada. Since no commercial market was immediately available to provide airlines with third-party civil liability coverage against war and terrorist acts in excess of US$150 million at commercially reasonable terms, it was necessary for individual governments to cover locally-based airlines against this risk until commercial insurance became available The Canadian government covers domestic air carriers accordingly.

The Canadian government continues to cover its air carriers, prompted by the licensing situation and by the U.S. government's decision to continue protecting its own carriers against such risks. However, there can be no assurance that the Canadian government will not withdraw its protection, particularly if the U.S. government should change its position.

## Casualty losses

We feel that we and our suppliers have adequate liability insurance to cover risks arising in the normal course of business, including claims for serious injury or death arising from accidents involving aircraft or other vehicles carrying our customers. Although we have never faced a liability claim for which we did not have adequate insurance coverage, there can be no assurance that our coverage will be sufficient to cover larger claims or that the insurer concerned will be solvent at the time of any covered loss. In addition, there can be no assurance that we will be able to obtain coverage at acceptable levels and cost in the future. These uncertainties could adversely affect our business and operating results.

## Slot and gate availability

Access to landing and departure runway slots, airport gates and facilities is critical to our operations and growth strategy. Future availability or cost of these facilities could have an adverse effect on our operations.

## Aircraft lease obligations

Transat has significant non-cancellable lease obligations relating to its aircraft fleet. If revenues from aircraft operations were to decrease, the payments to be made under our existing lease agreements could have a substantial impact on our operations.

## Key personnel

Our future success depends on our ability to attract and retain qualified personnel. The loss of key individuals could adversely affect our business and operating results.

### Bargaining agreements

Our operations could be adversely affected in the event of an inability to reach an agreement with a labour union representing our employees, including pilots.

## OUTLOOK

Generally, international tourism is expanding, and the Corporation considers that thanks to its vertical integration and international footprint, it is well positioned to continue growing and face challenges, in particular certain operating expenses over which it has little or no control (such as fuel costs or airport and navigation fees) and the impact of competition, which remains fierce.

At the time this annual report was being issued, the Corporation's bookings in North America for winter 2007 where sharply higher than at the same period in 2006, whereas bookings in Europe were slightly higher than at the same time in 2006.

# *MANAGEMENT'S REPORT AND AUDITOR'S REPORT*

The consolidated financial statements are the responsibility of management and have been approved by the Board of Directors. Management's responsibility in this respect includes the selection of appropriate accounting principles as well as the exercise of sound judgment in establishing reasonable and fair estimates in accordance with Canadian generally accepted accounting principles which are adequate in the circumstances. The financial information presented throughout this annual report is consistent with that appearing in the financial statements.

The Corporation and its affiliated companies have set up accounting and internal control systems designed to provide reasonable assurance that the Corporation's assets are safeguarded against loss or unauthorized use and that its books of account may be relied upon for the preparation of financial statements.

The Board of Directors is responsible for the consolidated financial statements through its Audit Committee. The Audit Committee reviews the annual consolidated financial statements and recommends their approval to the Board of Directors. The Audit Committee is also responsible for analyzing, on an ongoing basis, the results of the audits by the external auditors of the accounting methods and policies used as well as of the internal control systems set up by the Corporation. These financial statements have been audited by Ernst & Young LLP, the external auditors. Their report on the consolidated financial statements appears opposite.

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

François Laurin
Vice-President, Finance and Administration
and Chief Financial Officer

To the Shareholders of Transat A.T. Inc.

We have audited the consolidated balance sheets of Transat A.T. Inc. as at October 31, 2006 and 2005 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at October 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Montréal, Canada
December 7, 2006

Ernst & Young LLP

Ernst & Young LLP
Chartered Accountants

# CONSOLIDATED BALANCE SHEETS

As at October 31 (In thousands of dollars)

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | 214,887 | 293,495 |
| Cash and cash equivalents in trust or otherwise reserved *[note 4]* | 203,613 | 182,268 |
| Accounts receivable | 87,996 | 69,611 |
| Future income tax assets *[note 18]* | 1,357 | 70 |
| Inventories | 8,312 | 7,524 |
| Prepaid expenses | 43,706 | 40,576 |
| Current portion of deposits | 29,849 | 29,259 |
| Total current assets | 589,720 | 622,803 |
| Deposits *[note 5]* | 19,350 | 24,127 |
| Future income tax assets *[note 18]* | 7,120 | 5,106 |
| Property, plant and equipment *[notes 6 and 10]* | 181,349 | 195,131 |
| Goodwill and other intangible assets *[note 7]* | 153,681 | 93,741 |
| Other assets *[note 8]* | 7,975 | 8,629 |
| | 959,195 | 949,537 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 236,282 | 193,277 |
| Income taxes payable | 10,122 | 4,763 |
| Customer deposits and deferred income | 218,875 | 182,752 |
| Debentures *[note 11]* | — | 10,000 |
| Payments on current portion of long-term debt | 26,885 | 6,199 |
| Total current liabilities | 492,164 | 396,991 |
| Long-term debt *[note 10]* | 57,363 | 87,414 |
| Debentures *[note 11]* | 3,156 | 3,156 |
| Provision for engine and airframe overhaul in excess of deposits | 64,961 | 63,809 |
| Other liabilities *[note 12]* | 31,934 | 30,833 |
| Future income tax liabilities *[note 18]* | 13,654 | 5,051 |
| | 663,232 | 587,254 |
| Shareholders' equity | | |
| Share capital *[note 13]* | 151,430 | 179,438 |
| Retained earnings | 142,116 | 183,718 |
| Contributed surplus | 1,379 | 531 |
| Warrants *[notes 11 and 13]* | 1,016 | 1,187 |
| Accumulated translation adjustments *[note 15]* | 22 | (2,591) |
| | 295,963 | 362,283 |
| | 959,195 | 949,537 |

Commitments and contingencies *[note 21]*

*See accompanying notes to consolidated financial statements.*

On behalf of the Board:
Jean-Marc Eustache, Director
André Bisson, O.C., Director

# CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

As at October 31 (In thousands of dollars)

| | 2006 $ | 2005 $ |
|---|---|---|
| Retained earnings, beginning of year, as previously reported | 183,718 | 135,322 |
| Change in accounting policy *[note 3]* | — | 12,151 |
| Retained earnings, beginning of year | 183,718 | 147,473 |
| Net income for the year | 65,770 | 55,416 |
| Premium paid on share repurchase *[note 13]* | (102,327) | (17,731) |
| Share repurchase costs, net of related income taxes of $145 | (308) | — |
| Dividends | (4,737) | — |
| Interest on equity component of debentures, net of related income taxes of $648 | — | (1,440) |
| Retained earnings, end of year | 142,116 | 183,718 |

# CONSOLIDATED STATEMENTS OF INCOME

Years ended October 31 (In thousands of dollars, except per share amounts)

| | 2006 $ | 2005 $ |
|---|---|---|
| Revenues | 2,603,746 | 2,364,481 |
| Operating expenses | | |
| Direct costs | 1,307,732 | 1,168,612 |
| Salaries and employee benefits | 290,385 | 241,776 |
| Aircraft fuel | 247,697 | 199,376 |
| Commissions | 171,116 | 181,587 |
| Aircraft maintenance | 81,150 | 91,778 |
| Airport and navigation fees | 71,833 | 67,937 |
| Aircraft rent | 48,870 | 52,064 |
| Other | 258,019 | 240,720 |
| | 2,476,802 | 2,243,850 |
| | 126,944 | 120,631 |
| Amortization *[note 16]* | 39,360 | 37,558 |
| Restructuring charge *[note 18]* | — | (934) |
| Interest on long-term debt and debentures | 7,264 | 10,815 |
| Other interest and financial expenses | 1,484 | 1,708 |
| Interest income | (15,706) | (12,963) |
| Foreign exchange gain on long-term monetary items | (4,162) | (2,309) |
| Gain on disposal of investment *[note 8]* | — | (5,747) |
| Share of net income of companies subject to significant influence | (375) | (461) |
| | 27,865 | 27,667 |
| Income before the following items | 99,079 | 92,964 |
| Income taxes (recovery) *[note 18]* | | |
| Current | 32,558 | 48,705 |
| Future | (512) | (12,403) |
| | 32,046 | 36,302 |
| Income before non-controlling interest in subsidiaries' results | 67,033 | 56,662 |
| Non-controlling interest in subsidiaries' results | (1,263) | (1,246) |
| Net income for the year | 65,770 | 55,416 |
| | | |
| Basic earnings per share *[note 13]* | 1.88 | 1.43 |
| Diluted earnings per share *[note 13]* | 1.85 | 1.33 |

*See accompanying notes to consolidated financial statements.*

# CONSOLIDATED STATEMENTS OF CASH FLOWS

As at October 31 (In thousands of dollars)

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net income | 65,770 | 55,416 |
| Operating items not involving an outlay (receipt) of cash | | |
| Amortization | 39,360 | 37,558 |
| Foreign exchange gain on long-term monetary items | (4,162) | (2,309) |
| Gain on disposal of investment | — | (5,747) |
| Share of net income of companies subject to significant influence | (375) | (461) |
| Non-controlling interest in subsidiaries' results | 1,263 | 1,246 |
| Future income taxes | (512) | (12,403) |
| Interest on debentures | — | 1,807 |
| Pension expense | 2,572 | 2,400 |
| Compensation expense related to stock option plan | 886 | 507 |
| | 104,802 | 78,014 |
| Net change in non-cash working capital balances related to operations | 8,749 | (8,565) |
| Net change in other liabilities | (1,424) | 3,716 |
| Net change in deposits, expenses and provision for engine and airframe overhaul | 1,152 | 991 |
| Cash flows relating to operating activities | 113,279 | 74,156 |
| INVESTING ACTIVITIES | | |
| Increase in deposits | (3,152) | (11,069) |
| Repayment of deposits | 6,582 | 8,601 |
| Additions to property, plant and equipment | (22,366) | (27,213) |
| Disposal of property, plant and equipment | — | 5,001 |
| Proceeds from disposal of investment | — | 6,900 |
| Cash and cash equivalents from acquired companies | 49,797 | 9,637 |
| Consideration paid for acquired companies | (56,780) | (9,203) |
| Net change in cash and cash equivalents in trust or otherwise reserved | (15,705) | (24,590) |
| Net change in other assets | (549) | (1,254) |
| Cash flows relating to investing activities | (42,173) | (43,190) |
| FINANCING ACTIVITIES | | |
| Repayment of long-term debt | (6,312) | (6,766) |
| Interest paid on convertible debentures | — | (2,868) |
| Proceeds from issuance of shares | 1,878 | 9,988 |
| Share repurchase | (132,422) | (22,545) |
| Share repurchase costs | (453) | — |
| Repayment of debentures | (10,000) | (21,900) |
| Dividends | (4,737) | — |
| Cash flows relating to financing activities | (152,046) | (44,091) |
| Effect of exchange rate changes on cash and cash equivalents | 2,332 | (4,255) |
| Net change in cash and cash equivalents | (78,608) | (17,380) |
| Cash and cash equivalents, beginning of year | 293,495 | 310,875 |
| Cash and cash equivalents, end of year | 214,887 | 293,495 |
| Supplementary information | | |
| Income taxes paid | 26,348 | 72,486 |
| Interest paid | 6,895 | 6,226 |

*See accompanying notes to consolidated financial statements.*

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005
(Amounts are expressed in thousands of dollars, except for share capital, stock option plans, warrants, deferred share units and amounts per share)

## 1) INCORPORATION AND NATURE OF BUSINESS

Transat A.T. Inc. [the "Corporation"], incorporated under the Canada Business Corporations Act, is an integrated company specializing in the organization, marketing and distribution of holiday travel. The core of its business consists of tour operators based in Canada and Europe. The Corporation is also involved in air transportation and value-added services at travel destinations. Finally, the Corporation has secured a dynamic presence in distribution through travel agency networks.

## 2) SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Corporation have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

### *Basis of consolidation*

The consolidated financial statements include the accounts of the Corporation, its subsidiaries and its variable interest entities where the Corporation is the primary beneficiary.

The Corporation consolidates the variable interest entities in accordance with Accounting Guideline 15, "Consolidation of Variable Interest Entities" ["AcG-15"]. This Guideline presents clarification on the application of consolidation principles to certain entities that are subject to control on a basis other than ownership of voting interests. AcG-15 provides guidance for determining when an enterprise includes the assets, liabilities and results of activities of a variable interest entity in its consolidated financial statements. Under AcG-15, an enterprise should consolidate a variable interest entity when that enterprise has a variable interest, or combination of variable interests, that will absorb a majority of the entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both (the "primary beneficiary").

Assets recognized as a result of consolidating certain variable interest entities do not represent additional assets that could be used to satisfy claims against the Corporation's general assets.

### *Cash equivalents*

Cash equivalents consist primarily of term deposits, bankers' acceptances and commercial paper that are readily convertible into known amounts of cash with initial maturities of less than three months. These investments are recorded at cost plus accrued interest, and their carrying value approximates their fair market value.

### *Inventories*

Inventories are valued at the lower of cost, determined according to the first-in, first-out method, and replacement cost.

## 2) SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

*Property, plant and equipment*

Property, plant and equipment are recorded at cost and are amortized, taking into account their residual value, on a straight-line basis over their estimated useful life as follows:

| | |
|---|---|
| Aircraft | 4 to 5 years |
| Improvements to aircraft under operating leases | Lease term |
| Aircraft equipment | 5 to 10 years |
| Computer hardware and software | 3 to 7 years |
| Aircraft engines | Cycles used |
| Office furniture and equipment | 4 to 10 years |
| Leasehold improvements | Lease term |
| Rotable aircraft spare parts | Use |
| Hangar and administrative buildings | 35 years |

*Goodwill and other intangible assets*

Goodwill and other intangible assets having an indefinite life have not been amortized.

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired. Goodwill is tested for impairment annually or more often if events or changes in circumstances indicate that it is more likely than not that it is impaired. The impairment test consists of a comparison of the fair value of the reporting unit to which goodwill is assigned with its carrying amount. Any impairment loss in the carrying amount compared with the fair value is charged to income in the period in which the loss is recognized. The Corporation uses the discounted cash flow method to assess the fair value of its reporting units.

Intangible assets acquired that have an indefinite life, such as trademarks, are also tested for impairment annually or more often if events or changes in circumstances indicate that it is more likely than not that they are impaired. The impairment test consists of a comparison of the fair value of intangible assets with their carrying amount. Any impairment loss in the carrying amount compared with the fair value is charged to income in the period in which the loss is recognized. The Corporation uses the discounted cash flow method to assess the fair value of its intangible assets.

Intangible assets with definite useful lives, such as customer lists, are amortized on a straight-line basis over terms ranging from three to ten years.

*Impairment of long-lived assets*

Property, plant and equipment and intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use together with its residual value [net recoverable value]. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value.

*Other assets*

Other assets consist in particular of development costs and long-term investments over which the Corporation has the ability to exercise significant influence.

Development costs are amortized over periods not exceeding five years. Long-term investments are accounted for using the equity method.

*Deposits, expenses and provision for engine and airframe overhaul*

The Corporation provides for engine and airframe overhaul expenses for its aircraft based on an estimate of all such future expenses until the expiry of the leases for these aircraft, or for their estimated useful lives anticipated for the Corporation while held, amortized over the total number of engine cycles and the total number of months anticipated for the airframe over the same periods.

These expenses are charged to income according to the number of cycles used or over the completed fiscal months, by a provision for future costs or the amortization of the capitalized overhaul costs, as the case may be. Actual results could differ from those estimates and differences could be significant.

The Corporation makes deposits representing a portion of expected engine and airframe overhaul expenses to certain aircraft lessors. These deposits are usually recoverable upon presentation of claims for eligible overhaul expenses. Amounts so claimed are included in assets as "Accounts receivable." The excess of the provision for future overhaul expenses over deposits made and unclaimed is included in liabilities as "Provision for engine and airframe overhaul in excess of deposits." The unamortized balance related to engine and airframe overhaul expenses is included, if any, in assets as "Deposits."

*Foreign currency translation*

(a) Self-sustaining foreign operations

The Corporation translates the accounts of its self-sustaining foreign subsidiaries using the current rate method. All assets and liabilities of self-sustaining foreign operations are translated at the exchange rates in effect at year-end. Revenues and expenses are translated at average rates of exchange during the period. Net gains or losses resulting from the translation of assets and liabilities are shown in accumulated translation adjustments under shareholders' equity.

(b) Accounts and transactions in foreign currencies

The accounts and transactions of the Corporation denominated in foreign currencies are translated using the temporal method. Under this method, monetary items on the balance sheet are translated at the exchange rates in effect at year-end, while non-monetary items are translated at the historical rates of exchange. Revenues and expenses are translated at the rates of exchange on the transaction date or at the average exchange rates for the period. Gains or losses resulting from the translation are included in the consolidated statement of income.

*Stock-based compensation plans*

The Corporation accounts for its stock option plan for executives and employees in respect of stock option awards granted after October 31, 2003 using the fair value method. The fair value of stock options at the grant date is determined using an option pricing model. Compensation expense is recognized in income over the vesting period of the stock options.

Prior to November 1, 2003, the Corporation accounted for its stock option plan for executives and employees as capital transactions. Accordingly, the issuance of options did not give rise to compensation expenses. The Corporation disclosed the impact of applying the fair value-based method by presenting pro forma net income and pro forma earnings per share by way of a note to the consolidated financial statements for the awards granted during 2003.

The Corporation's contributions to the stock ownership incentive and capital accumulation plan for officers and the permanent stock ownership incentive plan for senior executives are recognized in income when the shares are awarded based on the fair value of the shares at the time of grant. No compensation expense is recognized for the other plans where the shares are issued to directors, executives and employees. Any consideration paid by directors, executives and employees upon purchasing shares is credited to share capital.

A description of the stock-based compensation plans offered by the Corporation is included in note 13.

*Revenue recognition*

The Corporation recognizes revenues once all the significant risks and rewards of the service have been transferred to the customer. As a result, revenues earned from passenger transportation are recognized upon each return flight. Revenues of tour operators and the related costs are recognized at the time of the departure of the passengers. Commission revenues of travel agencies are recognized at the time of reservation. Amounts received for services not yet rendered are included in current liabilities as "Customer deposits and deferred income."

*Financial instruments*

The Corporation uses foreign exchange forward contracts to hedge against future currency exchange rate variations related to its long-term debt obligations, operating lease payments, payments on long-term debt, receipts of revenue from certain tour operators and disbursements pertaining to certain operating expenses in other currencies. The gains or losses on contracts designated as hedges resulting from exchange rate variations are recorded in income when the related hedging transactions are realized.

To protect itself against variations in fuel costs, the Corporation has entered into fuel price hedging contracts. The gains or losses resulting from designated hedge contracts are recorded in fuel costs as purchases of fuel are made.

The gains or losses on contracts not designated as hedges or that cease being designated as such are recognized at their fair value in the balance sheet and any subsequent change in fair value is recognized in the statement of income.

Amounts receivable or payable on hedging instruments, which are used to hedge foreign currency debt obligations are recorded concurrently with the unrealized translation gains and losses on the obligation being hedged.

It is the Corporation's policy not to speculate on financial instruments; thus, these instruments are normally designated as hedges and maintained until maturity according to the primary objective of hedging risks.

## 2) SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

*Income taxes*

The Corporation provides for income taxes using the liability method. Under this method, future income tax assets and liabilities are calculated based on differences between the carrying value and tax bases of assets and liabilities and measured using substantively enacted tax rates and laws expected to be in effect when the differences reverse. A valuation allowance has been recorded to the extent that it is more likely than not that future income tax assets will not be realized.

*Deferred lease inducements*

Deferred lease inducements are amortized on a straight-line basis over the term of the leases and are recognized as a reduction of the amortization expense.

*Employee future benefits*

The Corporation offers defined benefit plans to certain members of senior management. The cost of pension benefits earned by employees is determined from actuarial calculations using the projected benefit method prorated on services and management's most likely estimate of the increase in eligible earnings and the retirement age of employees. The past service costs and amendments to the agreements are amortized on straight -line basis over the average remaining service period of the active employees generally affected thereby. The excess of net actuarial gains and losses over 10% of the benefit obligation is amortized over the average remaining service period of active employees, which is 8.7 years as at November 1, 2006. Plan obligations are discounted using current market interest rates and are included in "Other liabilities."

*Earnings per share*

Earnings per share are calculated based on the weighted average number of Class A Variable Voting Shares and Class B Voting Shares outstanding during the year. Diluted earnings per share are calculated using the treasury stock method and take into account all the elements that have a dilutive effect.

## 3) CHANGES TO ACCOUNTING POLICIES

*Consolidation of variable interest entities*

The Corporation has conducted certain aircraft financing transactions whereby it guaranteed a portion of the residual value at the end of the lease term involving special purpose entities. These entities are considered variable interest entities and the Corporation is considered to be the primary beneficiary thereof. The adoption of AcG-15 resulted in a $12,151 increase in the Corporation's retained earnings as at November 1, 2004, a $116,009 net increase in property, plant and equipment, and a $103,858 increase in liabilities, including $101,773 [US$83,372] for long-term debt. The adoption of this Guideline had no impact on the Corporation's cash flows. However, it resulted in a decline of $2,034 in net income for the year ended October 31, 2005 and $0.05 in basic earnings per share.

## 4) CASH AND CASH EQUIVALENTS IN TRUST OR OTHERWISE RESERVED

As at October 31, 2006, cash and cash equivalents in trust or otherwise reserved included $168,164 [$140,675 as at October 31, 2005] in funds received from customers for services not yet rendered and $35,449 [$41,593 as at October 31, 2005] was pledged as collateral security against letters of credit and foreign exchange forward contracts *[note 20]*.

## 5) DEPOSITS

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| Deposits on leased aircraft and engines | 10,036 | 10,125 |
| Deposits with suppliers | 39,163 | 43,261 |
| | 49,199 | 53,386 |
| Less current portion | 29,849 | 29,259 |
| | 19,350 | 24,127 |

## 6) PROPERTY, PLANT AND EQUIPMENT

| | 2006 Cost $ | 2006 Accumulated amortization $ | 2005 Cost $ | 2005 Accumulated amortization $ |
|---|---|---|---|---|
| Aircraft | 150,937 | 60,230 | 150,937 | 47,579 |
| Improvements to aircraft under operating leases | 26,525 | 15,054 | 23,643 | 10,015 |
| Aircraft equipment | 36,603 | 31,133 | 35,669 | 29,079 |
| Computer hardware and software | 98,789 | 73,161 | 87,106 | 63,436 |
| Aircraft engines | 20,358 | 7,768 | 20,358 | 6,482 |
| Office furniture and equipment | 28,853 | 21,681 | 24,531 | 18,439 |
| Leasehold improvements | 27,328 | 15,295 | 21,432 | 11,674 |
| Rotable aircraft spare parts | 25,234 | 9,426 | 25,118 | 7,464 |
| Hangar and administrative buildings | 850 | 380 | 844 | 339 |
| | 415,477 | 234,128 | 389,638 | 194,507 |
| Accumulated amortization | 234,128 | | 194,507 | |
| Net book value | 181,349 | | 195,131 | |

## 7) GOODWILL AND OTHER INTANGIBLE ASSETS

| | 2006 $ | 2005 $ |
|---|---|---|
| Goodwill | 121,138 | 93,741 |
| Trademarks | 18,454 | — |
| Customer lists | 14,089 | — |
| | 153,681 | 93,741 |

The change in goodwill is detailed as follows:

| | 2006 $ | 2005 $ |
|---|---|---|
| Balance, beginning of year | 93,741 | 86,966 |
| Acquisitions *[note 17]* | 26,866 | 8,541 |
| Translation adjustment | 531 | (1,766) |
| | 121,138 | 93,741 |

Other intangible assets are detailed as follows:

| | 2006 Cost $ | 2006 Accumulated amortization $ | 2005 Cost $ | 2005 Accumulated amortization $ |
|---|---|---|---|---|
| Intangible assets subject to amortization | | | | |
| Customer lists | 14,683 | 594 | — | — |
| Intangible assets not subject to amortization | | | | |
| Trademarks | 18,454 | — | — | — |

## 8) OTHER ASSETS

| | 2006 $ | 2005 $ |
|---|---|---|
| Deferred costs, unamortized balance | 3,387 | 4,380 |
| Investments in companies subject to significant influence and other investments | 874 | 1,071 |
| Miscellaneous | 3,714 | 3,178 |
| | 7,975 | 8,629 |

On June 6, 2005, the Corporation sold its 44.27% ownership interest in Star for a cash consideration of €4,500 [$6,900], subject to approval by authorities in France. On August 5, 2005, the French authorities approved the transaction and, as a result, the Corporation accounted for a $5,747 gain on that date.

## 9) BANK LOANS

For its Canadian operations, the Corporation has a revolving credit facility renewable annually amounting to $60,000. Under the terms and conditions of the agreement, funds may be drawn by issuing letters of credit. As at October 31, 2006, letters of credit had been issued for a total of $33,166 [$39,613 as at October 31, 2005], thereby reducing the undrawn balance of the revolving term credit facility by the same amount.

Operating lines of credit totalling €11,800 [$16,921] [€11,800 [$16,702] in 2005] have been authorized for certain French subsidiaries. These operating lines of credit are renewable annually and were unused as at October 31, 2006 and 2005.

## 9) BANK LOANS [Cont'd]

For its European operations, the Corporation has guarantee facilities renewable annually amounting to €17,893 [$25,660] [€17,793 [$25,184] in 2005]. As at October 31, 2006, letters of guarantee had been issued totalling €3,747 [$5,373] [€11,906 [$16,851] in 2005].

## 10) LONG-TERM DEBT

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| Loans secured by aircraft amounting to US$54,000 [US$57,828 as at October 31, 2005], bearing interest at the LIBOR rate plus 2.15% and 3.25% and maturing in 2008 | 60,314 | 68,243 |
| Loans secured by aircraft amounting to US$18,905 [US$20,311 as at October 31, 2005], bearing interest at the LIBOR rate plus 2.95% and 3.64% and maturing in 2007 | 21,116 | 23,969 |
| Other | 2,818 | 1,401 |
| | 84,248 | 93,613 |
| Less current portion | 26,885 | 6,199 |
| | 57,363 | 87,414 |

Payments on long-term debt due in the next two years are as follows:

| | $ |
|---|---|
| 2007 | 26,885 |
| 2008 | 57,363 |

## 11) DEBENTURES

(a) The $10,000 debenture of the subsidiary Transat Tours Canada Inc. ["Transat Tours"] bears interest at 17.5% and matured on November 1, 2005. The debenture is repayable at the option of Transat Tours at a price such that the holder earns a compound annual return of 20.5% from its issuance on November 1, 1995, taking into consideration annual interest already paid and recorded at a rate of 17.5%. The debenture, if not redeemed, is convertible into 25% of the common shares of Transat Tours.

The debenture is collateralized by certain intercorporate guarantees and by a movable hypothec on the shares of a number of the Corporation's subsidiaries and on all of the tangible assets of the subsidiary Air Transat A.T. Inc. ["Air Transat"] and of Transat Tours. Should the Corporation be subject to a takeover bid, the lender has the option to acquire all of the outstanding shares of Transat Tours at a price determined under an agreed formula.

On November 1, 2005, Transat Tours repaid the $10,000 debenture.

(b) On January 10, 2002, the Corporation and Air Transat issued debentures to certain shareholders and executives of the Corporation in the amount of $21,865, bearing interest at a rate of 6% and maturing in January 2009. The debentures are redeemable early as of January 2005 in return for payment of a penalty equal to three months' interest. The Corporation and Air Transat must also pay the holders a premium at maturity, upon early redemption or at conversion, such that the holders would earn a compound annual return of 15%, taking into consideration interest already paid at a rate of 6%.

In the course of this financing, the Corporation issued 1,421,225 warrants entitling the holders to subscribe to the same number of Class B Voting Shares of the Corporation at an exercise price of $6.75 each. These warrants expire on January 10, 2007.

On January 10, 2005, the Corporation redeemed these debentures with a nominal value of $21,865 in advance. The early redemption resulted in a total payment of $30,009, including accrued interest amounting to $7,324 and an $820 penalty, which was recorded at redemption. Furthermore, this early redemption resulted in an additional non-cash charge at the redemption date of $1,644 corresponding to the difference between the nominal value of the debentures and their carrying amount at that time.

(c) On April 6, 2004, a subsidiary of the Corporation issued a debenture in the amount of $3,156, bearing interest at a rate of 6%. The debenture is repayable in one instalment in September 2009 in cash or shares of the Corporation at the Corporation's option. The debenture is also redeemable in advance at the subsidiary's option as of April 2007 in return for a premium whereby the holder would earn a return of 9% from its issuance, taking into consideration annual interest already paid and recorded at the rate of 6%.

## 12) OTHER LIABILITIES

| | 2006 $ | 2005 $ |
|---|---|---|
| Deferred lease inducements | 15,260 | 16,219 |
| Non-controlling interest | 8,264 | 8,776 |
| Accrued benefit liability | 8,410 | 5,838 |
| | 31,934 | 30,833 |

## 13) SHARE CAPITAL

*Authorized*

Class A Variable Voting Shares

An unlimited number of Class A Variable Voting Shares ["Class A Shares"], participating, which may be owned or controlled by non-Canadians as defined by the Canada Transportation Act ["CTA"], carrying one vote per Class A Share unless (i) the number of issued and outstanding Class A Shares exceeds 25% of the total number of all issued and outstanding voting shares (or any higher percentage that the Governor in Council may specify pursuant to the CTA); or (ii) the total number of votes cast by or on behalf of holders of Class A Shares at any meeting exceeds 25% (or any higher percentage that the Governor in Council may specify pursuant to the CTA) of the total number of votes that may be cast at such meeting.

If either of the above-noted thresholds is surpassed, the vote attached to each Class A Share will decrease automatically, without further act or formality. Under the circumstance described in subparagraph (i) above, the Class A Shares as a class cannot carry more than 25% (or any higher percentage that the Governor in Council may specify pursuant to the CTA) of the aggregate votes attached to all issued and outstanding voting shares of the Corporation. Under the circumstance described in subparagraph (ii) above, the Class A Shares as a class cannot, for a given shareholders' meeting, carry more than 25% (or any higher percentage that the Governor in Council may specify pursuant to the CTA) of the total number of votes that may be cast at the said meeting.

Each issued and outstanding Class A Share shall be automatically converted into one Class B Voting Share without any further act on the part of the Corporation or of the holder if (i) the Class A Share is or becomes owned and controlled by a Canadian as defined by the CTA; or (ii) the provisions contained in the CTA relating to foreign ownership restrictions are repealed and not replaced with other similar provisions.

Class B Voting Shares

An unlimited number of Class B Voting Shares ["Class B Shares"], participating, which may be owned and controlled by Canadians as defined by the CTA only and shall confer the right to one vote per Class B Share at all meetings of shareholders of the Corporation.

Each issued and outstanding Class B Share shall be converted into one Class A Share automatically without any further act on the part of the Corporation or the holder if the Class B Share is or becomes owned or controlled by a non-Canadian as defined by the CTA.

Preferred shares

An unlimited number of preferred shares, non-voting, issuable in series, each series bearing the number of shares, designation, rights, privileges, restrictions and conditions as determined by the Board of Directors.

*Issued and outstanding*

On March 4, 2005, the Corporation's common shares were restructured into two classes of shares: Class A Shares and Class B Shares. Each issued and outstanding share that was not owned or controlled by a Canadian as defined by the CTA was converted into one Class A Share of the share capital of the Corporation and cancelled. Each issued and outstanding share owned and controlled by a Canadian as defined by the CTA was converted into one Class B Share of the share capital of the Corporation and cancelled. Immediately following the conversion, the number of Class A Shares and Class B Shares amounted to 7,818,212 and 27,228,227 respectively. The unissued common shares of the Corporation were cancelled and the Class A Shares and Class B Shares were substituted for the exercise of all rights to subscribe, purchase or convert the common shares thus cancelled.

## 13) SHARE CAPITAL [Cont'd]

The changes affecting the Class A Shares and the Class B Shares were as follows:

| | Number of shares | $ |
|---|---|---|
| Balance as at October 31, 2004 | 33,954,825 | 120,306 |
| Issued from treasury | 23,102 | 477 |
| Exercise of options | 456,992 | 3,074 |
| Conversion of warrants | 967,550 | 9,338 |
| Conversion of debentures | 5,835,081 | 51,057 |
| Repurchase and cancellation of shares | (1,081,100) | (4,814) |
| Balance as at October 31, 2005 | 40,156,450 | 179,438 |
| Issued from treasury | 38,392 | 768 |
| Exercise of options | 123,904 | 748 |
| Conversion of warrants | 59,150 | 571 |
| Repurchase and cancellation of shares | (6,730,299) | (30,095) |
| Balance as at October 31, 2006 | 33,647,597 | 151,430 |

As at October 31, 2006, the number of Class A Shares and Class B Shares amounted to 2,794,011 and 30,853,586 respectively [7,598,306 and 32,558,144 as at October 31, 2005].

*Normal course issuer bid*

On November 14, 2005, the Corporation announced an issuer bid to repurchase and cancel Class A Shares and Class B Shares. A maximum of 7,142,857 shares, or approximately 18% of the Corporation's 40,156,450 issued and outstanding Class A Shares and Class B Shares could have been repurchased at a price of not less than $17.50 per share and not more than $20.00 per share, for a total of $125,000. The issuer bid expired on December 22, 2005.

In accordance with its issuer bid, the Corporation repurchased, on January 3, 2006, a total of 6,443,299 voting shares, consisting of 1,780,797 Class A Shares and 4,662,502 Class B Shares, for a cash consideration of $125,000.

On June 13, 2006, he Corporation renewed its normal course issuer bid, which began on June 14, 2005, for a 12-month period. With this renewal, the Corporation intends to purchase for cancellation up to a maximum of 3,270,939 Class A Shares and Class B Shares, representing less than 10% of the issued and outstanding Class A Shares and Class B Shares at the offer renewal date [3,935,000 Class A Shares and Class B Shares, representing less than 10% of the issued and outstanding Class A Shares and Class B Shares as at June 8, 2005]. Shares are purchased at market prices plus brokerage fees.

In accordance with its normal course issuer bids, the Corporation repurchased, during the year ended October 31, 2006, a total of 287,000 voting shares, consisting of Class A Shares and Class B Shares, for a cash consideration of $7,422 [1,081,100 voting shares, consisting of Class A Shares and Class B Shares, for a cash consideration of $22,545 in 2005].

*Subscription rights plan*

At the annual meeting held on April 27, 2005, the shareholders ratified the renewal, by the Corporation, of a shareholders' subscription rights plan ["rights plan"]. The rights plan entitles holders of Class A and Class B Shares to acquire, under certain conditions, additional shares at a price equal to 50% of their market value at the time the rights are exercised. The rights plan is designed to give the Board of Directors time to consider offers, thus allowing shareholders to receive full and fair value for their shares. The rights plan will terminate at the annual shareholders' meeting in 2008, unless it is terminated earlier by the Corporation's Board of Directors.

*Share purchase plan*

A share purchase plan is available to eligible employees of the Corporation and its subsidiaries. Under the plan, as at October 31, 2006, the Corporation was authorized to issue up to 611,483 Class B Shares. The plan allows each eligible employee to purchase shares for a subscription limit up to 10% of his or her annual salary in effect at the time of the subscription. The purchase price of the shares under the plan is equal to the weighted average price of the Class B Shares during the five trading days prior to the issue of the shares, less 10%.

During the year, the Corporation issued 38,392 Class B Shares [23,102 Class B Shares in 2005] for a total of $768 [$477 in 2005] under the share purchase plan.

*Stock ownership incentive and capital accumulation plan*

Subject to participation in the share purchase plan offered to all eligible employees of the Corporation, the Corporation attributes annually to each eligible officer a number of Class B Shares, the aggregate subscription price of which is equal to an amount ranging from 20% to 60% of the maximum percentage of salary contributed, which may not exceed 5%. Shares so attributed by the Corporation will vest gradually to the eligible officer, subject to the eligible officer's retaining, during the first six months of the vesting period, all the shares subscribed for under the Corporation's share purchase plan.

During the year ended October 31, 2006, the Corporation accounted for a compensation expense of $79 [$65 in 2005] related to its stock ownership incentive and capital accumulation plan.

*Permanent stock ownership incentive plan*

Subject to participation in the share purchase plan offered to all eligible employees of the Corporation, the Corporation attributes annually to each eligible senior executive a number of Class B Shares, the aggregate subscription price of which is equal to the maximum percentage of salary contributed, which may not exceed 10%. Shares so attributed by the Corporation will vest gradually to the eligible senior executive, subject to the senior executive's retaining, during the vesting period, all the shares subscribed for under the Corporation's share purchase plan.

During the year ended October 31, 2006, the Corporation accounted for a compensation expense of $207 [$194 in 2005] related to its permanent stock ownership incentive plan.

*Deferred share unit plan*

Deferred share units ["DSUs"] are awarded in connection with the senior executive deferred share unit plan and the independent director deferred share unit plan. Under these plans, each eligible senior executive or independent director receives a portion of his or her compensation in the form of DSUs. The value of a DSU is determined based on the average closing price of the Class B Shares for the five trading days prior to the award of the DSUs. The DSUs are repurchased by Corporation when a senior executive or a director ceases to be a plan participant. For the purpose of repurchasing DSUs, the value of a DSU is determined based on the average closing price of the Class B Shares for the five trading days prior to the repurchase of the DSUs.

As at October 31, 2006, the number of DSUs awarded amounted to 31,653 [19,719 as at October 31, 2005]. During the year ended October 31, 2006, the Corporation accounted for a compensation expense of $501 [$316 in 2005] related to its deferred share unit plan.

*Stock option plan*

Options are granted under a stock option plan for executives and employees. Under the plan, as at October 31, 2006, the Corporation may grant 995,999 additional Class A or Class B Shares to eligible persons at a share price equal to the weighted average price of the shares during the five trading days prior to the granting of the options. Options granted may be exercised during a ten-year period subject to a maximum of one-third during the first two years after the grant date, an additional third in the third year and a final third after the start of the fourth year. The tables below summarize all outstanding options:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Number of options | Weighted average price $ | Number of options | Weighted average price $ |
| Beginning of year | 796,069 | 10.69 | 1,125,678 | 7.69 |
| Granted | 129,927 | 22.84 | 127,383 | 22.27 |
| Exercised | (123,904) | 5.73 | (456,992) | 6.52 |
| Cancelled | (91,630) | 8.42 | — | — |
| End of year | 710,462 | 14.07 | 796,069 | 10.69 |
| Options exercisable, end of year | 480,027 | 10.89 | 369,947 | 10.19 |

| 2006 | Outstanding options | | | Exercisable options | |
|---|---|---|---|---|---|
| Range of exercice prices $ | Number of options outstanding as at October 31, 2006 | Weighted average remaining life | Weighted average price $ | Number of options exercisable as at October 31, 2006 | Weighted average price $ |
| 3.00 to 4.50 | 138,813 | 6.5 years | 3.82 | 138,813 | 3.82 |
| 6.01 to 7.50 | 56,388 | 4.7 years | 6.86 | 56,388 | 6.86 |
| 7.51 to 9.00 | 17,973 | 3.5 years | 7.95 | 17,973 | 7.95 |
| 9.01 to 11.50 | 109,263 | 4.4 years | 9.80 | 101,763 | 9.82 |
| 15.01 to 17.00 | 128,922 | 7.6 years | 15.68 | 81,190 | 15.68 |
| 22.01 to 25.00 | 259,103 | 9.1 years | 22.57 | 83,900 | 22.57 |
| | 710,462 | | 14.07 | 480,027 | 10.89 |

## 13) SHARE CAPITAL [Cont'd]

*Compensation expense related to stock option plan*

During the year ended October 31, 2006, the Corporation granted 129,927 stock options [127,383 in 2005] to certain key employees. The average fair value of each option granted was estimated on the date of grant using the Black-Scholes option pricing model. The assumptions used and the weighted average fair value of the options on the date of grant are as follows:

| | 2006 | 2005 |
|---|---|---|
| Risk-free interest rate | 4.48% | 4.12% |
| Expected life | 6 years | 6 years |
| Expected volatility | 55.6% | 54.7 % |
| Dividend yield | — | — |
| Weighted average grant-date fair value | 12.70 $ | 12.26 $ |

During the year ended October 31, 2006, the Corporation recorded a compensation expense of $886 [$507 in 2005] related to its stock option plan. A total of $38 [$95 in 2005] was recognized in share capital subsequent to the exercise of options.

*Pro forma disclosure of fair value of stock options*

Prior to November 1, 2003, the Corporation accounted for options granted under its stock option plan as capital transactions. The following table shows what the impact on the financial statements would have been had the Corporation recorded the options granted between November 1, 2002 and October 31, 2003 using the fair value method. The pro forma figures do not take into account stock options granted prior to November 1, 2002.

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| Net income | 65,770 | 55,416 |
| Adjustment – stock-based compensation | (292) | (292) |
| Pro forma net income | 65,478 | 55,124 |
| Pro forma basic earnings per share | 1.88 | 1.42 |
| Pro forma diluted earnings per share | 1.84 | 1.33 |

The assumptions used and the weighted average fair value of the options on the date of grant for the year ended October 31, 2003 are as follows:

| | |
|---|---|
| Risk-free interest rate | 4.73% |
| Expected life | 6 years |
| Expected volatility | 55% |
| Dividend yield | — |
| Weighted average grant-date fair value | 2.09$ |

*Warrants*

On January 10, 2002, the Corporation granted 1,421,225 warrants *[note 11(b)]*. As at October 31, 2006, the balance of the warrants amounted to 350,325 [409,475 as at October 31, 2005], and 59,150 warrants were exercised during the year [967,550 in 2005].

*Earnings per share*

Basic earnings per share and diluted earnings per share were computed as follows:

| (In thousands, except per share amounts) | 2006<br>$ | 2005<br>$ |
|---|---|---|
| NUMERATOR | | |
| Net income | 65,770 | 55,416 |
| Interest on convertible debentures | — | (1,440) |
| Income attributable to voting shareholders | 65,770 | 53,976 |
| Interest on convertible debentures | — | 1,440 |
| Interest on debentures that may be settled in voting shares | 129 | 129 |
| Income used to calculate diluted earnings per share | 65,899 | 55,545 |
| DENOMINATOR | | |
| Weighted average number of outstanding shares | 34,907 | 37,863 |
| Effect of dilutive securities | | |
| Convertible debentures | — | 2,668 |
| Debentures that may be settled in voting shares | 141 | 135 |
| Stock options | 330 | 612 |
| Warrants | 282 | 406 |
| Adjusted weighted average number of outstanding shares used in computing diluted earnings per share | 35,660 | 41,684 |
| Basic earnings per share | 1.88 | 1.43 |
| Diluted earnings per share | 1.85 | 1.33 |

For the purposes of calculating diluted earnings per share for the year ended October 31, 2006, 129,927 stock options were excluded since the exercise price of these options was higher than the average price of the Corporation's shares.

## 14) CONVERTIBLE DEBENTURES

On February 19, 2002, the Corporation issued $51,105 of convertible unsecured subordinated debentures maturing on March 1, 2007. The debentures bore interest at 9%, payable semi-annually in cash or in common shares of the Corporation, at its option. The debentures were convertible into common shares of the Corporation, at a conversion price of $8.75 per share, at the holder's option at any time.

On or after March 1, 2005 and prior to March 1, 2006, the debentures were redeemable at par by the Corporation provided its common shares were traded at a price of $10.94 or more for 20 consecutive trading days before the notice of redemption. After March 1, 2006, the debentures were redeemable at par. The Corporation had the option to repay the debentures, in whole or in part, in cash or by delivering a number of common shares obtained by dividing the principal amount of the debentures by 95% of the market price of the Corporation's shares at the redemption date or at maturity.

On March 24, 2005, the Corporation sent a redemption notice to the holders of its convertible unsecured subordinated debentures. Under the notice, on April 25, 2005, the Corporation redeemed, at their nominal value, $35 of such debentures, representing all outstanding debentures as at that date. During the year ended October 31, 2005, but prior to the redemption date, a total of $51,057 in convertible debentures was converted into 5,835,081 shares, consisting of Class A Shares and Class B Shares.

## 15) ACCUMULATED TRANSLATION ADJUSTMENTS

Accumulated translation adjustments are detailed as follows:

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| Balance, beginning of year | (2,591) | 274 |
| Effect of foreign currency exchange rate changes on translation of net assets of self-sustaining foreign operations | 2,613 | (2,865) |
| Balance, end of year | 22 | (2,591) |

## 16) AMORTIZATION

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| Property, plant and equipment | 38,301 | 36,991 |
| Intangible assets subject to amortization | 590 | — |
| Other assets | 2,226 | 2,327 |
| Deferred lease inducements | (1,757) | (1,760) |
| | 39,360 | 37,558 |

## 17) BUSINESS ACQUISITIONS

During the years ended October 31, 2006 and 2005, the Corporation acquired several businesses. These acquisitions were recorded using the purchase method. The results of these businesses were included in the Corporation's results as of their respective dates of acquisition, unless otherwise indicated.

*2006 Acquisitions*

On December 1, 2005, the Corporation acquired the assets of 20 travel agencies operating in France and belonging to the Carlson Wagonlit Travel network for a total cash consideration of €3,102 [$4,314]. Goodwill amounting to $3,920 was recorded subsequent to this transaction. The results of these agencies have been consolidated as of January 1, 2006.

During the year ended October 31, 2006, the Corporation acquired the assets, via Travel Superstore Inc., of six travel agencies for a total consideration of $1,096. Of that amount, $338 was paid in cash on the acquisition dates, with the $619 balance payable in instalments over periods ranging from three to five years. Goodwill amounting to $925 was recognized subsequent to these transactions. The results of these agencies have been consolidated as of their respective acquisition dates.

On May 1, 2006, the Corporation acquired 100% of the issued and outstanding shares of the Thomas Cook Travel Limited ["TCT"] travel agency network, located in Canada, for a cash consideration of $8,297. TCT operates a network of 67 wholly owned agencies and 124 franchised agencies under the Thomas Cook and Marlin Travel banners. TCT also operates 22 foreign exchange offices. Subsequent to this transaction, the Corporation undertook a restructuring program that it completed prior to the end of the fiscal year ended October 31, 2006. A total of $1,651, consisting mainly of employee termination benefits, was reflected in purchase price allocation with regard to this restructuring. The Corporation does not foresee any further disbursements in respect of this integration. Goodwill amounting to $732 was recognized subsequent to this transaction.

## 17) BUSINESS ACQUISITIONS [Cont'd]

On August 1, 2006, the Corporation acquired 100% of the issued and outstanding shares of British tour operator The Airline Seat Company, which operates under the Canadian Affair brand, for £20,670 [$43,692] in cash. Goodwill amounting to $21,289 was recognized subsequent to this transaction.

### *2005 Acquisitions*

On November 1, 2004, the Corporation acquired a 70% ownership interest in Air Consultants Europe ["ACE"], a Dutch outgoing tour operator, for a total consideration of €1,050 [$1,634]. A cash consideration of €950 [$1,473] was paid on the date of acquisition. The balance of €100 is payable in two staggered instalments through November 1, 2006. As a result of this acquisition, goodwill increased by $1,579.

On May 1, 2005, the Corporation acquired a 50.1% ownership interest in Travel Superstore Inc., a Canadian company operating a travel agency network, for a cash consideration of $4,478. As a result of this acquisition, goodwill increased by $2,799.

On June 26, 2005, the Corporation acquired all of the outstanding shares of Bennett Voyages, a French outgoing tour operator, for a total consideration of €1,773 [$2,629]. A cash consideration of €1,075 [$1,594] was paid on the date of acquisition. The balance of €698 [$1,035] is payable in staggered monthly instalments through December 31, 2006. As a result of this acquisition, goodwill increased by $1,971.

On August 1, 2005, the Corporation acquired the assets of Blenus Travel Service Limited and Fundy Travel Limited, both Canadian companies operating a travel agency network, for a total consideration of $1,259. On the date of acquisition, a cash consideration of $260 was paid and the balance of $999 is payable over a five-year period without interest. As a result of this acquisition, goodwill increased by $1,117.

On October 31, 2005, the Corporation acquired the assets of Turissimo Caribe & Excursiones C. Por A., an incoming tour operator in the Dominican Republic, for a cash consideration of US$1,185 [$1,398]. As a result of this acquisition, goodwill increased by $1,075.

Business acquisitions are summarized as follows:

| | 2006 | | | | 2005 |
|---|---|---|---|---|---|
| | Thomas Cook Travel Ltd.<br>$ | The Airline Seat Company Ltd.<br>$ | Other<br>$ | Total<br>$ | Total<br>$ |
| Assets acquired | | | | | |
| Cash and cash equivalents | 3,478 | 46,319 | — | 49,797 | 7,025 |
| Cash and cash equivalents in trust or otherwise reserved | 779 | 4,861 | — | 5,640 | — |
| Other current assets | 3,710 | 7,229 | 156 | 11,095 | 14,912 |
| Property, plant and equipment | 1,284 | 420 | 409 | 2,113 | 699 |
| Intangible assets | | | | | |
| Trademarks | 2,600 | 15,642 | — | 18,242 | — |
| Customer lists | 2,900 | 11,626 | — | 14,526 | — |
| Future income taxes | 1,736 | — | — | 1,736 | — |
| Goodwill | 732 | 21,289 | 4,845 | 26,866 | 8,541 |
| | 17,219 | 107,386 | 5,410 | 130,015 | 31,177 |
| Liabilities assumed | | | | | |
| Current liabilities | 7,907 | 56,712 | — | 64,619 | 19,523 |
| Future income tax liabilities | — | 6,982 | — | 6,982 | — |
| Long-term debt | 1,015 | — | — | 1,015 | 256 |
| | 8,922 | 63,694 | — | 72,616 | 19,779 |
| Net assets acquired at fair value | 8,297 | 43,692 | 5,410 | 57,399 | 11,398 |

## 18) INCOME TAXES

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | $ | % | $ | % |
| Income taxes at the statutory rate | 32,662 | 33.0 | 30,802 | 33.1 |
| Change in income taxes arising from the following: | | | | |
| Effect of differences in Canadian and foreign tax rates | (390) | (0.4) | — | — |
| Non-deductible items | 2,701 | 2.7 | 900 | 1.0 |
| Recognition of previously unrecorded tax benefits | (2,545) | (2.6) | (2,269) | (2.4) |
| Effect of tax rate changes | 516 | 0.5 | — | — |
| Unrecorded tax benefits | — | — | 1,165 | 1.3 |
| Valuation allowance | — | — | 5,591 | 6.0 |
| Other | (898) | (0.9) | 113 | 0.1 |
| | 32,046 | 32.3 | 36,302 | 39.1 |

Income taxes as reported differ from the amount calculated by applying the statutory income tax rates to income before income taxes and non-controlling interest in subsidiaries' results.

The reasons for this difference and the effect on income taxes are detailed in the table above.

Significant components of the Corporation's future income tax assets and liabilities are detailed in the table below.

Non-capital losses carried forward and other temporary differences, which are available to reduce future taxable income of certain subsidiaries in Europe, for which no related income tax benefits have been recognized, amounted to €43,836 [$62,862] as at October 31, 2006 [€40,545 [$57,388] as at October 31, 2005]. Of these losses and deductions, an amount of €19,056 [$27 326] will expire in four years, the balance has no specific expiry date.

Undistributed earnings of the Corporation's foreign subsidiaries are considered to be indefinitely reinvested and, accordingly, no provision for income taxes has been provided thereon. Upon distribution of these earnings in the form of dividends or otherwise, the Corporation may be subject to withholding taxes.

| | 2006 | 2005 |
|---|---|---|
| | $ | $ |
| Future income taxes | | |
| Net operating loss carry-forwards and other tax deductions | 24,937 | 20,574 |
| Carrying value of capital assets in excess of tax basis | (35,935) | (25,089) |
| Non-deductible reserves and provisions | 27,910 | 27,317 |
| Other | 354 | (1,007) |
| Total future income taxes | 17,266 | 21,795 |
| Valuation allowance | (22,443) | (21,670) |
| Net future income tax assets (liabilities) | (5,177) | 125 |
| Current future income tax assets | 1,357 | 70 |
| Long-term future income tax assets | 7,120 | 5,106 |
| Long-term future income tax liabilities | (13,654) | (5,051) |
| Net future income tax assets (liabilities) | (5,177) | 125 |

## 19) RELATED PARTY TRANSACTIONS AND BALANCES

In the normal course of its operations, the Corporation enters into transactions with related companies. These transactions are measured at the exchange amount, which is the amount of consideration determined and agreed to by the related parties. Significant transactions between related parties are as follows:

| | 2006 $ | 2005 $ |
|---|---|---|
| Revenues from companies subject to significant influence | 220 | 3 002 |
| Operating expenses incurred from companies subject to significant influence | 1,340 | 3,996 |

The balances receivable from and payable to related parties included in accounts receivable and accounts payable and accrued liabilities are as follows:

| | 2006 $ | 2005 $ |
|---|---|---|
| Accounts receivable from companies subject to significant influence | 32 | 240 |
| Accounts payable and accrued liabilities due to companies subject to significant influence | 54 | 202 |

## 20) EMPLOYEE FUTURE BENEFITS

The Corporation offers defined benefit pension arrangements to certain senior executives. These arrangements provide for payment of benefits based on the number of years of eligible service provided and the average eligible earnings for the five years in which the participant's eligible earnings were the highest. These arrangements are not funded; however, to secure its obligations, the Corporation has issued a letter of credit to the trustee amounting to $13,146 *[note 9]*. The Corporation uses an actuarial estimate to measure the accrued benefit obligation as at October 31 each year.

The following table provides a reconciliation of the changes in the accrued benefit obligation:

| | 2006 $ | 2005 $ |
|---|---|---|
| Accrued benefit obligation, beginning of year | 11,739 | 5,348 |
| Current service cost | 682 | 578 |
| Cost of plan amendments | — | 4,213 |
| Interest cost | 756 | 691 |
| Actuarial loss | 1,172 | 909 |
| Accrued benefit obligation, end of year | 14,349 | 11,739 |

The funded status of the pension plan and the amounts recorded in the balance sheet under other liabilities were as follows:

| | 2006 $ | 2005 $ |
|---|---|---|
| Plan assets at fair value | — | — |
| Accrued benefit obligation | 14,349 | 11,739 |
| Plan deficit | 14,349 | 11,739 |
| Unamortized past service costs | 3,680 | 4,740 |
| Unamortized net actuarial loss | 2,259 | 1,161 |
| Accrued benefit liability | 8,410 | 5,838 |

Pension plan expense is allocated as follows:

| | 2006 $ | 2005 $ |
|---|---|---|
| Current service cost | 682 | 578 |
| Interest cost | 756 | 691 |
| Amortization of past service costs | 1,060 | 1,060 |
| Amortization of net actuarial loss | 74 | 71 |
| Pension expense | 2,572 | 2,400 |

The significant actuarial assumptions adopted to determine the Corporation's accrued benefit obligation and pension expense were as follows:

| | 2006 $ | 2005 $ |
|---|---|---|
| Accrued benefit obligation | | |
| Discount rate | 5.50 | 5.75 |
| Rate of increase in eligible earnings | 3.00 | 3.00 |
| Charge de retraite | | |
| Discount rate | 5.75 | 6.25 |
| Rate of increase in eligible earnings | 3.00 | 3.00 |

## 21) COMMITMENTS AND CONTINGENCIES

(a) The Corporation's commitments under agreements with suppliers and operating leases relating to aircraft, buildings, automotive equipment, telephone systems, maintenance contracts and office premises amounted to $544,224 and are broken down as follows: $103,118, US$203,406, €91,118 and £38,312.

The annual instalments to be made under these commitments during the next five years are as follows:

| | $ |
|---|---|
| 2007 | 248,194 |
| 2008 | 116,431 |
| 2009 | 75,715 |
| 2010 | 32,321 |
| 2011 | 16,402 |

(b) In 2009, the minority shareholder in Jonview's parent company may require the Corporation to buy the shares of Jonview's parent company which it holds at a price equal to the fair market value. The price paid may be settled, at the Corporation's option, in cash or by a share issue.

(c) The minority shareholder of ACE could require, between now and 2007, that the Corporation acquires the shares of ACE that it holds according to a predetermined pricing formula calling for a cash settlement.

(d) The minority shareholders of Travel Superstore Inc. could require, between 2011 and 2015, that the Corporation acquires the shares of Travel Superstore Inc. that they hold at a price equal to their fair market value and payable in cash.

(e) In the normal course of its operations, the Corporation is exposed to various claims and legal proceedings. These disputes often involve numerous uncertainties and the outcome of the individual cases is unpredictable. According to management, these claims and proceedings are adequately provided for or covered by insurance policies and their settlement should not have a significant negative impact on the Corporation's financial position.

## 22) GUARANTEES

In the normal course of business, the Corporation has entered into agreements that contain features which meet the definition of a guarantee. These agreements provide compensation and guarantees to counterparties in transactions such as operating leases, irrevocable letters of credit and security contracts.

These agreements may require the Corporation to compensate the counterparties for costs and losses incurred as a result of various events, including breaches of representations and warranties, loss of or damages to property, claims that may arise while providing services and environmental liabilities.

Notes 4, 9, 10, 11 and 20 to the financial statements provide information relating to some of these agreements. The following constitutes additional disclosure.

*Operating leases*

The Corporation's subsidiaries have general indemnity clauses in many of their airport and other real estate leases whereby they, as lessee, indemnify the lessor against liabilities related to the use of the leased property. These leases mature at various dates through 2034. The nature of the agreements varies based on the contracts and therefore prevents the Corporation from estimating the total potential amount its subsidiaries would have to pay to lessors. Historically, the Corporation's subsidiaries have not made any significant payments under such agreements and have liability insurance coverage in such circumstances.

*Irrevocable letters of credit*

The Corporation has entered into irrevocable letters of credit with some of its suppliers. Under these letters of credit, the Corporation guarantees the payment of certain tourist services such as hotel rooms whether it sells the services or not. These agreements, which are entered into for significant blocks of tourist services, typically cover a one-year period and are renewable. The Corporation has also issued letters of credit to provincial regulatory agencies in Ontario and British Columbia guaranteeing amounts to the Corporation's clients for the performance of its obligations. In addition to the letters of credit and security contracts mentioned in notes 4 and 9, the other guarantees totalled $378 as at October 31, 2006. Historically, the Corporation has not made any significant payments under such letters of credit.

## 22) GUARANTEES [Cont'd]

*Security contracts*

The Corporation has entered into security contracts whereby it has guaranteed a prescribed amount to its clients at the request of regulatory agencies for the performance of the obligations included in mandates by its clients during the term of the licenses granted to the Corporation for its travel agent and wholesaler activities in the province of Québec. These agreements typically cover a one-year period and are renewable annually. As at October 31, 2006, the secured amount totalled $780. Historically, the Corporation has not made any significant payments under such agreements.

As at October 31, 2006, no amounts have been accrued with respect to the above-mentioned agreements.

## 23) FINANCIAL INSTRUMENTS

In the normal course of its operations, the Corporation is exposed to risks related to exchange rate variations for certain currencies and fuel cost variations. The Corporation manages these risks through various financial instruments. The Corporation's management is responsible for determining the acceptable level of risk and only uses financial instruments to hedge existing commitments or obligations and not to realize a profit on trading operations.

*Credit risk related to financial instruments*

The theoretical risk to which the Corporation is exposed in relation to financial instruments is limited to the replacement cost of contracts at market prices in effect in the event of default by one of the parties. Management is of the opinion that the credit risk related to financial instruments is well controlled because the Corporation only enters into agreements with large financial institutions and multinational companies.

*Management of fuel price and foreign exchange risks*

The Corporation has entered into fuel purchasing contracts to manage fuel price fluctuation risks. As at October 31, 2006, 53% of estimated fuel requirements for fiscal 2007 and 12% of estimated requirements for fiscal 2008 were covered by fuel purchasing contracts [39% of fuel requirements for fiscal 2006 were covered as at October 31, 2005].

The Corporation has entered into foreign exchange forward contracts, expiring in less than two years, for the purchase and sale of foreign currencies to manage its foreign exchange risk. As at October 31, 2006, the face value of these contracts for the purchase of foreign currencies amounted to $645,878 [$427,085 as at October 31, 2005].

The fair value of financial instruments generally reflects the estimated amounts that the Corporation would receive from settlements of favourable contracts or that it would be required to pay to cancel unfavourable contracts at the balance sheet date. These estimated fair values are based on the prices obtained from large financial institutions and multinational companies. As at October 31, 2006 and 2005, the fair values in the event of a settlement were as follows:

| 2006 | Favourable $ | Unfavourable $ |
|---|---|---|
| Foreign exchange forward contracts | 3,020 | 3,027 |
| Fuel purchasing contracts | 52 | 18,605 |
| | 3,072 | 21,632 |

| 2005 | Favourable $ | Unfavourable $ |
|---|---|---|
| Foreign exchange forward contracts | 1,095 | 9,400 |
| Fuel purchasing contracts | 1,791 | 2,972 |
| | 2,886 | 12,372 |

*Credit risk*

The Corporation believes it is not exposed to a significant concentration of credit risk. Cash and cash equivalents are invested on a diversified basis in investment-grade corporations. Accounts receivable generally arise from the sale of vacation packages to individuals through retail travel agencies and the sale of seats to tour operators which are dispersed over a wide geographic area. As at October 31, 2006 and 2005, no account represented more than 10% of the total accounts receivable.

*Fair value of financial instruments reported in the balance sheets*

Due to the short-term nature of current financial assets and liabilities reported in the consolidated balance sheets, their carrying amount approximates their fair value.

Due to the nature of long-term debt reported in the consolidated balance sheets, its carrying amount approximates its fair value.

The fair value of the debentures could not be determined with sufficient reliability due to their specific nature.

## 24) SEGMENT DISCLOSURE

The Corporation has determined that it conducts its activities in a single industry segment, namely holiday travel. Therefore, the statements of income include all the required information. With respect to geographic areas, the Corporation operates mainly in North America and in Europe. Geographic intersegment sales are accounted for at prices that take into account market conditions and other considerations.

| | North America<br>$ | Europe<br>$ | Total<br>$ |
|---|---|---|---|
| 2006 | | | |
| Revenues from third parties | 2,059,611 | 544,135 | 2,603,746 |
| Operating expenses | 1,940,816 | 535,986 | 2,476,802 |
| | 118,795 | 8,149 | 126,944 |
| 2005 | | | |
| Revenues from third parties | 1,896,487 | 467,994 | 2,364,481 |
| Operating expenses | 1,776,811 | 467,039 | 2,243,850 |
| | 119,676 | 955 | 120,631 |

| | Revenues[1] | | Property, plant and equipment, goodwill and other intangible assets | |
|---|---|---|---|---|
| | 2006<br>$ | 2005<br>$ | 2006<br>$ | 2005<br>$ |
| Canada | 2,038,594 | 1,892,749 | 215,899 | 225,492 |
| France | 465,728 | 452,323 | 60,374 | 53,929 |
| U.K. | 62,055 | — | 49,266 | — |
| Other | 37,369 | 19,409 | 9,491 | 9,451 |
| | 2,603,746 | 2,364,481 | 335,030 | 288,872 |

[1] Revenues are allocated based on the subsidiary's country of domicile.

## 25) COMPARATIVE FIGURES

Certain comparative figures were reclassified to conform to the presentation adopted in the current year.

# SUPPLEMENTARY FINANCIAL DATA

(In thousands of dollars, except per share data)

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Consolidated Statements of Income | | | | | |
| Revenues | 2,603,746 | 2,364,481 | 2,199,822 | 2,096,649 | 2,073,508 |
| Operating expenses | 2,476,802 | 2,243,850 | 2,036,067 | 2,021,687 | 1,999,360 |
| | 126,944 | 120,631 | 163,755 | 74,962 | 74,148 |
| Expenses and other income | | | | | |
| Amortization | 39,360 | 37,558 | 33,027 | 42,138 | 43,189 |
| Restructuring charge | — | (934) | 11,350 | 47,972 | — |
| Interest on long-term debt and debentures | 7,264 | 10,815 | 7,712 | 9,839 | 12,491 |
| Other interest and financial expenses | 1,484 | 1,708 | 1,907 | 3,071 | 4,563 |
| Interest income | (15,706) | (12,963) | (11,307) | (9,530) | (5,628) |
| Foreign exchange (gain) loss on long-term monetary items | (4,162) | (2,309) | 1,474 | (3,873) | (984) |
| Gain on disposal of investment | — | (5,747) | — | — | — |
| Share of net (income) loss of companies subject to significant influence | (375) | (461) | 1,509 | (673) | (919) |
| | 27,865 | 27,667 | 45,672 | 88,944 | 52,712 |
| Income (loss) before the following items | 99,079 | 92,964 | 118,083 | (13,982) | 21,436 |
| Income taxes (recovery) | 32,046 | 36,302 | 45,010 | (5,533) | 9,649 |
| Non-controlling interest in subsidiaries' results | (1,263) | (1,246) | (753) | (766) | (182) |
| Income (loss) from continuing operations for the year | 65,770 | 55,416 | 72,320 | (9,215) | 11,605 |
| Income (loss) from discontinued operations for the year | — | — | — | 54,083 | (1,853) |
| Net income for the year | 65,770 | 55,416 | 72,320 | 44,868 | 9,752 |
| Basic earnings (loss) per share | | | | | |
| Continuing operations | 1.88 | 1.43 | 2.07 | (0.38) | 0.30 |
| Discontinued operations | — | — | — | 1.65 | (0.06) |
| | 1.88 | 1.43 | 2.07 | 1.27 | 0.24 |
| Diluted earnings (loss) per share[2] | | | | | |
| Continuing operations | 1.85 | 1.33 | 1.76 | (0.38) | 0.30 |
| Discontinued operations | — | — | — | 1.65 | (0.06) |
| | 1.85 | 1.33 | 1.76 | 1.27 | 0.24 |
| Cash flows from: | | | | | |
| Operating activities (continuing operations) | 113,279 | 74,156 | 184,321 | 77,257 | 186,428 |
| Investing activities (continuing operations) | (42,173) | (43,190) | (84,475) | (9,150) | (85,347) |
| Financing activities (continuing operations) | (152,046) | (44,091) | (35,359) | (61,368) | 14,069 |
| Effect of exchange rate changes on cash and cash equivalents | 2,332 | (4,255) | 3,436 | (470) | 437 |
| Net change in cash and cash equivalents from continuing operations | (78,608) | (17,380) | 67,923 | 6,269 | 115,587 |
| Net change in cash and cash equivalents from discontinued operations | — | — | — | 77,858 | 434 |
| Net change in cash and cash equivalents | (78,608) | (17,380) | 67,923 | 84,127 | 116,021 |
| Cash and cash equivalents, end of year | 214,887 | 293,495 | 310,875 | 242,952 | 158,823 |
| Operating cash flow | 104,802 | 78,014 | 124,039 | 52,795 | 73,942 |
| Total assets | 959,195 | 949,537 | 838,389 | 714,757 | 773,468 |
| Long-term debt (including current portion) | 84,248 | 93,613 | — | 35,350 | 82,702 |
| Debentures | 3,156 | 13,156 | 33,214 | 31,731 | 30,907 |
| Shareholders' equity | 295,963 | 362,283 | 311,106 | 239,596 | 192,062 |
| Debt/equity ratio[1] | 0.69 | 0.62 | 0.63 | 0.66 | 0.75 |
| Book value per share | 8.80 | 9.02 | 9.16 | 7.29 | 5.92 |
| Return on weighted average shareholders' equity | 19.98% | 16.03% | 25.11% | 19.32% | 4.76% |
| Shareholding statistics (in thousands) | | | | | |
| Outstanding shares at year-end | 33,648 | 40,156 | 33,955 | 32,864 | 32,460 |
| Weighted average number of outstanding shares (before dilution) | 34,907 | 37,863 | 33,374 | 32,796 | 32,418 |
| Weighted average number of outstanding shares (after dilution)[2] | 35,660 | 41,684 | 41,156 | 32,796 | 32,497 |

[1] Represents total liabilities over total liabilities plus shareholders' equity.
[2] See note 11 to audited Consolidated Financial Statements.

# *Board of Directors*

**Jean-Marc Eustache**
Chairman of the Board,
President and Chief Executive Officer, Transat A.T. Inc.

**André Bisson, O.C.**
Chairman of the Board, CIRANO
Chancellor Emeritus, Université de Montréal

**John P. Cashman**
President, Humphrey Management Limited

**Lina De Cesare**
President, Tour Operators, Transat A.T. Inc.

**Benoît Deschamps**
President, Champré Capital Inc.

**Jean Guertin**
Corporate Advisor and Director
Honorary Professor, HEC Montréal

**H. Clifford Hatch Jr.**
President and Chief Executive Officer,
Cliffco Investments Limited

**Jacques Simoneau**
Executive Vice President, Investment,
Business Development Bank of Canada

**Philippe Sureau**
President, Distribution, Transat A.T. Inc.

**John D. Thompson**
Deputy Chairman,
Montreal Trust Company of Canada

**Dennis Wood, O.C.**
President and Chief Executive Officer, DWH Inc.

- Executive Committee
- Human Resources and Compensation Committee
- Audit Committee
- Corporate Governance and Nominating Committee
- President of the Committee

## *Senior Management Transat A.T. Inc.*

Jean-Marc Eustache
President and Chief Executive Officer

Philippe Sureau
President, Distribution

Lina De Cesare
President, Tour Operators

Bernard Bussières
Vice-President, General Counsel and Corporate Secretary

Corinne Charette
Vice-President and Chief Information Officer

André De Montigny
Vice-President, Corporate Development

François Laurin
Vice-President, Finance and Administration and Chief Financial Officer

Michel Lemay
Vice-President, Communications and Corporate Affairs

Louise Piché
Corporate Vice-President, Human Resources

## *Subsidiaries Management*

Air Consultants Europe
Elisabeth van Raalte
General Manager

Air Transat
Allen B. Graham
President and Chief Executive Officer

Canadian Affair
Anette Rayner
President and General Manager

Club Voyages (France)
Patricia Chastel
General Manager

Handlex
Jean-Luc Paiement
President and Chief Executive Officer

Jonview Canada
Donald Obonsawin
President

Look Voyages
Olivier Kervella
General Manager

Rêvatours
Amina Hafez
General Manager

Tourgreece
Vassilis P. Sakellaris
President

Transat Distribution Canada
Philippe Sureau
President

Transat Tours Canada
Nelson Gentiletti
President

Trip Central
Richard Vanderlubbe
President

Vacances Transat (France)
Patrice Caradec
General Manager

*Information for Shareholders*

### Head Office

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### Information

Press releases are available on our website at www.transat.com
For additional information, investors and analysts are invited to contact, in writing, the Vice-President, Finance and Administration and Chief Financial Officer.

*Ce rapport annuel est disponible en français : Pour l'obtenir, écrire au vice-président, finances et administration et chef de la direction financière.*

### Stock Exchange

Toronto Stock Exchange (TSX) TRZ.B; TRZ.A.

### Transfer Agent and Registrar

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www.cibcmellon.com

### Auditors

Ernst & Young LLP
Montréal, Québec

### Annual General Meeting of shareholders

March 14, 2007, 10:00 a.m
The Fairmont Royal York Hotel
100 Front St. West
Imperial Room
Toronto, Ontario

Graphic Design: Claude Angers
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