



***Telesat***<sup>®</sup>

2006 Annual Report

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

**March 7, 2007**

This management's discussion and analysis of financial condition and results of operations (MD&A) comments on Telesat Canada's (Telesat or the Company) operations, performance and financial condition for the years ended December 31, 2006 and 2005. Please refer to the consolidated financial statements and related notes when reading this MD&A. Additional information about Telesat can be found in the Investor Relations section of Telesat's website at [www.telesat.com](http://www.telesat.com) and on SEDAR at [www.sedar.com](http://www.sedar.com). In this MD&A, *we*, *us*, *our* and *Telesat* mean Telesat Canada and its subsidiaries.

The financial information presented herein has been prepared on the basis of Canadian GAAP.

All amounts in this MD&A are in millions of Canadian dollars unless otherwise specified.

### **ABOUT FORWARD-LOOKING STATEMENTS**

Certain statements in this MD&A are not historical facts and are "forward-looking statements" within the meaning of applicable securities laws. We intend that those statements be covered by the safe harbors created under those laws. Words such as "believes," "expects," "estimates," "may," "intends," "should" or "anticipates" and similar expressions or their negatives identify forward-looking statements. Unless otherwise indicated, forward-looking statements in Telesat's MD&A describe our expectations at March 7, 2007.

Our actual results could differ materially from what we expect if known or unknown risks affect our business, or if our estimates or assumptions turn out to be inaccurate. As a result, we cannot guarantee that any forward-looking statement will materialize and, accordingly, you are cautioned not to place undue reliance on these forward-looking statements. Except as otherwise indicated by Telesat, forward-looking statements do not take into account the effect that transactions or non-recurring or other special items announced or occurring after the statements are made may have on our business. The financial impact of these transactions or non-recurring and other special items can be complex and depends on the facts particular to each of them. We therefore cannot describe the expected impact in a meaningful way or in the same way we present known risks affecting our business.

A number of assumptions were made by Telesat in making forward-looking statements in this MD&A, such as certain Canadian economic and market assumptions, operational and financial assumptions, and assumptions about transactions. Certain factors that could cause results or events to differ materially from our current expectations include, among others, our ability to exploit and respond to technological innovation, the effects of laws and regulations (including tax laws and regulations) and legal and regulatory changes, our anticipated future revenues, our anticipated capital spending (including for future satellite procurements), our anticipated financial resources, our expectations about the future operational performance of our satellites (including their projected operational lives), the expected strength of and growth prospects for our existing customers and the markets that we serve, and other statements contained in this annual report regarding matters that are not historical facts. Statements of that sort involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by any statements of that sort.

For further information on risks and uncertainties see the Risk Factors section of this MD&A. We disclaim any intention and assume no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

## COMPANY OVERVIEW

We are the leading satellite service provider in Canada, with a significant and growing presence in the Americas. We provide our satellite and communication services throughout Canada and the Americas from a fleet of satellites that occupy Canadian orbital slots to which we have been granted access. Since our inception in 1969, we have developed strong relationships with high-quality customers. We provide our services through five business segments: *Broadcast, Business Networks, Carrier, Consulting & Other* and *Subsidiaries*.

We currently own and operate five satellites, comprised of three FSS satellites, Anik F1, Anik F1-R and Anik F2, and two DBS satellites, Nimiq 1 and Nimiq 2. Construction on a fourth FSS satellite, Anik F3, is complete and its launch is scheduled for the first half of 2007. Our construction contract for Nimiq 4, for delivery in 2008, was signed in January 2006. The construction contract for Nimiq 5, for delivery in 2009, was signed in December 2006. We lease and operate two satellites, Nimiq 3 and Nimiq 4i, that are owned by DIRECTV Inc. (DIRECTV), but are located in our orbital slots and are used by us. Nimiq 4i will be replaced in the second quarter of 2007 by another interim satellite. In addition, we operate eight satellites for others: two Mobile Satellite Services, or MSS, satellites for an entity managed by MSV LP, one satellite for DIRECTV, four satellites for XM Satellite Radio and, beginning in January 2007, one satellite for WildBlue Communications, Inc.

We are regulated as a telecommunications common carrier by the Canadian Radio-television and Telecommunications Commission (CRTC) as well as being licensed by Industry Canada for access and use of Canadian orbital slots and associated spectrum resources. The use of our orbital slots, as well as our other operations, is subject to a variety of other Canadian and international regulations.

### ***Reorganization of Telesat***

BCE Inc. (BCE) owns 100% of Telesat and on December 18, 2006 announced the sale of Telesat to a new company formed by Canada's Public Sector Pension Investment Board (PSP Investments) and Loral Space & Communications Inc. (Loral). Net of Telesat's debt, BCE will, at closing of the sale, realize total proceeds of \$3.25 billion from the all cash transaction. The sale is subject to customary closing conditions, including regulatory approval both in Canada and the United States and the absence of a material adverse change affecting Telesat's business. The transaction is expected to close in mid-2007.

On January 1, 2007, Telesat, its parent Alouette Telecommunications Inc. (Alouette), a wholly owned subsidiary of BCE, and Telesat's subsidiary 4387678 Canada Inc. (4387678) were amalgamated. The name of the newly amalgamated entity is Telesat Canada.

It is expected that prior to the completion of the sale to PSP Investments and Loral, Telesat will sell both its interest in WildBlue Communications, Inc. and its promissory notes receivable from TMI Communications and Company, Limited Partnership (TMI) (see notes 10 and 11 (a) of the consolidated financial statements) to BCE in return for promissory notes receivable from BCE. Certain patents held by BCE on behalf of Telesat will be transferred to Telesat in exchange for common shares of Telesat. The notes payable to BCE received on the 2006 acquisition of a tax loss company will be used to cancel a portion of the notes receivable from BCE and the balance of the promissory notes receivable from BCE, including the notes received on the 2006 sale of Telesat's interest in TMI to BCE, will be used in order to satisfy a dividend to BCE to be declared in 2007 (see note 3 of the consolidated financial statements).

In connection with the sale transaction, Loral is expected to combine the fixed satellite services and network services assets of Loral Skynet with Telesat. Telesat expects that it will have to incur a substantial amount of indebtedness concurrent with the sale transaction to PSP Investments and Loral.

### ***Revenue Sources and Recognition***

We earn the majority of our revenues by providing video and data services using satellite transponder capacity. We also earn revenue by providing ground-based transmit and receive services, selling equipment, managing satellite networks, and providing consulting services in the field of satellite communications. Our broadcast, business networks, carrier and subsidiaries segments each generate revenues from both satellite (or space) services as well as ground (or earth) based services.

We recognize revenues when earned, as services are rendered or as products are delivered to customers. For us to recognize revenue there must be clear proof that an arrangement exists, the amount of revenue must be fixed or determinable and our ability to collect must be reasonably assured. In particular, broadcast, carrier and business networks revenues are generally pre-billed to the customers and recognized in the month for which the service is rendered. Equipment sales revenues are recognized when the equipment is delivered to the customer and accepted. Consulting revenues for cost plus contracts are recognized after the work has been completed and accepted by the customer. The percentage of completion method is used for fixed price contracts.

### ***Expenses***

A significant expense is the straight-line amortization of the cost of each of our satellites over its useful life.

Our operations and administration expenses consist mainly of labour, the cost of which is relatively stable. As we take advantage of growth opportunities through the addition of satellites to our fleet, we can significantly increase revenue with relatively smaller increases in expenses from operations and administration. Our most significant variable expenses are in-orbit insurance and direct-billed expenses, such as third-party contractor services. The majority of our operations and administration expenses are recorded on a segment-by-segment basis; however, management makes allocation estimates for some general administrative costs over business segments.

Cost of equipment sales has been significant because of our role in setting up comprehensive communication networks for our large corporate customers. We generally do not bear inventory risk but rather purchase equipment as part of an overall service to the customer.

## **CRITICAL ACCOUNTING ESTIMATES**

Our significant accounting policies are described in note 1 to our audited consolidated financial statements. Under Canadian GAAP, the preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities in the financial statements.

Estimates are based on past experience and on other reasonable factors. Because this involves varying degrees of judgment and uncertainty, actual results reported in the financial statements could, in the future, prove to be inaccurate.

The following estimates rely heavily on management's judgment and are based on factors that are highly uncertain.

### ***Receivables***

We continuously monitor collections and payments from customers and maintain an allowance for doubtful accounts based upon historical experience and any specific customer collection issues which have been identified. If our ability to collect the receivable is not reasonably assured at the time services are performed, we will not initially record the revenues. If there is a change in the customer's financial status or the receivable is collected, revenues are recorded at that time. The estimate of our allowance for doubtful accounts could materially change from period to period due to the allowance being a function of the composition of accounts receivable, which can vary on a month-to-month basis.

### ***Evaluation of satellites and other long-lived assets for impairment and insurance coverage***

We periodically evaluate potential impairment loss relating to the satellites and other long-lived assets, when a change in circumstances occurs, by assessing whether the carrying amount of these assets can be recovered over their remaining lives through undiscounted future expected cash flows generated by those assets. If the expected undiscounted future cash flows are determined to be less than the carrying value of the long-lived asset, an impairment charge would be recorded. Changes in estimates of future cash flows could result in a write-down of the asset in a future period. Estimated future cash flows could be impacted by, among other things:

- changes in estimates of the useful life of the satellite;
- changes in estimates of our ability to operate the satellite at expected levels;
- changes in the manner in which the satellite is to be used; and
- the loss of one or several significant customer contracts on the satellite.

If an impairment loss were indicated, such amount would be recognized in the period of the occurrence, net of any insurance proceeds to be received so long as such amounts are determinable and receipt is probable. If no impairment loss were indicated and insurance proceeds were received, the proceeds would offset the carrying value of the satellite. In the event that the insurance proceeds received exceeded the carrying value of the satellite, the excess of the proceeds over the carrying value of the satellite would be recognized in the statement of earnings.

### ***Depreciable lives***

Management makes assumptions of the estimated useful lives of assets which it believes are reasonable. The estimated useful lives of assets are determined by a continuing program of asset life studies. The recoverability of tangible assets is significantly impacted by the estimated useful lives of assets.

The estimated useful lives of the satellites are based upon the lesser of the satellite's design life or the estimated life of the satellite as determined by an engineering analysis performed during initial in-orbit testing. As the telecommunications industry is subject to rapid technological change and the satellites can be subject to certain anomalies, the estimated useful lives of satellites and communications equipment may have to be revised and the carrying value adjusted. Accordingly, the estimated useful lives of the satellites are periodically reviewed using current engineering data. If a significant change in the estimated useful lives of the satellites is identified, the effect of such changes on amortization expense would be accounted for on a prospective basis. Reductions in the estimated useful lives of the satellites would result in additional amortization expense in future periods and may necessitate acceleration of planned capital expenditures in order to replace or supplement the satellite earlier than planned. If the reduction in the estimated useful life of a satellite results in undiscounted future cash flows for the satellite to be less than the carrying value of the satellite, an impairment charge would be recorded.

### ***Investments***

We assess the recoverability of our long-term investments on a regular, recurring basis. The estimate of our recoverability of long-term investments could materially change from period to period due to the nature of long-term investments as we do not control the investees.

### ***Goodwill impairment***

The valuation of goodwill is assessed every year and whenever events or changes in circumstances indicate that it might be impaired. We generally measure for impairment using a projected discounted cash flow method and confirm the assessment using other valuation methods. If the asset's carrying value is more than its fair value, the difference is recorded as a reduction in the amount of goodwill on the balance sheet and an impairment charge in the statement of earnings.

A number of significant estimates are made when calculating fair value using a projected discounted cash flow method. These estimates include the assumed growth rates for future cash flows, the number of years used in the cash flow model, the discount rate and many others.

Management believes that all of the estimates are reasonable. They are consistent with the internal planning and reflect best estimates, but they have inherent uncertainties that management may not be able to control.

Any changes in each of the estimates used could have a material impact on the calculation of the fair value and resulting impairment charge. As a result, we are not able to reasonably quantify the changes in the overall financial performance had different assumptions been used. We cannot predict whether an event that triggers impairment will occur, when it will occur or how it will affect the reported asset values.

There were no impairment charges recorded in 2005 or 2006.

### ***Employee benefit plans***

We maintain defined benefit plans that provide pension, other retirement and post-employment benefits for some of our employees. The amounts reported in the financial statements relating to these benefits are determined using actuarial calculations that are based on several assumptions.

A valuation is performed at least every three years to determine the actuarial present value of the accrued pension and other retirement benefits. The last valuation was done as of January 1, 2004. The valuation uses management's assumptions for the discount rate, expected long-term rate of return on plan assets, rate of compensation increase, health-care cost trends and expected average remaining years of service of employees.

While management believes that these assumptions are reasonable, differences in actual results or changes in assumptions could materially affect employee benefit obligations and future net benefit plans costs. The differences between actual and assumed results are accounted for by recognizing differences in benefit obligations and plan performance over the working lives of the employees who benefit from the plans.

The two most significant assumptions used to calculate the net employee benefit plans cost are the discount rate and the expected long-term rate of return on plan assets:

- *Discount rate.* The discount rate is the interest rate used to determine the present value of the future cash flows required to settle employee benefit obligations. It is based on the yield on long-term high-quality corporate fixed income investments, with maturities matching the estimated cash flows from the plan. The appropriate discount rate is determined at the end of each year. At December 31, 2006, the discount rate was 5.3%, an increase from 5.2% at December 31, 2005. A lower discount rate results in a higher accrued benefit obligation and a lower pension surplus which could trigger cash contributions to the plan.
- *Expected long-term rate of return.* The expected long-term rate of return is a weighted average rate of management's forward-looking view of long-term returns on each of the major plan asset categories in our funds. The appropriate expected long-term rate of return is determined at the end of every year. In 2006, a 7.5% rate of return on plan assets was estimated, which is the same as it was in 2005. A poor fund performance results in a lower fair value of plan assets and a lower pension surplus which could result in cash contributions to the plan.

### ***Contingencies***

We accrue a potential loss where management believes the loss is probable and it can be reasonably estimated. The decision is based on information that is available at the time. The amount of the loss is estimated by consulting with outside counsel when applicable, and can involve analyzing potential outcomes and assuming various litigation and settlement strategies.

If the final resolution of a legal or regulatory matter results in a judgment against us or requires the payment of a large settlement, it could have a material and negative effect on the results of operations, cash

flows and financial position in the period that the judgment or settlement occurs. Any accrual would be charged to operating income and included in other current or long-term liabilities. Any cash settlement would be included in cash from operating activities.

We do not have any significant provisions relating to pending litigation, regulatory initiatives or regulatory proceedings at December 31, 2006. There have not been any significant changes to the Company's estimates in the past two years.

### ***Income taxes***

Management believes that it has adequately provided for income taxes based on all of the information that is currently available. The calculation of income taxes in many cases, however, requires significant judgment in interpreting tax rules and regulations, which are constantly changing.

Tax filings are also subject to audits, which could materially change the amount of current and future income tax assets and liabilities. Any change would be recorded as a charge or a credit to income tax expense. Any cash payment or receipt would be included in cash from operating activities. There were no significant changes to the estimates made in the past three years.

## **SELECTED ANNUAL AND QUARTERLY INFORMATION**

### ***Annual Financial Information***

The following selected three year consolidated financial information has been derived from and should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2006.

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(Dollars in millions except per share data)		
Operating revenues.....	\$ 479.0	\$ 474.7	\$ 362.2
Operating expenses.....	338.7	318.5	220.9
Other expense (income).....	14.6	14.8	8.2
Income tax expense .....	21.7	50.7	47.9
Net earnings.....	104.0	90.7	85.2
Dividends on preferred shares .....	1.5	1.8	1.8
Net earnings applicable to common shares .....	102.5	88.9	83.4
Basic and diluted net earnings per common share (1) .....	\$ 14.98	\$ 12.99	\$ 12.19
Total assets	1 773.8	1 664.3	1 502.5
Long-term debt (including current portion)	203.9	285.0	287.2
Future tax liability	195.4	193.7	145.1
Other long-term liabilities	348.0	387.0	365.6
Cash dividends on common shares	nil	nil	nil
Cash dividends on preferred shares	1.5	1.8	1.8

(1) At December 31, 2006, there were 6,842,547 common shares outstanding with a stated value of \$111.9 million. On November 1, 2006, we redeemed the \$50 million of preferred shares outstanding with a stated value of \$50.0 million.

Some significant changes over the three years included:

- the addition of new satellite capacity in combination with the associated amortization expense. Telesat obtained Nimiq 3 in the third quarter of 2004; brought Anik F2 into service in October 2004; brought Anik F1-R, the Anik F1 replacement, into service in October 2005, and obtained Nimiq 4i in February 2006. Anik F1 is being used solely for South American services.
- the acquisition of SpaceConnection by Telesat in 2005 and of Able Leasing Co. by Infosat in 2006.

- the continued growth of our Ka-band service for DTH Internet access on Anik F2.
- the installation in 2005 of an interactive distance learning (IDL) network entailed significant revenues and the associated cost of sale and installation expenses. The network continues to generate revenues with the maintenance work under a 5 year contract.
- changes in 2006 at the senior executive level led to non-recurring special compensation charges.
- the receipt of insurance proceeds for Anik F1 in 2004 and 2005, the repayment of the 7.4% Notes in June 2006 and the redemption of the preferred shares in November 2006.
- start of construction in April 2004 for Anik F3, in March 2006 for Nimiq 4, and the signing of the Nimiq 5 construction contract in December 2006.
- the 2006 acquisition of a loss company from BCE and the sale of the investment in TMI resulted in significant receivables and payables.

### *Quarterly Financial Information*

(in millions of dollars except per share data)

	1 Q	2 Q	3 Q	4 Q
<b>2006</b>				
Operating revenues	117.9	119.6	113.5	128.0
Earnings from operations	39.2	39.2	31.2	30.7
Net earnings applicable to common shares	21.6	43.0	19.8	18.1
Earnings per common share, basic and diluted	\$3.16	\$6.28	\$2.89	\$2.65
<b>2005</b>				
Operating revenues	107.7	137.3	112.2	117.5
Earnings from operations	36.4	43.4	43.1	33.3
Net earnings applicable to common shares	19.5	26.3	25.3	17.8
Earnings per common share, basic and diluted	\$2.85	\$3.84	\$3.70	\$2.60

In general terms, 2006 quarterly revenues were higher than 2005 quarterly revenues as a result of the acquisition of Able, Infosat's Connect service hardware and airtime revenues, the additional satellite capacity provided by Nimiq 4i and consulting work for the preparation of the WildBlue 1 satellite launch. However the second quarter of 2005 reflects the non-recurring impact of the IDL network and was therefore higher than the same quarter in 2006.

The 2006 earnings from operations as compared to the 2005 earnings from operations, were higher in the first quarter of 2006 due to higher revenues, but lower in the second quarter due to the impact in 2005 of the IDL network and lower in the last two quarters due to higher operations and administration expenses for changes at the executive level. The net earnings applicable to common shares in 2006 reflect a significant reduction in future taxes.

Operating revenues increased \$10.5 million to \$128.0 million for the fourth quarter of 2006, compared with the same period last year. The increase is due to Infosat and the Business Networks and Broadcast segments. Infosat had incremental revenues from the acquisition of Able earlier in 2006, continued Connect service equipment sales to their American oil and gas servicing customer and the associated space capacity requirements, and higher sales in their security hardware division. Business Networks experienced increases for the Ka-band Internet access service, and our new Telipro™ and iMPACT™ services. Broadcast revenues increased due to the revenues from ExpressVu for Nimiq 4i and to the additional revenues for the distribution of certain DTH services by Starchoice.

Earnings from operations decreased \$2.6 million to \$30.7 million for the fourth quarter of 2006, compared with the same period last year. The higher revenues were offset by higher operations and administration costs for the non-recurring special compensation, for Able and for the IPO costs, and by higher cost of sales at Infosat.

Net earnings applicable to common shares increased \$0.3 million to \$18.1 million in the fourth quarter of 2006, compared with the same period last year, as the lower earnings from operations were offset by lower debt service costs resulting from the repayment of the 7.4% \$150 million notes in June 2006, and by lower taxes.

## FINANCIAL RESULTS ANALYSIS

	<b>Year Ended December 31,</b>		<b>% Change</b>
	<b>2006</b>	<b>2005</b>	
	(Dollars in millions)		
Operating revenues:			
Broadcast.....	\$ 219.6	\$ 207.1	6.0%
Business Networks .....	104.3	121.5	(14.2)%
Carrier.....	24.5	30.5	(19.7)%
Consulting and Other.....	29.6	26.2	13.0%
Subsidiaries .....	<u>101.0</u>	<u>89.4</u>	13.0%
Total operating revenues .....	<u>479.0</u>	<u>474.7</u>	0.9%
Operating expenses:			
Amortization.....	120.7	111.8	8.0%
Operations and administration.....	183.4	161.0	13.9%
Cost of equipment sales.....	<u>34.6</u>	<u>45.7</u>	(24.3)%
Total operating expenses .....	<u>338.7</u>	<u>318.5</u>	6.3%
Earnings from operations .....	140.3	156.2	(10.2)%
Other expense (income):			
Interest expense .....	24.6	29.5	(16.6)%
Other income .....	<u>(10.0)</u>	<u>(14.7)</u>	(32.0)%
Earnings before income taxes.....	125.7	141.4	(11.1)%
Income taxes.....	<u>21.7</u>	<u>50.7</u>	(57.2)%
Net earnings.....	104.0	90.7	14.7 %
Dividends on preferred shares .....	<u>1.5</u>	<u>1.8</u>	(16.7)%
Net earnings applicable to common shares .....	\$ 102.5	\$ 88.9	15.3%

### *Operating Revenues*

Consolidated operating revenues increased slightly in 2006, when compared with 2005, going from \$474.7 million to \$479.0 million, or a 0.9% increase. The increase was the result of higher revenues at our subsidiary Infosat, higher Broadcast revenue and increased sales from the provision of Ka-band services on Anik F2. These were largely offset by the non-recurring revenue in 2005 for the installation and related equipment sales of an interactive distance learning network.

Broadcast revenues grew by \$12.5 million, or 6%, to \$219.6 million in 2006. The increase can be attributed to the arrival in February 2006 of Nimiq 4i which was used to supplement the ExpressVu DTH services on Nimiq 1 and to increased revenues on Anik F1-R and Anik F2 for the distribution of certain DTH services by Starchoice.

Business Networks revenues decreased \$17.2 million, or 14.2%, to \$104.3 million. In 2005, we completed the installation of the Canadian, Mexican and American portions of an IDL network for a large North American business to over 9,100 sites. We continued to provide the associated maintenance requirements for the network in 2006, however the non-recurring revenue component from 2005 amounted to \$25.8 million. Total revenues of \$105 million will be generated pursuant to this agreement over a five-year period that commenced in the fourth quarter of 2004.

Our Ka-band service for DTH Internet access continues to gain acceptance by consumers without access to high-speed Internet from the terrestrial providers, and represents a \$9.2 million increase in revenue over 2005, the first full year of service. Steady growth has been maintained with our new Telipro™ service, an IP-based network satellite solution delivering bi-directional broadband connectivity throughout North America, and our iMPACT™ service, a two way broadband satellite network solution. 2006 was also the first full year of service provided from a navigational payload on Anik F1-R which enhances the global positioning system for aviation use in Canada and the United States. The payload went into service in October 2005.

Carrier revenues decreased by \$6.0 million, or 19.7%, to \$24.5 million in 2006 mainly as a result of one-time revenues derived from the Anik E2 satellite relocation during the fall of 2005 for services to both Argentina and Venezuela, and to a decrease in capacity requirements from Canadian and US customers.

Consulting and Other revenues increased by \$3.4 million, or 13%, in 2006 to \$29.6 million. This was largely due to the consulting work provided to WildBlue for the launch of their WildBlue 1 satellite, which took place in December 2006.

Subsidiaries revenues continue to reflect substantial growth, increasing \$11.6 million over 2005 to \$101.0 million, or 13%. In 2006, our Infosat subsidiary generated an additional \$18.0 million of revenue. In February 2006, Infosat acquired Able Leasing Co. (Able), resulting in a contribution of \$9.5 million to revenues. Infosat also continued to make Connect service equipment sales to an American oil and gas servicing company, which have in turn generated increased airtime revenues from the subsequent use of the equipment. These activities earned an additional \$7.6 million of revenue. Higher sales from their security division and on Iridium airtime make up the balance of their increase in 2006. Revenues for SpaceConnection decreased by \$4.1 million in 2006 as a result of lower demand for full time revenues and of a weaker American dollar. In February 2005, Telesat Brasil undertook to maintain an existing VSAT network servicing a number of essential service organizations in Brazil during a transition to a newer network offered by a different service provider. Notwithstanding delays in the implementation of the new network, revenue generated in 2006 decreased by \$1.7 million.

### ***Operating Expenses***

Total operating expenses in 2006 were \$338.7 million (including amortization), an increase of \$20.2 million in 2006 over 2005, principally as a result of higher amortization on satellites and higher operations and administration costs, partially offset by lower cost of equipment sales.

Amortization expense in 2006 grew by \$8.9 million over 2005 to \$120.7 million, or 8%. The increase was attributable to the higher satellite amortization from a full year of expense for Anik F1-R which was put into service in October 2005, and was partially offset by lower amortization on Anik F1 resulting from the application of the 2005 receipt of insurance proceeds which were applied against the carrying cost of the satellite.

Operations and administration expenses increased in 2006 by \$22.4 million over 2005 to \$183.4 million, or 13.9%. A significant portion of this increase was due to non-recurring special compensation costs for executive changes at Telesat Canada. A new president was appointed in September 2006 and the outgoing president remained as a senior advisor until his retirement at the end of December 2006. In addition, a \$2.0 million charge was taken for costs incurred for a planned Initial Public Offering (IPO) that did not occur. The balance of the increase was due to higher compensation and other expenses due to the addition of Able's operations to Infosat in February 2006.

Cost of equipment sales in 2006 were \$34.6 million, a decrease of \$11.1 million, or 24.3%, over 2005. The decrease was attributable to the cost of equipment required for the installation of the IDL network in 2005, partially offset by higher costs in 2006 at Infosat for their hardware sales for their Connect service to an American oil and gas servicing company and for the new radio service through Able.

### ***Earnings from Operations***

<u>Segmented Earnings from Operations</u>	<u>Year Ended</u> <u>December 31,</u>		<u>% Change</u>
	<u>2006</u>	<u>2005</u>	
	(Dollars in millions)		
Broadcast.....	\$ 131.0	\$ 129.4	1.2%
Business Networks .....	(8.7)	(5.8)	(50.0)%
Carrier.....	0.6	12.9	(95.3)%
Consulting and Other.....	10.1	9.4	7.4%
Subsidiaries .....	7.3	10.3	(29.1)%
Total earnings from operations.....	\$ 140.3	\$ 156.2	(10.2)%

Earnings from operations in 2006 reflect several notable shifts in the contributions from the individual segments. Earnings from operations in our Broadcast segment increased from 83% of our total earnings from operations in 2005 to 93% in 2006 as a result of higher margin sales of satellite capacity. This segment continues to be by far the main contributor to earnings from operations.

Earnings from operations in our Business Networks segment went from a negative contribution of -4% of our total earnings from operations in 2005 to a negative contribution of -6% in 2006, mainly due to the impact of the allocation of the non-recurring special compensation and IPO charges in addition to the Ka-band amortization on Anik F2, our most expensive satellite. The new Ka-band service is still in the process of ramping up and is not expected to become profitable until a 43,000 basic Canadian subscriber level is achieved. At December 31, 2006 the Canadian customer base for Ka-band service from Anik F2 was equivalent to 33,500 basic subscribers.

Earnings from operations in our Carrier segment decreased from 8% of our total earnings from operations in 2005 to 1% in 2006, mainly due to the decrease in revenues from customers and to the additional revenues from the relocation of Anik E2 in 2005 which had generated negligible expenses for the fully amortized satellite.

The contribution from our Consulting and Other segment grew from 6% of our total earnings from operations in 2005 to 7% in 2006, and our Subsidiaries segment decreased from 7% in 2005 to 5% in 2006.

#### ***Other Expense (Income)***

Other expense (income) includes interest expense on our debt and various liabilities, as well as capitalized interest income on the satellite construction programs, interest income and foreign exchange gains and losses. Our total other expenses (income) in 2006 remained relatively stable, with an expense of \$14.6 million in 2006 compared to \$14.8 million in 2005.

The interest expense component decreased by \$4.9 million over 2005 mainly due to repayment in June 2006 of the \$150 million note issue. This debt was not replaced immediately, and bank loans totaled \$72 million at December 31, 2006, resulting in lower interest charges.

The other income component decreased by \$4.7 million over 2005 due to the following factors:

- \$2.8 million less capitalized interest in 2006 as compared to 2005 due to lower construction-in-progress balances as a result of the launch of Anik F1-R in the second half of 2005;
- \$2.5 million less interest income from lower cash balances resulting from the repayment of the \$150 million note issue and the redemption of the \$50 million of preferred shares in November 2006;
- \$1.9 million swing in foreign exchange as we had \$1.3 million of foreign exchange gains in 2005 compared to \$0.6 million of foreign exchange losses in 2006. We hedge significant U.S. dollar assets and liabilities to alleviate the exposure of exchange fluctuations.

These decreases to other income were partially offset by lower interest expense for performance incentive payments and on the deferred milestone payments in 2006 as payments made throughout the 2005-2006 period decreased the liabilities on which the interest is based.

## ***Income Taxes***

Income taxes in 2006 decreased significantly in 2006, going from \$50.7 million in 2005 to \$21.7 million in 2006. The 57.2% decrease is attributable to lower future tax rates and the elimination of the large corporation tax on a retroactive basis to January 1, 2006, both of which resulted from the enactment of the Canadian federal budget proposals in the second quarter of 2006, and to the lower income before tax in 2006. Our effective tax rate decreased from 35.9% in 2005 to 17.2% in 2006, largely due to the tax rate changes.

## **FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

### ***Capitalization***

	<b>At December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in millions)</b>		
Debt due within one year.....	\$ 3.2	\$ 152.8	\$ 2.6
Long-term debt.....	200.7	132.2	284.6
Total debt.....	203.9	285.0	287.2
Total shareholders' equity.....	879.6	684.4	558.9
Total capitalization.....	\$ 1 083.5	\$ 933.4	\$ 846.1

### ***Cash Flows from Operating Activities***

Cash flows from operating activities decreased 5.7%, or \$13.1 million, to \$217.1 million in 2006 from \$230.2 million in 2005. This decrease is mainly due to the costs for the special one-time compensation arrangements for both the new and outgoing Presidents, and to the expenses related to the now-cancelled IPO.

### ***Cash Flows from (used in) Investing Activities***

#### ***Capital Expenditures***

We continue to make investments to expand our satellite fleet and to update our networks in order to satisfy our customers' needs. Capital expenditures for satellite construction programs totaled \$177.3 million in 2006 with the ongoing activities for Anik F3, the start of construction of Nimiq 4, deferred milestones for Anik F2 and a final adjustment for Anik F1-R. This was \$52.4 million lower than the 2005 satellite expenditures of \$229.7 which included the completion of Anik F1-R, ongoing activities for Anik F3 and deferred milestones for Anik F2. In 2007, we will launch Anik F3, continue the construction of Nimiq 4 which has an anticipated launch in 2008, and start construction of Nimiq 5, which is slated for launch in 2009.

Property additions totaled \$16.0 million in 2006, a slight increase of \$0.2 million over the 2005 total of \$15.8 million and represents general expenditures to support our general infrastructure.

#### ***Other Investing Activities***

Cash flows from all other investing activities totaled \$45.2 million in 2006. This included \$49.0 million on the net maturity of short-term investments and \$0.2 million as proceeds on disposal of assets, partially offset by \$3.9 million spent on business acquisitions, comprised of \$1.3 million for the Able acquisition by Infosat, and \$2.6 million for the first contingent consideration payment for SpaceConnection which became due as a result of its achievement of certain performance criteria by December 2005.

Cash flows from all other investing activities in 2005 totaled \$110.9 million. This included \$79.4 million on the net maturity of short-term investments, \$5.4 million in proceeds on disposal of assets and \$30.4 million of insurance proceeds received on Anik F1. A number of insurers elected to pay a discounted amount of the second instalment due in 2007 according to the negotiated settlement for Anik F1 (see note

21 of the consolidated financial statements, Commitments and Contingencies). We acquired 100% of SpaceConnection for net proceeds of \$4.3 million.

### ***Cash Flows from (used in) Financing Activities***

Cash flows used in financing activities totaled \$143.8 million in 2006, an increase of \$130.4 million over the 2005 total of \$13.4 million.

In 2006 we repaid the \$150.0 million note issue and redeemed the \$50.0 million of preferred shares. In addition, we made cash payments of \$4.6 million for capital leases (mainly SpaceConnection transponder capacity in the United States), \$6.1 million for satellite performance incentive payments, and \$17.0 million for other debt financing and preferred share dividends. These uses of cash were partially offset by proceeds from bank loans of \$83.9 million.

In 2005 we made cash payments of \$4.5 million for capital leases (again mainly SpaceConnection), \$5.4 million for satellite performance incentive payments, and \$3.5 million for other debt financing and preferred share dividends.

### ***Preferred Shares***

For the period March 31, 2004 to the date of redemption the cumulative preferred share dividend rate had been fixed at an annual rate of 3.56%. On November 1, 2006, Telesat redeemed the \$50 million of preferred shares for cash at a redemption price of \$10 per share, together with accrued but unpaid dividends.

### ***Liquidity***

Our future liquidity requirements are expected to be significant, primarily due to the debt service requirements associated with the reorganization expected to follow the sale transaction in 2007. We expect that our liquidity requirements will arise principally from our need to:

- fund capital expenditures for the construction and launch of new satellites;
- fund our debt service requirements;
- fund working capital requirements;
- expand our business organically; and
- finance any acquisitions we may make.

We believe that cash flow from operations, cash flow from customer prepayments, our cash balances and our credit facilities will be sufficient to meet our present liquidity needs. However, we cannot assure you that our operations will generate sufficient cash, or that sufficient customer prepayments or borrowings under our credit facilities will be available, to enable us to meet these needs.

The following credit facilities were available to us at December 31, 2006:

	<u>Expiry</u>	<u>Available</u>	<u>Usage(1)</u>
Revolving credit facility (Telesat Canada).....	June 3, 2010	\$165.0 million	\$72.8 million
Bank facilities (Infosat Communications).....	uncommitted	\$ 10.3 million	\$0.1 million

(1) The usage for Telesat was for draws on the credit facility and for committed but undrawn letters of credit. The usage for Infosat was for committed but undrawn letters of credit.

In addition to these credit facilities, we had cash and cash equivalents of \$38.6 million and short-term investments of \$2.1 million.

Our revolving credit facility is unsecured and contains customary covenants including a requirement that we not permit our unconsolidated Debt to trailing 12-month EBITDA ratio to exceed 3.0:1 (approximately 0.8:1 at December 31, 2006) and not permit our unconsolidated Interest Coverage ratio (EBITDA to Cash Interest Expense which is defined as debt service cost less interest income) to be less than 3.5:1 (approximately 16.1:1 at December 31, 2006) at the end of any financial quarter. Our revolving credit facility also contains a requirement that we maintain satellite risk management arrangements, including minimum levels of satellite insurance or back-up capacity for certain satellites. Continued access to our credit facility is not dependent on maintenance by us of a specific credit rating, unless BCE ceases to own or control at least 50% plus one of the total number of voting rights attached to our voting shares. BCE has no obligation to retain such ownership interest. It would be an event of default under our revolving credit facility if such a change of control were to occur and a decline in the credit rating of our general, unsecured debt to less than investment grade has occurred.

The bank facilities of our subsidiary, Infosat, are demand, revolving, secured credit facilities, renewed periodically, and are subject to customary terms and conditions included in secured facilities.

We are exposed to certain liquidity risks related to our contractual obligations and contingencies, off-balance sheet arrangements and derivative instruments. We are not able to quantify all of these risks. See note 21 to the audited consolidated financial statements for more information.

### ***Contractual Obligations***

The following table summarizes the contractual obligations at December 31, 2006 that are due in each of the next five years and after 2011.

	2007	2008	2009	2010	2011	After 2011	Total
	(Dollars in millions)						
Other debt financing, including interest (1).....	\$ 3.7	\$ 3.7	\$ 0.3	\$ -	\$ -	\$ -	\$ 7.7
Notes payable and bank loans, including interest (2).....	31.7	133.8	-	72.0	-	-	237.5
Capital leases, including interest.....	9.1	9.0	9.0	9.0	9.0	26.1	71.2
Operating leases.....	15.6	16.9	12.0	6.8	2.4	3.2	56.9
Post-retirement and employment benefit payments (3)	4.2	4.3	4.4	4.4	4.5	23.7	45.5
Commitments for capital expenditures (4).....	167.7	98.0	41.4	2.7	3.1	49.1	362.0
Other purchase obligations (4).....	4.8	4.5	-	-	-	-	9.3
Other long-term liabilities (including current portion) (5).....	<u>37.7</u>	<u>3.6</u>	<u>3.4</u>	<u>3.6</u>	<u>2.9</u>	<u>21.5</u>	<u>72.7</u>
Total.....	\$274.5	\$273.8	\$70.5	\$98.5	\$21.9	\$123.6	\$862.8

(1) Other debt financing does not include the \$0.9 million of committed but undrawn letters of credit at December 31, 2006.

(2) Includes our \$125 million 8.2% Notes due November 7, 2008.

(3) Benefit payments to 2015 only as obligations beyond this date are not quantifiable.

(4) The commitments for capital expenditures include the construction and launch of the Anik F3, Nimiq 4 and Nimiq 5 satellites (see note 21 to our audited consolidated financial statements), inventory purchases and the further development of the Ka-band ground infrastructure. Other purchase obligations consist mainly of contractual obligations under service contracts.

(5) Other long-term liabilities included in the table relate to performance incentive payments on various satellites within our fleet and to deferred milestones for the Anik F2 satellite. See note 15 (b) and (c) of our audited consolidated financial statements. Certain payment milestones related to the Anik F2 program have been deferred for a three-year period following the launch in 2004. The present values of these payments have been capitalized to the satellite asset and recorded as liabilities.

Our future contributions to the pension plans and future income tax liabilities have not been included in the table as the timing and amount of cash required cannot be accurately determined as:

- future contributions to the pension plans depend largely on the result of actuarial valuations that are performed periodically and on the investment performance of the pension fund assets; and
- future payments of income taxes depend on the amount of taxable earnings and on whether there are tax loss carry forwards available to reduce income tax liabilities.

Deferred revenues and gains on assets have not been included in the table above because they do not represent future cash payments. See note 15 to our audited consolidated financial statements.

### ***Off-Balance Sheet Arrangements***

In the normal course of business, we enter into agreements that provide for indemnification and guarantees to counterparties in transactions involving sales of assets, sales of services, purchases and development of assets, securitization agreements and operating leases.

The nature of almost all of these indemnifications prevents us from making a reasonable estimate of the maximum potential amount that we could be required to pay counterparties. As a result, we cannot

determine how they could affect future liquidity, capital resources or our credit risk profile. We have not made any significant payments under these indemnifications in the past. See note 21 to our audited consolidated financial statements for more information.

### ***Market Risk***

We use derivative instruments to manage our exposure to foreign currency risk and we do not use derivative instruments for speculative purposes.

Financial instruments that potentially subject us to a concentration of credit risk consist of cash and cash equivalents and short-term investments. Investment of these funds is done with high quality financial institutions and is governed by our corporate investment policy, which aims to reduce credit risk by restricting investments to high-grade U.S. dollar and Canadian dollar denominated investments.

We are exposed to credit risk if counterparties to our derivative instruments are unable to meet their obligations. It is expected that these counterparties will be able to meet their obligations as they are institutions with strong credit ratings. We regularly monitor their credit risk and credit exposure. There was no credit risk relating to derivative instruments at December 31, 2006.

We use forward contracts to hedge foreign currency risk on anticipated transactions. At December 31, 2006, we had \$228.8 million (December 31, 2005 — \$92.2 million) of outstanding foreign exchange contracts which require us to pay Canadian dollars to receive US \$197.0 million (December 31, 2005 — US \$72.2 million) for future capital expenditures. The fair value of these derivative contract liabilities was \$0.8 million (December 31, 2005 — \$8.6 million) and the forward contracts are due between January 2007 and July 2008.

Fair value is the amount that willing parties would accept to exchange a financial instrument based on the current market for instruments with the same risk, principal and remaining maturity. Fair values are based on estimates using present value and other valuation methods.

These estimates are affected significantly by the assumptions for the amount and timing of estimated future cash flows and discount rates, which all reflect varying degrees of risk. Potential income taxes and other expenses that would be incurred on disposition of these financial instruments are not reflected in the fair values. As a result, the fair values are not necessarily the net amounts that would be realized if these instruments were actually settled.

The carrying amounts for cash and cash equivalents, short-term investments, trade receivables, other current liabilities, accounts payable and accrued liabilities approximate fair market value due to the short maturity of these instruments. It is not possible to determine the fair value of the non-interest bearing promissory notes receivable as they are the result of a related party transaction. The carrying value of the debt financing is an approximation of the fair market value due to our intention to hold the debt and pay it out at maturity.

### **RELATED PARTY TRANSACTIONS**

We have entered into various commercial arrangements with certain entities affiliated with BCE, including Bell ExpressVu, Bell Canada, NorthwTel and Bell Aliant Regional Communications, Limited Partnership. These arrangements primarily relate to the sale or use of satellite transponder capacity and are entered into in the form of either service agreements or transponder purchase and operating services agreements. Additionally, we provide Bell Canada with earth station, maintenance and installation services. See note 22 to the consolidated financial statements.

Pursuant to Section 27 of the Telecom Act, the rates, terms and conditions that we provide to our customers must be just and reasonable and not be unduly discriminatory, nor convey an undue preference. All the satellite capacity services that we provide to related parties fall under this legislation.

## **CONTROLS AND PROCEDURES**

### ***Evaluation of Disclosure Controls and Procedures***

Disclosure controls and procedures are designed to provide reasonable assurance that all material information is reported to the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) on a timely basis to allow appropriate decisions to be made regarding public disclosure. An evaluation of the effectiveness of the disclosure controls and procedures was conducted as of December 31, 2006 under the supervision of, and with the participation of the CEO and the CFO. Based on this evaluation, the CEO and the CFO have concluded that the disclosure controls and procedures, as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuer's Annual and Interim Filings, are adequate and effective and designed to ensure that all material information relating to Telesat and its subsidiaries would be made known to them by others within those entities on a timely basis.

### ***Changes in Internal Control over Financial Reporting***

During the year ended December 31, 2006, there were no changes in Telesat's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Telesat's internal control over financial reporting.

## **RISK FACTORS**

### **Risks Relating to Our Business**

***Our in-orbit satellites may fail to operate as expected due to operational anomalies resulting in lost revenue, increased costs or termination of contracts.***

Satellites utilize highly complex technology and operate in the harsh environment of space and therefore are subject to significant operational risks while in orbit. The risks include in-orbit equipment failures, malfunctions and other kinds of problems commonly referred to as anomalies. Satellite anomalies include, for example, circuit failures, transponder failures, solar array failures, battery cell and other power system failures, satellite control system failures and propulsion system failures. Our satellites may suffer from other problems that could reduce their commercial lives. Acts of war, terrorism, magnetic, electrostatic or solar storms, space debris or micrometeoroids could also damage our satellites. Additionally, due to the specialized nature of the Ka-band payload on our Anik F2 satellite, our largest and most expensive satellite, and the fact that it is partially uninsured and that no alternate satellite capacity is available, a partial or complete failure of Anik F2 could result in the total loss of revenues associated with this service with no restoration possible.

Despite working closely with the satellite manufacturers to determine and eliminate the cause of anomalies in new satellites and to provide for on-satellite back-ups for certain critical components to minimize or eliminate service disruptions in the event of failure, anomalies are likely to be experienced in the future, whether due to the types of anomalies described above or arising from the failure of other systems or components, and an on-satellite back-up may not be available upon the occurrence of such anomalies. We cannot assure you that, in these cases, it will be possible to restore normal operations. Where service cannot be restored, the failure could cause the satellite to have less capacity available for sale, to suffer a performance degradation, or to cease operating prematurely, either in whole or in part. We have experienced certain anomalies on our satellites in the past.

Any single anomaly or series of anomalies or other failure (whether full or partial) of one of our satellites could cause our revenues, cash flows and backlog to decline materially, could require us to repay prepayments made by customers of the affected satellite and could materially and adversely affect our relationships with current customers and our ability to attract new customers for satellite services. A failure could result in a customer terminating its contract for service on the affected satellite. In addition, an anomaly that has a material adverse effect on a satellite's overall performance or anticipated future commercial life could require us to recognize an impairment loss. It may also require that we expedite our planned replacement program, adversely affecting our profitability, increasing our financing needs and

limiting the availability of funds for other business purposes. Finally, the occurrence of anomalies may adversely affect our ability to insure satellites at commercially reasonable premiums, if at all, and may cause insurers to carve out additional exclusions in policies they issue.

DIRECTV Inc., or DIRECTV, has a right to terminate one of the contracts for satellites we have leased from them if there is a significant failure of one or more of their satellites. Any termination by DIRECTV would have a significant impact on our back-up and redundancy schedule for some of the services we provide to Bell ExpressVu.

***Our satellites may have launch failures or may fail to reach their planned orbital positions. Any such failure could result in the loss of a satellite or cause significant delays in the deployment of the satellite which could have a material adverse effect on our business.***

Satellites are subject to certain risks related to failed launches. Launch vehicles may fail. Launch failures result in significant delays in the deployment of satellites because of the need to construct replacement satellites, which typically takes up to 30 months or longer, and to obtain another launch vehicle. Such significant delays could materially and adversely affect operations, revenues, cash flows and backlog. Launch vehicles may also underperform, in which case the satellite may be lost or, if it can be placed into service by using its onboard propulsion systems to reach the desired orbital location, will have a shorter useful life. Certain launch vehicles used by us or scheduled to be used, such as the Proton rocket which we will be using to launch Anik F3, have experienced launch failures. Although we have had launch insurance on all of our launches to date, should we not be able to obtain launch insurance on reasonable terms and a launch failure were to occur, we could directly suffer the loss of the cost of the satellite and related costs. A failed launch could also increase, perhaps prohibitively, our cost of insuring future launches. In addition, our contracts with customers that purchase or reserve satellite capacity allow the customers to terminate their contracts in the event of material delays such as would be caused by a launch failure. Any such termination would result in the repayment of any prepayment and in a reduction in our contracted backlog and would delay or prevent our pursuit of new business opportunities.

***The launch of satellites may be delayed which could have a material adverse effect on our ability to meet our contractual commitments and to generate and grow future revenues.***

The launch of satellites is subject to certain delays. Launch delays can result from the delays in the construction of satellites and launch vehicles, the periodic unavailability of reliable launch opportunities, possible delays in obtaining regulatory approvals and launch failures. If satellite construction schedules are not met, a launch opportunity may not be available at the time the satellite is ready to be launched. Delays in the commencement of service could enable customers who have contracted for transponder capacity to terminate their contracts, could affect plans to replace an in-orbit satellite prior to the end of its useful life, could result in the expiration or cancellation of launch insurance and could result in the loss of orbital rights. The failure to implement a satellite deployment plan on schedule could have a material adverse effect on our financial condition and results of operations. We currently have two satellites scheduled for launch.

***Our insurance will not protect us against all satellite-related losses. Further, we may not be able to renew insurance on our existing satellites or obtain insurance on future satellites on acceptable terms or at all.***

Our current satellite insurance does not protect us against all satellite-related losses that we may experience, and we do not have in-orbit insurance coverage for all of the satellites in our fleet. As of December 31, 2006, the total net book value of in-orbit satellites for which we do not have insurance is approximately \$225 million. Typically, we do not insure against all possible partial failures. The insurance will not protect us against business interruption, lost revenues or delay of revenues. In addition, we do not insure the net book value of performance incentives as these are payable only to the extent that the satellite operates in accordance with contracted technical specifications. Our existing launch and in-orbit insurance policies include, and any future policies that we obtain can be expected to include, specified exclusions, deductibles and material change limitations. Typically, these insurance policies exclude coverage for damage arising from acts of war, lasers, and other similar potential risks for which exclusions are customary in the industry at the time the policy is written. In addition, they typically exclude coverage for

satellite health-related problems affecting our satellites that are known at the time the policy is written. The Anik F2 Satellite Launch and In-Orbit insurance policy contains an exclusion for the failure of the experimental Ka-Band processor or any of its components to perform in accordance with the performance specifications. Any claims under existing policies are subject to settlement with the insurers and may be used to compensate customers. Any failure of a revenue-producing satellite, whether insured or not, could require additional, unplanned capital expenditures or an acceleration of planned capital expenditures, and may result in interruptions in service, a reduction in contracted backlog and lost revenue, any of which could have a material adverse effect on our results of operations, business prospects and financial condition.

The price, terms and availability of satellite insurance has fluctuated significantly in recent years. These fluctuations can be affected by recent satellite launch or in-orbit failures and general conditions in the insurance industry. Launch and in-orbit policies on satellites may not continue to be available on commercially reasonable terms or at all. To the extent we experience a launch or in-orbit failure that is not fully insured, or for which insurance proceeds are delayed or disputed, we may not have sufficient resources to replace the affected satellite. In addition, higher premiums on insurance policies increase our costs, thereby reducing our profit. In addition to higher premiums, insurance policies may provide for higher deductibles, shorter coverage period, higher loss percentages required for constructive total loss claims and additional satellite health-related policy exclusions.

We may elect to reduce or eliminate insurance coverage relating to certain of our existing satellites, or elect not to obtain insurance policies for our future satellites, especially if exclusions make such policies ineffective or the costs of coverage make such insurance impractical or if the use of back-up transponders and self-insurance is deemed more effective.

***We may experience a failure of ground operations infrastructure that impairs the commercial performance of, or the services delivered over, our satellites or the satellites of other operators for whom we provide ground services, which could result in a material loss of revenue and could cause us to incur material contractual or civil liability.***

We own and operate an extensive ground infrastructure including our satellite control centre in Ottawa, our main earth station and back up facility at Allan Park, our six teleports throughout Canada, our two teleports located in the United States and Brazil and our TT&C facility in Perth, Australia. These ground facilities are used for the provision of end-to-end services for our customers. For example, our Toronto teleport houses equipment used in the provision of broadcast services for major broadcasters and DTH customers, VSAT services for enterprise customers and gateway services for the provision of direct-to-home Internet services to consumers.

We may experience a partial or total loss of one or more of these facilities due to natural disasters (tornado, flood, hurricane or other such Acts of God), fire, acts of war or terrorism or other catastrophic events. A failure at one of these facilities would cause a significant loss of service for our customers. Additionally, we may experience a failure in the necessary equipment at the satellite operations center, at the back-up facility, or in the communication links between these facilities and remote teleport facilities. A failure or error affecting tracking, telemetry and control operations might lead to a break-down in the ability to communicate with one or more satellites or cause the transmission of incorrect instructions to the affected satellite(s), which could lead to a temporary or permanent degradation in satellite performance or to the loss of one or more satellites. A failure at one of our facilities or in the communications links between our facilities could cause our revenues and backlog to decline materially and could adversely affect our ability to market our services and generate future revenues, our profitability, our financing needs and our ability to use available funds for other purposes.

***We derive a substantial amount of our revenues from only a few of our customers. A loss of one or more of these major customers, or a material adverse change in any such customer's business, could materially reduce our future revenues and contracted backlog.***

For the year ended December 31, 2006, Bell ExpressVu and Star Choice together accounted for 38% of our revenues, and our top five customers together accounted for 49%. Any of our major customers could refuse to renew their contracts, or could seek to negotiate concessions, particularly on price, that would

have a material adverse effect on our business, financial condition and results of operations. In addition, our customers could experience a downturn in their business, find themselves in financial difficulties or consolidate, which could result in their ceasing or reducing their use of our services (or becoming unable to pay for services they had contracted to buy).

Our customers' industries are undergoing significant consolidation, and our customers may be acquired by other companies, including by our competitors. Such acquisitions could adversely affect our ability to sell services to such customers and to any end-users whom they serve.

***Government regulations may adversely affect our ability to sell our services, or increase the expense of such services or otherwise limit our ability to run or grow our business.***

We are subject to the laws of Canada and the regulation of regulatory authorities of the Canadian government, primarily the Canadian Radio-television and Telecommunications Commission, or CRTC, and Industry Canada, as well as the laws and regulations of countries to, from or within which we provide services. Such laws and regulations may limit or prohibit our ability to sell our services in certain markets. In addition, the laws, regulations and practices of some countries may make it harder for us to compete against a domestic or regional satellite system operator from that country. Obtaining and maintaining regulatory approvals involves significant time and expense. Generally, once we have received regulatory authorization, we need an additional authorization only if we introduce new services or place a new or replacement satellite into operation. We do, however, need to renew our spectrum licenses upon expiry. Furthermore, our spectrum licenses are subject to periodic review during the term of the license. Our radio licenses also need to be renewed on an annual basis.

Countries or their regulatory authorities may adopt new laws, policies or regulations, or change their interpretation of existing laws, policies or regulations, that could cause our existing authorizations to be changed or cancelled, require us to incur additional costs, impose or change existing price ceilings, or otherwise adversely affect our operations or revenues. As a result, any currently held regulatory approvals are subject to rescission and renewal and may not remain sufficient or additional approvals may be necessary that we may not be able to obtain on a timely basis or on terms that are not unduly burdensome. Further, because the regulatory schemes vary by country, we may be subject to regulations in foreign countries of which we are not presently aware with which we are not in compliance, and as a result could be subject to sanctions by a foreign government.

If we fail to obtain or maintain particular approvals on acceptable terms, such failure could delay or prevent us from offering some or all of our services and adversely affect our results of operations, business prospects and financial condition. In particular, we may not be able to obtain all of the required regulatory approvals for the construction, launch and operation of any of our future satellites, or for the orbital slots planned for these satellites. Even if we were able to obtain the necessary approvals and orbital slots, the licenses we obtain may impose significant operational restrictions, or permit interference that could affect the use of our satellites.

Prior to March 1, 2000, the CRTC regulated our Radio Frequency Channel service rates under a form of rate of return regulation. Effective after this date, the CRTC approved an alternative form of regulation for these service rates based on certain price ceilings. While the price ceiling levels were established based on prevailing market conditions and are above current rates for certain of our existing satellite services, there can be no assurance that these ceilings will be appropriate for services offered on any future satellites operated by us.

In November 2000, the CRTC issued a decision, known as Decision 2000-745, which changed the mechanism by which local telephone service in high-cost areas is subsidized in Canada. Decision 2000-745 requires us to remit a contribution payment based on a percentage of eligible telecommunications revenues. Although these rates have not been material to date, they may increase materially in the future.

In fiscal 1999, the U.S. State Department published amendments to the International Traffic in Arms Regulations which included satellites on the list of items requiring export permits. These provisions have constrained our access to technical information and have had a negative impact on our international consulting revenues.

Provision of services into Latin American markets could be materially adversely affected by changes in applicable government regulations and telecommunication standards, licensing requirements, tariffs, taxes and other matters. Latin American operations are also subject to risks associated with economic and social instability, regulatory and licensing restrictions, exchange controls and significant fluctuations in the value of applicable currencies.

***Section 28(2) of the Telecommunications Act (Canada) may require us to reallocate capacity away from existing customers.***

Section 28(2) of the Telecommunications Act (Canada) legislates that the CRTC may allocate satellite capacity to particular broadcasting undertakings if it is satisfied that the allocation will further the implementation of the broadcasting policy for Canada. Third parties have a right to petition the CRTC for reallocation of satellite capacity and on three occasions between 1997 and 2001 a customer or potential customer has made such a petition, in one case succeeding in blocking our ability to “claw back” transponder capacity in accordance with a contract with that customer. The exercise by the CRTC of its rights under section 28(2) of the Telecommunications Act could affect our contractual agreements with existing customers, which could have a material adverse effect on our results, business prospects and financial condition.

***Our operations may be limited or precluded by future changes in ITU rules or processes, and we are required to coordinate our operations with those of nearby satellites. We cannot guarantee that other operators will comply with ITU rules requiring coordination of operations; and failure of such other operators to comply could cause harmful interference to the signals that we, or our customers, transmit.***

The International Telecommunications Union, or ITU, a specialized United Nations agency with roughly 190 member states, regulates the global allocation of bands of the radiofrequency spectrum and the registration of radiofrequency assignments and any associated orbital position in the geostationary satellite orbit. The ITU also establishes binding rules, or Radio Regulations, on radiofrequency use. These rules and spectrum allocation decisions are periodically reviewed and revised at The World Radiocommunication Conference, which takes place every two to three years. As a result, we cannot guarantee that the ITU will not change its allocation decisions and rules in the future in a way that could limit or preclude our use of some or all of our existing or future orbital positions or frequencies.

The Radio Regulations define the allocation of radiofrequency to specific uses. They also establish operating procedures for stations and prescribe detailed coordination, notification and recording procedures. With respect to the primary frequencies used by commercial geostationary satellites, the Radio Regulations set forth a process for protecting earlier-registered satellite systems from interference from later-registered satellite systems. In order to comply with these rules, we must coordinate the operation of our satellites, including any replacement satellite that has performance characteristics that are different from or exceed those of the satellite it replaces, with other satellites. The coordination process may require us to modify our proposed coverage areas, or satellite design or transmission plans, in order to eliminate or minimize interference with other satellites or ground-based facilities. Those modifications may mean that our use of a particular orbital position is restricted, possibly to the extent that it may not be commercially desirable to place a new satellite in that location.

In certain countries, a failure to resolve coordination issues is used by regulators as a justification to limit or condition market access by foreign satellite operators. In addition, while the Radio Regulations oblige later-in-time systems to coordinate their operations with us, we cannot guarantee that other operators will conduct their operations so as to avoid transmitting any signals that would cause harmful interference to the signals that we, or our customers, transmit. This interference could require us to take steps, or pay or refund amounts, that could have a material adverse effect on our business, financial position, results of operations and cash flows.

***We may incur additional indebtedness, which, if incurred, could further exacerbate the risks associated with our substantial indebtedness.***

We may incur significant additional indebtedness in the future. Although the agreements governing our existing indebtedness contain restrictions on our ability to incur additional indebtedness, these restrictions are subject to a number of important qualifications and exceptions and the indebtedness we incur in compliance with these restrictions could be substantial. If we incur additional indebtedness in the future, the related risks that we now face, including those described above, could intensify.

***The agreements governing our indebtedness will contain significant restrictions that limit our operating and financial flexibility.***

The indenture governing our existing notes and our existing credit agreement contains, and the agreements governing the indebtedness we may incur could contain, covenants that, among other things, limit our ability to:

- incur additional indebtedness and issue preferred stock;
- pay dividends and make distributions;
- repurchase stock or repay subordinated indebtedness;
- make certain investments;
- transfer, sell or make certain dispositions of assets or engage in sale and leaseback transactions;
- incur liens;
- enter into transactions with affiliates;
- create dividend or other payment restrictions affecting restricted subsidiaries; and
- merge, consolidate, amalgamate or sell all or substantially all of our assets to another party.

In addition, certain of these agreements will require us to maintain financial covenant ratios. In the event of a default under any of these agreements the lender or note holder, as applicable, could seek to declare all amounts that we have borrowed thereunder, together with accrued and unpaid interest, to be immediately due and payable. This could result in a cross-default under the instruments governing our other indebtedness. If any of our indebtedness were accelerated, our assets or other available capital resources might not be sufficient to repay in full that indebtedness or any of our other indebtedness.

***We are subject to significant and intensifying competition. We experience competition both within the satellite industry and from other providers of communications capacity.***

We provide point-to-point and point-to-multipoint services for voice, data and video communications and for high-speed Internet access. We compete against other global and regional satellite operators and against suppliers of ground-based communications capacity. Some of our direct and indirect competitors, both those in and outside of the satellite industry, have greater scale and financial resources and operating flexibility than we do. This may permit them to respond better to changes in the industry. Our primary business activities (broadcast, business networks and carrier services) have been largely dedicated to the Canadian domestic market. This market is characterized by increasing competition and rapid technological development among satellite providers. We face significant and intensifying competition in the satellite industry in both North America and South America from companies such as Intelsat Ltd and SES Global, among others. There has been a trend toward consolidation of major FSS providers. Our business is also subject to competition from ground based forms of communications technology. For many point-to-point and other services, the offering provided by terrestrial companies can be more competitive than the services offered via satellite. A number of companies are increasing their ability to transmit signals from existing terrestrial infrastructures, such as fiber optic cable. The ability of any of these companies to significantly increase their capacity through existing infrastructures would result in a decrease in the demand for our services. Increasing availability of satellite capacity, improvements in transmission technology and increasing capacity from other forms of communications technology can create an excess supply of

telecommunications capacity, decreasing the prices we would be able to charge for our services under new service contracts and thereby negatively affecting our profitability. Our failure to compete effectively would result in a loss of revenue and a decline in profitability, a decrease in the value of our business and a downgrade of our credit rating, which would restrict our access to the capital markets.

***Demand for our current and planned services may decrease materially due to downturns in the economy and technological developments.***

The market for fixed satellite services may not grow or may shrink due to downturns in the economy and competing technologies that provide cheaper or better service. As a result, we may not be able to attract customers for the services that we are providing as part of our strategy to sustain our business. Also, the implementation of new transmission technologies, or the improvement of existing technologies such as signal compression, may reduce the transponder capacity needed to transmit a given amount of information thereby reducing the total demand for capacity. Decreasing demand could reduce the number and value of our contract renewals and could have a material adverse effect on our business and results of operations going forward. In addition, there could be a negative impact on our credit ratings and our ability to access the capital markets.

Developments that we expect to support the growth of the satellite service industry, such as continued growth in data traffic and the proliferation of HDTV, may fail to materialize or may not occur in the manner or to the extent we anticipate. For example, the Ka-band payload on Anik F2 permits us to provide broadband Internet access via satellite to markets that we have not previously served. We are working with Internet service providers, telephone companies, and other partners to relay the service to end users. The sale or license of this Ka-band capacity represents a new area of business which may not be adopted as we expect.

***We are subject to competition in Canada for rights of access to existing and new orbital slots.***

Canada has the rights to a limited number of orbital slots, in conformity with the ITU Radio Regulations. Industry Canada has authorized us to access spectrum at three Canadian FSS slots and three DBS orbital slots. In September 2004, Ciel Satellite Group, or Ciel, received provisional authority from Industry Canada to operate a broadcast satellite at 129° WL, and Ciel has begun satellite operations. As a result of increased competition in Canada for access rights to Canadian orbital slots, we may in the future lose our access rights to certain Canadian orbital slots, which generally come up for review when an existing satellite reaches the end of its useful life. Our failure to retain access rights to the orbital slots we currently have could have a material adverse effect on our business, financial position, results of operations and cash flows. On July 7, 2006, Industry Canada invited applications for up to 29 licences to be awarded for Canadian satellite spectrum. We have applied for a number of licences that we can develop. We may not be successful in some or all of our applications, which could have an adverse effect on our current plans for growth.

***Our strategy of selectively pursuing acquisitions and strategic transactions may result in unexpected barriers or expenses.***

Our strategy includes selectively pursuing acquisitions and strategic transactions. Acquisitions and strategic transactions involve a number of risks, including:

- potential disruption of our ongoing business;
- distraction of management;
- difficulty with integration;
- additional staffing; and
- increasing the scope and complexity of our operations.

The presence of one or more material liabilities of an acquired company that are unknown to us at the time of acquisition may have a material adverse effect on our business. In addition, we may encounter unforeseen obstacles or costs in the integration of acquired businesses.

***We are subject to exchange rate risk.***

A substantial portion of our capital expenditures is in U.S. dollars. Our satellite insurance policies are also denominated in U.S. dollars. The currency denomination of our revenue and earnings that may be received from satellite infrastructure investments is subject to individual customer contractual arrangements. As a result, we may become exposed to foreign exchange risks which we attempt to mitigate through the use of forward currency contracts.

***We could experience the departure of key employees or may be unable to recruit the employees needed for our success.***

We rely on a number of key employees, both in management and in operations, with highly specialized skills and extensive experience in their respective fields. If we are unable to retain these employees, it could be difficult to replace them. In addition, our business, with its constant technological developments, must continue to attract highly qualified and technically skilled employees. In the future, our inability to retain or replace these employees, or our inability to attract new highly qualified employees, could have a material adverse effect on our business, financial condition and results of operations.

***We depend on a limited number of major suppliers of satellite construction and launch services. These suppliers are therefore able to negotiate favourable terms in our contracts. We also bear material risk if our suppliers experience financial or logistical difficulty.***

The number of manufacturers able to design and build satellites according to the technical specifications and standards of quality we require is limited, as is the number of agencies able to launch such satellites. The small number of these suppliers may reduce our negotiating power and could mean that we obtain less favourable financial terms. In addition, the small number of suppliers may make it difficult for us to implement our deployment program according to the desired schedule. We are also exposed to the risk that our suppliers experience operating or financial problems, that they seek bankruptcy protection, or that they are involved in lawsuits over intellectual property rights. The small number of suppliers could therefore have a material adverse effect on our business, financial condition and results of operations.

***Restrictions on non-Canadian ownership and control may reduce the possibility of our business being acquired or otherwise limit our ability to participate in industry consolidation, which may adversely affect our business.***

Telesat must be Canadian-owned and controlled under requirements enacted or adopted under the Telecommunications Act (Canada) and the Radiocommunication Act (Canada). The requirements generally provide that Canadians must own at least 80% of Telesat's voting shares, at least 80% of the members of Telesat's board of directors must be Canadian, and Telesat must not be controlled in fact by non-Canadians. In addition, at least 66 2/3% of the parent company, such as BCE, must be held by Canadians and the parent company must not be controlled in fact by non-Canadians in order that such parent corporation may qualify as Canadian. Although we believe that we are in compliance with the relevant legislation, a future CRTC or Industry Canada determination, or events beyond our control, could result in us ceasing to comply with the relevant legislation. If such a development were to occur, we may lose our license, our ability to operate our business could be jeopardized and our business could be materially affected.

Many of our competitors in the satellite industry have participated in consolidating transactions, such as mergers, in recent years. Because of the Canadian ownership restrictions, our ability to participate in industry consolidation is significantly reduced. As a result, our competitors may grow at a rate outpacing ours, allowing them to realize greater economies of scale and access to resources.

***Our operations in South America subject us to specific regulatory, political and competitive risks that could cause a material adverse effect on our business, financial condition and results of operations.***

Our provision of services into the South American markets is subject to certain risks such as changes in foreign government regulations and telecommunication standards, licensing requirements, tariffs, taxes and other matters. Our South American operations are also subject to risks associated with economic and social instability, regulatory and licensing restrictions, exchange controls and significant fluctuations in the value of foreign currencies.

***Telesat may not have access to the usual protections from creditors and other rights available to insolvent persons under applicable bankruptcy and insolvency laws.***

Pursuant to the Telesat Canada Reorganization and Divestiture Act, or the Divestiture Act, Telesat is subject to certain special conditions and restrictions. The Divestiture Act provides that no act relating to the solvency or winding-up of a corporation applies to it and in no case shall its affairs be wound up unless authorized by an Act of Parliament. As a result of such legislative provisions, Telesat may not have access to the usual protections from creditors, the restructuring process and other rights available to insolvent persons under applicable bankruptcy and insolvency laws.

## **ACCOUNTING STANDARDS**

### ***Recent Changes to Canadian Accounting Standards and Policies***

#### *Comprehensive income and equity*

The CICA has issued section 1530 of the CICA Handbook, *Comprehensive Income*. The section comes into effect for fiscal years beginning on or after October 1, 2006. It describes how to report and disclose comprehensive income and its components.

Comprehensive income is the change in a company's net assets that results from transactions, events and circumstances from sources other than the company's shareholders. It includes items that would not normally be included in net earnings such as changes in the currency translation adjustment relating to self-sustaining foreign operations and unrealized gains or losses on available-for-sale investments.

The CICA also made changes to section 3250 of the CICA Handbook, *Surplus*, and reissued it as section 3251, *Equity*. The section also comes into effect for fiscal years beginning on or after October 1, 2006. The changes in how to report and disclose equity and changes in equity are consistent with the new requirements of section 1530, *Comprehensive Income*.

Adopting these sections on January 1, 2007 will require the reporting of comprehensive income and its components and accumulated other comprehensive income and its components in the consolidated financial statements.

#### *Financial instruments*

The CICA issued section 3855 of the CICA Handbook, *Financial Instruments — Recognition and Measurement*. The section comes into effect for fiscal years beginning on or after October 1, 2006. It describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives.

This section requires that:

- all financial assets be measured at fair value, with some exceptions like loans, receivables and other financial assets that are classified as held-to-maturity, which are measured at amortized cost;
- all financial liabilities be measured at fair value if they are derivatives or classified as held for trading purposes (other financial liabilities are measured at their amortized cost); and

- all derivative instruments be measured at fair value, even when they are part of a hedging relationship.

The CICA has also reissued section 3860 of the CICA Handbook as section 3861, *Financial Instruments — Disclosure and Presentation*, which establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. These revisions come into effect for fiscal years beginning on or after October 1, 2006.

The impact on the consolidated financial statements of adopting these sections on January 1, 2007 will result in the recording of significant derivative assets and liabilities, as well as the corresponding adjustments to the opening balances of retained earnings and other comprehensive income.

### *Hedges*

The CICA has issued section 3865 of the CICA Handbook, *Hedges*. The section is effective for fiscal years beginning on or after October 1, 2006, and describes when and how hedge accounting can be used. Hedging is an activity used by a company to change an exposure to one or more risks by creating an offset between:

- changes in the fair value of a hedged item and a hedging item;
- changes in the cash flows attributable to a hedged item and a hedging item; or
- changes resulting from a risk exposure relating to a hedged item and a hedging item.

Hedge accounting makes sure that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the statement of earnings in the same period.

The impact on the consolidated financial statements of adopting this section on January 1, 2007 is that Telesat will recognize the effective portion of gains or losses from cash flow hedges in Other Comprehensive Income until such time as the hedged item is recorded in the statement of earnings.

Telesat Canada  
Auditors' Report  
Consolidated Financial Statements  
(in Canadian dollars)  
December 31, 2006 and 2005

The financial statements contain the results and financial history for the past two years. The notes are an important part of understanding the financial results. They explain how the numbers in the financial statements were arrived at, describe significant events or changes that affect the numbers, and explain certain items in the financial statements. They also include details about the financial results that do not appear in the financial statements.

#### Management's report

The accompanying consolidated financial statements of Telesat Canada (Telesat or the Company) consist of the financial information of Telesat's various holdings which are presented as one "consolidated" company. These financial statements form the basis for all financial information that appears in this annual report, are the responsibility of the management of Telesat and have been approved by the Board of Directors. The Board of Directors is responsible for ensuring that management fulfills its financial reporting responsibilities. Deloitte & Touche LLP, Chartered Accountants, the shareholders' auditors, have audited the financial statements.

Management has prepared the financial statements according to Canadian generally accepted accounting principles. Under these principles, management has made certain estimates and assumptions that are reflected in the financial statements and notes. Management believes that these financial statements fairly present Telesat's consolidated financial position, results of operations and cash flows.

To ensure the accuracy and completeness of the financial statements, management has a system of internal controls which includes communication to employees about policies for ethical business conduct. Management believes that the internal controls provide reasonable assurance that the financial records are reliable and form a proper basis for preparing the financial statements, and that the assets are properly accounted for and safeguarded.

The Board of Directors has appointed an Audit Committee, made up of unrelated and independent directors. The Audit Committee's responsibilities include reviewing the financial statements and other information in this annual report, and recommending them to the Board of Directors for approval. The shareholders' auditors have free and independent access to the Audit Committee.

Daniel S. Goldberg, President and Chief Executive Officer  
Ted H. Ignacy, Chief Financial Officer

#### Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Telesat Canada (Telesat or the Company) as at December 31, 2006 and 2005 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company'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 consolidated 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 financial statements present fairly, in all material respects, the financial position of the Company as at December 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.

Deloitte & Touche LLP  
Chartered Accountants

January 29, 2007

*Telesat Canada*  
*Consolidated Statements of Earnings*  
*for the years ended December 31, 2006 and 2005*

(in thousands of dollars, except number of shares and per share data)	Notes	2006	2005
<b>Operating revenues</b>			
Service revenues		435 123	420 297
Equipment sales revenues		43 842	54 444
<b>Total operating revenues</b>	(2)	<b>478 965</b>	<b>474 741</b>
<b>Operating expenses</b>			
Amortization	(2)	120 712	111 809
Operations and administration		183 388	160 964
Cost of equipment sales		34 578	45 705
<b>Total operating expenses</b>		<b>338 678</b>	<b>318 478</b>
<b>Earnings from operations</b>	(2)	<b>140 287</b>	<b>156 263</b>
Interest expense		(24 643)	(29 526)
Other income	(4)	10 029	14 739
<b>Earnings before income taxes</b>		<b>125 673</b>	<b>141 476</b>
Income taxes	(5)	(21 688)	(50 782)
<b>Net earnings</b>		<b>103 985</b>	<b>90 694</b>
Dividends on preferred shares		(1 487)	(1 780)
<b>Net earnings applicable to common shares</b>		<b>102 498</b>	<b>88 914</b>
Basic and diluted net earnings per common share		14.98	12.99
Weighted average number of shares outstanding		6 842 547	6 842 547

*Consolidated Statements of Retained Earnings*  
*for the years ended December 31, 2006 and 2005*

(in thousands of dollars)	2006	2005
<b>Balance at beginning of year</b>	488 309	399 505
Net earnings	103 985	90 694
Dividends on preferred shares	(1 487)	(1 780)
Other	36	( 110)
<b>Balance at end of year</b>	<b>590 843</b>	<b>488 309</b>

*Telesat Canada*  
*Consolidated Balance Sheets*  
*as at December 31, 2006 and 2005*

(in thousands of dollars)	Notes	2006	2005
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	(17)	38 633	113 477
Short term investments		2 061	51 058
Accounts and notes receivable	(6)	241 857	59 380
Current future tax asset	(5)	4 476	3 737
Other current assets	(7)	27 548	36 177
<b>Total current assets</b>		<b>314 575</b>	<b>263 829</b>
Capital assets, net	(8)	1 388 319	1 335 442
Investments	(10)	15 131	15 537
Other assets	(11)	25 642	17 063
Finite-life intangible assets, net	(9)	5 475	8 843
Goodwill	(1)	24 616	23 595
<b>Total assets</b>		<b>1 773 758</b>	<b>1 664 309</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		41 060	38 905
Other current liabilities	(12)	105 769	111 244
Debt due within one year	(13)	3 134	152 838
<b>Total current liabilities</b>		<b>149 963</b>	<b>302 987</b>
Debt financing	(14)	200 742	132 202
Future tax liability	(5)	195 382	193 742
Other long-term liabilities	(15)	348 041	387 019
<b>Total liabilities</b>		<b>894 128</b>	<b>1 015 950</b>
Commitments and contingent liabilities	(21)		
<b>Shareholders' Equity</b>			
Capital stock - common shares	(16)	111 898	111 898
Contributed surplus		180 266	1 002
Retained earnings		590 843	488 309
Cumulative translation adjustment		(3 377)	(2 850)
<b>Total common equity</b>		<b>879 630</b>	<b>598 359</b>
Capital stock - preferred shares	(16)	-	50 000
<b>Total shareholders' equity</b>		<b>879 630</b>	<b>648 359</b>
<b>Total liabilities and shareholders' equity</b>		<b>1 773 758</b>	<b>1 664 309</b>

On behalf of the board of directors:

\_\_\_\_\_  
 Director

\_\_\_\_\_  
 Director

*Telesat Canada*  
*Consolidated Statements of Cash Flow*  
*for the years ended December 31, 2006 and 2005*

(in thousands of dollars)	Notes	2006	2005
<b>Cash flows from operating activities</b>			
Net earnings		103 985	90 694
Adjustments to reconcile net earnings to cash flows from operating activities:			
Amortization		120 712	111 809
Capitalized interest		(12 184)	(14 974)
Future income taxes		1 205	36 756
Unrealized foreign exchange		( 390)	(1 649)
Deferred milestone interest		2 613	5 170
Customer prepayments on future satellite services		12 322	6 130
Other items		( 151)	1 167
Net change in operating assets and liabilities	(17)	(11 014)	(4 880)
<b>Cash flows from operating activities</b>		<b>217 098</b>	<b>230 223</b>
<b>Cash flows from investing activities</b>			
Satellite programs		(177 260)	(229 675)
Property additions		(15 963)	(15 789)
Maturity (purchase) of short term investments		48 997	79 442
Business acquisition		(3 942)	(4 363)
Proceeds on disposal of assets		178	5 353
Insurance proceeds		-	30 407
<b>Cash flows used in investing activities</b>		<b>(147 990)</b>	<b>(134 625)</b>
<b>Cash flows from financing activities</b>			
Preceeds from bank loans		83 862	-
Repayment of debt financing and bank loans		(15 026)	(2 209)
Note repayment		(150 000)	-
Share repurchase		(50 000)	-
Capital lease payments		(4 612)	(4 461)
Satellite performance incentive payments		(6 108)	(5 351)
Preferred dividends paid		(1 936)	(1 331)
<b>Cash flows used in financing activities</b>		<b>(143 820)</b>	<b>(13 352)</b>
Effect of changes in exchange rates on cash and cash equivalents		( 132)	334
Increase (decrease) in cash and cash equivalents		(74 844)	82 580
Cash and cash equivalents, beginning of year		113 477	30 897
<b>Cash and cash equivalents, end of year</b>	(17)	<b>38 633</b>	<b>113 477</b>
<b>Supplemental disclosures of cash flow information</b>			
Interest paid		30 661	31 207
Income taxes paid		34 032	13 056
		64 693	44 263

## **Notes to Consolidated Financial Statements**

*(all amounts in thousands of Canadian dollars, except where otherwise noted)*

**December 31, 2006 and 2005**

### **1. Summary of significant accounting policies**

#### **Financial statement presentation**

The consolidated financial statements of Telesat Canada (Telesat or the Company) have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Telesat consolidates the financial statements of its wholly owned subsidiaries Infosat Communications Inc. (Infosat), Telesat Brasil Limitada (Telesat Brazil), The SpaceConnection, Inc. (SpaceConnection) and 4387678 Canada Inc. All transactions and balances between these companies have been eliminated on consolidation. Some of the figures for the comparative period have been reclassified in the consolidated financial statements to make them consistent with the current period's presentation. Customer prepayments for satellite services and promissory note repayments from customers have been reclassified from cash flows from financing activities to cash flows from operating activities.

#### **Regulation**

The Company operates Canada's domestic fixed satellite telecommunication system and is subject to regulation by the Canadian Radio-television and Telecommunications Commission (CRTC). Under the current regulatory regime, Telesat has pricing flexibility subject to a price ceiling on certain Full Period Fixed Satellite Services (FSS) offered in Canada under minimum five-year lease arrangements. Telesat's Direct Broadcast Services offered within Canada are also subject to CRTC regulation, but have been treated as separate and distinct from Telesat's FSS and facilities. The Commission has approved the specific customer agreements relating to the sale of the capacity on the Nimiq satellites, including the rates, terms and conditions of service set out therein. Telesat's ground network services have been forborne from regulation since 1994. The Commission has the right of examination of the Company's accounting policies.

#### **Use of estimates**

When preparing financial statements according to GAAP, management makes estimates and assumptions relating to the reported amounts of revenues and expenses, assets and liabilities and the disclosure of contingent assets and liabilities. We base our estimates on a number of factors, including historical experience, current events and actions that the Company may undertake in the future, and other assumptions that we believe are reasonable under the circumstances. Actual results could differ from those estimates under different assumptions or conditions. We use estimates when accounting for certain items such as revenues, allowance for doubtful accounts, useful lives of capital assets, capitalized interest, assets impairments, inventory reserves, legal and tax contingencies, employee compensation plans, employee benefit plans, evaluation of minimum lease terms for operating leases, income taxes and goodwill impairment. We also use estimates when recording the fair values of assets acquired and liabilities assumed in a business combination.

#### **Revenue recognition**

Telesat recognizes operating revenues when earned, as services are rendered or as products are delivered to customers. There must be clear proof that an arrangement exists, the amount of revenue must be fixed or determinable and collectibility must be reasonably assured. In particular, broadcast, carrier and business networks revenues are generally pre-billed to the customers and recognized in the month for which the service is received. Consulting revenues for cost plus contracts are recognized after the work has been completed and accepted by the customer. The percentage of completion method is used for fixed price contracts. Deferred revenues consist of remuneration received in advance of the provision of service and are brought into income over the period to which the prepayment applies. When a transaction involves more than one product or service, revenue is allocated to each based on its relative fair value. Telesat defers upfront fees and recognizes revenue on a straight-line basis over the term of the related service contract. When it is questionable whether or not Telesat is the principal in a transaction, the transaction is evaluated to determine whether it should be recorded on a gross or net basis. Equipment sales revenues are recognized when the equipment is delivered to the customer and accepted. Only equipment sales are subject to warranty or return and there is no general right of return. Historically Telesat has not incurred significant expense for warranties and consequently no provision for warranty is recorded.

#### **Cash and cash equivalents**

All highly liquid investments with an original maturity of 90 days or less are classified as cash and cash equivalents. For the purposes of the cash flow statement, bank overdrafts are also classified as cash and cash equivalents.

**Capital assets**

Property, which is carried at cost less accumulated amortization, includes the contractual cost of equipment, capitalized engineering and, with respect to satellites, the cost of launch services, launch insurance and capitalized interest during construction. Capitalized interest provides a return on capital invested in new assets and is not currently realized in cash, but is expected to be realized over the life of the asset.

The Company shares equally with a developer, the ownership, cost and debt of the Company's headquarters land and building. The Company has leased the developer's share of the building which is accounted for as a capital lease.

Amortization is calculated using the straight line method over the respective estimated service lives of the assets based on equal life group procedures. The annualized composite rate of amortization was 7.1% in 2006 (7.5% in 2005). The expected useful lives of satellites are 11 to 15 years, earth stations are 8 to 15 years, transponders under capital lease are 12 to 15 years, office buildings are 19 to 30 years and all others are 5 to 16 years. The estimate of useful lives are reviewed every year and adjusted if necessary.

Liabilities related to the legal obligation of retiring property, plant and equipment are initially measured at fair value and are adjusted for any changes resulting from the passage of time or to the amount of the current estimate of the undiscounted cash flows.

In the event of an unsuccessful launch or total in-orbit satellite failure, all unamortized costs that are not recoverable under launch or in-orbit insurance are recorded as an operating expense.

Capital assets are assessed for impairment when events or changes in circumstances indicate that the carrying value exceeds the total undiscounted cash flows expected from the use and disposition of the assets. If impairment is indicated, the loss is determined by deducting the asset's fair value (based on discounted cash flows expected from its use and disposition) from its carrying value and is recorded as an operating expense.

The investment in each satellite will be removed from the property accounts when the satellite has been fully amortized and is no longer in service. When other property is retired from operations at the end of its useful life, the amount of the investment and accumulated amortization are removed from the accounts. Earnings are credited with the amount of any net salvage and charged with any net cost of removal. When an item is sold prior to the end of its useful life, the gain or loss is recognized in earnings immediately.

**Translation of foreign currencies**

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rates in effect as of the balance sheet dates. Operating revenues and expenses, and interest on debt transacted in foreign currencies are reflected in the financial statements using the average exchange rates during the year. The translation gains and losses are included in Other income in the statement of earnings.

Telesat Brazil and Space Connection (see note 10) are considered to be self-sustaining foreign operations as they are largely independent of Telesat. Assets and liabilities are translated at the exchange rate in effect on the balance sheet date. Revenues and expenses are translated at average exchange rates during the year. The resulting unrealized gains or losses are reflected as a currency translation adjustment in shareholders' equity.

**Accounting for investments**

Telesat uses the equity method to account for investments that are not consolidated where it has significant influence on the operating, investing and financing activities. The cost method is used for all other non-consolidated investments.

**Goodwill**

The goodwill was recorded on the acquisition of Infosat, SpaceConnection and Able Leasing Co. An assessment for impairment is undertaken in the fourth quarter of every year and when events or changes in circumstances indicate that the carrying amount of goodwill exceeds the fair value of goodwill. To date, Telesat has not recognized any permanent impairment in value.

**Derivative financial instruments**

The Company uses derivative financial instruments to hedge against foreign exchange rate risk. The use of derivatives is expected to generate enough cash flows and gains or incur losses to offset this risk. Telesat does not use derivative financial instruments for speculative or trading purposes. The Company documents all relationships between derivatives and the items they hedge, and the risk management objective and strategy for using various

hedges. This process includes linking every derivative to a specific asset or liability on the balance sheet, or to a specific firm commitment or to an anticipated transaction.

The effectiveness of the derivative in managing risk is assessed when the hedge is put in place and on an ongoing basis. Hedge accounting is stopped when a hedge is no longer effective.

When accounting for derivatives, Telesat follows these policies:

- deferred gains or losses relating to derivatives that qualify for hedge accounting are recognized in earnings when the hedged item is sold or the anticipated transaction is ended
- gains and losses related to hedges of anticipated transactions are recognized in earnings or are recorded as adjustments of carrying values when the transaction takes place
- any premiums paid for financial instrument contracts are deferred and expensed to earnings over the term of the contract

Telesat recognizes gains and losses on forward contracts the same way as the gains and losses on the hedged item. Unrealized gains or losses are included with the related assets or liabilities.

### **Employee benefit plans**

As of January 1, 2000, the costs of post-employment and post-retirement benefits other than pensions are accrued over the working lives of the employees, whereas previously the costs were generally charged to earnings as incurred. Telesat has made this change on a prospective basis which provides for a gradual recognition of the fair value of the pension surplus while at the same time recognizing the liability for costs of non-pension employee future benefits. Telesat is amortizing the net transitional obligation on a straight-line basis over 14 years (regular plans) and 9 years (designated plans), which was the average remaining service period of employees expected to receive benefits under the benefit plan as of January 1, 2000.

Telesat maintains one contributory and three non-contributory defined benefit pension plans which provide benefits based on length of service and rate of pay. Telesat is responsible for adequately funding these defined benefit pension plans. Contributions are made based on various actuarial cost methods that are permitted by pension regulatory bodies and reflect actuarial assumptions about future investment returns, salary projections and future service benefits. Telesat also provides other post-employment and retirement benefits, including health care and life insurance benefits on retirement and various disability plans, workers compensation and medical benefits to former or inactive employees, their beneficiaries and covered dependents, after employment but before retirement, under certain circumstances. The Company accrues its obligations under employee benefit plans and the related costs, net of plan assets. Actuaries determine pension costs and other retirement benefits using the projected benefit method prorated on service and management's best estimate of expected investment performance, salary escalation, retirement ages of employees and expected health care costs.

Pension plan assets are valued at fair value which is also the basis used for calculating the expected rate of return on plan assets. The discount rate is based on the market interest rate of high quality long-term bonds. Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of the employees active at the date of amendment. The Company deducts 10% of the benefit obligation or the fair value of plan assets, whichever is greater, from the net actuarial gain or loss and amortizes the excess over the average remaining service period of active employees. The actuaries perform a valuation at least every three years to determine the actuarial present value of the accrued pension and other retirement benefits. The 2006 pension expense calculation is extrapolated from an actuarial valuation performed as of January 1, 2004. The accrued benefit obligation is extrapolated from an actuarial valuation as of January 1, 2004. The most recent actuarial valuation of the pension plans for funding purposes was as of January 1, 2004, and the next required valuation is as of January 1, 2007.

### **Stock-based compensation plans**

The Company's stock-based compensation plans consist primarily of an employees' savings plan (ESP), long-term incentive programs which can include special compensation payments (SCP), deferred share units (DSU) and starting in 2005, a restricted share unit plan (RSU). Stock options that are settled in BCE Inc. (BCE) stock are recorded as contributed surplus. Stock options that are settled in cash are recorded as liabilities. Telesat recognizes a compensation expense or recovery relating to SCPs and a compensation expense for any contributions under the ESP.

For each RSU granted the Company records a compensation expense that equals the market value of a BCE common share at the date of grant prorated over the vesting period. The compensation expense is adjusted for

subsequent changes in the market value of BCE common shares until the vesting date and an assessment of the number of RSUs that will vest in the future. The cumulative effect of the change in value is recognized in the period of the change. Vested RSUs will be paid in BCE common shares purchased on the open market or in cash, as the holder chooses, as long as the minimum share ownership requirements are met.

For each DSU granted Telesat records a compensation expense that equals the market value of a BCE common share at the grant date. The compensation expense is adjusted for subsequent changes in the market value of BCE common shares with the effect of this change in value recognized in the period of the change. DSUs are paid in BCE common shares purchased on the open market following the cessation of the participant's employment.

The Company has adopted the fair-value based method for measuring the compensation cost of employee stock options using the Black-Scholes pricing model. This method has been used for options granted on or after January 1, 2002.

### **Income taxes**

Current income tax expense is the estimated income taxes payable for the current year before any refunds or the use of losses incurred in previous years. The Company uses the asset and liability method to account for future income taxes. Future income taxes reflect:

- the temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for tax purposes, on an after-tax basis
- the benefit of losses and non-refundable tax credits that will more likely than not be realized and carried forward to future years to reduce income taxes.

The Company estimates future income taxes using the rates enacted by tax law and those substantively enacted. A tax law is substantively enacted when it has been tabled in the legislature but may not have been passed into law. The effect of a change in tax rates on future income tax assets and liabilities is included in earnings in the period when the change is substantively enacted.

### **Recent changes to accounting standards**

#### *Comprehensive income and equity*

Section 1530 of the CICA Handbook, Comprehensive Income comes into effect for fiscal years beginning on or after October 1, 2006. Comprehensive income is the change in a company's net assets that results from transactions, events and circumstances from sources other than the company's shareholders and includes items that would not normally be included in net earnings.

The CICA also made changes to section 3250 of the CICA Handbook, Surplus, and reissued it as section 3251, Equity. The section also comes into effect for fiscal years beginning on or after October 1, 2006. The changes in how to report and disclose equity and changes in equity are consistent with the new requirements of section 1530, Comprehensive Income.

Adopting these sections on January 1, 2007 will require the reporting of comprehensive income and its components and accumulated other comprehensive income and its components in the consolidated financial statements.

#### *Financial instruments*

Section 3855 of the CICA Handbook, Financial Instruments - Recognition and Measurement comes into effect for fiscal years beginning on or after October 1, 2006. The section requires that all financial assets, with some exceptions, be measured at fair value; that all financial liabilities be measured at fair value if they are derivatives or classified as held for trading purposes while other financial liabilities be measured at their carrying value; and that all derivative financial instruments be measured at fair value, even when they are part of a hedging relationship.

Section 3860 of the CICA Handbook has been reissued as section 3861, Financial Instruments - Disclosure and Presentation, and establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. These revisions come into effect for fiscal years beginning on or after October 1, 2006.

The impact on the consolidated financial statements of adopting these sections on January 1, 2007 will result in the recording of significant derivative assets and equity.

## Hedges

Section 3865 of the CICA Handbook, Hedges comes into effect for fiscal years beginning on or after October 1, 2006, and describes when and how hedge accounting can be used. Hedge accounting makes sure that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the statement of earnings in the same period. The impact on the consolidated financial statements of adopting this section on January 1, 2007 is that Telesat will recognize the effective portion of gains or losses from cash flow hedges in Other Comprehensive Income until such time as the hedged item is recorded in the statement of earnings.

## 2. Segmented information

The Company operates in the five reportable business segments described below. This reporting structure reflects how the business is managed and how operations are classified for planning and measuring performance.

- **Broadcast** – distribution or collection of video and audio signals in the domestic and North American markets which include television transmit and receive services, occasional use, bundled Digital Video Compression and radio services.
- **Business Networks** – provision of satellite capacity and ground network services for voice, data, and image transmission and internet access in Canada, the United States and South America.
- **Carrier** – satellite voice and data transmission services sold to other carriers located in Canada, the United States or South America.
- **Consulting and Other** – all consulting services related to space and earth segments, government studies, satellite control services, R&D projects as well as management services for TMI Communications and Company, Limited Partnership.
- **Telesat Canada Subsidiaries** – includes the financial results of Infosat, SpaceConnection and Telesat Brazil.

All transactions between reportable segments are recorded in the normal course of operations and are recorded at the exchange amount, which is the amount of consideration given for the service or the asset.

Business segments	December 31,	
	2006	2005
<b>Operating revenues</b>		
Broadcast - external	219 570	207 131
Broadcast - inter-segment	1 199	22
Business Networks - external	104 256	121 555
Business Networks - inter-segment	14 093	10 965
Carrier - external	24 482	30 504
Carrier - inter-segment	1 847	4 580
Consulting and Other - external	29 644	26 171
Consulting and Other - inter-segment	12	30
	<hr/>	<hr/>
	395 103	400 958
Telesat Canada Subsidiaries	101 640	89 380
Inter-segment eliminations	(17 778)	( 15 597 )
<b>Total operating revenues</b>	<hr/>	<hr/>
	478 965	474 741
	<hr/>	<hr/>
	<b>2006</b>	<b>2005</b>
<b>Amortization expense</b>		
Broadcast	51 967	45 598
Business Networks	42 380	40 580
Carrier	13 401	11 454
Consulting and Other	1 525	2 417
Telesat Canada Subsidiaries	11 439	11 760
	<hr/>	<hr/>
	120 712	111 809
	<hr/>	<hr/>

**Earnings from operations**

Broadcast	130 958	129 431
Business Networks	( 8 708 )	( 5 835 )
Carrier	627	12 910
Consulting and Other	10 059	9 439
Total Telesat Canada	132 936	145 945
Telesat Canada Subsidiaries	7 351	10 318
<b>Total earnings from operations</b>	140 287	156 263
Interest expense	( 24 643 )	( 29 526 )
Other income	10 029	14 739
Income taxes	( 21 688 )	( 50 782 )
<b>Net earnings</b>	103 985	90 694

**Capital assets**

The Company's capital assets are attributable to reportable segments as follows:

	December 31,	
	2006	2005
Broadcast	55%	50%
Business Networks	34%	36%
Carrier	7%	8%
Consulting and Other	1%	1%
Telesat Canada Subsidiaries	3%	5%
	100%	100%

	December 31,	
	2006	2005
<b>Geographic information</b>		
Revenues – Canada	329 838	299 228
Revenues – United States	114 609	138 824
Revenues – Brazil	17 096	17 683
Revenues – all others	17 422	19 006
	478 965	474 741
Capital assets – Canada	1 329 042	1 268 570
Capital assets – United States	51 216	57 592
Capital assets – Brazil	2 926	3 596
Capital assets – Other	5 135	5 684
	1 388 319	1 335 442
Goodwill – Canada	16 537	16 537
Goodwill – United States	8 079	7 058
	24 616	23 595

The point of origin of revenues (destination of billing invoice) and the location of capital assets determine the geographic areas. The Anik and Nimiq satellites have been classified as located in Canada for disclosure purposes.

### Major customers

For the year ended December 31, 2006, two customers from the Broadcast segment represented \$111.2 and \$70.8 million of consolidated revenues. In 2005, two same two customers represented \$101.2 and \$62.2 million of consolidated revenues.

### 3. Business acquisitions

On January 4, 2005, Telesat acquired 100% of the outstanding common shares of The SpaceConnection, Inc. (SpaceConnection). SpaceConnection is a provider of programming-related satellite transmission services to all the major US television networks and cable programmers. The purchase price of US \$5 million was determined based on the fair value of assets acquired and the liabilities assumed at the date of acquisition.

The purchase price was settled in cash net of cash acquired for a total of CAD \$4.4 million. There are two additional contingent payments. In 2006 a cash payment was made for the first contingent payment of US \$2.25 million, which was due based on achieving certain performance criteria by December 2005. This additional payment of contingent consideration was accrued in December 2005. The second contingent payment has not been accrued. This contingent payment is based on achieving certain performance criteria by the third quarter of 2007 and if satisfied will result in an expensed payment of US \$2.25 million. The acquisition has been accounted for using the purchase method of accounting and results from operations have been included in the consolidated financial statements from the date of acquisition.

The allocation of the purchase price consists of the following:

	<b>Acquisition Date</b>	<b>Contingent Consideration</b>	<b>Total</b>
Current assets	3 213	-	3 213
Capital assets	59 918	-	59 918
Intangible assets	11 777	-	11 777
Goodwill	4 427	2 631	7 058
Other assets	700	-	700
<b>Total assets acquired</b>	<b>80 035</b>	<b>2 631</b>	<b>82 666</b>
Current liabilities	( 2 838 )	-	( 2 838 )
Long-term debt	( 59 538 )	-	( 59 538 )
Future income tax liability	( 11 763 )	-	( 11 763 )
<b>Total liabilities assumed</b>	<b>( 74 139 )</b>	<b>-</b>	<b>( 74 139 )</b>
<b>Net assets acquired</b>	<b>5 896</b>	<b>2 631</b>	<b>8 527</b>

On February 16, 2006, Infosat Communications Inc. (USA), a subsidiary of Infosat, acquired 100% of the outstanding common shares of Able Leasing Co (Able). Able provides sales and service of land mobile radio, microwave radio, marine radio, closed circuit television and satellite communications. The purchase price of US \$1.3 million was determined based on the fair value of assets acquired and liabilities assumed at the date of acquisition. The acquisition of Able has been accounted for using the purchase method of accounting and the results of operations have been included in the consolidated financial statements from the date of acquisition. Initially net cash of \$0.4 million was paid for net assets acquired including goodwill. There are two additional contingent payments of US \$0.6 million based on achieving certain performance criteria by December 2006 and 2007. The first contingent payment has been satisfied and accounted for as an incremental cost of the acquisition resulting in an increase to goodwill. If satisfied, the second contingent payment will be expensed.

The allocation of the purchase price consists of the following:

	<b>Acquisition Date</b>	<b>Contingent Consideration</b>	<b>Total</b>
Current assets (net of cash acquired)	1 737	-	1 737
Capital assets	381	-	381
Goodwill	405	673	1 078
<b>Total assets acquired</b>	<b>2 523</b>	<b>673</b>	<b>3 196</b>
Current liabilities	( 1 932 )	-	( 1 932 )
Long-term debt	( 179 )	-	( 179 )
Future income tax liability	( 14 )	-	( 14 )
<b>Total liabilities assumed</b>	<b>( 2 125 )</b>	<b>-</b>	<b>( 2 125 )</b>
<b>Net assets acquired</b>	<b>398</b>	<b>673</b>	<b>1 071</b>

In October 2006, Telesat acquired 100% of 3652041 Canada Inc. from BCE Inc. (BCE), its shareholder, in return for a promissory note payable of \$21.2 million. The excess of the \$21.2 million cost over BCE's carrying value (a nominal amount) has been recorded as a reduction of \$21.2 million in contributed surplus. Telesat then proceeded to amalgamate its wholly owned subsidiary 3484203 Canada Inc. with 3652041 Canada Inc., creating a new entity: 4387678 Canada Inc.

4387678 Canada Inc. then sold its \$0.7 million interest in the limited partnership units of TMI Communications and Company, Limited Partnership (TMI) to BCE and a numbered company owned by BCE in return for promissory notes with a fair market value of \$201 million. The excess of the fair market value over the Telesat carrying cost was booked as an increase of \$200.3 million in contributed surplus.

#### 4. Other income

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Capitalized interest	12 184	14 974
Foreign exchange gains (losses)	( 581 )	1 317
Interest income	4 504	6 849
Gain (loss) on disposal of assets	173	123
Performance incentive payments and milestone interest expense	( 6 018 )	( 8 529 )
Other	( 233 )	5
	<b>10 029</b>	<b>14 739</b>

#### 5. Income taxes

A reconciliation of the statutory income tax rate, which is a composite of federal and provincial rates, to the effective income tax rate is as follows:

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Statutory income tax rate	35.4%	35.3%
Large corporations tax	-	1.3%
Permanent differences	2.0%	( 1.2% )
Adjustment for tax rate changes	( 14.5% )	1.0%
Other	( 5.7% )	( 0.5% )
<b>Effective income tax rate</b>	<b>17.2%</b>	<b>35.9%</b>

The components of the income tax expense are as follows:

Future	1 205	36 756
Current	20 483	14 026
<b>Total income tax expense</b>	<b>21 688</b>	<b>50 782</b>

The tax effects of temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for tax purposes are presented below:

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Future tax assets</b>		
Investments	11 694	12 857
Loss carry forwards – (expiring from 2012 to 2025)	6 813	6 202
Reserves	3 990	3 114
Lease obligations	1 169	2 001
Performance incentive payments	15 053	18 861
Other	4 157	3 811
Less: valuation allowance	( 2 428 )	( 2 669 )
<b>Total future tax assets</b>	<b>40 448</b>	<b>44 177</b>
<b>Future tax liabilities</b>		
Capital assets	210 608	195 720
Capitalized interest	6 092	2 362
Insurance proceeds	12 116	14 774
Other	2 538	21 326
<b>Total future tax liabilities</b>	<b>231 354</b>	<b>234 182</b>
<b>Total future income taxes</b>	<b>190 906</b>	<b>190 005</b>

Total future income taxes are comprised of:

Net future income tax asset – current portion	4 476	3 737
Net future income tax liability – long-term portion	195 382	193 742
<b>Total future income taxes</b>	<b>190 906</b>	<b>190 005</b>

## 6. Accounts and notes receivable

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Trade receivables - net of allowance for doubtful accounts	42 799	46 894
Less: long-term portion of trade receivables	( 1 942 )	( 568 )
Promissory notes receivable (Note 3)	201 000	13 054
	<b>241 857</b>	<b>59 380</b>

The allowance for doubtful accounts was \$3.7 in 2006 and \$5.4 million in 2005.

The long-term portion of trade receivables includes items that will not be collected during the subsequent year and is included in other assets in note 11. The 2005 promissory note was repaid in 2006. The promissory notes received in return for the interest in TMI are non-interest bearing and due on demand.

## 7. Other current assets

	December 31,	
	2006	2005
Inventories	12 226	19 180
Income taxes recoverable	3 500	7 373
Investment tax credit benefits	290	231
Prepaid expenses and other	11 532	9 393
	<hr/> 27 548	<hr/> 36 177

Inventories are valued at lower of cost or market and consist of \$9.8 million (2005 - \$17.0 million) of finished goods and \$2.4 million (2005 - \$2.2 million) of work in process. Cost for substantially all network equipment inventories is determined on an average cost basis. Cost for work in process and some one-of-a kind finished goods is determined using specific identification.

## 8. Capital assets

	Cost	Accumulated Amortization	Net Book Value
<b>2006</b>			
Satellites	1 223 564	335 675	887 889
Earth stations	275 776	143 180	132 596
Transponders under capital lease	56 992	11 271	45 721
Office buildings and other	87 931	62 655	25 276
Construction in progress	296 837	-	296 837
	<hr/> 1 941 100	<hr/> 552 781	<hr/> 1 388 319
<b>2005</b>			
Satellites	1 221 985	250 799	971 186
Earth stations	285 600	146 294	139 306
Transponders under capital lease	57 201	5 523	51 678
Office buildings and other	89 130	60 145	28 985
Construction in progress	144 287	-	144 287
	<hr/> 1 798 203	<hr/> 462 761	<hr/> 1 335 442

The cost of assets under capital lease, including satellite transponders, was \$74.5 million at December 31, 2006 and \$75.4 million at December 31, 2005. At December 31, 2006 the net book value of these assets was \$47.7 million (2005 - \$55.0 million).

See note 21 for a description of the insurance proceeds received in 2005 for Anik F1.

## 9. Finite-life intangible assets

	Cost	Accumulated Amortization	Net Book Value
<b>2006</b>			
Non-competition agreement	6 991	2 330	4 661
Long-term contracts and customer lists	5 710	4 896	814
	<hr/> 12 701	<hr/> 7 226	<hr/> 5 475

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
<b>2005</b>			
Non-competition agreement	6 991	1 165	5 826
Long-term contracts and customer lists	5 710	2 693	3 017
	<b>12 701</b>	<b>3 858</b>	<b>8 843</b>

The non-competition agreement is being amortized on a straight-line basis over six years beginning January 1<sup>st</sup>, 2005. The long-term contracts are being amortized at variable rates based on the associated revenue until 2009. The customer lists are being amortized on a straight-line basis over 3 to 4 years.

## 10. Investments

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
WildBlue Communications, Inc. - at cost	14 526	14 526
Hellas-Sat Consortium Limited - at cost	315	315
TMI Communications and Company, Limited Partnership - at cost	-	696
Comstar ISA Ltd. - at equity	290	-
	<b>15 131</b>	<b>15 537</b>

The fair value of all investments recorded at cost has not been estimated as there were no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investments. It is not practicable to estimate the fair value.

Telesat has a portfolio interest in WildBlue Communications, Inc. (WildBlue), a US-based company offering high-speed satellite-based Internet services to the United States using the Anik F2 satellite. The initial investment in preferred shares was acquired in 2000 as partial consideration for the grant of an exclusive license to WildBlue for the use and access of the Ka-band payload on Anik F2.

Telesat has a portfolio interest in Hellas-Sat Consortium Limited. The consortium has one satellite which provides regional coverage to Greece, Cyprus and the Balkans.

Telesat indirectly held 100% of the limited partnership units of TMI Communications and Company, Limited Partnership (TMI) up to October 2006 (see note 3).

Telesat holds 100% of the shares of 4387678 Canada Inc., the result of the October 2006 amalgamation of the Telesat subsidiary 3484203 Canada Inc. and a company acquired in October 2006, 3652041 Canada Inc. See note 23 for a description of the January 2007 amalgamation. In 2005 Telesat held 100% of the shares of 3484203 Canada Inc, which directly held 100% of the limited partner units of TMI (see note 3).

Telesat holds 100% of the shares of Infosat Communications, Inc. (Infosat) and consolidates its results. Infosat is a full service provider of satellite-based voice, fax, paging, and data communications. Infosat holds 100% of the shares of Able Infosat Communications, Inc. (Able). Able provides turn-key communications solutions for the energy industry to be used in special environments, off-shore and overseas. Infosat has a 22% interest in Pakistan's Comstar ISA Ltd., a satellite service provider.

Telesat holds 100% of the shares of Telesat Brasil Limitada and consolidates their results. The holding company holds 100% of Telesat Serviços de Telecomunicação Limitada, which is being used to provide services in the Brazilian market using Anik F1.

Telesat holds 100% of the shares of The SpaceConnection Inc. (SpaceConnection) and consolidates its results. SpaceConnection is a provider of C-Band and Ku-Band space segment for video, audio, data and internet services (see note 3).

## 11. Other assets

	December 31,	
	2006	2005
Promissory notes receivable from TMI Communications and Company, Limited Partnership (a)	3 840	3 840
Long term portion of trade receivables	1 942	568
Accrued pension benefit (see note 20)	11 592	8 105
Deferred charges (b)	7 543	3 834
Other	725	716
	<hr/> 25 642	<hr/> 17 063

(a) During 1998 Telesat renegotiated the repayment terms of the TMI promissory notes (discounted at the time of the original transactions, gross value of \$37.8 million) whereby \$22.8 million was ranked prior to any indebtedness of the Partnership. TMI has made partial repayments of \$10.0 million in 2001, \$5.0 million in 2003 and \$4.0 million in 2004.

(b) Deferred charges include cost of equipment sales related to deferred revenues from multiple deliverable arrangements. These deferred charges are amortized to cost of equipment sales over the term of the related revenue contract.

## 12. Other current liabilities

	December 31,	
	2006	2005
Deferred revenues and deposits (see note 15)	37 485	30 314
Deferred milestone payments (see note 15)	25 670	32 276
Capital lease liabilities (see note 15)	4 698	4 748
Income taxes payable	1 009	16 895
Satellite performance incentive payments (see note 15)	11 499	10 569
Dividends payable	-	449
Promissory note payable (see note 3) (a)	21 200	-
Other liabilities (b)	4 208	15 993
	<hr/> 105 769	<hr/> 111 244

(a) The promissory note is non-interest bearing and payable on demand.

(b) Other liabilities have been reduced by \$2 million due to the reversal of estimated license fees accrued in prior periods.

## 13. Debt due within one year

	December 31,	
	2006	2005
7.4% Notes due June 28, 2006	-	150 000
Other debt financing (see note 14)	3 134	2 838
	<hr/> 3 134	<hr/> 152 838

## 14. Debt financing

	December 31,	
	2006	2005
8.2% Notes due November 7, 2008	125 000	125 000
Bank loans	72 000	-
Other debt financing	3 742	7 202
	<hr/> 200 742	<hr/> 132 202

At December 31, 2006, the Canadian bank loans, which are unsecured, carried an average interest rate of 5.305%. The Telesat Canada revolving credit facility expires on June 3, 2010 and the Infosat bank facilities are uncommitted. The unused bank lines of credit available to Telesat at December 31, 2006 amounted to \$92.2 million (2005 - \$164.3 million). The unused bank line of credit available to Infosat at December 31, 2006 amounted to \$10.2 million (2005 - \$8.5 million).

Other debt financing includes the financing for the Company's headquarters building. With respect to the headquarters building, the Company shares equally with the developer, the ownership, cost and debt of the building. The Company has leased the developer's share for twenty years beginning January 25, 1989 for an annual rent, excluding operating costs, of \$1.8 million. Total headquarters financing of \$6.8 million (2005 - \$9.5 million) includes the amount owing under this capital lease of \$3.3 million at December 31, 2006 (2005 - \$4.6 million). The imputed interest rate for the capital lease is 10.69% per annum.

Mortgage financing for the Company's share of the facility has been arranged by the developer for a twenty-year term coincident with the lease with interest at 11% per annum and with annual payments of principal and interest of \$1.8 million.

The outstanding short and long term debt financing at December 31, 2006 of \$203.9 million is repayable as follows:

	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
	3 134	128 433	309	72 000

#### **15. Other long-term liabilities**

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Deferred revenues and deposits (a)	265 493	261 771
Deferred satellite performance incentive payments (b)	35 003	42 427
Deferred milestone payments (c)	-	21 678
Capital lease liabilities (d)	44 887	49 749
Other liabilities	2 658	11 394
	<b>348 041</b>	<b>387 019</b>

(a) Deferred revenues represent the Company's liability for the provision of future services. The prepaid amount is brought into income over the period of service to which the prepayment applies. The net amount outstanding at December 31, 2006 will be reflected in the Statements of Earnings as follows: \$37.5 million in 2007, \$28.9 million in 2008, \$25.6 in 2009, \$23.9 in 2010, \$23.5 in 2011 and \$163.6 million thereafter.

(b) Deferred satellite performance incentive payments are payable over the lives of the Nimiq 1, Anik F1, Anik F2 and Anik F1R satellites. The present value of the payments is capitalized as part of the cost of the satellite, recorded as a liability, and charged against operations as part of the normal amortization of the satellite. The amounts payable on the successful operation of the transponders are US \$9.9 million in 2007, US \$3.1 million in 2008, US \$2.9 million in 2009, US \$3.1 million in 2010, US \$2.5 million in 2011 and US \$18.4 million thereafter.

(c) Deferred milestone payments represent the present value of liabilities associated with the Anik F2 satellite. Payments of principal and interest are US \$21.1 million in 2007.

(d) Future minimum lease payments payable under capital leases are \$4.7 million in 2007, \$4.8 million in 2008, \$5.3 million in 2009, \$5.8 million in 2010, \$6.4 million in 2011 and \$22.5 million thereafter.

## 16. Capital stock

The authorized capital of the Company is comprised of 10,000,000 common shares and 5,000,000 preferred shares. Ownership by non-residents in the common shares of the Company is limited to twenty percent.

At December 31, 2006 and 2005 there were 6,842,547 common shares outstanding with a stated value of \$111.9 million. At December 31, 2005 there were 5,000,000 non-voting preferred shares outstanding with a stated value of \$50 million. On November 1, 2006, Telesat redeemed the \$50 million of preferred shares for cash at a redemption price of \$10 per share, together with accrued but unpaid dividends.

For the period March 31, 2004 to the date of redemption the cumulative preferred share dividend rate had been fixed at an annual rate of 3.56%.

## 17. Cash flow information

	December 31,	
	2006	2005
Cash and cash equivalents is comprised of:		
Cash	10 757	-
Bank overdrafts	-	( 4 191 )
Short term investments, original maturity 90 days or less	27 876	117 668
	<hr/> 38 633	<hr/> 113 477
Net change in operating assets and liabilities is comprised of:		
Receivables	12 355	6 406
Other assets	( 3 910 )	( 18 294 )
Accounts payable	( 1 326 )	( 747 )
Income taxes payable	( 15 238 )	622
Other liabilities	( 15 950 )	( 13 370 )
Promissory notes receivable repayments	13 055	20 503
	<hr/> ( 11 014 )	<hr/> ( 4 880 )

## 18. Financial instruments

Telesat uses derivative instruments to manage the exposure to foreign currency risk and does not use derivative instruments for speculative purposes. Since there is no active trading in derivative instruments, there is no exposure to any significant liquidity risks relating to them.

### *Credit risk*

Financial instruments that potentially subject the Company to a concentration of credit risk consists of cash and cash equivalents and short term investments. Investment of these funds is done with high quality financial institutions and is governed by the Company's corporate investment policy, which aims to reduce credit risk by restricting investments to high-grade US dollar and Canadian dollar denominated investments.

Telesat is exposed to credit risk if counterparties to its derivative instruments are unable to meet their obligations. It is expected that these counterparties will be able to meet their obligations as they are institutions with strong credit ratings. Telesat regularly monitors the credit risk and credit exposure. There was no credit risk relating to derivative instruments at December 31, 2006.

Telesat has a number of diverse customers, which limits the concentration of credit risk. The Company has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks. Anticipated bad debt losses have been provided for in the allowance for doubtful accounts.

### *Currency exposures*

Telesat uses forward contracts to hedge foreign currency risk on anticipated transactions. At December 31, 2006, the Company had \$228.8 million (2005 - \$92.2 million) of outstanding foreign exchange contracts which require the Company to pay Canadian dollars to receive US \$197 million (2005 - \$72.2 million) for future capital expenditures. The fair value of these derivative contract liabilities was \$0.8 million (2005 - \$8.6 million). The forward contracts are due between January 2007 and July 2008.

### *Fair value*

Fair value is the amount that willing parties would accept to exchange a financial instrument based on the current market for instruments with the same risk, principal and remaining maturity. Fair values are based on estimates using present value and other valuation methods.

These estimates are affected significantly by the assumptions for the amount and timing of estimated future cash flows and discount rates, which all reflect varying degrees of risk. Potential income taxes and other expenses that would be incurred on disposition of these financial instruments are not reflected in the fair values. As a result, the fair values are not necessarily the net amounts that would be realized if these instruments were actually settled.

The carrying amounts for cash and cash equivalents, short term investments, trade receivables, other current liabilities, accounts payable and accrued liabilities approximate fair market value due to the short maturity of these instruments. It is not possible to determine the fair value of the non-interest bearing promissory notes receivable as they are the result of a related party transaction. The carrying value of the debt financing is an approximation of the fair market value due to the Company's intention to hold the debt and pay it out at maturity.

## **19. Stock-based compensation plans**

### *Employee savings plans (ESPs)*

The ESP enables Telesat employees to acquire BCE common shares through payroll deductions of up to 10% of their annual base earnings and target bonus plus employer contributions of up to 2%. The trustee of the ESPs buys BCE common shares for the participants on the open market, by private purchase or from BCE (where shares are issued from Treasury). BCE chooses the method the trustee uses to buy the shares. Compensation expense for ESPs was \$0.6 million in 2006 (2005 - \$0.6 million).

### *Stock options*

Under the long-term incentive programs, options may be granted to key employees of Telesat to purchase BCE common shares. The subscription price is usually equal to the market value of the shares on the last trading day before the grant comes into effect. For options granted before January 1, 2004, the right to exercise the options generally vests or accrues by 25% a year for four years of continuous employment from the date of grant, except where a special vesting period applies. Options become exercisable when they vest and can be exercised for a period of up to 10 years from the date of grant.

For options granted after January 1, 2004, the right to exercise options vests after two to three years of continuous employment from the date of grant, if specific performance targets are met. Options become exercisable when they vest and can be exercised for a period of up to six years from the date of grant. Subject to achieving specific performance targets, 50% of the options will vest after two years and 100% after three years.

The following tables are a summary of the status of Telesat's portion of the BCE stock option programs at December 31, 2006.

	Number of Shares 2006	Weighted- Average Exercise Price (\$) 2006	Number of Shares 2005	Weighted- Average Exercise Price (\$) 2005
Outstanding, beginning of year	543 884	32	516 598	31
Granted	101 972	29	67 224	29
Exercised	( 17 625 )	17	( 33 050 )	16
Expired/forfeited	( 2 200 )	41	( 6 888 )	41
Outstanding, end of year	626 031	32	543 884	32
Exercisable, end of year	349 412	33	261 826	34

**At December 31, 2006**

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number	Weighted- Average Remaining Life	Weighted- Average Exercise Price (\$)	Number	Weighted- Average Exercise Price (\$)
Below \$20	20 750	2.39	17	20 750	17
\$20 to \$29	446 087	4.69	29	169 468	29
\$30 to \$39	10 000	3.52	35	10 000	35
\$40 and over	149 194	3.67	41	149 194	41
	626 031	4.35	32	349 412	33

The assumptions used to determine the stock-based compensation expense under the Black-Scholes option pricing model were as follows:

	December 31,	
	2006	2005
Compensation cost	170	408
Number of stock options granted	101 972	67 224
Weighted-average fair value per option granted (\$)	2.3	3.0
Assumptions:		
Dividend yield	4.4%	4.6%
Expected volatility	17%	24%
Risk-free interest rate	4.0%	3.0%
Expected life (years)	3.5	3.5

During 2006, stock options were granted under the stock-based compensation plan and an expense of \$0.2 million (2005 - \$0.4 million) was charged to contributed surplus.

*Restricted share units (RSUs)*

In 2005 and 2006, RSUs were granted to Telesat executives. The value of an RSU is always equal to the value of one BCE common share. Dividends in the form of additional RSUs are credited to the participant's account on each dividend payment date and are equivalent in value to the dividend paid on BCE common shares. Each executive is

granted a specific number of RSUs for a given performance period, based on his or her position and level of contribution. At the end of each given performance period, RSUs will vest if performance objectives are met or will be forfeited.

Vested RSUs will be paid in BCE common shares purchased on the open market, in cash or through a combination of both, as the holder chooses, as long as individual share ownership requirements are met.

The table below is a summary of the status of RSUs:

	<b>Number of RSUs</b>	
	<b>2006</b>	<b>2005</b>
Outstanding, January 1	76 237	-
Granted	136 523	73 777
Dividends credited	883	2 460
Payments	(77 120)	-
Expired/forfeited	-	-
Outstanding, December 31	136 523	76 237

For the year ended December 31, 2006 a compensation expense for RSUs of \$0.2 million (2005 - \$1.7 million) was recorded.

#### *Special compensation payments (SCPs)*

Before 2000, when options were granted to employees, related rights to SCPs were also often granted. SCPs are cash payments representing the amount that the market value of the shares on the date of exercise exceeds the exercise price of these options.

The number of SCPs for BCE common shares outstanding at December 31, 2006 was 20,750 (2005 – 38,275). All of the outstanding SCPs cover the same number of shares as the options to which they relate. It is Telesat's responsibility to make the payments under the SCPs. The annual compensation expense for the SCP was a recovery of \$0.1 million in 2006 (2005 – expense of \$0.2 million).

#### *Deferred share units (DSUs)*

DSUs are granted to executives when they choose to receive their bonuses in the form of DSU units instead of cash. The value of a DSU is always equal to the value of one BCE common share. Dividends in the form of additional DSUs are credited to the participant's account on each dividend payment date and are equivalent in value to the dividend paid on BCE common shares. DSUs are paid in cash when the holder chooses to exercise their units.

The table below is a summary of the status of the DSUs:

	<b>Number of DSUs</b>	
	<b>2006</b>	<b>2005</b>
Outstanding, January 1	4 399	965
Granted	1 846	3 283
Dividends credited	267	151
Exercised	-	-
Outstanding, December 31	6 512	4 399

For the year ended December 31, 2006, the company recorded a compensation expense for DSUs of \$0.1 million (2005 – \$0.1 million).

## **20. Employee benefit plans**

The Company's funding policy is to make contributions to its pension funds based on various actuarial cost methods as permitted by pension regulatory bodies. Contributions reflect actuarial assumptions concerning future investment

returns, salary projections and future service benefits. Plan assets are represented primarily by Canadian and foreign equity securities, fixed income instruments and short-term investments.

The changes in the benefit obligations and in the fair value of assets and the funded status of the defined benefit plans were as follows:

	<b>Pension Benefits 2006</b>	<b>Other Benefits 2006</b>	<b>Pension Benefits 2005</b>	<b>Other Benefits 2005</b>
<b>Change in benefit obligations</b>				
Benefit obligation, beginning of year	153 610	14 486	125 646	11 189
Current service cost	4 315	465	3 160	394
Interest cost	8 212	767	7 730	684
Actuarial (gains) losses	( 2 071 )	( 248 )	18 961	2 488
Benefit payments	( 9 407 )	( 315 )	( 3 594 )	( 269 )
Employee contributions	1 884	-	1 707	-
Other	900	-	-	-
<b>Benefit obligation, end of year</b>	<b>157 443</b>	<b>15 155</b>	<b>153 610</b>	<b>14 486</b>

	<b>Pension Benefits 2006</b>	<b>Other Benefits 2006</b>	<b>Pension Benefits 2005</b>	<b>Other Benefits 2005</b>
<b>Change in fair value of plan assets</b>				
Fair value of plan assets, beginning of year	150 939	-	136 165	-
Return on plan assets	20 798	-	16 193	-
Benefit payments	( 9 407 )	( 315 )	( 3 594 )	( 269 )
Employee contributions	1 884	-	1 707	-
Employer contributions	6 150	315	468	269
<b>Fair value of plan assets, end of year</b>	<b>170 364</b>	<b>-</b>	<b>150 939</b>	<b>-</b>

**Funded status**

Plan surplus (deficit)	12 921	( 15 155 )	( 2 671 )	( 14 486 )
Unamortized net actuarial (gain) loss	9 607	861	22 985	1 109
Unamortized transitional (asset) obligation	( 10 936 )	4 325	( 12 209 )	4 943
<b>Accrued benefit asset (liability)</b>	<b>11 592</b>	<b>( 9 969 )</b>	<b>8 105</b>	<b>( 8 434 )</b>

The fair value of the plan assets consists of the following asset categories:

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Equity securities	62%	64%
Fixed income instruments	35%	34%
Short-term investments	3%	2%
<b>Total</b>	<b>100%</b>	<b>100%</b>

Plan assets are valued as at the measurement date of December 31 each year. Equity securities include common shares of a related party in the amounts of nil (0% of total plan assets) and \$1.1 million (1% of total plan assets) at December 31, 2006 and 2005 respectively.

The significant weighted-average assumptions adopted in measuring Telesat's pension and other benefit obligations were as follows:

	<b>Pension Benefits 2006</b>	<b>Other Benefits 2006</b>	<b>Pension Benefits 2005</b>	<b>Other Benefits 2005</b>
Accrued benefit obligation as of December 31:				
Discount rate	5.3%	5.3%	5.2%	5.2%
Rate of compensation increase	3.5%	3.5%	3.5%	3.5%
Benefit costs for years ended December 31:				
Discount rate	5.2%	5.2%	6.0%	6.0%
Expected long-term rate of return on plan assets	7.5%	7.5%	7.5%	7.5%
Rate of compensation increase	3.5%	3.5%	3.5%	3.5%

For measurement purposes, a 10.5% (drugs) / 4.5% (other) annual rate of increase in the per capita cost of covered health care benefits (the health care cost trend) was assumed for 2006. The drug rate is assumed to gradually decrease to 4.5% over 6 years and remain at that level thereafter.

The net benefit expense included the following components:

	<b>Pension Benefits 2006</b>	<b>Other Benefits 2006</b>	<b>Pension Benefits 2005</b>	<b>Other Benefits 2005</b>
Current service cost	4 315	465	3 160	394
Interest cost	8 212	767	7 730	684
Expected return on plan assets	( 11 271 )	-	( 10 165 )	-
Amortization of past service cost	900	-	-	-
Amortization of net actuarial (gain)/loss	1 780	-	96	( 22 )
Amortization of transitional obligation	( 1 273 )	618	( 1 454 )	618
<b>Net benefit expense</b>	<b>2 663</b>	<b>1 850</b>	<b>( 633 )</b>	<b>1 674</b>

## 21. Commitments and contingent liabilities

Off balance sheet commitments include operating leases, commitments for future capital expenditures and other future purchases.

	2007	2008	2009	2010	2011	Thereafter	Total
Off balance sheet commitments	\$ 188,053	\$ 119,335	\$ 53,424	\$ 9,451	\$ 5,470	\$ 52,407	\$ 428,140

Certain of the Company's satellite transponders, offices, warehouses, earth stations, vehicles, and office equipment are leased under various terms. Minimum annual commitments under operating leases determined as at December 31, 2006 are \$15.5 million in 2007, \$16.9 million in 2008, \$12.0 million in 2009, \$6.8 million in 2010, \$2.4 million in 2011 and \$3.3 million thereafter. The annual aggregate lease expense in each of fiscal 2006 and 2005 was \$18.0 million and \$17.5 million respectively. The expiry terms range from June 2006 to July 2016.

Telesat has non-satellite purchase commitments of CAD \$12.1 million, which include commitments of US \$10.2 million, with various suppliers at December 31, 2006 (2005 – CAD \$25.4 million, including commitments of US \$20.9 million).

Telesat has entered into contracts for the construction and launch of Anik F3 (targeted for launch in 2007) and of Nimiq 4 (targeted for launch in 2008), the construction of Nimiq 5 (targeted for launch in 2009) and a capital lease for Nimiq 4ii (in service in 2007). The outstanding commitments at December 31, 2006 on these contracts are CAD \$358.5 million, which include commitments of US \$303.2 million.

Telesat has agreements with various customers for prepaid revenues on several satellites which take effect on final acceptance of the spacecraft. Telesat is responsible for operating and controlling these satellites. Deposits of \$273.7 million (2005 - \$272.8 million), refundable under certain circumstances, are reflected in other liabilities, both current and long-term.

In the normal course of business, Telesat has executed agreements that provide for indemnification and guarantees to counterparties in various transactions. These indemnification undertakings and guarantees may require Telesat to compensate the counterparties for costs and losses incurred as a result of certain events including, without limitation, loss or damage to property, change in the interpretation of laws and regulations (including tax legislation), claims that may arise while providing services, or as a result of litigation that may be suffered by the counterparties.

Certain indemnification undertakings can extend for an unlimited period and may not provide for any limit on the maximum potential amount, although certain agreements do contain specified maximum potential exposure representing a cumulative amount of approximately \$16.7 million. The nature of substantially all of the indemnification undertakings prevents the Company from making a reasonable estimate of the maximum potential amount Telesat could be required to pay counterparties as the agreements do not specify a maximum amount and the amounts are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, Telesat has not made any significant payments under such indemnifications.

In August 2001, Boeing, the manufacturer of the Anik F1 satellite, advised Telesat of a gradual decrease in available power on-board the satellite. Telesat filed an insurance claim with its insurers on December 19, 2002, and in March 2004 reached a final settlement agreement. The settlement calls for an initial payment in 2004 of US \$136.2 million and an additional payment of US \$49.1 million in 2007 if the power level on Anik F1 degrades as predicted by the manufacturer. In the event that the power level on Anik F1 is better than predicted, the amount of the payment(s) will be adjusted by applying a formula which is included in the settlement documentation and could result in either a pro-rated payment to Telesat of the additional US \$49.1 million or a pro-rated repayment of up to a maximum of US \$36.1 million to be made by Telesat to the insurers. The initial payment has been received. During December 2005, a number of insurers elected to pay a discounted amount of the proceeds due in 2007. A total of US \$26.2 million was received in December 2005 (pre-discount value of US \$29.1 million) leaving US \$20.0 million to be paid in 2007. The degradation continues as predicted.

## 22. Related party transactions

Related parties include BCE, the sole common shareholder, together with its subsidiaries and affiliates.

The following transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Operating revenues for services provided	139 335	131 880
Operating expenses for services received	7 340	9 273

The balances with related parties are as follows:

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Receivables at year end	631	3 566
Promissory notes receivable (see note 3)	201 000	-
Deferred revenues and deposits	13 019	1 040
Promissory notes payable (see note 3)	21 200	-

### **23. Subsequent events**

On January 1, 2007, Telesat, its parent Alouette Telecommunications Inc. (Alouette) and its subsidiary 4387678 Canada Inc. (4387678) were amalgamated. The name of the amalgamated entity is Telesat Canada and its authorized capital is an unlimited number of common shares. The shares of Telesat and 4387678 were cancelled, and the class A, B and C shares of Alouette were converted into 100 common shares of the amalgamated entity.