# 20.10 ANNUALREPORT

COGECO

# Profile

COGECO Inc. ("COGECO" or "the Company") is a diversified holding company with subordinate voting shares listed on the Toronto Stock Exchange ("TSX"), under the symbol CGO. The Company's current holdings are concentrated in various segments of the communications sector.

Cogeco Cable Inc. ("Cogeco Cable" or the "cable subsidiary") is a major cable telecommunications company with shares listed on the Toronto Stock Exchange ("TSX") under the symbol CCA. Cogeco Cable builds on its cable distribution base by offering Analogue and Digital Television, High Speed Internet ("HSI"), Telephony, data communications and other advanced telecommunication services such as Ethernet, private line, Voice-over-Internet Protocol ("VoIP"), HSI access, dark fibre, data storage, data security and co-location services.

Cogeco Cable serves 3,179,349 revenue-generating units to the 2,499,102 homes passed by its cable network in the territories it serves. It is the second largest hybrid fibre coaxial cable system operator in Ontario, Québec and Portugal.

Cogeco Cable focuses its attention on the satisfaction of residential and business customers' varied electronic communication needs by investing in state-of-the-art broadband network facilities, delivering a wide range of services over these facilities with great speed and reliability at attractive prices, and striving to provide superior customer service and growing profitability.

Through its Cogeco Diffusion Inc. subsidiary ("CDI"), COGECO operates and wholly-owns the Rythme FM network which has four radio stations throughout the province of Québec, in Montréal, Québec City, and in the Mauricie and Eastern Townships regions, as well as the FM 93 radio station in Québec City.

**Annual Report**

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## Forward-looking statements

Certain statements in this Annual Report may constitute forward-looking information within the meaning of securities laws. Forward-looking information may relate to COGECO's future outlook and anticipated events, business, operations, financial performance, financial condition or results and, in some cases, can be identified by terminology such as "may"; "will"; "should"; "expect"; "plan"; "anticipate"; "believe"; "intend"; "estimate"; "predict"; "potential"; "continue"; "foresee", "ensure" or other similar expressions concerning matters that are not historical facts. In particular, statements regarding the Company's future operating results and economic performance and its objectives and strategies are forward-looking statements. These statements are based on certain factors and assumptions including expected growth, results of operations, performance and business prospects and opportunities, which COGECO believes are reasonable as of the current date. While management considers these assumptions to be reasonable based on information currently available to the Company, they may prove to be incorrect. The Company cautions the reader that the economic downturn experienced over the past two years make forward-looking information and the underlying assumptions subject to greater uncertainty and that, consequently, they may not materialize, or the results may significantly differ from the Company's expectations. It is impossible for COGECO to predict with certainty the impact that this economic environment may have on future results. Forward-looking information is also subject to certain factors, including those described in the "Uncertainties and main risk factors" section starting on page 16 of the Management's Discussion and Analysis ("MD&A") that could cause actual results to differ materially from what COGECO currently expects. These factors include technological changes, changes in market and competition, governmental or regulatory developments, general economic conditions, the development of new products and services, the enhancement of existing products and services, and the introduction of competing products having technological or other advantages, many of which are beyond the Company's control. Therefore, future events and results may vary significantly from what management currently foresees. The reader should not place undue importance on forward-looking information and should not rely upon this information as of any other date. While management may elect to do so, the Company is under no obligation (and expressly disclaims any such obligation), and does not undertake to update or alter this information before the next quarter, except as required by law.

This analysis should be read in conjunction with the Company's Management's Discussion and Analysis, consolidated financial statements and the notes thereto, prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). Throughout this discussion, all amounts are in Canadian dollars unless otherwise indicated.

**Acronyms**

| | |
|---|---|
| DOCSIS | Data Over Cable Service Interface Specifications |
| DVR | Digital Video Recorder (Same as Personal Video Recorder or PVR) |
| € | Euro Currency |
| HD | High Definition |
| HSI | High Speed Internet |
| IP | Internet Protocol |
| Mbps | Megabits per second |
| MHz | Megahertz |
| RGU | Revenue-Generating Units include Basic Cable, HSI, Digital Television and Telephony Service Customers |
| SVOD | Subscription Video on Demand Services |
| VOD | Video on Demand Services |
| VoIP | Voice-over-Internet Protocol |

# Financial highlights

| (in thousands of dollars, except percentages, RGU growth and per share data) | 2010 $ | 2009[1] $ | Change % |
|---|---|---|---|
| **Operations** | | | |
| Revenue | **1,321,694** | 1,252,794 | 5.5 |
| Operating income before amortization[2] | **519,339** | 515,494 | 0.7 |
| Operating margin[2] | **39.3%** | 41.1% | – |
| Operating income | **259,882** | 258,867 | 0.4 |
| Impairment of goodwill and intangible assets | **–** | 399,648 | – |
| Net income (loss) | **56,264** | (79,014) | – |
| Adjusted net income[2] | **46,644** | 36,406 | 28.1 |
| **Cash flow** | | | |
| Cash flow from operating activities | **425,336** | 420,704 | 1.1 |
| Cash flow from operations[2] | **502,219** | 390,288 | 28.7 |
| Capital expenditures and increase in deferred charges | **320,962** | 289,270 | 11.0 |
| Free cash flow[2] | **181,257** | 101,018 | 79.4 |
| **Financial condition** | | | |
| Fixed assets | **1,328,866** | 1,305,769 | 1.8 |
| Total assets | **2,744,656** | 2,670,128 | 2.8 |
| Indebtedness[3] | **961,354** | 1,064,542 | (9.7) |
| Shareholders' equity | **381,635** | 332,122 | 14.9 |
| **RGU growth** | **287,111** | 175,364 | 63.7 |
| **Per share data**[4] | | | |
| Earnings (loss) per share | **3.36** | (4.73) | – |
| Adjusted earnings per share[2] | **2.79** | 2.18 | 28.0 |
| Weighted average number of outstanding shares | **16,726,135** | 16,704,962 | 1.3 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 of the Management's Discussion and Analysis for more details.
(2) The indicated terms do not have standardized definitions prescribed by Canadian Generally Accepted Accounting Principles ("GAAP") and therefore, may not be comparable to similar measures presented by other companies. For Further details, please consult the "Non-GAAP financial measures" section on page 40 of the Management's Discussion and Analysis.
(3) Indebtedness is defined as the total of bank indebtedness, principal on long-term debt and obligations under derivative financial instruments.
(4) Per multiple and subordinate voting share.

| (in millions of dollars) | Original projections October 29, 2009 Fiscal 2010 $ | Revised projections January 12, 2010 Fiscal 2010 $ | **Actuals Fiscal 2010 $** | Achievement of the revised projections[1] Fiscal 2010 |
|---|---|---|---|---|
| **Financial guidelines** | | | | |
| Revenue | 1,285 | 1,325 | **1,322** | Achieved |
| Operating income before amortization | 486 | 512 | **519** | Surpassed |
| Financial expense | 70 | 69 | **65** | Surpassed |
| Current income taxes | (55) | (40) | **(39)** | Under-achieved |
| Net income | 30 | 45 | **56** | Surpassed |
| Capital expenditures and increase in deferred charges | 341 | 341 | **321** | Surpassed |
| Free cash flow | 130 | 140 | **181** | Surpassed |

(1) Achievement of the projections is defined as within 1% above or below the projected amount.

# Message to shareholders

Dear Shareholders,

COGECO continues to navigate successfully through the turbulence of the last few years in financial markets and the global economy, staying the course on growth and value creation for our shareholders. Consolidated revenue rose 5.5%. Furthermore, operating income before amortization[(1)] is up 0.7%, while adjusted net income[(1)] grew 28.1% to $46.6 million. These results are highly satisfying given the turnaround initiatives in the cable sector in Portugal.

For Cogeco Cable, our cable subsidiary, RGU growth was strong in both Canada and Europe in fiscal 2010, with a net increase of 287,000, with over 190,000 in Canada and over 96,000 in Portugal. Customer growth is tangible evidence that our services remain popular with customers and that the strategies deployed during the fiscal year in our different markets have been effective, despite persistently robust competition.

Cogeco Cable continued to reinvent itself with characteristic flexibility, intrapreneurship, and an intense focus on customer satisfaction. To meet the need for a more personalized and higher quality experience, we enhanced our video content offering in residential markets in Canada by expanding Digital content, VOD and HD services. We augmented our Internet offering with new packages, including services powered by DOCSIS 3.0, which enables customers to benefit from speeds up to 50 Mbps, with higher speeds to be implemented in the near future. We also introduced new Telephony packages tailored more closely to different customer needs.

Our drive to constantly improve our customer experience and satisfaction is supported by evolving technology, well tailored service offerings, sustained investment in resources, improved processes and controls, and the innovativeness and agility of employees, senior managers and Board members. Continuous network upgrades and improvements enable us to revamp our offering with expanded networks and the gradual deployment of technologies such as DOCSIS 3.0 that promote more effective bandwidth utilization. Innovation also included implementing new management methods to improve process quality and effectiveness, periodic reviews of risks and the actions taken to manage risk, and developing the skills of our teams. All these activities are centered on the goal of winning new customers and increasing the loyalty and satisfaction of current customers.

Cogeco Data Services Inc. (“CDS”), our subsidiary serving large corporations, also continues to gather strength, expanding its co-location facilities to meet the increasingly pressing needs of business customers. CDS has also started building networks to serve all of the buildings of the two Toronto school boards and the City of Toronto under contracts signed in 2009.

In Portugal, strategies to retain and win customers have proved effective despite sustained competition. We enriched our video offering with HD and Digital content and improved Internet packages for triple-play customers while our Telephony packages have achieved a 94% penetration of Basic Cable service customers, one of the highest penetration rates in Europe. Cabovisão is intensifying efforts to increase the number of business customers. Management expects financial results to start showing growth again following the significant changes of the last two years. Cabovisão’s efforts to outdistance the competition with quality offerings and attentive customer service have already started to generate the expected results.

Meanwhile, capital markets have acknowledged the Company’s prudent and disciplined efforts to grow, focusing on what it does best – serving its customers. A Revolving Term Facility was concluded by the cable subsidiary, Cogeco Cable Inc., in July 2010 for $750 million maturing in 2014, granting it the necessary flexibility to support future growth.

Fiscal 2010 was also marked by a number of developments at the regulatory level. The decision of the Canadian Radio-television and Telecommunications Commission (CRTC) on the Local Programming Improvement Fund (LPIF) had a direct impact on consumers but did not provide for controls to ensure the improvement of local programming. The CRTC also ruled in favour of negotiations for fee-for-carriage payable by cable companies such as Cogeco Cable to conventional TV broadcasters. However, this matter is still before the courts and no decision has been made. On another note, the CRTC commended Cogeco Cable’s exceptional performance in exceeding the objectives of the regulatory framework in the operation of its community TV channels.

We were especially proactive in our radio business, announcing on April 30, 2010 our intention to acquire Corus Entertainment Inc.’s (“Corus”) radio stations in Québec. With this ambitious acquisition – valued at $80 million for 11 stations in various regions of the province – COGECO will become the second largest radio broadcaster in Québec. Our plan focuses mainly on local radio, giving priority to local news and public affairs in talk radio stations. This project contemplates the creation of a new news agency. The transaction with Corus is subject to approval by the CRTC, and we submitted a detailed project at the public hearings held in September 2010. The transaction should be completed in the first half of fiscal 2011.

Meanwhile, our radio teams stayed on track with their excellent work in fiscal 2010. Rythme FM Montréal and FM 93 in Québec City are the leaders in their respective target markets, namely women between the ages of 25 and 54 and men from 25 to 54. They were also the most

(1) The indicated terms do not have standardized definitions prescribed by Canadian Generally Accepted Accounting Principles (“GAAP”) and therefore, may not be comparable to similar measures presented by other companies. For Further details, please consult the “Non-GAAP financial measures” section on page 40 of the Management’s Discussion and Analysis.

popular stations for adults in their regions. In Trois-Rivières, Rythme FM holds an enviable position, while in Sherbrooke, technical enhancements made in fiscal 2010 should boost the station's performance during the coming months. Radio, because of its closeness to the public and relatively affordable prices compared to other media, remains popular with both listeners and advertisers.

As the fiscal year closes, we would like to take a moment to pay tribute to Ms. Germaine Gibara, a Director of COGECO, who passed away last spring. We wish to underscore her exemplary contribution to the Board of Directors since 2007, particularly as a member of the Human Resources Committee and the Strategic Opportunities Committee. We will miss her sound judgment, her commitment and the unbounded positive spirit she demonstrated over the years.

With strong competition in the telecommunications market continuing to demand enhanced performance from all players, the members of our Board of Directors are a valuable source of support – they guide our development with flexibility and determination.

Our last word must highlight the first reason for our continued success. Our ability to attract and retain our customers and audiences is the result of the drive and dedication of our employees who have made COGECO a strong Company enjoying sustained growth. We extend our sincere thanks and gratitude and count on them to keep striving to satisfy our customers and audiences with a warm welcome, an attentive ear and commitment to service.

Louis Audet
President and Chief Executive Officer

Jan Peeters
Board Chair

# Management's Discussion and Analysis (MD&A)

**Management's Discussion and Analysis (MD&A)**

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# Overview of the business

COGECO Inc. ("COGECO" or the "Company") is a diversified communications company that provides Cable Television, HSI, Telephony services and other telecommunications services to its residential and commercial customers in Canada and in Portugal through Cogeco Cable Inc. ("Cogeco Cable" or the "cable subsidiary") and is engaged in Radio broadcasting in Canada through Cogeco Diffusion Inc. ("CDI").

Cogeco Cable is the second largest hybrid fibre coaxial cable system operator in Ontario, Québec and Portugal. Cogeco Cable's operations are supported by hybrid fibre and co-axial cable and fibre optic broadband networks. Cogeco Cable provides its residential customers with Audio, Analogue and Digital Television as well as HSI and Telephony services. In Canada, Cogeco Cable provides, as at August 31, 2010, Basic Cable service to 874,505 customers, Digital Television service to 559,418 customers, HSI service to 559,057 customers and Telephony service to 357,597 customers. In Portugal, through its indirect subsidiary Cabovisão – Televisão por Cabo, S.A. ("Cabovisão"), Cogeco Cable provides, as at August 31, 2010, Basic Cable service to 260,267 customers, Digital Television service to 159,852 customers, HSI service to 163,187 customers and Telephony service to 245,466 customers. Cogeco Cable provides its Canadian business customers data networking, e-business applications, video conferencing, hosting services, Ethernet, private line, VoIP, HSI access, dark fibre, data storage, data security and co-location services, and other advanced communications services.

Through its subsidiary, CDI, COGECO wholly-owns and operates the Rythme FM network which has four radio stations: in Montréal (105.7), Québec City (91.9), Trois-Rivières (100.1) and Sherbrooke (93.7) as well as a repeater station in Magog (98.1). It also wholly-owns Station FM 93 (93.3) in Québec City.

On April 30, 2010, the Company has concluded an agreement with Corus Entertainment Inc. to acquire all of its Québec radio stations for $80 million in cash (the "Corus acquisition"), subject to customary closing adjustments and conditions, including approval by the Canadian Radio-television and Telecommunications Commission (the "CRTC"). On June 30, 2010, the Company submitted its transfer application for approval to the CRTC. A public hearing took place on September 28 and 29, 2010, and the transaction is expected to close during the first half of fiscal 2011.

# Corporate objectives and strategies

COGECO's business objective is to maximize shareholder value by increasing profitability, notably operating income before amortization[(1)], and by ensuring continued revenue growth. To achieve these objectives, COGECO uses strategies, specific to each activity sector which, in turn, are supported by tight controls over the Company's costs and improved business processes.

The main strategies used to reach COGECO's objectives in the cable sector focus on sustained corporate growth and continuous improvement of networks and equipment.

The radio activities focus on continuous improvement of its programming in order to increase its market share and thereby its profitability.

## Tight control over costs and improved business processes

The Company maximizes profitability and shareholder value by maintaining strict controls over spending. In order to achieve this, COGECO has to become more efficient with its processes making its offer more attractive to customers. In addition, tight controls over processes ensure that shareholders receive timely information on the Company's development.

## Cable sector

Cogeco Cable's business objectives are to ensure corporate growth through the expansion of its service offering and its customer base while maximizing shareholder value through profitability, notably operating income before amortization.

To achieve these objectives, Cogeco Cable has developed strategies that focus on expanding its service offering, enhancing its existing services and bundles, improving customer experience and business processes as well as keeping a sound capital management and a strict control over spending. These strategies will be supported by developing continuously the infrastructure network in accordance with sound capital expenditures management. Genuine customer service will arise by focusing on customer needs with services at attractive prices while taking into account the competitive landscape and the economic environment, using a variety of sales channels, simplifying and tightening customer-related processes thus providing better cost controls. To this effect, Cogeco Cable completed a realignment of its operational structure during the 2010 fiscal year in order to capitalize on synergies and increase efficiency across the various operational functions.

(1) Operating income before amortization does not have a standardized definition prescribed by Canadian Generally Accepted Accounting Principles ("GAAP") and therefore, may not be comparable to similar measures presented by other companies. For further details, please consult the "Non-GAAP financial measures" section on page 40.

## Anticipated results of these strategies

The successful implementation of the previously described strategies should result in heightened profitability and ensure continued growth that will be measured based on the following criteria (these criteria are described in greater detail on page 39 in "Fiscal 2011 financial guidelines"):

- COGECO expects to achieve operating income before amortization of $538 million in fiscal 2011 as a result of the following factors in the cable sector; RGU growth and the rate increases implemented in fiscal 2010 in the Canadian operations, however the economic climate in Europe is expected to remain difficult in the short-term, and the decrease in the expected exchange rate for the Euro compared to the Canadian dollar in the upcoming fiscal year is expected to offset the favourable impact of the growth in the European operations' customer base in the coming year;
- The Company expects to generate a free cash flow(1) of $60 million as a result of growth in operating income before amortization described above which will be offset by a return to usual cash income tax payments, reflecting the realization of significant current income tax savings in fiscal 2010 stemming from modifications to the corporate structure in the cable sector. The majority of the free cash flow will be used to reduce Indebtedness;
- Cable sector RGU are expected to grow by approximately 250,000 in the coming year, stemming from increases in penetration of the various services offered and the ongoing strong interest in Cogeco Cable's growing HD service offerings, and the acquisition and retention strategies implemented in the second half of fiscal 2009 in the European operations.

Please refer to the "Key performance indicators" section on page 10 for further details on the fiscal 2010 results and achievements.

# Cable networks

## Canada

The Company's subsidiary, Cogeco Cable, provides its residential and business customers cable, data and telecommunication services in Canada through state-of-the-art fibre optic and broadband distribution networks. It is Cogeco Cable's general policy to fully own its distribution networks, head-ends and data centres as well as its transmission equipment and access facilities. As at August 31, 2010, Digital Television, VOD and Telephony services were available to approximately 99%, 95% and 92% of homes passed, respectively, and approximately 96% of homes passed were served by a two-way cable plant. Cogeco Cable's inter-city optical fibre network extends over 10,930 kilometres and includes 105,044 kilometres of optical fibre. Cogeco Cable has deployed optical fibre to nodes serving clusters of typically at or below 1,000 homes passed, with multiple fibres per node in most cases, which allows Cogeco Cable to rapidly extend the capacity of the fibre plant to clusters of 500 homes or less if and when necessary. This process, known as "Node Splitting", leads to further improvement in the quality and reliability and an increase in the capacity of two-way services such as HSI, VOD and Telephony.

Cogeco Cable currently uses DOCSIS 1.1, DOCSIS 2.0 and DOCSIS 3.0 standards within its IP platform. The DOCSIS standard includes numerous features including the prioritization of packets to ensure a continuous transmission and quality. This prioritization is important for services that need to be transmitted in real time, such as those of the Telephony service. In addition, when required, DOCSIS 2.0 and DOCSIS 3.0 features can be activated to achieve increased speed and capacity in the return path by using advanced modulation or features that can allow the use of portions of the spectrum that are not otherwise usable. This gives Cogeco Cable a flexible and expandable platform for providing other products like symmetrical services, which are particularly well suited for commercial customer applications. The new standard, DOCSIS 3.0, while still compatible with the earlier versions, will make it possible to further increase IP transmission speeds up to 160 Mbps and beyond. Cogeco Cable is in the process of a gradual deployment of DOCSIS 3.0 head-end and customer premise equipment.

Cogeco Cable has implemented an infrastructure with 550 MHz and 750 MHz capacity, depending on the cable system and customer needs. The infrastructure with 550 MHz capacity allows for the transmission of up to 80 analogue channels and the 750 MHz infrastructure allows for the transmission of up to 110 analogue channels. For reference purposes, each analogue channel (representing 6 MHz of bandwidth), with the current compression, multiplexing and modulation technologies used by Cogeco Cable, allows for the transmission of up to 15 standard definition digital television signals, or of up to 3 HD signals.

Cogeco Cable intends to deploy the Switched Digital Video ("SDV") technology and the Digital Terminal Adapter ("DTA") technology in its systems where and when bandwidth capacity is required. SDV technology allows Cogeco Cable to selectively broadcast only the Digital Television channels that are currently being viewed by customers, effectively allowing Cogeco Cable to offer a greater selection of digital channels, and is used particularly for low viewership content and channels. DTA technology converts Digital Television signals to analogue signals in the viewer's home through a device installed on the television set. Deployment of this technology would allow for a broader use of Digital Television service and for the further conversion of analogue channel capacity.

Cogeco Cable is deploying the Fibre to the Home ("FTTH") technology in new residential subdivision developments which meet specific criteria of size, proximity to the existing plant and service penetration rate. The FTTH topology selected is Radio Frequency Over Glass ("RFoG"). The primary benefit of RFoG is the ability to leverage existing Cable Modem Termination Systems ("CMTS"), cable modem investments and back-office applications, all while maintaining service continuity with existing video, VoIP, and ultra-broadband Internet services.

In addition, Cogeco Data Services Inc. ("CDS") operates a 625 kilometre fibre optic network that extends throughout the Greater Toronto Area ("GTA"). The multiple facilities based infrastructure (Ethernet, Dense wave division multiplexing and Multiprotocol Label Switching) connects over 600 commercial buildings within the city and enables high bandwidth services.

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(1) Free cash flow does not have a standardized definition prescribed by Canadian GAAP and therefore, may not be comparable to similar measures presented by other companies. For further details, please consult the "Non-GAAP financial measures" section on page 40.

## Portugal

The Company's indirect Portuguese subsidiary, Cabovisão, provides its cable services through state-of-the-art 750 MHz broadband distribution networks. Cabovisão fully owns its distribution networks, head-ends and drops. HSI service is offered to 100% of homes passed and served by a two-way cable plant. Telephony service is also offered to 100% of homes passed, with standard based embedded Multimedia Terminal Adapters ("e-MTA"). Cabovisão currently uses class-5 circuit switches and class-5 advanced softswitches.

Cabovisão's intercity fibre optic network extends over 3,414 kilometres and includes approximately 232,000 kilometres of optical fibre. Cabovisão has deployed optical fibre to nodes serving clusters of typically 1,200 homes passed, with many fibres per node in most cases, which allows Cabovisão to further extend the fibre plant to smaller clusters of 500 homes rapidly with relative ease if and when necessary. Node splitting leads to further improvements in the quality and reliability of the network and services and allows for increasing traffic of two-way services, such as HSI, VOD and Telephony.

Cabovisão currently uses DOCSIS 1.1, DOCSIS 2.0 and DOCSIS 3.0 standards within its IP platform. DOCSIS 3.0 has been deployed in all major centres and expansion to all homes will continue in the coming years, providing up to 120 Mbps for HSI service.

In Portugal and in most of Europe, Phase Alternated Line ("PAL") B and PAL G television standards are used and each analogue channel requires 7 MHz (PAL B is used up to 300 MHz) and 8 MHz (PAL G is used above 300 MHz) of bandwidth compared to 6 MHz in North America, which uses the National Television System Committee ("NTSC") standards. An infrastructure with 750 MHz capacity in Portugal allows for the transmission of up to 83 analogue channels. For reference purposes, each analogue channel (representing 7 or 8 MHz of bandwidth), with the current compression, multiplexing and modulation technologies used by Cabovisão, allows for the transmission of up to 13 standard definition Digital Television signals, or of up to 6 HD signals.

# Key performance indicators

COGECO is dedicated to increasing shareholder value and consequently focuses on optimizing profitability while efficiently managing its use of capital without jeopardizing future growth. The following key performance indicators are closely monitored to ensure that business strategies and objectives are closely aligned with shareholder value creation. The key performance indicators are not measurements in accordance with Canadian GAAP and should not be considered an alternative to other measures of performance in accordance with GAAP. The Company's method of calculating key performance indicators may differ from other companies and, accordingly, these key performance indicators may not be comparable to similar measures presented by other companies.

| *(in millions of dollars, except RGU growth)* | Original projections October 29, 2009 Fiscal 2010 $ | Revised projections January 12, 2010[1] Fiscal 2010 $ | **Actuals Fiscal 2010 $** | Achievement of the revised projections[2] Fiscal 2010 |
|---|---|---|---|---|
| **Financial guidelines** | | | | |
| Operating income before amortization | 486 | 512 | **519** | Surpassed |
| Operating margin[3] | 37.8% | 38.6% | **39.3%** | Surpassed |
| Free cash flow | 130 | 140 | **181** | Surpassed |
| RGU growth | 125,000 | 200,000 | **287,111** | Surpassed |

(1) RGU growth guidelines for Fiscal 2010 were revised on April 7, 2010.
(2) Achievement of the projections is defined as within 1% above or below the projected amount.
(3) Operating margin does not have a standardized definition prescribed by Canadian GAAP and therefore, may not be comparable to similar measures presented by other companies. For further details, please consult the "Non-GAAP financial measures" section on page 40.

## Operating income before amortization and operating margin

Operating income before amortization and operating margin are benchmarks commonly used in the telecommunications industry, as they allow comparisons with companies that have different capital structures and are more current measures since they exclude the impact of historical investments in assets. Operating income before amortization indicators assess COGECO's ability to seize growth opportunities in a cost effective manner, to finance its ongoing operations and to service its debt. Operating income before amortization is a proxy for cash flow from operations[1] excluding the impact of the capital structure chosen. Consequently, operating income before amortization is one of the key metrics used by the financial community to value the business and its financial strength. Operating margin is calculated by dividing operating income before amortization by revenue. In the 2009 Annual Report, the Company projected operating income before amortization of $486 million for the 2010 year, which was then increased to $512 million in the revised projections issued on January 12, 2010 in order to reflect improved performance of the Company during the first quarter, the expected trend for fiscal 2010. Operating income before amortization for the 2010 fiscal year amounted to $519 million, surpassing the Company's revised projections. The operating margin reached 39.3% for the fiscal year, compared to the revised projections of 38.6%. The favourable results for operating income before amortization and the operating margin are discussed in further detail in the "Operating and financial results" section on page 24.

(1) Cash flow from operations does not have a standardized definition prescribed by Canadian GAAP and therefore, may not be comparable to similar measures presented by other companies. For further details, please consult the "Non-GAAP financial measures" section on page 40.

## Free cash flow

Free cash flow is defined as cash flow from operations less capital expenditures (including assets acquired under capital leases that are disclosed in note 16 B) of the consolidated financial statements on page 69, which are not reflected in the consolidated statements of cash flows) and the increase in deferred charges. The financial community also closely follows this indicator since it measures the Company's ability to repay debt, distribute capital to its shareholders and finance its growth. On January 12, 2010, COGECO issued revised fiscal 2010 free cash flow projections of $140 million, up from the initial projection of $130 million issued in the 2009 Annual Report. COGECO surpassed the revised projections for the 2010 year with free cash flow of $181 million mainly due to fewer capital expenditures than projected and an increase in cash flow from operations in the cable sector.

## Cable sector

### RGU growth and penetration of service offerings

RGU expansion is an important driver of revenue growth and measures the success of the marketing strategy and the competitiveness of the service offerings and pricing. For the 2010 fiscal year, as revised on April 7, 2010, Cogeco Cable's projected growth of 200,000 RGU was largely surpassed with 287,111 RGU primarily due to strong growth in Digital Television service customers in both Canadian and European operations, continued growth in Telephony and HSI service customers in the Canadian operations and a return to growth for the European operations. Penetration statistics measure Cogeco Cable's market share. Cogeco Cable computes the penetration for Basic Cable services as a percentage of homes passed and, in the case of all other services, as a percentage of Basic Cable Service customers in the areas where the service is offered. For further details please consult the customer statistics in the "Performance highlights" section.

# Critical accounting policies and estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to adopt accounting policies and to make estimates and assumptions that affect the reported amounts of assets and liabilities, contingent assets and liabilities and revenue and expenses during the reporting year. A summary of the Company's significant accounting policies is presented in note 1 on page 49 of the consolidated financial statements. The following accounting policies were identified as critical to COGECO's business operations.

## Revenue recognition

The Company considers revenue to be earned as services are rendered, provided that ultimate collection is reasonably assured. The Company earns revenue from several sources. The recognition of revenue from the principal sources is as follows:

- Revenue from Cable Television, HSI, Telephony and other telecommunications services are recognized when services are rendered;
- Revenue generated from sales of home terminal devices is recorded as equipment revenue upon activation of services as management considers the sale of home terminal devices as a single unit of accounting of a multiple element arrangement;
- Installation revenue is deferred and amortized over the average life of a customer's subscription for residential customers, not exceeding four years, and over the term of the contract for business customers. Management considers that installation revenue is part of a multiple element arrangement and has no standalone value. Accordingly, installation revenue is deferred and amortized at the same pace as revenue from Cable Television, HSI, Telephony and other telecommunications services are earned;
- Promotional offers are accounted for as deductions from revenue when customers take advantage of such offers;
- Advertising revenue is recognized when aired.

Amounts received or invoiced that do not comply with these criteria are accounted for as deferred and prepaid revenue.

## Allowance for doubtful accounts

The Company's revenue is earned mostly from residential and business customers in the cable sector. Accordingly, allowance for doubtful accounts is calculated based on the specific credit risk of its customers by examining such factors as the number of overdue days of the customer's balance owing as well as the customer's collection history with the Company. As a result, conditions causing fluctuations in the aging of customer accounts will directly impact the reported amount of bad debt expense.

## Accrued liabilities

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of accrued liabilities at the date of the financial statements and the reported amounts expensed during the year. Actual results could differ from those estimates.

## Amortization policies and useful lives

COGECO amortizes fixed assets and intangible assets with finite useful lives over the estimated useful lives of the items. In estimating useful lives, the Company considers such factors as life expectancy of the assets, changing technologies and industry trends. The Company reviews its estimated useful lives on a regular basis. If changes in the above-mentioned factors happen more quickly than anticipated, COGECO may have to shorten the estimated lives of certain assets, which could result in a higher amortization expense in future periods.

## Purchase price allocation

The allocation of the purchase prices for the Company's acquisitions involves considerable judgement in determining the fair values assigned to the tangible and intangible assets acquired and the liabilities assumed on acquisition. Among other things, the determination of these fair values involves the use of discounted cash flow analyses, estimated future margins and estimated future customer counts. Should actual rates and cash flows differ from these estimates, revisions to the carrying value of the related assets and liabilities acquired may be required, including revisions that may impact net income in future periods.

## Impairment of fixed assets and intangible assets with finite useful lives

The Company reviews, when a triggering event occurs, the carrying values of its fixed assets and intangible assets with finite useful lives by comparing the carrying amount of the asset or group of assets to the expected future undiscounted cash flows to be generated by the asset or group of assets. An impairment loss is recognized when the carrying amount of an asset or group of assets held for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposal. The impairment loss is measured as the amount by which the asset or group of assets' carrying amount exceeds its fair value. Future cash flows are based on internal forecasts and consequently, considerable management judgement is necessary to estimate future cash flows. Significant changes in assumptions could result in an impairment of these assets.

## Impairment of intangible assets with indefinite useful lives and goodwill

The valuation of customer base, broadcasting licences and goodwill are subject to review for impairment annually or whenever significant events or changes in circumstances occur, to determine if the carrying value can be recovered. In conducting impairment testing, the Company compares the carrying value to the sum of the expected future discounted cash flows. Future cash flows are based on internal forecasts and discounted by using a weighted average cost of capital rate. Considerable management judgement is necessary to estimate future cash flows. Significant changes in assumptions could result in an impairment of these assets. The Company's annual impairment tests are performed as at August 31 of each fiscal year.

## Income taxes

The Company uses assumptions to estimate income tax expense as well as future income tax liabilities. This process includes estimating the actual amount of income taxes payable and evaluating income tax loss carryforwards and temporary differences as a result of differences between the values of the items reported for accounting and tax purposes. Realization of future income tax assets is dependent upon generating sufficient taxable income during the period in which temporary differences are expected to be recovered or settled. The likelihood of realization of future income tax assets is evaluated by considering such factors as estimated future earnings based on internal forecasts, prudent and feasible tax planning strategies and reversal of temporary differences that result in future income tax liabilities. Future income tax assets and liabilities are calculated according to enacted or substantively enacted income tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. Future income tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Accordingly, changes in assumptions will directly impact the reported amount of income tax expense.

## Foreign currency translation

Financial statements of self-sustaining foreign subsidiaries are translated into Canadian dollars using the exchange rate in effect at the balance sheet date for asset and liability items, and using the average exchange rates during the period for revenue and expenses. Adjustments arising from this translation are deferred and recorded in the foreign currency translation adjustment in accumulated other comprehensive income and are included in income only when a reduction in the investment in these foreign subsidiaries is realized.

Other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rates prevailing at the balance sheet date for monetary items and at the transaction date for non-monetary items. Revenue and expenses are translated at average exchange rates prevailing during the period except for transactions being hedged, which are translated using the terms of the hedges. Amounts payable or receivable on cross-currency swap agreements, all of which are used to hedge foreign currency debt obligations, are recorded concurrently with the unrealized gains and losses on the obligations being hedged. Other foreign exchange gains and losses are recognized as financial expense, except for unrealized foreign exchange gains and losses on foreign-denominated long-term debt that is designated as a hedge of a net investment in self-sustaining foreign subsidiaries, which are included in the foreign currency translation adjustment in accumulated other comprehensive income, net of income taxes and non-controlling interest.

## Financial instruments

### Classification, recognition and measurement

All of the Company's financial assets are classified as held-for-trading or loans and receivables. The Company has classified its cash and cash equivalents as held-for-trading. Held-for-trading assets and liabilities are carried at fair value on the consolidated balance sheet, with changes in fair value recorded in the consolidated statements of income. Accounts receivable have been classified as loans and receivables. All of the Company's financial liabilities are classified as other liabilities, except for the cross-currency swap and interest rate swap agreements. Loans and receivables instruments and all financial liabilities are carried at amortized cost using the effective interest rate method. The Company has determined that none of its financial assets are classified as available-for-sale or held-to-maturity.

### Transaction costs

Transaction costs are capitalized on initial recognition and presented as a reduction of the related financing, except for transaction costs on the revolving loan and the swingline facility, which are presented as deferred charges. These costs are amortized over the term of the related financing using the effective interest rate method, except for transaction costs on the revolving loan and the swingline facility, which are amortized over the term of the related financing on a straight-line basis.

### Derivative financial instruments and hedge accounting

The Company uses cross-currency swap and interest rate swap agreements as derivative financial instruments to manage risk in fluctuation in interest and foreign exchange rates related to its long term debt. All derivatives are measured at fair value with changes in fair value recorded in the consolidated statements of income unless they are effective cash flow hedging instruments. The changes in fair value of cash flow hedging derivatives are recorded in other comprehensive income, to the extent effective, until the variability of cash flows relating to the hedged asset or liability is recognized in the consolidated statements of income. Any hedge ineffectiveness is recognized in the consolidated statements of income immediately. Accordingly, the Company's cross-currency swap and interest rate swap agreements must be measured at fair value in the consolidated financial statements. Since these cross-currency swap and interest rate swap agreements are used to hedge cash flows on Senior Secured Notes Series A denominated in US dollars and a portion of the Euro-denominated loans outstanding under the Term Revolving Facility and previously the Term Facility, the changes in fair value are recorded in other comprehensive income. The Company does not hold or use any derivative financial instruments for speculative purposes. Net receipts or payments arising from cross-currency and interest rate swap agreements are recognized as financial expense.

### Embedded derivatives

All embedded derivatives that are not closely related to the host contracts are measured at fair value, with changes in fair value recorded in the consolidated statements of income. At August 31, 2010 and 2009, there were no significant embedded derivatives or non-financial derivatives that required separate fair value recognition on the consolidated balance sheets.

## Contingencies and commitments

The Company is subject to various claims and contingencies related to lawsuits, taxes and commitments under contractual and other commercial obligations. The contractual and other commercial obligations primarily relate to network fees and operating lease agreements for use of transmission facilities. The Company recognizes liabilities for contingencies and commitments when a loss is probable and can be reasonably estimated based on currently available information. Significant changes in assumptions as to the likelihood and estimates of a loss could result in the recognition of an additional liability.

## Cable sector

### Capitalization of direct labour and overhead

Capitalization of costs includes the expenditures to acquire, construct, develop or improve an item of property, plant or equipment, as well as all costs directly attributable to those activities. The cost of an item includes direct construction or software development costs, such as materials, labour and overhead costs directly attributable to the construction or software development activity. The cost to enhance the service potential of an item is considered an improvement and as a result is capitalized. Costs incurred in the maintenance of service potential are expensed.

Cogeco Cable capitalizes direct labour and direct overhead costs incurred to construct new assets, enhance existing assets and connect new customers. Although capitalization of financial expense is permitted for construction activities, it is Cogeco Cable's policy not to capitalize them.

### Capitalization of costs to acquire customers

Cogeco Cable incurs significant costs to reconnect or activate additional services for Basic Cable, HSI, Digital Television and Telephony customers. These costs include material and labour costs incurred to reconnect or activate additional services for customers. Reconnect and additional service activation costs are capitalized up to a maximum amount not exceeding the revenue generated by the reconnect activity. These costs are amortized over the average life of a customer's subscription, not exceeding four years. The average life of a customer's subscription is reviewed annually and changes could have a significant impact on the amortization expense.

# Adoption of new accounting standards

## Adopted during fiscal 2010

### Goodwill and intangible assets

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064, *Goodwill and intangible assets*, replacing Section 3062, *Goodwill and other intangible assets* and Section 3450, *Research and development costs*. The new section established standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill remained unchanged from the standards included in the previous Section 3062. The new section was applicable to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008, with retroactive application. The adoption of Section 3064 resulted in the elimination of the deferral of new service launch costs which are now recognized as operating costs when they are incurred. Reconnect and additional service activation costs are capitalized up to an amount not exceeding the revenue generated by the reconnect activity. Consequently, the Company adjusted opening retained earnings on a retroactive basis and the prior period comparative figures have been restated. The adoption of this new section had the following impacts on the Company's consolidated financial statements:

**Consolidated statement of income (loss)**

| *Increase (decrease)*<br>*(in thousands of dollars)* | Year ended<br>August 31, 2009<br>$ |
|---|---|
| Operating costs | 16,519 |
| Amortization of deferred charges | (14,373) |
| Future income tax expense | (605) |
| Non-controlling interest | (1,052) |
| Net income | (489) |

**Consolidated balance sheets**

| *Increase (decrease)*<br>*(in thousands of dollars)* | August 31,<br>2009<br>$ | September 1,<br>2008<br>$ |
|---|---|---|
| Deferred charges | (34,551) | (32,405) |
| Future income tax liabilities | (10,229) | (9,624) |
| Non-controlling interest | (16,428) | (15,376) |
| Retained earnings | (7,894) | (7,405) |

### Financial instrument disclosures

In 2009, the Canadian Accounting Standards Board ("AcSB") amended CICA Handbook Section 3862, *Financial instruments – disclosures*, to require enhanced disclosures about the relative reliability of the data, or inputs, that an entity uses in measuring the fair values of its financial instruments. The new requirements are effective for annual financial statements for fiscal years ending after September 30, 2009. The adoption of this amendment did not have any impact on the classification and measurement of the Company's financial instruments. The new disclosures pursuant to this amendment are included in note 18 of the Company's consolidated financial statements.

## Adopted during fiscal 2009

### Capital disclosures and financial instruments

Effective September 1, 2008, the Company adopted the CICA Handbook Section 1535, *Capital disclosures*, Section 3862, *Financial instruments – disclosures* and Section 3863, *Financial instruments – presentation.*

**Capital disclosures**
Section 1535 of the CICA Handbook requires that an entity disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences for non-compliance. These new disclosures are included in note 18 of the Company's consolidated financial statements.

**Financial Instruments**
Section 3862 on financial instrument disclosures requires the disclosure of information about the significance of financial instruments for the entity's financial position and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, gains and losses, and circumstances in which financial assets and financial liabilities are offset.

The adoption of these standards did not have any impact on the classification and measurements of the Company's financial instruments. The new disclosures pursuant to these new sections are included in note 18 of the Company's consolidated financial statements.

### General standards of financial statement presentation

The CICA amended Section 1400 of the CICA Handbook, *General standards of financial statement presentation*, to include a requirement for management to make an assessment of the entity's ability to continue as a going concern when preparing financial statements. These changes, including the related disclosure requirements, were adopted by the Company on September 1, 2008 and had no impact on the consolidated financial statements.

### Credit risk and fair value of financial assets and financial liabilities

On January 20, 2009, the Emerging Issues Committee ("EIC") of the Canadian AcSB issued EIC Abstract 173, *Credit risk and fair value of financial assets and financial liabilities*, which establishes guidance requiring an entity to consider its own credit risk as well as the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC-173 is applicable to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009 and was applicable to the Company for its second quarter of fiscal 2009 with retrospective application to the beginning of the 2009 fiscal year, without restatement of prior periods. The adoption of this new abstract during the second quarter had no significant impact on the consolidated balance sheet at September 1, 2008.

## Future accounting pronouncements

### Harmonization of Canadian and International accounting standards

In March 2006, the AcSB of the CICA released its new strategic plan, which proposed to abandon Canadian GAAP and effect a complete convergence to the International Financial Reporting Standards ("IFRS") for Canadian publicly accountable entities. This plan was confirmed in subsequent exposure drafts issued in April 2008, March 2009 and October 2009. The changeover will occur no later than fiscal years beginning on or after January 1, 2011. Accordingly, the Company's first interim consolidated financial statements presented in accordance with IFRS will be for the quarter ending November 30, 2011, and its first annual consolidated financial statements presented in accordance with IFRS will be for the year ending August 31, 2012.

IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosure requirements. The Company has established a project team including representatives from various areas of the organization to plan and complete the transition to IFRS. This team reports periodically to the Audit Committee, which oversees the IFRS implementation project on behalf of the Board of Directors. The Company is assisted by external advisors as required.

The implementation project consists of three primary phases, which may occur concurrently as IFRS are applied to specific areas of operations:

| Phase | Area of impact | Key activities | Status |
|---|---|---|---|
| Scoping and diagnostic | Pervasive | Perform a high-level impact assessment to identify key areas that are expected to be impacted by the transition to IFRS.<br>Rank IFRS impacts in order of priority to assess the timing and complexity of transition efforts that will be required in subsequent phases. | Completed |
| Impact analysis, evaluation and design | For each area identified in the scoping and diagnostic phase | Identify the specific changes required to existing accounting policies.<br>Analyse policy choices permitted under IFRS.<br>Present analysis and recommendations on accounting policy choices to the Audit Committee. | Completed |
| | Pervasive | Identify impacts on information systems and business processes.<br>Prepare draft IFRS consolidated financial statement template.<br>Identify impacts on internal controls over financial reporting and other business processes. | Completed |
| Implementation and review | For each area identified in the scoping and diagnostic phase | Test and execute changes to information systems and business processes. | Completed |
| | | Obtain formal approval of required accounting policy changes and selected accounting policy choices. | In progress - to be completed in fiscal 2011 |
| | | Communicate impact on accounting policies and business processes to external stakeholders. | To be completed during fiscal 2011 |
| | Pervasive | Gather financial information necessary for opening balance sheet and comparative IFRS financial statements.<br>Update and test internal control processes over financial reporting and other business processes. | In progress - to be completed in fiscal 2011 |
| | | Collect financial information necessary to compile IFRS-compliant financial statements.<br>Provide training to employees and end-users across the organization.<br>Prepare IFRS compliant financial statements.<br>Obtain the approval from the Audit Committee of the IFRS consolidated financial statements. | In progress - to be completed during fiscal 2012 |
| | | Continually review IFRS and implement changes to the standards as they apply to the Company. | To be completed throughout transition and post-conversion periods |

The Company's project for the transition from Canadian GAAP to IFRS is progressing according to the established plan and the Company expects to meet its target date for migration.

### Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the CICA issued Handbook Section 1582, *Business combinations*, which replaces Section 1581 of the same name, and Sections 1601, *Consolidated Financial Statements* and 1602, *Non-controlling interests*, which together replace Section 1600, *Consolidated Financial Statements*. These new sections harmonize significant aspects of Canadian accounting standards with the IFRS that will be mandated for publicly accountable entities with fiscal years beginning on or after January 1, 2011.

Section 1582 requires that all business acquisitions be measured at the fair value of the acquired entity at the acquisition date even if the business combination is achieved in stages, or if less than 100% of the equity interest in the acquiree is owned at the acquisition date, and expands the definition of a business subject to an acquisition. The section also establishes new guidance on the measurement of consideration given and the recognition and measurement of assets acquired and liabilities assumed in a business combination. Furthermore, under this new guidance, acquisition costs, which were previously included as a component of the consideration given, and any negative goodwill resulting from the allocation of the purchase price, which was allocated as a reduction of non-current assets acquired under the previous standard, will be recorded in earnings in the current period. This new section will be applied prospectively and will only impact the Company's consolidated financial statements for future acquisitions concluded in periods subsequent to the date of adoption.

Sections 1601 and 1602 dealing with consolidated financial statements require an entity to measure non-controlling interest upon acquisition either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The new sections also require non-controlling interest to be presented as a separate component of shareholders' equity.

The new standards will apply as of the beginning of the first annual reporting period beginning on or after January 1, 2011, with simultaneous early adoption permitted. Early adoption may reduce the amount of restatement required upon conversion to IFRS. The Company has elected not to early-adopt these sections, and in light of the harmonization of Canadian and International accounting standards taking effect at that same date, these sections will not be applicable to the Company.

### Multiple deliverable revenue arrangements

In December 2009, the EIC issued a new abstract concerning multiple deliverable revenue arrangements, EIC-175, *Multiple deliverable revenue arrangements*, which amended EIC-142, *Revenue arrangements with multiple deliverables*. EIC-175 requires a vendor to allocate arrangement consideration at the inception of the arrangement to all deliverables using the relative selling price method, thereby eliminating the use of the residual value method. The amendment also changes the level of evidence of the standalone selling price required to separate deliverables when more objective evidence of the selling price is not available. EIC-175 should be adopted prospectively to revenue arrangements entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011, with early adoption permitted. The Company is currently evaluating the option to early-adopt this EIC in fiscal 2011.

# Controls and procedures

The President and Chief Executive Officer ("CEO") and the Senior Vice President and Chief Financial Officer ("CFO"), together with management, are responsible for establishing and maintaining adequate disclosure controls and procedures and internal controls over financial reporting, as defined in National Instrument 52-109. COGECO's internal control framework is based on the criteria published in the report "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission and is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

The CEO and CFO, supported by management, evaluated the design and operation of the Company's disclosure controls and procedures and internal controls over financial reporting as of August 31, 2010, and have concluded that they are effective. Furthermore, no significant changes to the internal controls over financial reporting occurred during the year ended August 31, 2010.

# Uncertainties and main risk factors

This section outlines general as well as more specific risks faced by COGECO and its subsidiaries that could significantly affect the financial condition, operating results or business of the Company. It does not purport to cover all contingencies, or to describe all possible factors that might have an influence on the Company or its activities at any point in time. Furthermore, the risks and uncertainties outlined in this section may or may not materialize in the end, may evolve differently than expected or may have different consequences than those that are being presently anticipated.

COGECO applies an on-going risk management process that includes a quarterly assessment of risks for the Company and its subsidiaries, under the oversight of the Audit committee. As part of this process, the Company endeavours to identify risks that are liable to have a major impact on the Company's financial situation, revenue or activities, and to mitigate such risks proactively as may be reasonable and appropriate in the circumstances. This section reflects management's current views on uncertainties and the main risk factors.

## Risks pertaining to markets and competition

### Cable sector

Electronic communications markets continue to evolve rapidly and are very competitive in both Canada and Portugal. Competitors offer video distribution, broadband HSI access, fixed telephone, mobile telephone and fixed and mobile data services through various means of telecommunications facilities, including terrestrial wireline and wireless networks as well as satellite. Rivalry extends over several elements comprising the value proposition, including the features of individual services, the composition of service bundles, the range of content or service options, quality of service, speed of delivery, regular introductory and promotional pricing or offers, duration of the commitment by the customer, terminal devices and customer service. Service bundles offered by competitors include up to “quadruple-play” offers combining television, HSI, fixed and mobile telecommunications to residential and commercial customers.

Cogeco Cable provides “double-play” and “triple-play” service bundles both in Canada and in Portugal, with various combinations of Telephony, HSI and Television distribution services being offered at attractive bundle prices, but does not offer “quadruple-play” service bundles that include mobile communications. Cogeco Cable does not offer mobile Internet service. Cogeco Cable continues to focus on its existing lines of service with a view to capturing the remaining growth opportunities for HSI, Digital Television and Telephony services in its footprint, making the most efficient use of its own hybrid fibre-coaxial (“HFC”) plant. As markets evolve and mobility becomes a more cost-effective substitute to wireline communications, Cogeco Cable may need to add mobility components to its service offerings, through suitable mobile virtual network (“MVNO”) arrangements with existing or future mobile operators, or otherwise through new wireless alternatives. There is no assurance that appropriate MVNO arrangements will be concluded by Cogeco Cable when needed, and their impact on the financial results cannot be assessed at this time. Also, the capital and operating expenditures eventually required to offer quadruple-play service bundles and mobile services may not be offset by the incremental revenue that such new bundles or mobile services would generate, thus resulting in downward pressure on operating margins.

In Canada, Cogeco Cable currently faces competition in its service areas mainly from a few large integrated telecommunications service providers. The largest, Bell Canada (“Bell”), offers through its various operating entities a full range of competitive voice, data and video services to residential, as well as to business customers in the Provinces of Québec and Ontario through a combination of fixed wireline, mobile terrestrial wireless and satellite platforms. Bell has commenced the rollout of Internet Protocol Television (“IPTV”) services over its fixed wireline platform and the deployment of optical fibre to residential premises in certain areas within its service footprint. Telus Communications Company (“Telus”) competes with all of Cogeco Cable’s services in the Lower St. Lawrence area of the Province of Québec through the use of its wireline network, and throughout Cogeco Cable’s Canadian footprint through the use of its mobile telecommunications network. Telus has also commenced the deployment of optical fibre to residential premises in certain areas within its service footprint. However, Cogeco Cable’s Telephony service is provided with the assistance of certain Telus carrier services through a long-term contractual arrangement. Shaw Direct (formerly Star Choice Television Network Incorporated), an indirect subsidiary of Shaw Communications Inc. (“Shaw”), competes for video and audio distribution services throughout Cogeco Cable’s Canadian footprint. Rogers Wireless Communications Inc., a subsidiary of Rogers Communications Inc. (“Rogers”), operates a mobile telecommunications network in Ontario and Québec and is the owner of the Inukshuk broadband wireless network in partnership with Bell. Rogers Cablesystems Inc., the cable subsidiary of Rogers, is licensed to extend its services in the Burlington, Oakville and Milton areas, which are part of Cogeco Cable’s footprint in Ontario, although there has not been any significant cable overwiring to date. Videotron Ltd. (“Videotron”), an indirect subsidiary of Quebecor Inc., offers competitive telecommunications services in Cogeco Cable’s Québec footprint and is now actively marketing its new mobile telecommunications services in Québec. Other advanced wireless service mobile telecommunications service operators, including Wind and Public Mobile, have also entered the market in Ontario and Québec. Incumbents Rogers, Bell and Telus are responding to new entrants with more attractive pricing and flexible service options, which may cause substitution between wireline and wireless telecommunications services to accelerate Cogeco Cable also competes within its network footprint with other telecommunications service providers, including Vonage, Primus and Rogers Home Phone (formerly known as Sprint), with alternative service providers that use resale or third-party access arrangements in effect, and with smaller facilities-based competitors such as Maskatel in certain local markets.

In Portugal, Cogeco Cable’s indirect subsidiary Cabovisão faces competition for all its lines of business mainly from incumbent telecommunications carrier Portugal Telecom, SGPS, S.A. (“PT”), Zon Multimedia, SGPS, S.A. (“Zon”), Vodafone, as well as from Sonaecom, SGPS, S.A. (“Sonaecom”), a subsidiary of diversified Portuguese conglomerate Sonae, SGPS, S.A. (“Sonae”). Zon owns TV Cabo, the largest cable telecommunications operator in Portugal, and also offers a direct-to-home satellite distribution service to the Portuguese market. Zon’s cable plant overlaps the major part of Cabovisão’s footprint in Portugal. Zon also owns extensive program content interests, including equity interests in several pay television channels distributed by Cabovisão. PT’s national telephone network, PT Communicações, which offers a full range of fixed and mobile telecommunications services throughout Portugal, is aggressively pursuing the rollout of MEO, its competitive IPTV service over its wireline plant, and is offering its own direct-to-home satellite service. In addition, PT has launched in Portugal a new digital terrestrial television service available directly over-the-air. Sonaecom owns and operates the Clix (residential fixed telephony, HSI and IPTV), Novis (business telephony solutions) and Optimus (wireless telephony and wireless HSI) services, which provide voice, data, HSI, video and mobile services to the residential and business markets. Vodafone offers its own video distribution service for bundling with its mobile telephone and Internet services. Cabovisão, Zon, PT, Sonaecom, Vodafone and AR Telecom all have competitive triple-play offers available in the Portuguese market. Cabovisão continues to aggressively market its Digital Television services, which include HD channels, throughout its footprint. While Cabovisão has been successful in stopping the decline of its customer base and has resumed positive RGU growth over the second half of the 2010 fiscal year, operating margins remain under pressure due to the addition of programming services and promotional price discounts required to meet the competition from large incumbents PT and Zon. Cabovisão intends to launch its new VOD service on its digital platform in 2011, and thus be able to compete with the other VOD service offerings available in the Portuguese market. While Cabovisão and Zon continue to carry a number of legacy video services on less bandwidth-efficient analog channels, the competitive television service offerings of the other competitors in the Portuguese market are all digital. PT, Zon and Vodafone each have a significantly larger overall customer base, and both Zon and PT have a larger video customer base, than Cabovisão. While several competitors in the Portuguese market are deploying optical fibre facilities to the premises of customers, Cabovisão will be focussing its investments for network upgrades in the near term on the deployment of DOCSIS 3.0 technology over its existing HFC platform.

The Portuguese market is facing more difficult times as a result of the government’s austerity program to stem its rising annual public accounts deficit and its national debt. The austerity program includes new income and sales tax initiatives that are expected to have a negative impact on net disposable income and discretionary consumer spending for the next few years. It is not possible to determine at this time if this situation will result in reduced customer acquisition, reduced RGU gains or higher bad debt expense for Cogeco Cable’s Portuguese operations.

The level of piracy of television signals and the actual penetration of illicit reception of television distribution services in households within Cogeco Cable’s service areas may also have a significant effect on Cogeco Cable’s business and the competitiveness of its service offerings.

## Technological risks

### Cable sector

The rapid evolution of telecommunications technologies is fuelled by a highly competitive global market for digital content, consumer electronics and broadband products and services. Cogeco Cable continues to monitor the development of technologies used for the transmission, distribution, reception and storage of data and their deployment by various existing or potential competitors in the broadband telecommunications markets.

There are now several terrestrial and satellite transmission technologies available to deliver a range of electronic communications services to homes and to commercial establishments with varying degrees of flexibility and efficiencies, and thus compete with cable telecommunications. On the other hand, cable telecommunications also continue to benefit from rapid improvements, particularly in the areas of modulation, digital compression, fractioning of optoelectronic links, multiplexing, HD distribution and switched video distribution.

Management of Cogeco Cable believes that broadband wireline distribution over fibre and coaxial cable continues to be an efficient, reliable, economical and competitive platform for the distribution of a full range of electronic communications products and services. However, competitive market forces drive the further deployment of fibre optic facilities right up to the user premises, both for business and residential customers. The competitiveness of the cable broadband telecommunications platform will therefore continue to require substantial additional capital investment on a timely basis in an increasingly competitive and uncertain market environment.

The growth in penetration of broadband connections of all types, the rapid increase in transmission speeds offered by competitors in the market and the deployment of the more powerful and efficient MPEG-4 video compression standard and of other similar compression technologies promote the increased distribution and consumption of video content directly over the Internet. This may eventually lead to fragmentation of the retail market for existing Analogue and Digital Television distribution services provided by Cogeco Cable and gradual disintermediation through direct transactions between video content suppliers and Cogeco Cable's customers. In this context, revenue and margins derived from Cogeco Cable's HSI access services may not entirely compensate for the eventual loss of revenue or margin derived from Cogeco Cable's Television services in the future. Alternative voice and data communications services are proliferating over the Internet, resulting in the risk that fragmentation and disintermediation may also occur in the future with respect to Cogeco Cable's Telephony service.

Electronic communications increasingly rely on advanced security technology, terminal devices, control systems and software to ensure conditional access, appropriate billing and service integrity. Security and business systems technology is provided worldwide by a small pool of global suppliers on a proprietary basis. As other providers of electronic communications, Cogeco Cable depends on the effectiveness of such technology for many of its services and the ability of technological solutions providers to offer cost-effective and timely solutions to deal with security breaches or new developments required in the marketplace.

## Regulatory risks

### Cable sector

In Canada, electronic communications facilities and services are subject to regulatory requirements depending mainly on the type of facilities involved, the incumbent status of service providers and their relative market power, the technology used and whether the activities are categorized as telecommunications or broadcasting. Canadian cable telecommunications facilities and services are subject to various requirements, mainly under federal legislation governing broadcasting, radiocommunication, telecommunications, copyright and privacy, and under provincial legislation governing consumer protection and access to certain municipal property and municipally-owned support structures. Broadcasting licences and broadcasting certificates are still required for the operation of larger cable systems. Various licence and licence exemption conditions apply in Canada. Canadian cable operators are also subject to Canadian ownership and control requirements. Changes in the regulatory framework or licences, which are subject to periodic renewal, may affect Cogeco Cable's existing business activities or future prospects.

The government of Canada issued a consultation paper in June 2010 on options for reform of Canadian ownership and control requirements for the telecommunications industry in Canada. The three options under consideration are an increase of the direct limit on foreign ownership to 49%, removal of the limit for start-up telecommunications companies and telecommunications companies with less than 10% of total telecommunications market revenues, and complete removal of the limit. The deadline for the filing of submissions was July 30, 2010. The government has not reacted to submissions filed and has not indicated how it intends to follow up on the consultation process.

In addition to the support structures of power utilities, Cogeco Cable makes extensive use for its wireline network of the support structures of Bell and Telus in its service footprint under terms and conditions set in tariffs approved by the CRTC. Pursuant to Telecom Notice of Consultation CRTC 2009-432, The CRTC is currently considering whether the support structure service rates of incumbent local exchange carriers ("ILECs") such as Bell and Telus should be reviewed. Contrary to the ILECs, cable carriers have argued that the pricing methodology used to determine current rates in effect is adequate and that support structure service rates should not be increased. The CRTC is expected to issue a decision before the end of the calendar year.

In Telecom Notice of Consultation CRTC 2010-43, the CRTC initiated a proceeding to review access to basic telecommunications services and other related issues, which include the obligation to serve, the local service subsidy, the existence and scope of the basic cable service objective, local competition and wireless number portability in the service areas of small ILECs, and forbearance from regulation of mobile wireless data services. A key issue under consideration is whether HSI access should be included in the basic service objective, and whether the existing contribution regime for the support of local telephone service should be extended to HSI access services in high-cost service areas. Public hearings will take place in October and November 2010, with a decision expected in the spring of 2011.

In Broadcasting Regulatory Policy CRTC 2010-167, the CRTC proposed to establish a value-for-signal ("VFS") regime providing the right for Canadian private local television stations to opt for either continued regulatory protection for the carriage of their signal and simultaneous program substitution by Broadcasting Distribution Undertakings ("BDUs"), or the negotiation of compensation for the value of the distribution of their service by BDUs with the possibility to require deletion on all other distributed signals of all programs for which they have respectively acquired exclusive contractual exhibition rights. Concurrently with this policy announcement, the CRTC issued Broadcasting Order CRTC 2010-168 referring a question to the Federal Court of Appeal on the CRTC's authority under the *Broadcasting Act* to establish the proposed VFS regime. The reference was considered by the Federal Court of Appeal at a hearing in September 2010, and a decision is expected by the end of the calendar year.

In another reference initiated by the CRTC, the Federal Court of Appeal ruled earlier this year that the CRTC does not have the statutory authority to regulate the transmission of program content by Internet service providers (ISPs). Four cultural groups are currently seeking leave to appeal to the Supreme Court of Canada.

In Portugal, Cabovisão has prevailed in its complaint to *Autoridade da Concorrência* ("AdC") against the anticompetitive practices of PT concerning access to support structures and ducts of the incumbent telephone company. AdC has imposed a fine of €38 million to PT, but the AdC decision has since been challenged in court and the matter is still pending. Following complaints by other parties, AdC imposed a further record-breaking €45 million fine to PT as well as an €8 million fine to its former subsidiary Zon for abuse of dominance and margin squeezing of competitors in the broadband Internet access market in Portugal. PT and Zon have both decided to challenge this AdC decision in court and the matter is still pending. Cabovisão has filed with AdC complaints against Zon that raise further issues of abuse of dominant position by that incumbent cable, satellite and content service provider. In the absence of any significant remaining *ex ante* regulation of Portuguese incumbents by *Autoridade Nacional das Communicações* ("Anacom"), the effective enforcement of the decisions issued by AdC, the Portuguese competition watchdog, is essential to discipline the dominant Portuguese incumbents. Cabovisão has also filed with the Competition Directorate of the European Commission a complaint concerning the fact that the dominant Portuguese incumbents have been given access to funding from the European Investment Bank for debt-financing at favourable terms with the backing of the Portuguese government, with the stated objective of helping these dominant Portuguese incumbents to further deploy fibre optic next generation networks ("NGN") in Portugal. The matter is still pending.

# Risks pertaining to operating costs

## Cable sector

Cogeco Cable applies itself to keeping its cost of goods sold in check so as to secure continued operating margin growth. The two largest drivers of cost of sales are network fees paid to audio and video programming service suppliers as well as data transport and connectivity charges, mostly for Telephony and HSI traffic.

The market for audio and video content services in Canada is already characterized by high levels of supplier integration and structural rigidities imposed by the CRTC's regulatory framework for broadcasting distribution. While Cogeco Cable has been able to conclude satisfactory distribution agreements with Canadian and foreign programming service suppliers to date, there is no assurance that network fees will not increase by larger increments in future years. There is also no assurance that programming service suppliers will not change other material terms of distribution agreements or extend preferences for the distribution of their content to competing distributors, or push for the distribution of their content over the Internet in the future.

The level of horizontal and vertical integration of the television and broadcasting distribution industries in Canada is likely to increase significantly in the current fiscal year with the recent approval by the CRTC of the acquisition of CanWest Global Communications Corp.'s television stations and specialty television services by Shaw Communications Inc., and the proposed acquisition of CTVglobemedia Inc. ("CTV") by BCE Inc. ("Bell"), for which regulatory approvals are currently pending. Shaw, the largest broadcasting distributor in Canada with approximately 3.2 million basic wireline and direct-to-home satellite customers, will ultimately control a national over-the-air television network, some 36 English-language specialty television services, as well as pay television and VOD services. Should the acquisition of CTV by Bell be approved, Bell, the third largest broadcasting distributor in Canada with approximately 2 million wireline and direct-to-home satellite customers, would control a national over-the-air television network, some 28 English and French-language specialty television services, including sports channels TSN and RDS, as well as pay television and VOD services. Cogeco Cable is required to distribute licensed Canadian over-the-air, specialty and pay television services to its Cable Television customers. The affiliation agreements for the programming services provided by CanWest and CTV respectively are subject to renewal in the current fiscal year. The affiliation agreements for the services provided by the Astral group of companies, another major program service supplier with some 11 English-language and 5 French-language specialty and pay television services, are also subject to renewal in the current fiscal year. It is not possible at this time to quantify the impact of these affiliation agreement renewals on cost of sales. The CRTC has initiated a separate policy proceeding to review the regulatory framework relating to vertical integration in the Canadian broadcasting system, with a public hearing scheduled to commence on May 9, 2011.

In Portugal, there is also a significant degree of vertical integration between programming content and the distribution or theatrical exhibition of programs, with the largest cable, satellite and theatrical program distributor ZON controlling or having equity interests in various programming services distributed by Cabovisão, including premium pay television sports and movie programming services.

Since the markets for data transport and connectivity remain very competitive in Canada and Portugal, Cogeco Cable and Cabovisão have negotiated cost effective arrangements in the past for voice and data traffic. However, as overall traffic increases and capacity on existing broadband telecommunications facilities becomes more widely used, Cogeco Cable may not be able to secure further cost efficiencies in the future.

## Risks pertaining to information systems

Flexible, reliable and cost-effective information systems are an essential requirement for the handling of sophisticated service options, customer account management, internal controls, provisioning, billing and the rollout of new services. Cogeco Cable uses different customer relations management tools and databases for its operations respectively in Ontario, Québec and Portugal. There is however no assurance that these or other information systems will be able to adequately meet future business or competitive requirements.

COGECO and its subsidiaries' implementation of a new version of the Oracle financial management and accounting system in order to implement the transition from Canadian GAAP to IFRS has been successfully completed in September 2010 and is now fully operational.

## Risks pertaining to disasters and other contingencies

The Company has disaster recovery and business continuity plans for dealing with the occurrence of natural disasters, quarantine, power failures, terrorist acts, intrusions, computer hacking or data corruption. Cabovisão is presently developing its disaster recovery and business continuity plan with a completion target date of the end of fiscal 2011. Cabovisão's insurance coverage has been integrated into Cogeco Cable's insurance coverage. COGECO is not insured against the loss of data, hacking or malicious interference with its electronic communications and systems, or against losses resulting from natural disasters affecting the cable or fibre network. In Canada, it relies on in house and third-party service providers for data protection and recovery systems. In Portugal, similar arrangements with third parties have not been implemented as yet. The Company completed the implementation of a comprehensive business continuity program and five tests on the implementation of this plan were completed in Canada in 2010. The emergency plans and procedures that are in place cannot provide the assurance that the effect of any disaster can and will be mitigated as planned.

## Financial risks

### Cable sector

Cable telecommunications is a very capital-intensive business that requires substantial and recurring investment in property, plant, equipment and customer acquisition. Cogeco Cable depends on capital markets for the availability of additional capital that it must deploy to support its internal and external growth. There is no assurance that future capital requirements will be met when needed, or that the cost to secure such needed incremental capital will not increase Cogeco Cable's weighted average cost of capital. Cogeco Cable entered into cross-currency and interest rate swap agreements to fix the liability for interest and principal payments on certain of its long-term debts. However, the global financial markets crisis and the ensuing global economic slowdown may extend further and constrain Cogeco Cable's ability to meet its future financing requirements, both internal and external, increase its weighted average cost of capital and cause other cost increases from counterparties also faced with liquidity problems and higher cost of capital.

Cogeco Cable's debt financing structure involves the borrowing of money from third parties by Cogeco Cable and the subsequent investment of equity and debt by Cogeco Cable into its direct and indirect subsidiaries. This financing structure requires that Cogeco Cable be able to receive upstream flows of funds from its subsidiaries through capital repayments, interest payments, dividend payments, management fees or other distributions that are sufficient to meet its corporate debt obligations. Future changes to corporate tax, currency exchange and other legal requirements applicable to Cogeco Cable, or to its direct or indirect subsidiaries could adversely affect such upstream flows of funds or the effectiveness of Cogeco Cable's existing debt financing structure.

Cogeco Cable's leverage and corporate risk profile is liable to vary from time to time as a result of new developments in its business activities and the investments required to support internal growth as well as external growth through acquisitions. More particularly, leverage may fluctuate as Cogeco Cable completes further business acquisitions domestically or abroad, and the risk profile may differ from one acquisition to the other depending on the characteristics of the acquired business and its relevant market. The development of new services or additional lines of business, and the acquisition of new business properties, may not necessarily generate the anticipated results or benefits. There is no assurance that Cogeco Cable will be able to maintain or increase distributions to shareholders by way of dividends or otherwise.

The net investment in Cabovisão is financed through the Term Revolving Facility. At August 31, 2010, the carrying amount in Euros of the net investment in the financial statements amounted to €182.1 million, while the Euro-denominated outstanding debt amounted to €90 million. The impact of the exchange rate fluctuations between the Euro and the Canadian dollar, from the conversion of the net investment and the Euro-denominated debt outstanding, is deferred in the shareholders' equity under the caption "Accumulated other comprehensive income". Since currency fluctuations may be significant from time to time, the impact on the shareholders' equity can be material. In addition, Cogeco Cable has set up a structure involving one of its Canadian subsidiaries and intermediate holding and financing entities located in Luxembourg with a view to maximizing returns. The objective of this structure is to support the payment of interest of the Euro-denominated debt of the Term Revolving Facility by the European subsidiaries. There is no certainty that Cabovisão can always support the required interest payments, and Cabovisão may require additional funding from time to time. Finally, Cogeco Cable is considering various options to extend the Term Revolving Facility with alternate sources of Euro-denominated financing.

Cogeco Cable is exposed to interest rate risks for both fixed interest rate and floating interest rate instruments. Fluctuations in interest rates will have an effect on the valuation and the collection or repayment of these instruments which could result in a significant impact on Cogeco Cable's financial expense. Considering the interest rate swap in effect at August 31, 2010, 97% of Cogeco Cable's debt is at fixed interest rates.

There continues to be some volatility of currency exchange and interest rates in the financial markets, which could lead to an increase in the level of risk on hedging instruments to which Cogeco Cable is a party, should one or more of the counterparties to these instruments become financially distressed and unable to meet their obligations.

### Radio activities

On April 29, 2010, Cogeco entered into a binding agreement to purchase all the shares of entities controlled by Corus Entertainment Inc. ("Corus") owning eleven radio stations in the province of Québec, for an aggregate purchase price of $80 million. The agreement is subject to usual conditions in the purchase of broadcasting properties, including prior approval of the proposed transactions by the CRTC. Cogeco considers that the CRTC has exclusive jurisdiction under the *Broadcasting Act* to determine the conditions for approval of these transactions. The CRTC held a hearing on September 28 and 29, 2010 and a decision is expected, and the transaction concluded, in the first half of fiscal 2011. Due to the CRTC policy in effect for joint ownership of radio stations in a local market in one or the other of the official languages of Canada, Cogeco has committed to have radio stations CJEC-FM, which it currently owns, and CFEL-FM, which it will acquire from Corus, subsequently put up for sale in the Quebec City market. Cogeco has requested an exemption to the policy in order to keep the ownership of station CHMP-FM, which it will acquire from Corus, in the Montreal French-language market, and to convert station CKOY-FM , which it will acquire from Corus, in the Sherbrooke market into a repeater of station CKAC-AM in Montreal, which is also to be acquired from Corus. It is possible that Cogeco may be required by the CRTC to also have either or both these two other stations put up for sale. Stations for which divestiture will be required by the CRTC, and the sale process, will be managed by a trustee to be approved by the CRTC pursuant to a voting trust agreement also to be approved by the CRTC. The aggregate purchase price of $80 million payable to Corus is not subject to adjustment for the subsequent sale of stations, and there is no assurance as to the time that will be required to sell each station that is put up for sale, or the consideration to be received from such sale. Some of the stations to be divested may need funding to support their operations during the sale process. There is no assurance that the integration of the stations that Cogeco is allowed to keep with the other radio operations of Cogeco will be successful, or that Cogeco will improve the profitability of the acquired stations.

### Other

Market conditions may also have an impact on COGECO's defined benefit pension plans as there is no assurance that the actual rate of return on plan assets will approximate the assumed rate of return used in the most recent actuarial valuation. Market driven changes may impact the assumptions used in future actuarial valuations and could result in the Company being required to make contributions in the future that differ significantly from the current contributions to the Company's defined benefit pension plans.

## Human resources

The employees of COGECO's cable subsidiary, Cogeco Cable, in the province of Québec are grouped into three units for the purposes of collective agreement negotiations. The collective agreements with two of these units expired on December 31, 2008, and the third expired on May 31, 2010. Negotiations for the renewal of these collective agreements are currently under way, but there is no assurance that requisite collective agreements will be renewed without conflict or disruption to the provision of its services. COGECO also maintains appropriate relations with its key personnel. The Company's success depends to a significant extent on its ability to attract and retain its managers and skilled employees in an increasingly competitive market. The Company's inability or failure to recruit, retain or adequately train its human resources may have a materially adverse effect on the Company's business and future prospects.

## Controlling shareholder and holding structure

Cogeco Cable is controlled by COGECO through the holding of multiple voting shares of Cogeco Cable, and COGECO is in turn controlled by Gestion Audem Inc., a company controlled by Mr. Henri Audet and members of his family (the "Audet Family"), through the holding of multiple and subordinate voting shares of COGECO. Both Cogeco Cable and COGECO are reporting issuers with subordinate voting shares listed on the Toronto Stock Exchange. Pursuant to the Conflicts Agreement in effect between Cogeco Cable and COGECO, all cable properties must be owned or controlled by Cogeco Cable. COGECO is otherwise free to own and operate any other business or invest as it deems appropriate. It is possible that situations could arise where the respective interests of the controlling shareholder, COGECO, and other shareholders of Cogeco Cable, or the respective interests of the Audet Family and other shareholders of COGECO, could differ.

# Environmental policy

## Overview

COGECO's environmental policy provides that respect for the environment is one of the fundamental principles set out in the COGECO group Corporate Code of Ethics. COGECO makes a point of adhering to this key principle in all its activities, business relationships and dealings with other stakeholders. It contributes to the broader application of this principle primarily through the delivery of efficient electronic communication.

The policy has four main objectives: to ensure a more efficient and responsible use of resources, including energy, water and materials; to eliminate, reduce and control pollution and waste as much as possible; to make continual improvements by remaining abreast of best practices applied through benchmarking; and to be an agent of change by collaborating with other stakeholders (partners, suppliers, clients, employees) in a coordinated implementation of environmentally responsible practices.

The responsibility of COGECO's environmental footprint is assigned to a Cogeco Cable officer and is supported by leaders throughout the organization. A committee-based approach is in place for corporate as well as for regionally-oriented initiatives in furtherance of the policy.

## Fiscal 2010 activities and achievements

COGECO's 2010 environmental program focused on internal initiatives within its cable subsidiary, Cogeco Cable, in order to reduce its carbon footprint such as awareness and communications campaigns, campaigns promoting the reduction of consumables such as bottled water, bags, and styrofoam in storefront locations, and participation in several regional community activities to reduce Cogeco Cable's carbon footprint as well as Earth Week and Earth Hour activities.

In addition to the implementation of awareness initiatives, in 2010, Cogeco Cable identified and developed the tools necessary to determine its current carbon footprint, as well as the key performance indicators required for sound environmental metrics reporting. Cogeco Cable also implemented an e-billing platform to reduce paper consumption, fuel efficient fleet procurement practices, an auxiliary battery program to reduce service vehicle idle time and geomatic vehicle systems in its fleet to help reduce fuel consumption, improve maintenance tracking and decrease idling time. Other achievements include the reduction of office energy consumption through the implementation of policy-based rules for the corporate personal computing environment, the assessment of environmental risks and site remediation activities for Cogeco Cable's facilities as well as the completion of a renovation retrofit using green products and programs, which will be used for future renovations.

## Fiscal 2011 environmental focus

In 2011, Cogeco Cable will focus on several environmental initiatives, such as calculating Cogeco Cable's current carbon footprint, determining greenhouse gas reduction objectives, implementing changes to ensure green energy procurement where necessary and integrating an environmentally sensitive attitude in its operations, relating notably to travel and consumables. Cogeco Cable also intends to conduct risk assessments for its fuel holding tanks and other environmental risks, identify remedial activities, where applicable, as well as implement several procurement initiatives for consumables such as green paper and printing.

## Measurement

To achieve its environmental goal of continually reducing energy consumption and improving energy efficiency, Cogeco Cable has developed key performance indicators, which are classified in five categories: save energy and carbon, reduce materials use, reduce waste, engage employees, and enhance customer satisfaction.

COGECO continues to believe that cable telecommunications has a smaller environmental impact as compared to many other industries. However, COGECO is committed to progressively reducing its environmental footprint in respect of the communities in which it operates and achieving an improved balance between its environmental and economic objectives.

Further, the Company anticipates that, once the key performance indicators have been implemented for its cable operations in Canada, similar indicators will be implemented in CDS and Cabovisão in Portugal.

# Performance highlights

## Cable sector

### Customer statistics

| | **August 31, 2010** | Net additions (losses) Years ended August 31, **2010** | 2009 | % of penetration(1) August 31, **2010** | 2009 |
|---|---|---|---|---|---|
| RGU | **3,179,349** | **287,111** | 175,364 | | |
| Basic Cable service customers | **1,134,772** | **10,487** | (28,944) | | |
| HSI service customers(2) | **722,244** | **63,578** | 25,898 | **65.4** | 60.4 |
| Digital Television service customers | **719,270** | **118,119** | 134,953 | **64.0** | 54.1 |
| Telephony service customers(3) | **603,063** | **94,927** | 43,457 | **56.6** | 48.8 |

(1) As a percentage of Basic Cable service in areas served.
(2) Customers subscribing only to HSI service totalled 108,683 at August 31, 2010 compared to 85,610 at August 31, 2009.
(3) Customers subscribing only to Telephony service totalled 47,810 at August 31, 2010 compared to 32,858 at August 31, 2009.

During fiscal 2010, the number of RGU grew by 287,111, or 9.9%, to reach 3,179,349, compared to a growth of 175,364 RGU, or 6.5% in fiscal 2009. All services showed an increase in customer additions in fiscal 2010 over fiscal 2009, despite early signs of maturation for some services, with the exception of the Digital Television service which showed slower growth in the 2010 fiscal year reflecting the extensive Digital roll-out period in the European operations in fiscal 2009. The increase in RGU for the Canadian operations stems from expansions of the network, the enhancement of the product offering, the impact of the bundled offer (*Cogeco Complete Connection*) of Cable Television, HSI and Telephony services, and promotional activities. Cogeco Cable also continues to benefit from targeted marketing initiatives to improve penetration of the Digital Television service and the continuing strong interest for HD television services. In the European operations, Cabovisão's customer retention and acquisition strategies launched at the end of the 2009 fiscal year in order to reduce the customer attrition brought on by the difficult competitive landscape in Portugal and the economic environment in Europe throughout the previous fiscal year have resulted in a return to customer growth. On a consolidated basis, net additions of Basic Cable service customers reached 10,487, compared to a loss of 28,944 customers in fiscal 2009. The number of HSI service customers stood at 63,578 compared to 25,898 in fiscal 2009. Net additions of Digital Television service customers stood at 118,119 compared to 134,953 in fiscal 2009, and Telephony service customers grew by 94,927 in fiscal 2010 compared to 43,457 in fiscal 2009.

# Financial results and cash flows

## Cable sector

For the 2010 fiscal year, Cogeco Cable achieved consolidated revenue growth of $63.5 million, or 5.2%, to reach $1,281.4 million. Revenue for the Canadian operations rose by $108.9 million, or 11.1%, compared to fiscal 2009, driven by increased RGU, the introduction of HSI usage billing, various rate increases implemented at the end of fiscal 2009 and the revenue related to the new levy amounting to 1.5% of gross Cable Television service revenue imposed by the CRTC in order to finance the new Local Programming Improvement Fund ("LPIF"). Revenue from the European operations amounted to $187.8 million compared to $233.1 million in the prior year, a decrease of $45.3 million, or 19.4%, as a result of a lower average number of Basic Cable service customers throughout fiscal 2010 compared to fiscal 2009 despite RGU growth, the impact of retention strategies implemented in the second half of fiscal 2009 in order to curtail customer attrition, and the decline of the Euro in relation to the Canadian dollar. Revenue from the European operations in the local currency amounted to €131 million, a decrease of €15.7 million, or 10.7%, when compared to the same period of the prior year. The average exchange rate prevailing during fiscal 2010 was $1.4316 per Euro compared to $1.5889 per Euro during fiscal 2009. As the fiscal 2010 consolidated results are within 1% of the revised projection, issued on January 12, 2010, of $1,290 million, management considers that the revenue projection for fiscal 2010 has been achieved.

Consolidated operating income before amortization rose by $2.2 million, or 0.4% to reach $510.1 million. Fiscal 2010 operating income before amortization for the Canadian operations rose by $33.7 million, or 7.6%, compared to fiscal 2009. Fiscal 2009 operating income before amortization included a favourable impact from the settlement of the Part II licence fees payable to the CRTC for the 2007 to 2009 fiscal years (the "Part II licence fee favourable settlement agreement") of $19.8 million. These results are attributable to increased revenue exceeding the growth in operating costs; which was mainly attributable to servicing additional RGU, the launch of new HD channels, additional marketing initiatives and the new levy amounting to 1.5% of gross Cable Television service revenue imposed by the CRTC in order to finance the LPIF. European operations' operating income before amortization decreased to $32.6 million in fiscal 2010 from $64.1 million in fiscal 2009, representing a decrease of $31.5 million, or 49.2%, mainly due to a decrease in revenue which outpaced the decrease in operating costs; itself primarily due to the decline of the value of the Euro over the Canadian dollar which surpassed increases in operating costs related to additional marketing initiatives and the launch of new channels, net of the impact of cost reduction initiatives implemented by Cabovisão. Operating income before amortization in the local currency for European operations amounted to €22.6 million for the year compared to €40.4 million for the previous year, representing a decrease of 44%. The consolidated fiscal 2010 operating income before amortization surpasses the revised projection of $505 million issued on January 12, 2010.

Amortization expense increased by $2.8 million to reach $258.9 million, mainly due to additional capital expenditures arising from customer premise equipment acquisitions to sustain RGU growth, partly offset by a decrease in amortization of intangible assets reflecting the impairment loss on intangible assets recorded in the 2009 fiscal year. Amortization expense for the 2010 fiscal year was well below Cogeco Cable's revised projections of $273 million.

Financial expense decreased by $4.8 million at $64.9 million, mainly due to a decrease in Indebtedness (defined as the total of bank indebtedness, principal on long-term debt and obligations under derivative financial instruments), partly offset by the increase in the average cost of Indebtedness when compared with the same periods of the 2009 fiscal year. Financial expense for the 2010 fiscal year was better than management's revised guideline of $69 million.

Cogeco Cable reported net income of $157.3 million, a significant improvement when compared to fiscal 2009, primarily due to the decrease in the Ontario provincial corporate income tax rates and the decrease in financial expense, coupled with the growth in operating income before amortization. The increase in net income was partly offset by the increase in amortization expense. Excluding the impact of the decrease in corporate income tax rates described above, adjusted net income[(1)] would have amounted to $127.5 million for the year. At $157.3 million, fiscal 2010 net income significantly exceeded the revised projection issued on January 12, 2010 of $125 million.

Capital expenditures, including assets acquired under capital leases, and the increase in deferred charges amounted to $319.7 million, were primarily the result of RGU growth and expansions and improvements to the network infrastructure during the year. Capital expenditures and the increase in deferred charges for the current year were below the revised projections of $341 million.

Free cash flows of $175.1 million were generated as a result of an increase in cash flow from operations, partly offset by an increase in capital expenditures to support RGU growth. Cogeco Cable largely surpassed the revised fiscal 2010 free cash flow target of $135 million issued on January 12, 2010.

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(1) Adjusted net income does not have a standardized definition prescribed by Canadian GAAP and therefore, may not be comparable to similar measures presented by other companies. For further details, please consult the "Non-GAAP financial measures" section on page 40.

# Operating and financial results

## Operating results

| Years ended August 31,<br>*(in thousands of dollars, except percentages)* | **2010**<br>**$** | 2009[1]<br>$ | Change<br>% |
|---|---|---|---|
| Revenue | **1,321,694** | 1,252,794 | 5.5 |
| Operating costs | **802,355** | 737,300 | 8.8 |
| Operating income before amortization | **519,339** | 515,494 | 0.7 |
| Operating margin | **39.3%** | 41.1% | |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

### Revenue

The Company's revenue totalled $1,321.7 million, an increase of $68.9 million, or 5.5% compared to the prior year. Cable sector revenue increased by $63.5 million, or 5.2%, for fiscal 2010, driven by RGU growth, the introduction of HSI usage billing, rate increases implemented at the end of fiscal 2009 and during fiscal 2010, and the revenue related to the new levy amounting to 1.5% of gross Cable Television service revenue imposed by the CRTC in order to finance the new LPIF in the Canadian operations, partly offset by the impact of retention and customer acquisition strategies launched in the second half of fiscal 2009, a lower average number of Basic Cable service customers in fiscal 2010 and the depreciation of the Euro relative to the Canadian dollar in the European operations.

### Operating costs

Fiscal 2010 operating costs amounted to $802.4 million compared to $737.3 million in fiscal 2009, and increase of $65.1 million, or 8.8%. Prior year operating costs included the impact of the Part II licence fee favourable settlement agreement of $21.3 million on a consolidated basis, as described below. The increase in operating costs was mainly due to servicing additional RGU, the launch of new HD channels, additional marketing initiatives and the new levy amounting to 1.5% of gross Cable Television service revenue imposed by the CRTC in order to finance the new LPIF in the Canadian operations, and to the increases in operating costs related to additional marketing initiatives and the launch of new channels, net of the impact of cost reduction initiatives implemented in the European operations. The increase in operating costs in the European operations was offset by the decline of the value of the Euro over the Canadian dollar.

Part II licence fees payable to the CRTC had been the subject of litigation between the members of the Canadian Association of Broadcasters ("CAB"), Videotron and CF Cable TV Inc. as plaintiffs and the Crown as the defendant. The Company's subsidiary, Cogeco Cable, sought and obtained intervener status in this proceeding with a view of supporting the position of the plaintiffs and protecting its rights to recover past payments of Part II licence fees. On October 7, 2009, the parties reached an out-of-court settlement in the matter whereby the Part II licence fees for the 2007 through 2009 fiscal years have been waived by the federal government and all pending proceedings discontinued. Accordingly, the Company's subsidiaries, Cogeco Cable and CDI, reversed their provisions for the Part II licence fees payable for the 2007 through 2009 fiscal years for an aggregate amount of $21.3 million in the 2009 fiscal year. The settlement agreement also provided that the federal government recommend that the CRTC develop a new, forward-looking fee regime that would be capped at $100 million per year for the aggregate Part II licence fee liability of broadcasting licencees, to be indexed annually based on the Consumer price index, which was concluded during fiscal 2010.

### Operating income before amortization

As a result of the increase in revenue which surpassed the increase in operating costs, operating income before amortization increased to $519.3 million in fiscal 2010 from $515.5 million in 2009, an increase of $3.8 million, or 0.7%, despite the impact of $21.3 million from the Part II licence fee favourable settlement agreement in the prior year. The cable sector contributed $2.2 million to the consolidated increase.

# Fixed charges

| Years ended August 31,<br>*(in thousands of dollars, except percentages)* | **2010**<br>**$** | 2009(1)<br>$ | Change<br>% |
|---|---|---|---|
| Amortization | **259,457** | 256,627 | 1.1 |
| Financial expense | **65,499** | 70,421 | (7.0) |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

Fiscal 2010 amortization amounted to $259.5 million compared to $256.6 million in fiscal 2009, an increase of $2.8 million or 1.1%. The increase in amortization stemmed from the cable sector and is attributable to additional capital expenditures arising from customer premise equipment acquisitions to sustain RGU growth, partly offset by a decrease in amortization of intangible assets stemming from the impairment loss recorded in fiscal 2009.

Fiscal 2010 financial expense decreased by $4.9 million compared to the prior year. The decrease is mainly due to a decrease in Indebtedness in the cable sector. The average interest rate was 6.2% in fiscal 2010 compared to 5.9% in fiscal 2009. The increase in the average interest rate reduction is discussed in the "Capital structure" section on page 30.

# Reduction of withholding and stamp tax contingent liabilities

At the date of acquisition, COGECO's indirect subsidiary, Cabovisão, recorded contingent liabilities for withholding and stamp taxes relating to fiscal years prior to its acquisition by Cogeco Cable. At that date, the amount accrued represented management's best estimate based on the information available at that time. Management reviews its estimate periodically to take into consideration payments made relating to these contingencies as well as newly available information which would allow Cogeco Cable to improve its previous estimate. During fiscal 2009, Cabovisão received reports from the Portuguese tax authorities with respect to some of the items included in the contingent liabilities. Accordingly, management revised its estimate of the contingent liabilities to reflect the new information available in these reports, and determined that a reduction of €10.3 million, equivalent to $16.1 million, of the amounts previously accrued was required at August 31, 2009, in order to reflect management's best estimate.

# Impairment of goodwill and intangible assets

During fiscal 2009, the competitive position of Cabovisão, in Portugal further deteriorated due to the continuing difficult competitive environment and recurring intense promotions and advertising initiatives from competitors in the Portuguese market. In accordance with applicable accounting standards, management considered that the continued customer, local currency revenue and operating income before amortization decline were more severe and persistent than expected, resulting in a decrease in the value of Cogeco Cable's investment in the Portuguese subsidiary. As a result, Cogeco Cable tested goodwill and all long-lived assets for impairment at February 28, 2009.

Goodwill is tested for impairment using a two step approach. The first step consists of determining whether the fair value of the reporting unit to which goodwill is assigned exceeds the net carrying amount of that reporting unit, including goodwill. In the event that the net carrying amount exceeds the fair value, a second step is performed in order to determine the amount of the impairment loss. The impairment loss is measured as the amount by which the carrying amount of the reporting unit's goodwill exceeds its fair value. Cogeco Cable completed its impairment tests on goodwill and concluded that goodwill was impaired at February 28, 2009. As a result, a non-cash impairment loss of $339.2 million was recorded in the second quarter of the 2009 fiscal year. Fair value of the reporting unit was determined using the discounted cash flow method. Future cash flows were based on internal forecasts and consequently, considerable management judgement was necessary to estimate future cash flows. Significant future changes in circumstances could result in further impairments of goodwill.

Intangible assets with finite useful lives, such as customer relationships, must be tested for impairment by comparing the carrying amount of the asset or group of assets to the expected future undiscounted cash flow to be generated by the asset or group of assets. The impairment loss is measured as the amount by which the asset or group of assets' carrying amount exceeds its fair value. Accordingly, Cogeco Cable completed its impairment test on customer relationships at February 28, 2009, and determined that the carrying value of customer relationships exceeded its fair value. As a result, a non-cash impairment loss of $60.4 million was recorded in the second quarter of the 2009 fiscal year.

The impairment loss affected the Company's financial results as follows during fiscal 2009:

| *(in thousands of dollars)* | $ |
|---|---|
| Impairment of goodwill | 339,206 |
| Impairment of customer relationships | 60,442 |
| Future income taxes | (16,018) |
| Impairment loss net of related income taxes | 383,630 |
| Non-controlling interest | (259,679) |
| Impairment loss net of related income taxes and non-controlling interest | 123,951 |

At August 31, 2010 and 2009, Cogeco Cable tested the value of goodwill for impairment, and concluded that no impairment existed.

# Income taxes

For fiscal 2010, income tax expense amounted to $31.7 million compared to $58.7 million for fiscal 2009. The decrease in income taxes is mainly due to the reduction in corporate income tax rates announced on March 26, 2009 by the Ontario provincial government and considered substantively enacted on November 16, 2009 (the "reduction of the Ontario provincial corporate income tax rates"). These lower corporate income tax rates reduced future income tax expense in the cable sector by $29.8 million in fiscal 2010. The income tax expense for the prior year included a future income tax recovery of $16 million related to the impairment loss recorded on Cogeco Cable's investment in the Portuguese subsidiary, partly offset by an unfavourable impact of $6.1 million resulting from the recognition and subsequent utilization of Cabovisão's pre-acquisition income tax losses following the receipt of tax audit reports for the 2003, 2004 and 2005 fiscal years and an unfavourable impact of $6.9 million from the income taxes resulting from the Part II licence fee favourable settlement agreement. Excluding these items, income tax expense would have amounted to $61.4 million in fiscal 2010, $0.2 million, or 0.3%, lower when compared to $61.6 million in fiscal 2009.

The Company's indirect subsidiary, Cabovisão, has income tax losses amounting to approximately €84.9 million ($114.8 million), the benefits of which have not been recognized in the Company's 2010 Financial statements. These losses may be used to reduce future years' taxable income. In accordance with the Portuguese Companies Income Tax Code ("CIRC"), tax losses incurred in a financial year can be carried forward and deducted from taxable profits of one or more of the following six taxation years for tax losses incurred before 2010 and for the following four taxation years for tax losses incurred in 2010 and beyond. However, the CIRC provides for certain exceptions whereby the general rule stated above ceases to apply. One such exception is that tax losses cannot be deducted if the ownership of at least 50% of the social capital changes from the moment when the tax losses were generated, unless a request is filed before such change in the ownership takes place, subject to approval by the Portuguese tax authorities. To this effect, a request for preservation of tax losses for the years preceding the 2006 taxation year was filed by Cabovisão on July 28, 2006 and approved by the Portuguese tax authorities on November 25, 2009. As part of their review, the Portuguese tax authorities have audited Cabovisão's tax returns for the 2003, 2004 and 2005 taxation years, which have resulted in notices of assessment to reduce tax losses by €7.3 million, €29.6 million and €17.1 million, respectively. However, Cabovisão does not agree with the assessments and has initiated legal proceedings against the Portuguese tax authorities. In accordance with current legislation, tax returns are subject to review and correction by the tax authorities during a four-year period. These periods can be extended or suspended when there are tax losses, tax benefits granted, tax inspections, claims or appeals in progress. Consequently, Cabovisão's tax returns for the taxation years 2006 to 2010 are still subject to review by the tax authorities and therefore, the amount of available tax losses could be significantly reduced based on past experience.

# Losses (gains) on dilution resulting from the issuance of shares by a subsidiary

During fiscal 2010, the Company's subsidiary, Cogeco Cable issued 17,911 subordinate voting shares pursuant to its Employee Stock Option Plan for cash consideration of $0.5 million. In the prior year, Cogeco Cable issued 12,030 subordinate voting shares for cash consideration of $0.3 million as part of its Employee Stock Purchase Plan and 28,785 subordinate voting shares for cash consideration of $0.6 million as part of its Employee Stock Option Plan. As a result of these share issuances, COGECO's interest in Cogeco Cable remained essentially the same at 32.3% and gains on dilution of $26,000 were recorded in fiscal 2010, compared to losses on dilution of $48,000 in fiscal 2009.

# Non-controlling interest

The non-controlling interest represents a participation of approximately 67.7% in Cogeco Cable's results. During fiscal 2010, the net income attributable to non-controlling interest amounted to $106.5 million. In the prior year, the net loss attributable to non-controlling interest amounted to $174.8 million due to the impairment loss recorded in the cable sector.

# Net income (loss)

Net income amounted to $56.3 million, or $3.36 per share, for the 2010 fiscal year. In the previous fiscal year, the Company reported a net loss of $79 million, or $4.73 per share. The net income in fiscal 2010 includes a favourable impact of $9.6 million, net of non-controlling interest, from the reduction of the Ontario provincial corporate income tax rates. Net loss for fiscal 2009 was affected by the impairment loss of

$399.6 million recorded on Cogeco Cable's investment in Cabovisão, as described in the "Impairment of goodwill and intangible assets" section. Net of related income taxes and non-controlling interest, the impairment loss reduced fiscal 2009 net income by $124 million. Furthermore, the fiscal 2009 net loss in the cable sector included an unfavourable impact of $2 million from the utilization of Cabovisão's pre-acquisition tax losses and a favourable impact from the reduction of withholding and stamp tax contingent liabilities in the amount of $5.2 million described on page 25, also in Cabovisão, both net of non-controlling interest, and the impact of $5.3 million from the Part II licence fee favourable settlement agreement net of related income taxes and non-controlling interest. Excluding the effect of these items, adjusted net income for fiscal 2010 would have amounted to $46.6 million, or $2.79 per share[1], compared to $36.4 million, or $2.18 per share in 2009, increases of 28.1% and 28%, respectively.

In fiscal 2010, the Company obtained a return on equity[2] of 15.8%, compared to a negative return on equity of 21.2% in the prior year due to the impairment loss recorded on Cogeco Cable's investment in Cabovisão. On the basis of adjusted net income, return on equity would have amounted to 13.1% in fiscal 2010, compared to 9.8% in fiscal 2009.

# Cable sector

| Years ended August 31,<br>*(in thousands of dollars, except percentages)* | **2010**<br>**$** | 2009[1]<br>$ | Change<br>% |
|---|---|---|---|
| Revenue | **1,281,376** | 1,217,837 | 5.2 |
| Operating costs | **762,261** | 700,942 | 8.7 |
| Management fees – COGECO Inc. | **9,019** | 9,019 | - |
| Operating income before amortization | **510,096** | 507,876 | 0.4 |
| Operating margin | **39.8%** | 41.7% | |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

## Revenue

Fiscal 2010 cable sector revenue increased by $63.5 million, or 5.2%, compared to the same period last year to reach $1,281.4 million.

Revenue from the Canadian operations rose by $108.9 million, or 11.1%, compared to fiscal 2009, driven by increased RGU, the introduction of HSI usage billing, various rate increases implemented at the end of fiscal 2009 and during fiscal 2010, and the revenue related to the new levy amounting to 1.5% of gross Cable Television service revenue imposed by the CRTC in order to finance the new LPIF. Despite an increase in RGU for the European operations, revenue amounted to $187.8 million compared to $233.1 million in the prior year, a decrease of $45.3 million, or 19.4%, as a result of a lower average number of Basic Cable service customers throughout fiscal 2010 compared to fiscal 2009 despite RGU growth, the impact of retention strategies implemented in the second half of fiscal 2009 in order to curtail customer attrition, and the decline of the Euro in relation to the Canadian dollar. Revenue from the European operations in the local currency amounted to €131 million, a decrease of €15.7 million, or 10.7%, when compared to the same period of the prior year.

## Operating costs and management fees

For fiscal 2010, operating costs in the cable sector increased by $61.3 million, or 8.7%, at $762.3 million.

The Canadian operations' operating costs, excluding management fees payable to COGECO, rose by $75.2 million, or 14.1%, compared to fiscal 2009. The increase in operating costs is mainly attributable to servicing additional RGU, the launch of new HD channels, additional marketing initiatives and the new levy amounting to 1.5% of gross Cable Television service revenue imposed by the CRTC in order to finance the LPIF. Fiscal 2009 also included the impact $19.8 million from the Part II licence fee favourable settlement agreement.

For fiscal 2010, European operations' operating costs decreased by $13.8 million to reach $155.2 million, a decrease of 8.2% compared to the prior year. The decrease in operating costs is mainly due to the decline of the value of the Euro over the Canadian dollar which surpassed increases in operating costs related to additional marketing initiatives and the launch of new channels, net of the impact of cost reduction initiatives implemented by Cabovisão. Operating costs from the European operations for fiscal 2010 in the local currency amounted to €108.4 million, an increase of €2 million, or 1.9% when compared to the preceding year.

Management fees paid to COGECO Inc. amounted to $9 million, the same amount as in fiscal 2009.

(1) The indicated terms do not have standardized definitions prescribed by Canadian GAAP and therefore, may not be comparable to similar measures presented by other companies. For further details, please consult the "Non-GAAP financial measures" section on page 40.
(2) Return on equity is defined as net income divided by average shareholders' equity (computed on the basis of the beginning and ending balance for a given fiscal year).

## Operating income before amortization and operating margin

Operating income before amortization for fiscal 2010, in the cable sector, increased by $2.2 million, or 0.4%, to reach $510.1 million.

Fiscal 2010 operating income before amortization for the Canadian operations rose by $33.7 million, or 7.6%, compared to fiscal 2009. The fiscal 2010 growth in operating income before amortization was reduced by the impact of $19.8 million from the Part II licence fee favourable settlement agreement in fiscal 2009. The operating income before amortization has risen due to the increased revenue exceeding the growth in operating costs. Cogeco Cable's Canadian operations' operating margin decreased to 43.7% from 45.1% for the same period of the prior year. Notwithstanding the Part II licence fee favourable settlement agreement, the operating margin increased year over year as a result of the introduction of HSI usage billing and various rate increases implemented at the end of fiscal 2009 and during fiscal 2010, partly offset by the launch of new services which generate lower margins, the migration of customers from Analogue to Digital Television services and the revenue from the new LPIF which does not generate operating income before amortization.

European operations' operating income before amortization decreased to $32.6 million in fiscal 2010 from $64.1 million in fiscal 2009, representing a decrease of $31.5 million, or 49.2%, mainly due to a decrease in revenue which outpaced the decrease in operating costs. European operations' operating margin decreased to 17.3% from 27.5% in fiscal 2009. Operating income before amortization in the local currency amounted to €22.6 million for the year compared to €40.4 million for the previous year, representing a decrease of 44%.

# Cash flow analysis

| Years ended August 31,<br>*(in thousands of dollars)* | **2010**<br>**$** | 2009(1)<br>$ |
|---|---|---|
| **Operating activities** | | |
| Cash flow from operations | **502,219** | 390,288 |
| Changes in non-cash operating items | **(76,883)** | 30,416 |
| | **425,336** | 420,704 |
| **Investing activities**(2) | **(320,653)** | (284,112) |
| **Financing activities**(2) | **(106,955)** | (134,614) |
| **Effect of exchange rate changes on cash and cash equivalents denominated in a foreign currency** | **(1,344)** | 8 |
| **Net change in cash and cash equivalents** | **(3,616)** | 1,986 |
| Cash and cash equivalents, beginning of year | **39,458** | 37,472 |
| **Cash and cash equivalents, end of year** | **35,842** | 39,458 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.
(2) Excludes assets acquired under capital leases.

# Operating activities

Fiscal 2010 cash flow from operations reached $502.2 million, an increase of 28.7% compared to the year before, primarily due to the reduction in income tax payments stemming from modifications to the corporate structure. Changes in non-cash operating items required cash outflows of $76.9 million, mainly as a result of a decrease in income tax liabilities combined with increases in income taxes receivable and accounts receivable, partly offset by an increase in deferred and prepaid revenue and other liabilities. The cash inflows of $30.4 million in the prior year were mainly attributable to the cable sector and resulted from an increase in accounts payable and accrued liabilities which was offset by the Part II licence fee favourable settlement agreement and an increase in income tax liabilities.

# Investing activities

## Capital expenditures

In fiscal 2010, capital expenditures, including assets acquired under capital leases, increased by $31.4 million compared to the prior year to reach $309.9 million mainly as a result of the following factors in the cable sector:

- An increase in customer premise equipment spending required to support RGU growth partly offset by depreciation of the Euro over the Canadian dollar;
- An increase in upgrade and rebuild and in line extensions, primarily in the Canadian operations to improve network capacity in existing areas served and to extend territories in new areas;
- An increase in support capital spending due to the acquisition of new facilities in the Canadian operations.

## Increase in deferred charges

The increase in deferred charges amounted to $11.1 million in fiscal 2010 compared to $10.8 million in fiscal 2009. A breakdown of the increase in deferred charges is presented in the table below:

| Years ended August 31,<br>*(in thousands of dollars)* | **2010**<br>**$** | 2009[1]<br>$ |
|---|---|---|
| Reconnect and additional service activation costs | **11,069** | 10,773 |
| Equipment subsidies | **–** | – |
| | **11,069** | 10,773 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

Cogeco Cable incurs significant costs to reconnect or activate additional services for Basic Cable, HSI, Digital Television and Telephony customers. Equipment subsidies, which were mainly related to subsidies on sales of digital terminals in Canada and cable modems in Portugal are now recorded as operating expenses as a result of the application of CICA Handbook Section 3064. The fiscal 2010 increase in deferred charges is essentially equivalent to the comparable amount in fiscal 2009.

## Fiscal 2009 adjustments related to a fiscal 2008 business acquisition

In fiscal 2009, Cogeco Cable finalized the purchase price allocation for the acquisition of CDS. The final allocation resulted in an increase in future income tax assets of $0.4 million as well as a decrease in future income tax liabilities of $0.3 million. The net impact of these adjustments combined with an increase in acquisition costs of $0.1 million, reduced goodwill by $0.6 million at August 31, 2009 in the cable sector.

# Free cash flow and financing activities

For fiscal 2010, free cash flow amounted to $181.3 million compared to $101 million last fiscal year as a result of an increase in cash flow from operations outpacing the increase in capital expenditures in the cable sector.

During fiscal 2010, the level of Indebtedness affecting cash decreased by $73.8 million, mainly due to the free cash flow of $181.3 million, partly offset by the outflows related to non-cash operating items of $76.9 million, the payment of dividends totalling $25.1 million described below and an increase in deferred transaction costs of $5.8 million. Indebtedness mainly decreased through net repayments on the cable subsidiary's term and revolving loans of $62.4 million and the Company's revolving loans of $9.5 million.

In fiscal 2009, Indebtedness affecting cash decreased by $115.1 million, mainly due to the free cash flow of $101 million and the inflows from non-cash operating items of $30.4 million, partly offset by the payment of dividends totalling $21.1 million described below. Indebtedness decreased through net repayments on Cogeco Cable's term and revolving loans of $254.9 million and on the Company's revolving loans in the amount of $9.4 million, as well as by the repayments, in the cable sector, of US$150 million Senior Secured Notes Series A and the related derivative financial instrument, both maturing on October 31, 2008, for a total of $238.7 million and the $150 million Senior Secured Debentures Series 1 at maturity on June 4, 2009, and by a decrease of $9.9 million in bank indebtedness, partly offset by the issuance on June 9, 2009 of Senior Secured Debentures Series 1 for $300 million maturing June 9, 2014 and the issuance on October 1, 2008 of US$190 million Senior Secured Notes Series A maturing October 1, 2015, and $55 million Senior Secured Notes Series B maturing October 1, 2018.

In fiscal 2010, the Company paid quarterly dividends of $0.10 per share to the holders of subordinate and multiple voting shares totalling $6.7 million, compared to quarterly dividends of $0.08 per share totalling $5.4 million in fiscal 2009. Dividends paid by a subsidiary to non-controlling interests were $18.4 million during fiscal 2010 compared to $15.8 million in fiscal 2009, bringing the consolidated dividend payments to $25.1 million for the current year compared to $21.1 million in the prior year.

# Financial position

During the year ended August 31, 2010, there have been major changes to the balances of "accounts receivable", "fixed assets", "goodwill", "accounts payable and accrued liabilities", "deferred and prepaid revenue and other liabilities", "income tax receivable", "income tax liabilities", "future income tax assets", "future income tax liabilities", "long-term debt" and "non-controlling interest".

The increase of $8.5 million in accounts receivable is mainly attributable to the cable sector and is due to the increase in revenue in the Canadian operations. The $23.1 million increase in fixed assets is mainly related to increases in capital expenditures to sustain RGU growth in the cable sector which exceeded the amortization expense of the current fiscal year, partly offset by the impact of the depreciation of the Euro over the Canadian dollar since August 31, 2009. The $9 million reduction in goodwill mainly reflects the depreciation of the Euro in relation to the Canadian dollar in the 2010 fiscal year. The $6.5 million decrease in accounts payable and accrued liabilities is related to the timing of payments made to suppliers and the impact of the depreciation of the Euro relative to the Canadian dollar. The increase of $11.1 million in deferred and prepaid revenue and other liabilities is mainly due to advance billing in the indirect data telecommunications cable subsidiary for services to be provided in the coming months. The $40.8 million decrease in income tax liabilities and the $40.2 million increase in income tax receivable are due to fiscal 2010 income tax payments relating to the 2009 fiscal year, and to the corporate structure modifications in the cable sector. The increases of $16 million in the future income tax assets and of $82.3 million in future income tax liabilities are mainly due to modifications made to the corporate structure in the cable sector. Long-term debt has decreased by $108.9 million as a result of the factors previously discussed in the "Free cash flow and financing activities" section above. Non-controlling interest has increased by $86.9 million, primarily due to the fiscal 2010 net income of Cogeco Cable, partly offset by the dividends paid as described above.

# Capital resources and liquidity

## Capital structure

The table below summarizes COGECO's debt-related financial ratios over the last two fiscal years and the fiscal 2011 guidelines.

| Years ended August 31, | 2011 Guidelines(1) | **2010** | 2009(2) |
|---|---|---|---|
| Average cost of indebtedness | 7.0% | **6.2%** | 5.9% |
| Fixed rate indebtedness(3) | 89% | **96%** | 92% |
| Average term: long-term debt (in years) | 3.2 | **4.2** | 4.5 |
| Net indebtedness(4) / shareholder's equity | 2.1 | **2.4** | 3.0 |
| Net indebtedness(4) / operating income before amortization | 1.7 | **1.8** | 1.9 |
| Operating income before amortization / financial expense | 7.7 | **7.9** | 7.6 |

(1) See the "Fiscal 2011 financial guidelines" section on page 39 for further details.
(2) In accordance with the Company and its subsidiaries' credit agreements, financial ratios for fiscal 2009 have not been restated to reflect the application of the CICA Handbook Section 3064.
(3) Taking into consideration the interest rate swap in effect at August 31, 2010 and 2009.
(4) Indebtedness net of cash and cash equivalents.

In 2010, the average cost of Indebtedness increased is mainly attributable to the cable sector and is due to a lower proportion the Term Revolving Facility relative to Cogeco Cable's Indebtedness, the increase in the Benchmark rate in 2010, and the full year impact of the Senior Secured Debentures Series 1 with a coupon rate of 5.95% which were issued on June 9, 2009. Please consult the "Financing and liquidity" section for further details.

For fiscal 2010, the average tenure of the long-term debt decreased as no long-term debt issue was completed in the fiscal year. It also reflects the lower amount drawn on the new Term Revolving Facilities entered into by both the Company and its subsidiary, which replaced their respective Term Facilities in July 2010 as described in the "Financing and liquidity" section.

In fiscal 2011, the financial leverage ratio relating to net indebtedness over operating income before amortization should decline slightly due to the projected increase in operating income before amortization, combined with a reduction in Indebtedness from the free cash flow. The financial expense coverage ratio should decrease as a result of the rise in the average cost of Indebtedness described above. See "Fiscal 2011 financial guidelines" section on page 39 for further details.

## Outstanding share data

A description of COGECO's share data as at September 30, 2010 is presented in the table below. Additional details are provided in note 14 of the consolidated financial statements on page 64.

| | Number of shares/options | Amount (in thousands of dollars) |
|---|---|---|
| **Common shares** | | |
| Multiple voting shares | 1,842,860 | 12 |
| Subordinate voting shares | 14,959,338 | 121,347 |
| **Options to purchase subordinate voting shares** | | |
| Outstanding options | 62,382 | |
| Exercisable options | 62,382 | |

During fiscal year 2010, the Company issued 16,868 subordinate voting shares pursuant to its Employee Stock Option Plan for a cash consideration of $0.4 million, compared to 43,708 voting shares issued in 2009 for cash consideration of $0.9 million. During fiscal 2009, 1,176 subordinate voting shares were issued pursuant to its Employee Stock Purchase Plan for a cash consideration of less than $0.1 million.

During fiscal 2010 and 2009, COGECO did not award any stock options, and its subsidiary, Cogeco Cable, granted 66,174 stock options in fiscal 2010 (153,381 in fiscal 2009). On April 6, 2009, Cogeco Cable cancelled 206,180 options which had been conditionally granted in relation with the acquisition of Cabovisão, at a price of $26.63 per share, subject to performance criteria of Cabovisão being met. Of these options, 93,518 were exercisable. The Company recorded compensation expense for options granted on or after September 1, 2003.

# Financing and liquidity

The Company benefits from a new Term Revolving Facility of up to $100 million with a group of financial institutions led by a large Canadian bank, which will now act as agent for the banking syndicate. This new Term Revolving Facility replaced the Company's $50 million Term Facility maturing on December 14, 2011. The Term Revolving Facility of up to $100 million includes a swingline limit of $7.5 million, is extendable by additional one-year periods on an annual basis, subject to lenders' approval, and if not extended, matures three years after its issuance or the last extension, as the case may be. The Term Revolving Facility is composed of two tranches of $50 million each, one being subject to the completion of the Corus Acquisition. The Term Revolving Facility can be repaid at any time without penalty. The Term Revolving Facility is indirectly secured by a first priority fixed and floating charge and a security interest on substantially all present and future real and personal property and undertaking of every nature and kind of the Company and certain of its subsidiaries, excluding the capital stock and assets of the Company's subsidiary, Cogeco Cable, and guaranteed by its subsidiaries excluding Cogeco Cable. Under the terms and conditions of the credit agreement, the Company must comply with certain restrictive covenants. Generally, the most significant restrictions are related to permitted investments, dividends on multiple and subordinate voting shares and reimbursement of long-term debt as well as incurrence and maintenance of certain financial ratios primarily linked to the operating income before amortization, financial expense, total indebtedness and shareholders' equity. The Term Revolving Facility bears interest, at the Company's option, on bankers' acceptance, LIBOR in Euros or in US dollars , bank prime rate or US base rate plus the applicable margin, and commitment fees are payable on the unused portion. At August 31, 2010, the Company was in compliance with all of its covenants and had used $1.7 million of its Term Revolving Facility for a remaining availability of $48.3 million.

The Term Facility of $50 million was fully repaid on July 7, 2010. The Term Facility of $50 million, including a swingline limit of $5 million, was renewable on an annual basis, subject to lenders' approval, and if not renewed it matured three years after its issuance or the last renewal, as the case may be. The Term Facility was secured by all assets of COGECO Inc. and its subsidiaries, excluding the capital stock and assets of Cogeco Cable and was guaranteed by its subsidiary, Cogeco Diffusion Inc. Under the terms and conditions of the amended and restated credit agreement, the Company had to comply with certain restrictive covenants, including the requirement to maintain certain financial ratios. The Term Facility bore interest, at the Company's option, on bankers' acceptance, LIBOR, EURIBOR, bank prime rate or US base rate plus the applicable margin, and commitment fees were payable on the unused portion. At August 31, 2009, the Company was in compliance with all of its covenants.

The Company's subsidiary, Cogeco Cable, benefits from a new $750 million Term Revolving Facility with a group of financial institutions led by two large Canadian banks, which became effective on July 12, 2010, and replaced Cogeco Cable's $862.5 million Term Facility maturing on July 28, 2011. This new Term Revolving Facility has an option to be increased up to $1 billion subject to lenders' participation. The Term Revolving Facility is available in Canadian, US or Euro currencies and includes a swingline of $25 million available in Canadian or US currencies. The Term Revolving Facility may be extended by additional one-year periods on an annual basis, subject to lenders' approval, and, if not extended, matures four years after its issuance or the last extension, as the case may be. The Term Revolving Facility can be repaid at any time without penalty. The Term Revolving Facility requires commitment fees, and interest rates are based on bankers' acceptance, LIBOR in Euros or in US dollars, bank prime rate loan or US base rate loan plus the applicable margin. The Term Revolving Facility is indirectly secured by a first priority fixed andfloating c harge on substantially all present and future real and personal property and undertaking of every nature and kind of Cogeco Cable and certain of its subsidiaries, and provides for certain permitted encumbrances, including purchased money obligations, existing funded obligations and charges granted by any subsidiary prior to the date when it becomes a subsidiary, subject to a maximum amount. The provisions under this facility provides for restrictions on the operations and activities of the Company's subsidiary, Cogeco Cable. Generally, the most significant restrictions relate to permitted investments and dividends on multiple and subordinate voting shares, as well as incurrence and maintenance of certain financial ratios primarily linked to operating income before amortization, financial expense and total indebtedness. At August 31, 2010, Cogeco Cable was in compliance with all of its covenants and had used $129.6 million of its $750 million Term Revolving Facility for a remaining availability of $620.4 million.

Cogeco Cable's Term Facility of a remaining amount of $862.5 million was fully repaid on July 12, 2010 and was composed of four tranches: a first tranche, a revolving loan for an amount of $700 million available in Canadian, US or Euro currencies; a second tranche, a swingline of $25 million available in Canadian or US currencies; a third tranche of a remaining amount of $112.5 million, fully drawn, available in Canadian currency, and a fourth tranche of €17.4 million fully drawn. The Term Facility was repayable on July 28, 2011, except for the third tranche of €104.6 million; €15.7 million of which was repaid on July 28, 2009 in addition to a repayment of €10.5 million on July 28, 2008; the remainder of which was repayable as follows: €26.1 million on July 28, 2010 and the balance on July 28, 2011. Earlier repayments could have been made without penalty. The Term Facility required commitment fees, and interest rates were based on bankers' acceptance, LIBOR, EURIBOR, bank prime rate loan or US base rate loan plus the applicable margin. The Term Facility was indirectly secured by a first priority fixed and floating charge on substantially all present and future real and personal property and undertaking of every nature and kind of Cogeco Cable and certain of its subsidiaries, and provided for certain permitted encumbrances, including purchased money obligations, existing funded obligations and charges granted by any subsidiary prior to the date when it becomes a subsidiary, subject to a maximum amount. The provisions under these facilities provided for restrictions on the operations and activities of Cogeco Cable. Generally, the most significant restrictions were related to permitted investments and dividends on multiple and subordinate voting shares, as well as incurrence and maintenance of certain financial ratios primarily linked to the operating income before amortization, financial expense and total indebtedness. At August 31, 2009, Cogeco Cable was in compliance with all of its covenants.

On June 9, 2009, Cogeco Cable completed, pursuant to a public debt offering, the issue of $300 million Senior Secured Debentures Series 1. These debentures mature on June 9, 2014 and bear interest at 5.95% per annum, payable semi-annually. These debentures are indirectly secured by a first priority fixed and floating charge and a security interest on substantially all present and future real and personal property and undertaking of every nature and kind of Cogeco Cable and certain of its subsidiaries. The net proceeds of sale of the Debentures were used to reimburse Cogeco Cable's existing Indebtedness and for general corporate purposes.

On October 1, 2008, Cogeco Cable completed, pursuant to a private placement, the issuance of US$190 million Senior Secured Notes Series A maturing October 1, 2015, and $55 million Senior Secured Notes Series B maturing October 1, 2018. The Senior Secured Notes Series B bear interest at the coupon rate of 7.60% per annum, payable semi-annually. In addition, Cogeco Cable entered into cross-currency swap agreements to fix the liability for interest and principal payments on the Senior Secured Notes Series A, which bear interest at the coupon rate of 7.00% per annum, payable semi-annually. Taking into account these agreements, the effective interest rate of the Senior Secured Notes Series A is 7.24% and the exchange rate applicable to the principal portion of the US dollar-denominated debt has been fixed at $1.0625. The net proceeds of $255 million were used to repay the US$150 million Senior Secured Notes Series A maturing on October 31, 2008, including the related derivative financial instruments, for a total of $238.7 million and to reduce existing Indebtedness.

As at August 31, 2010, the Company had a working capital deficiency of $202.9 million compared to $245.8 million as at August 31, 2009. The decreased deficiency is mainly attributable to the repayment of Cogeco Cable's Term Facility through the issuance of a new Term Revolving Facility. As part of the usual conduct of its cable business, COGECO maintains a working capital deficiency due to a low level of accounts receivable since the majority of the cable subsidiary's customers pay before their services are rendered, unlike accounts payable and accrued liabilities, which are paid after products are delivered or services are rendered, thus enabling Cogeco Cable to use cash and cash equivalents to reduce Indebtedness.

During the next five years, the required principal repayments on COGECO's long-term debt, excluding those under capital leases, will amount to $596.7 million. Cogeco Cable's Senior Secured Notes Series B of $175 million will have to be repaid in fiscal 2012. In addition, Cogeco Cable's Senior Secured Debentures Series 1 for $300 million and the amount €90 million ($121.6 million) drawn on the Term Revolving Facility will mature in 2014. Based on the aggregate availability of $668.6 million as at August 31, 2010 under its committed Term Revolving Facilities and the anticipated free cash flow of $60 million for fiscal 2011, the Company has the ability to manage its long-term debt maturities until the expiry of its Term Facilities. In the years to come, management expects to use most of its annual free cash flows after dividend payments to reduce Indebtedness. Management believes that the committed Term Revolving Facilities will provide sufficient liquidity to manage the maturities of its long-term debt and satisfy working capital requirements and that the next key refinancing milestones are related to the maturities of both the Company and Cogeco Cable's respective Term Revolving Facilities in July 2014. Refer to page 20 for a detailed description of financial risks.

On October 6, 2010, Dominion Bond Rating Service ("DBRS") confirmed their rating on the Senior Secured Debentures and Notes of Cogeco Cable to BBB (low). Obligations rated in the "BBB" category are in the fourth highest category and are regarded as of adequate credit quality, where the degree of protection afforded interest and principal is considered acceptable, but the entity is fairly susceptible to adverse changes in financial and economic conditions, or there may be other adverse conditions present which reduce the strength of the entity and its rated securities.

On October 1, 2010, Fitch Ratings ("Fitch") upgraded the Issuer Default Rating ("IDR") of Cogeco Cable to BBB- from BB+ and confirmed their rating on the Senior Secured Debentures and Notes to BBB-, one notch above the corporate credit ratings of BB+. Obligations rated in the "BBB" category are regarded as of good credit quality, where the capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category.

On June 24, 2010, Standard & Poor's Ratings Services ("S&P") maintained their rating on the Senior Secured Debentures and Notes of Cogeco Cable to BBB–, two notches above the corporate credit ratings of BB to reflect very high recovery prospects of first lien secured issues. Obligations rated in the "BBB" category are in the fourth highest category and are regarded as investment-grade. Such obligations show adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation. The ratings may be modified by the addition of a plus (+) or minus (–) sign to show relative standing within the major rating categories. S&P has assigned a recovery rating of "1" to Cogeco Cable's credit facility and other senior secured first-priority debt. The "1" recovery rating indicates expectations of very high recovery (90%-100%) of principal in the event of payment default.

The table below shows Cogeco Cable's credit ratings:

| As at August 31, 2010 | **DBRS** | **Fitch** | **S&P** |
|---|---|---|---|
| Senior secured notes and debentures | **BBB (low)** | **BBB–** | **BBB–** |

# Financial management

The Company has established guidelines whereby swap agreements can be used to manage risks associated with fluctuations in interest and exchange rates related to its long-term debt. All such agreements are exclusively used for hedging purposes. In order to minimize the risk of counter-party default, COGECO completes transactions with financial institutions that carry a credit rating equal or superior to its own credit rating.

Cogeco Cable has entered into a swap agreement with a financial institution to fix the floating benchmark interest rate with respect to a portion of the Euro-denominated loans outstanding under the Term Revolving Facility, and previously the Term Facility, for a notional amount of €111.5 million, which has been reduced to €95.8 million on July 28, 2009, and to €69.6 million on July 28, 2010. The interest rate swap to hedge these loans has been fixed at 2.08% until the maturity of the swap agreement on July 28, 2011. In addition to the interest rate swap of 2.08%, Cogeco Cable will continue to pay the applicable margin on these loans in accordance with its Term Revolving Facility. In fiscal 2010, the fair value of interest rate swap increased by $1 million, which is recorded as an increase of other comprehensive income, net of income taxes and non-controlling interest, compared to a decrease of $2.2 million which was recorded as a decrease of other comprehensive income, net of income taxes and non-controlling interest, in the prior year.

Cogeco Cable has also entered into cross-currency swap agreements to set the liability for interest and principal payments on its US$190 million Senior Secured Notes Series A maturing on October 1, 2015. These agreements have the effect of converting the U.S. interest coupon rate of 7.00% per annum to an average Canadian dollar interest rate of 7.24% per annum. The exchange rate applicable to the principal portion of the debt has been fixed at $1.0625 per US dollar. During the current fiscal year, amounts due under the US$190 million Senior Secured Notes Series A decreased by $5.4 million due to the US dollar's depreciation relative to the Canadian dollar. The fair value of cross-currency swaps increased by a net amount of $0.8 million, of which a decrease of $5.4 million offsets the foreign exchange gain on the debt denominated in US dollars. The difference of $6.3 million was recorded as an increase of other comprehensive income, net of income taxes and non-controlling interest. In fiscal 2009, amounts due under the US$190 million Senior Secured Notes Series A increased by $6.2 million due to the US dollar's appreciation over the Canadian dollar. The fair value of cross-currency swaps increased by a net amount of $4.2 million, of which an increase of $6.2 million offsets the foreign exchange loss on the debt denominated in US dollars. The difference of $1.9 million was recorded as a decrease of other comprehensive income, net of income taxes and non-controlling interest.

Furthermore, Cogeco Cable's net investment in self-sustaining foreign subsidiaries is exposed to market risk attributable to fluctuations in foreign currency exchange rates, primarily changes in the values of the Canadian dollar versus the Euro. This risk is mitigated since the major part of the purchase price for Cabovisão was borrowed directly in Euros. This debt is designated as a hedge of a net investment in self-sustaining foreign subsidiaries and, accordingly, Cogeco Cable recorded a foreign exchange loss of $8.2 million in fiscal 2010, compared to a foreign exchange gain of $8 million in fiscal 2009, which is deferred and recorded in the consolidated statement of comprehensive income. The exchange rate used to convert the Euro currency into Canadian dollars for the balance sheet accounts as at August 31, 2010 was $1.3515 per Euro compared to $1.5698 per Euro as at August 31, 2009. The average exchange rate prevailing during fiscal 2010 used to convert the operating results of the European operations was $1.4316 per Euro compared to $1.5889 per Euro for fiscal 2009. Since Cogeco Cable's consolidated financial statements are expressed in Canadian dollars but a portion of its business is conducted in the Euro currency, exchange rate fluctuations can increase or decrease revenue, operating income before amortization, net income and the carrying value of assets and liabilities.

The following table shows the Canadian dollar equivalents of the Euro-denominated results of operations. Based on the Company's fiscal 2010 results of operations, a 10% change in the average exchange rate of the Euro currency into Canadian dollars would increase or decrease the full-year revenue and operating income before amortization by the following amounts:

| Year ended August 31, 2010 | As reported | Exchange rate impact |
|---|---|---|
| *(in thousands of dollars)* | $ | $ |
| Revenue | **187,756** | **18,776** |
| Operating income before amortization | **32,567** | **3,257** |

# Commitments and guarantees

COGECO and its subsidiaries' contractual obligations as at August 31, 2010 are shown in the table below:

| Years ended August 31, | 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| *(in thousands of dollars)* | $ | $ | $ | $ | $ | $ | $ |
| Long-term debt(1) | 13 | 175,002 | – | 421,635 | – | 356,875 | 953,525 |
| Capital lease obligations(2) | 2,909 | 2,209 | 873 | 41 | – | – | 6,032 |
| Operating lease agreements and other long-term contracts | 29,287 | 25,613 | 21,528 | 17,102 | 16,264 | 35,775 | 145,569 |
| Other long-term obligations(3) | – | – | – | – | – | – | 10,568 |
| Total contractual obligations(4) | 32,209 | 202,824 | 22,401 | 438,778 | 16,264 | 392,650 | 1,115,694 |

(1) Includes principal repayments and the impact of cross-currency swap agreements but excludes capital leases.
(2) Includes principal repayments and financial expense.
(3) Other long-term obligations reflected on COGECO'S balance sheet include pension plan liabilities and accrued employee benefits. The nature of those obligations prevents the company from estimating an annual breakdown.
(4) Annual breakdown excludes other long-term obligations.

In the normal course of business, the Company and its subsidiaries enter into agreements containing features that meet the criteria for a guarantee.

In connection with the acquisition or sale of a business or assets, in addition to possible indemnification relating to failure to perform covenants and breach of representations and warranties, the Company's subsidiaries, Cogeco Cable and CDI, have agreed to indemnify the seller or the purchaser against claims related to events that occurred prior to the date of acquisition or sale. The term and amount of such indemnification will sometimes be limited by the agreement. The nature of these indemnification agreements prevents the Company from estimating the maximum potential liability required to be paid to guaranteed parties. In management's opinion, the likelihood that a significant liability will be incurred under these obligations is low. The Company has purchased directors' and officers' liability insurance with a deductible per loss. As at August 31, 2010 and 2009, no liability has been recorded associated with these indemnifications.

Under the terms of the Senior Secured Notes, the Company's cable subsidiary, Cogeco Cable, has agreed to indemnify the other parties against changes in regulation relative to withholding taxes and costs incurred by the lenders due to changes in laws. These indemnifications extend for the term of the related financings and do not provide any limit on the maximum potential liability. The nature of the indemnification agreement prevents Cogeco Cable from estimating the maximum potential liability it could be required to pay. As at August 31, 2010 and 2009, no liability associated with these indemnifications has been recorded.

During fiscal 2008 and 2010, the Company's subsidiary, Cogeco Cable, issued letters of credit amounting to €1.7 million and €4.2 million to guarantee the payment by Cabovisão of stamp taxes for the 2000 through 2002 years and withholding taxes for the years 2004 and 2005 assessed by the Portuguese tax authorities, which are all currently being challenged by Cabovisão. Even though the principal amounts in dispute are fully recorded in the books of its subsidiary Cabovisão, the Company's subsidiary, Cogeco Cable, may be required to pay the amounts following final judgements, up to a maximum aggregate amount of €5.9 million ($7.9 million), should Cabovisão fail to pay such required amounts.

The Company's subsidiary, CDI, indemnifies certain of its on-air hosts against charges, costs and expenses as a result of any lawsuit, resulting from judicial or administrative proceedings in which they are named as defending party and arising from the performance of their services. The claims covered by such indemnification are subject to statutory or other legal limitation periods. The nature of the indemnification agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to beneficiaries of such indemnification agreements. The Company has purchased employees' and contractual's liability insurance with a deductible per loss. As at August 31, 2010 and 2009, no liability has been recorded associated with these indemnifications.

# Three-year annual financial highlights and quarterly financial highlights

## Three-year financial highlights

| Years ended August 31,<br>*(in thousands of dollars, except percentages and per share data)* | **2010**<br>**$** | 2009[1]<br>$ | 2008[1][2]<br>$ |
|---|---|---|---|
| Revenue | **1,321,694** | 1,252,794 | 1,108,900 |
| Operating income from continuing operations before amortization | **519,339** | 515,494 | 431.913 |
| Operating margin | **39.3%** | 41.1% | 38.9% |
| Operating income from continuing operations | **259,882** | 258,867 | 214,329 |
| Impairment of goodwill and intangible assets | **–** | 399,648 | – |
| Income (loss) from continuing operations | **56,264** | (79,014) | 42,177 |
| Loss from discontinued operations | **–** | – | (18,057) |
| Net income (loss) | **56,264** | (79,014) | 24,120 |
| Adjusted net income[3] | **46,644** | 36,406 | 34,268 |
| Cash flow from operating activities from continuing operations | **425,336** | 420,704 | 381,482 |
| Cash flow from operations from continuing operations | **502,219** | 390,288 | 345,779 |
| Capital expenditures and increase in deferred charges | **320,962** | 289,270 | 245,343 |
| Free cash flow | **181,257** | 101,018 | 100,436 |
| Total assets | **2,744,656** | 2,670,128 | 3,027,076 |
| Long term financial liabilities[4] | **963,309** | 1,031,879 | 746,700 |
| **Per share data**[5] | | | |
| Basic | | | |
| Income (loss) from continuing operations per share | **3.36** | (4.73) | 2.53 |
| Loss from discontinued operations per share | **–** | – | (1.08) |
| Earnings (loss) per share | **3.36** | (4.73) | 1.45 |
| Adjusted earnings per share | **2.79** | 2.18 | 2.06 |
| Diluted | | | |
| Income (loss) from continuing operations per share | **3.35** | (4.73) | 2.52 |
| Loss from discontinued operations per share | **–** | – | (1.08) |
| Earnings (loss) per share | **3.35** | (4.73) | 1.44 |
| Adjusted earnings per share | **2.78** | 2.17 | 2.05 |
| Dividend | **0.40** | 0.32 | 0.28 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information for fiscal 2009 and 2008 has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.
(2) Includes the results of CDS since the date of acquisition of control by Cogeco Cable on July 31, 2008.
(3) In addition to the adjustments described in the "Non-GAAP financial measures" section on page 40, net income for the 2008 fiscal year has been adjusted to remove the loss on discontinued operations of $18.1 million and the income tax adjustment of $7.9 million related to the reduction of Canadian federal income tax rates net of non-controlling interest.
(4) Long-term financial liabilities include long-term debt, derivative financial instrument liabilities and pension plan liabilities and accrued employee benefits.
(5) Per multiple and subordinate voting share.

# Quarterly financial highlights

| Quarters ended[1] *(in thousands of dollars, except percentages and per share data)* | **Nov. 30** | **Feb. 28** | **May 31** | **Aug. 31** | Nov. 30[2] | Feb. 28[2] | May 31[2] | Aug. 31[2] |
|---|---|---|---|---|---|---|---|---|
| | | | | **Fiscal 2010** | | | | Fiscal 2009 |
| | **$** | **$** | **$** | **$** | $ | $ | $ | $ |
| Revenue | **328,003** | **329,087** | **330,933** | **333,671** | 308,375 | 311,825 | 316,310 | 316,284 |
| Operating income before amortization | **129,263** | **124,363** | **127,928** | **137,785** | 120,711 | 123,505 | 126,624 | 144,654 |
| Operating margin | **39.4%** | **37.8%** | **38.7%** | **41.3%** | 39.1% | 39.6% | 40.0% | 45.7% |
| Operating income | **63,562** | **58,370** | **64,008** | **73,942** | 59,829 | 60,171 | 62,623 | 76,244 |
| Impairment of goodwill and intangible assets | **–** | **–** | **–** | **–** | – | 399,648 | – | – |
| Net income (loss) | **22,748** | **10,511** | **10,740** | **12,265** | 10,861 | (115,210) | 10,704 | 14,631 |
| Adjusted net income | **13,128** | **10,511** | **10,740** | **12,265** | 10,861 | 8,741 | 9,157 | 7,647 |
| Cash flow from operating activities | **(1,410)** | **117,498** | **110,756** | **198,492** | 26,477 | 117,322 | 99,873 | 177,032 |
| Cash flow from operations | **135,518** | **120,331** | **119,140** | **127,230** | 91,633 | 97,193 | 92,718 | 108,744 |
| Capital expenditures and increase in deferred charges | **68,387** | **74,549** | **69,511** | **108,515** | 69,862 | 65,104 | 60,302 | 94,002 |
| Free cash flow | **67,131** | **45,782** | **49,629** | **18,715** | 21,771 | 32,089 | 32,416 | 14,742 |
| Earnings (loss) per share[3] | | | | | | | | |
| Basic | **1.36** | **0.63** | **0.64** | **0.73** | 0.65 | (6.90) | 0.64 | 0.87 |
| Diluted | **1.35** | **0.63** | **0.64** | **0.73** | 0.65 | (6.90) | 0.64 | 0.87 |
| Adjusted earnings per share[3] | | | | | | | | |
| Basic | **0.79** | **0.63** | **0.64** | **0.73** | 0.65 | 0.52 | 0.55 | 0.46 |
| Diluted | **0.78** | **0.63** | **0.64** | **0.73** | 0.65 | 0.52 | 0.55 | 0.46 |

(1) The addition of quarterly information may not correspond to the annual total due to rounding.
(2) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.
(3) Per multiple and subordinate voting share.

# Seasonal variations

Cogeco Cable's operating results are not generally subject to material seasonal fluctuations. However, the customer growth in the Basic Cable and HSI services are generally lower in the second half of the fiscal year as a result of a decrease in economic activity due to the beginning of the vacation period, the end of the television seasons, and students leaving their campuses at the end of the school year. Cogeco Cable offers its services in several university and college towns such as Kingston, Windsor, St. Catharines, Hamilton, Peterborough, Trois-Rivières and Rimouski in Canada, and Aveiro, Covilhã, Evora, Guarda and Coimbra in Portugal. Furthermore, the operating margin in the third and fourth quarters is generally higher as the maximum amount payable to COGECO under the management agreement is usually reached in the second quarter of the year. As part of the management agreement between Cogeco Cable and COGECO, Cogeco Cable pays management fees to COGECO equivalent to 2% of its revenue subject to an annual maximum amount, which is adjusted annually to reflect the increase in the Canadian Consumer Price index. Since the maximum amount was reached in the second quarters of fiscal 2010 and 2009, Cogeco Cable has paid no management fees in the second halves of either fiscal year.

# 2010 VS 2009 fourth-quarter operating results

## Customer statistics

| | Canada | Europe | August 31, 2010<br>Consolidated | Canada | Quarter ended August 31, 2010<br>Europe | Net additions<br>Consolidated |
|---|---|---|---|---|---|---|
| RGU | **2,350,577** | **828,772** | **3,179,349** | **43,707** | **20,596** | **64,303** |
| Basic Cable service customers | **874,505** | **260,267** | **1,134,772** | **433** | **1,591** | **2,024** |
| HSI service customers | **559,057** | **163,187** | **722,244** | **8,904** | **2,778** | **11,682** |
| Digital Television service customers | **559,418** | **159,852** | **719,270** | **17,472** | **12,017** | **29,489** |
| Telephony service customers | **357,597** | **245,466** | **603,063** | **16,898** | **4,210** | **21,108** |
| | Canada | Europe | August 31, 2009<br>Consolidated | Canada | Quarter ended August 31, 2009<br>Europe | Net additions (losses)<br>Consolidated |
| RGU | 2,159,863 | 732,375 | 2,892,238 | 27,740 | 20,430 | 48,170 |
| Basic Cable service customers | 864,805 | 259,480 | 1,124,285 | (924) | (5,318) | (6,242) |
| HSI service customers | 515,052 | 143,614 | 658,666 | 5,619 | 1,430 | 7,049 |
| Digital Television service customers | 498,398 | 102,753 | 601,151 | 9,674 | 23,456 | 33,130 |
| Telephony service customers | 281,608 | 226,528 | 508,136 | 13,371 | 862 | 14,233 |

In the cable sector, Canadian operations' fiscal 2010 fourth-quarter RGU net additions was higher than in the comparable period of the prior year, and the Canadian operations continue to generate RGU growth despite early signs of maturation of some of its services. The net customer additions for Basic Cable service customers stood at 433 for the quarter, compared to a net customer loss of 924 in the fourth quarter of the prior year. In the quarter, Telephony service customers grew by 16,898 compared to 13,371 for the same period last year, and the number of net additions to the HSI service stood at 8,904 customers for the quarter, compared to 5,619 customers for the same period last year. HSI and Telephony net additions continue to stem from the enhancement of the product offering, the impact of the bundled offer (Cogeco Complete Connection) of Television, HSI and Telephony services, and promotional activities. The Digital Television service net additions stood at 17,472 customers compared to 9,674 customers for the three month period of the prior year. Digital Television service net additions are due to targeted marketing initiatives to improve penetration and to the continuing strong interest for HD television services.

In the European operations of the Cable sector, 2010 fourth-quarter net additions show a return to customer growth for Cogeco Cable, and the Basic Cable service customer base has begun to stabilize and reflect the benefits of Cabovisão's customer retention and acquisition strategies launched at the end of the 2009 fiscal year in order to reduce the customer attrition brought on by the difficult competitive landscape in Portugal and the economic environment in Europe throughout the previous fiscal year. In the fourth quarter of fiscal 2010, the number of Basic Cable service customers grew by 1,591 customers compared to a loss of 5,318 customers in the comparable period of the prior year. HSI service customers increased by 2,778 customers for the quarter, compared to 1,430 customers in the fourth quarter of fiscal 2009. The number of Digital Television service customers grew by 12,017 customers in the fourth quarter ended August 31, 2010, compared to 23,456 customers in the comparable period of the previous fiscal year mainly due to the extensive Digital roll-out period during fiscal 2009. The Telephony service customers gained 4,210 customers in the fourth quarter of fiscal 2010, compared to 862 customers for the comparable period of the preceding year.

## Operating results

| Quarters ended August 31, | Cable<br>2010 | 2009(2) | Other and eliminations(1)<br>2010 | 2009(2) | Consolidated<br>2010 | 2009(2) |
|---|---|---|---|---|---|---|
| *(in thousands of dollars, except percentages)* | **$** | $ | **$** | $ | **$** | $ |
| Revenue | **324,323** | 307,807 | **9,348** | 8,477 | **333,671** | 316,284 |
| Operating costs | **186,146** | 163,915 | **9,740** | 7,715 | **195,886** | 171,630 |
| Operating income (loss) before amortization | **138,177** | 143,892 | **(392)** | 762 | **137,785** | 144,654 |
| Operating margin | **42.6%** | 46.7% | **(4.2%)** | 9.0% | **41.3%** | 45.7% |

(1) The other and eliminations segment is comprised of radio operations and head office costs, as well as eliminations.
(2) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

Consolidated revenue for the fourth quarter rose by $17.4 million, or 5.5% compared to the corresponding period last year. Cable revenue, driven by increased RGU, the introduction of HSI usage billing, various rate increases implemented at the end of fiscal 2009 and in fiscal 2010 and the revenue related to the new LPIF in the Canadian operations, increased by $16.5 million, or 5.4%. Other sector revenue increased by $0.9 million, or 10.3%, in the fourth quarter of 2010 due to favourable ratings for the Company's radio stations.

Operating costs increased by $24.3 million, or 14.1%, at $195.9 million compared to the fourth quarter of fiscal 2009 mainly due to the cable sector. The increase in operating costs in the cable sector is mainly attributable to servicing additional RGU, the launch of new HD channels, additional marketing initiatives and the new levy amounting to 1.5% of gross Cable Television service revenue imposed by the CRTC in order to finance the LPIF in Canada. Fourth-quarter operating costs were also favourably affected by the decline of the value of the Euro over the Canadian dollar, which surpassed increases in operating costs related to additional marketing initiatives and the launch of new channels, net of the impact of cost reduction initiatives implemented by Cabovisão in the European operations. On a consolidated basis, fiscal 2009 operating costs also included an impact of $21.3 million from the Part II licence fee favourable settlement agreement.

Operating income before amortization decreased by $6.9 million, or 4.7%, at $137.8 million in the fourth quarter 2010, compared to $144.7 million for the corresponding period last year. Fiscal 2009 operating income before amortization included the impact of the Part II licence fee favourable settlement agreement. As a result, the Company's fourth-quarter operating margin decreased to 41.3% from 45.7% for the corresponding period of the prior year. Notwithstanding the Part II licence fee favourable settlement agreement, the operating margin increased year over year as a result of rate increases, partly offset by the launch of new services which generate lower margins, the migration of customers from Analogue to Digital Television services and the revenue from the new LPIF which does not generate operating income before amortization, all in the Canadian operations. The reduction in the operating margin also reflects a decrease in revenue in the European operations which outpaced the decrease in operating costs.

## Cash flow analysis

| Quarters ended August 31,<br>*(in thousands of dollars)* | **2010**<br>**$** | 2009[(1)]<br>$ |
|---|---|---|
| **Operating activities** | | |
| Cash flow from operations | **127,230** | 108,744 |
| Changes in non-cash operating items | **71,262** | 68,288 |
| | **198,492** | 177,032 |
| **Investing activities**[(2)] | **(108,492)** | (91,529) |
| **Financing activities**[(2)] | **(75,671)** | (92,348) |
| **Effect of exchange rate changes on cash and cash equivalents denominated in a foreign currency** | **402** | 546 |
| **Net change in cash and cash equivalents** | **14,731** | (6,299) |
| Cash and cash equivalents, beginning of period | **21,111** | 45,757 |
| **Cash and cash equivalents, end of period** | **35,842** | 39,458 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.
(2) Excludes assets acquired under capital leases.

During the fourth quarter of 2010, cash flow from operations reached $127.2 million, 17% higher than the comparable period last year, primarily due to the reduction in income tax payments stemming from modifications to the corporate structure in the cable sector. Changes in non-cash operating items generated cash inflows of $71.3 million, mainly as a result of an increase in accounts payable and accrued liabilities. In the fourth quarter of the prior year, the cash inflows of $68.3 million mainly stemmed from increases in accounts payable and accrued liabilities which were partly offset by the Part II licence fee favourable settlement agreement, an increase in income tax liabilities and a decrease in income taxes receivable.

Investing activities in the fourth quarter of fiscal 2010 rose to $108.5 million compared to $91.5 million in the prior year, primarily due to an increase in customer premise equipment spending required to support RGU growth in the cable sector, partly offset by depreciation of the Euro over the Canadian dollar.

In the fourth quarter of 2010, the Company generated free cash flow amounting to $18.7 million, compared to $14.7 million for the same period of the preceding year. The increase in free cash flow is the result of an increase in cash flow from operations outpacing the increase in capital expenditures.

In the fourth quarter of 2010, indebtedness affecting cash decreased by $63.8 million mainly due to the inflows generated by changes in non-cash operating items of $71.3 million and the free cash flow of $18.7 million, partly offset by the increase in cash and cash equivalents of $14.7 million and the payment of dividends totalling $6.3 million described below and an increase in deferred transaction costs of $5.8 million. Indebtedness mainly reduced through a decrease of $52.2 million in bank indebtedness and net repayments on Cogeco Cable's term and revolving loans of $7.6 million. In the fourth quarter of fiscal 2009, indebtedness affecting cash decreased by $87.1 million mainly due to the increase in non-cash operating items of $68.3 million, the free cash flows of $14.7 million and the decrease in cash and cash equivalents of $6.3 million, net of the dividend payment of $5.3 million described below. Indebtedness mainly decreased through the net repayments, in the cable sector, on Cogeco Cable's term and revolving loans of $175.4 million, the repayment of Cogeco Cable's $150 million Senior Secured Debentures Series 1 at maturity on June 4, 2009, and by a decrease of $55 million in bank indebtedness, partly offset by the issuance by the cable subsidiary on June 9, 2009 of Senior Secured Debentures Series 1 for $300 million maturing June 9, 2014.

During the fourth quarter of fiscal 2010, the Company paid a dividend of $0.10 per share to the holders of subordinate and multiple voting shares totalling $1.7 million, compared to a quarterly dividend of $0.08 per share totalling $1.3 million in fiscal 2009. Dividends paid by a subsidiary to non-controlling interests amounted to $4.6 million during the fourth quarter of fiscal 2010 compared to $3.9 million in the fourth quarter of fiscal 2009, bringing the consolidated dividend payments to $6.3 million in the current year compared to $5.3 million in the prior year.

# Fiscal 2011 financial guidelines

## Consolidated financial guidelines

COGECO confirms its preliminary financial guidelines for fiscal 2010, as issued on July 7, 2010, and expects revenue of approximately $1,380 million and operating income before amortization of approximately $538 million. Free cash flow should generate approximately $60 million and net income of approximately $45 million should be earned as a result of growth in operating income before amortization outpacing fixed charges. The fiscal 2011 financial guidelines exclude the Corus acquisition, which is subject to customary closing adjustments and conditions, including approval by the CRTC.

| *(in millions of dollars)* | Projections Fiscal 2011 $ | Actuals Fiscal 2010 $ |
|---|---|---|
| **Financial guidelines** | | |
| Revenue | 1,380 | 1,322 |
| Operating income before amortization | 538 | 519 |
| Financial expense | 70 | 65 |
| Current income taxes | 65 | (39) |
| Net income | 45 | 56 |
| Capital expenditures and increase in deferred charges | 341 | 321 |
| Free cash flow | 60 | 181 |

## Cable sector

For fiscal 2011, Cogeco Cable maintains its preliminary projections issued on July 7, 2010. Cogeco Cable expects to achieve revenue of $1,340 million, representing growth of $59 million, or 4.6% when compared to fiscal 2010 financial results. The guidelines take into consideration the current global economic environment. In Canada, Cogeco Cable's footprint includes certain regions in Southern Ontario where the automobile manufacturing industry is a significant driver of economic activity. The sharp downturn experienced by this industry in the past years is expected to continue to have an adverse impact on the level of economic activity including consumer expenditures on goods and services within those communities. In previous recessionary periods, demand for cable telecommunications services has generally proven to be resilient. However, there is no assurance that demand would remain resilient in a prolonged difficult economic environment. These guidelines also take into consideration the competitive environment and the deployment of new technologies such as FTTH, Fibre to the Node ("FTTN") and IPTV by the incumbent telecommunications providers.

Revenue from the Canadian operations should increase as a result of RGU growth stemming from targeted marketing initiatives to improve penetration rates of the Digital Television, HSI and Telephony services. Furthermore, the Digital Television service should continue to benefit from the customers' ongoing strong interest in Cogeco Cable's growing HD service offerings. Canadian operations revenue will also benefit from the impact of rate increases implemented in June 2010 in Ontario and Québec, averaging $2 per Basic Cable service customer. Cogeco Cable's strategies include consistently effective marketing, competitive product offerings and superior customer service, which combined, lead to the expansion and loyalty of the Canadian operations' Basic Cable Service clientele. As the penetration of HSI, Telephony and Digital Television services increase, the new demand for these products should slow, reflecting early signs of maturity.

European operations are expected to continue to grow their customer base with projected net additions across all services that should result from the acquisition and retention strategies implemented in the second half of fiscal 2009. The economic difficulties being experienced by the European market at large and the transitory competitive environment which has plagued the Portuguese telecommunications industry for the past two years are beginning to assuage, which should lead to an increase in revenue in local currency for the 2011 fiscal year, however the economic climate is expected to remain difficult in the short-term, and the decrease in the expected exchange rate for the Euro compared to the Canadian dollar in the upcoming fiscal year is expected to offset the favourable impact on Euro-denominated revenue. For fiscal 2011, it is anticipated that the Euro should be converted at a rate of approximately $1.35 per Euro, compared to an average rate of $1.4316 per Euro in fiscal 2010.

As a result of increased costs to service additional RGU, inflation and manpower increases, as well as the continuation of the marketing initiatives and retention strategies launched in Portugal in the second half of fiscal 2009, consolidated operating costs are expected to expand by approximately $39 million, or 5.1% in the 2011 fiscal year when compared to for the financial results for fiscal 2010.

For fiscal 2011, Cogeco Cable expects operating income before amortization of $530 million, an increase of $20 million, or 3.9% when compared to fiscal 2010. The operating margin is expected to reach approximately 39.6% in fiscal 2011, compared to 39.8% for the 2010 fiscal year.

Cogeco Cable expects the amortization of capital assets and deferred charges to increase by $16 million for fiscal 2011, mainly from capital expenditures and deferred charges related to RGU growth and other initiatives of fiscal 2011 and the full year impact of those of fiscal 2010. Cash flow from operations should finance capital expenditures and the increase in deferred charges amounting to $340 million, an increase of $20 million compared to the actuals for fiscal 2010. Capital expenditures projected for the 2011 fiscal year are mainly due to customer premise equipment required to support RGU growth, scalable infrastructure for product enhancements and the deployment of new technologies, line extensions to expand existing territories, and support capital to improve business information systems and facility requirements.

Fiscal 2011 free cash flow is expected to decline to $55 million. The decrease of approximately $120 million, when compared to the $175 million actuals for the 2010 fiscal year, is primarily due to the projected fiscal 2011 income tax payments of approximately $65 million compared to the expected fiscal 2010 income tax recoveries of $41 million as a result of modifications to the corporate structure and to the increase of $20 million in capital expenditures. The $106 million variation in cash income taxes year over year combined with the increase in capital expenditures will be partly offset by the growth in operating income before amortization. Generated free cash flow should be used primarily to reduce Indebtedness, thus improving Cogeco Cable's leverage ratios. Financial expense will increase to $70 million as the anticipated decrease in Indebtedness will be offset by an increase in Cogeco Cable's cost of debt reflecting current market conditions and additional costs related to the new Term Revolving Facility previously described in the "Financial position" section. As a result, net income of approximately $120 million should be achieved compared to $157 million for fiscal 2010. Fiscal 2010 net income includes a favourable income tax adjustment of $29.8 million related to the reduction of the Ontario provincial corporate income tax rates for the Canadian operations. Excluding this amount, fiscal 2011 projected net income of $120 million represents a decrease of $7 million when compared to adjusted net income of $127 million for fiscal 2010.

| *(in millions of dollars, except percentages and RGU growth)* | Projections Fiscal 2011 $ | Actuals Fiscal 2010 $ |
|---|---|---|
| **Financial guidelines** | | |
| Revenue | 1,340 | 1,281 |
| Operating income before amortization | 530 | 510 |
| Operating margin | 39.6% | 39.8% |
| Amortization | 275 | 259 |
| Financial expense | 70 | 65 |
| Current income taxes | 65 | (41) |
| Net income | 120 | 157 |
| Capital expenditures and increase in deferred charges | 340 | 320 |
| Free cash flow | 55 | 175 |
| **Net customer addition guidelines** | | |
| RGU growth | 250,000 | 287,111 |

# Non-GAAP financial measures

This section describes non-GAAP financial measures used by COGECO throughout this MD&A. It also provides reconciliations between these non-GAAP measures and the most comparable GAAP financial measures. These financial measures do not have standard definitions prescribed by Canadian GAAP and therefore, may not be comparable to similar measures presented by other companies. These measures include "cash flow from operations", "free cash flow", "operating income before amortization", "operating margin", "adjusted net income" and "adjusted earnings per share".

## Cash flow from operations and free cash flow

Cash flow from operations is used by COGECO's management and investors to evaluate cash flows generated by operating activities excluding the impact of changes in non-cash operating items. This allows the Company to isolate the cash flow from operating activities from the impact of cash management decisions. Cash flow from operations is subsequently used in calculating the non-GAAP measure "free cash flow". Free cash flow is used by COGECO's management and investors to measure the Company's ability to repay debt, distribute capital to its shareholders and finance its growth.

The most comparable Canadian GAAP financial measure is cash flow from operating activities. Cash flow from operations is calculated as follows:

| | Quarters ended August 31, 2010 | 2009(1) | Years ended August 31, 2010 | 2009(1) |
|---|---|---|---|---|
| *(in thousands of dollars)* | **$** | $ | **$** | $ |
| **Cash flow from operating activities** | **198,492** | 177,032 | **425,336** | 420,704 |
| Changes in non-cash operating items | **(71,262)** | (68,288) | **76,883** | (30,416) |
| **Cash flow from operations** | **127,230** | 108,744 | **502,219** | 390,288 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

Free cash flow is calculated as follows:

| | Quarters ended August 31, 2010 | 2009(1) | Years ended August 31, 2010 | 2009(1) |
|---|---|---|---|---|
| *(in thousands of dollars)* | **$** | $ | **$** | $ |
| **Cash flow from operations** | **127,230** | 108,744 | **502,219** | 390,288 |
| Acquisition of fixed assets | **(105,513)** | (89,199) | **(309,752)** | (273,733) |
| Increase in deferred charges | **(3,002)** | (2,462) | **(11,069)** | (10,773) |
| Assets acquired under capital leases – as per note 16 B) on page 69 | **–** | (2,341) | **(141)** | (4,764) |
| **Free cash flow** | **18,715** | 14,742 | **181,257** | 101,018 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

# Operating income before amortization and operating margin

Operating income before amortization is used by COGECO's management and investors to assess the Company's ability to seize growth opportunities in a cost effective manner, to finance its ongoing operations and to service its debt. Operating income before amortization is a proxy for cash flow from operations excluding the impact of the capital structure chosen, and is one of the key metrics used by the financial community to value the business and its financial strength. Operating margin is a measure of the proportion of the Company's revenue which is left over, before income taxes, to pay for its fixed costs, such as interest on Indebtedness. Operating margin is calculated by dividing operating income before amortization by revenue.

The most comparable Canadian GAAP financial measure is operating income. Operating income before amortization and operating margin are calculated as follows:

| | Quarters ended August 31, 2010 | 2009(1) | Years ended August 31, 2010 | 2009(1) |
|---|---|---|---|---|
| *(in thousands of dollars, except percentages)* | **$** | $ | **$** | $ |
| **Operating income** | **73,942** | 76,244 | **259,882** | 258,867 |
| Amortization | **63,843** | 68,410 | **259,457** | 256,627 |
| **Operating income before amortization** | **137,785** | 144,654 | **519,339** | 515,494 |
| Revenue | **333,671** | 316,284 | **1,321,694** | 1,252,794 |
| **Operating margin** | **41.3%** | 45.7% | **39.3%** | 41.1% |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

# Adjusted net income and adjusted earnings per share

Adjusted net income and adjusted earnings per share are used by COGECO's management and investors to evaluate what would have been the net income and earnings per share excluding the impairment of goodwill and intangible assets, non-recurring tax adjustments and the Part II licence fee favourable settlement agreement, all net of non-controlling interest. This allows the Company to isolate the unusual adjustments in order to evaluate net income and earnings per share from ongoing activities.

The most comparable Canadian GAAP financial measures are net income and earnings per share. Adjusted net income and adjusted earnings per share are calculated as follows:

| | Quarters ended August 31, | | Years ended August 31, | |
|---|---|---|---|---|
| | **2010** | 2009(1) | **2010** | 2009(1) |
| *(in thousands of dollars, except the number of shares and per share data)* | **$** | $ | **$** | $ |
| **Net income (loss)** | **12,265** | 14,631 | **56,264** | (79,014) |
| Adjustments: | | | | |
| Impairment of goodwill and intangible assets net of related income taxes and non-controlling interest | **–** | – | **–** | 123,951 |
| Non-recurring tax adjustments net of non-controlling interest: | | | | |
| Reduction of the Ontario provincial income tax rates | **–** | – | **(9,620)** | – |
| Reduction of withholding and stamp tax contingent liabilities | **–** | (1,680) | **–** | (5,211) |
| Utilization of pre-acquisition tax losses | **–** | – | **–** | 1,984 |
| Part II licence fee favourable settlement agreement net of related income taxes and non controlling interest | **–** | (5,304) | **–** | (5,304) |
| **Adjusted net income** | **12,265** | 7,647 | **46,644** | 36,406 |
| Weighted average number of multiple voting and subordinate voting shares outstanding | **16,730,336** | 16,728,881 | **16,726,135** | 16,704,962 |
| Effect of dilutive stock options | **9,299** | 730 | **10,681** | 8,757 |
| Effect of dilutive subordinate voting shares held in trust under the Incentive Share Unit Plan | **71,862** | 56,449 | **67,837** | 51,648 |
| Weighted average number of diluted multiple voting and subordinate voting shares outstanding | **16,811,497** | 16,786,060 | **16,804,653** | 16,765,367 |
| **Adjusted earnings per share** | | | | |
| Basic | **0.73** | 0.46 | **2.79** | 2.18 |
| Diluted | **0.73** | 0.46 | **2.78** | 2.17 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 for more details.

# Additional information

This MD&A was prepared on October 27, 2010. Additional information relating to the Company, including its Annual Information Form, is available on SEDAR at www.sedar.com.

# Consolidated Financial Statements

**Consolidated Financial Statements**

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# Management's responsibility

## Related to the consolidated financial statements

The consolidated financial statements of COGECO Inc. (the "Company") and the financial information contained in this annual report are the responsibility of management. The consolidated financial statements include amounts determined by management based on estimates, which in their opinion are reasonable and fair. The consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles and have been approved by the Board of Directors. Operating and financial information used elsewhere in the annual report is consistent with that of the consolidated financial statements.

In fulfilling its responsibilities, management of COGECO Inc. and its subsidiaries has developed, and continues to improve administrative and accounting systems in order to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and maintains internal accounting controls to ensure that financial records are reliable for preparing the financial statements. The Board of Directors carries out its responsibility for the financial statements in this annual report principally through its Audit Committee, which reviews the annual consolidated financial statements of the Company and recommends their approval to the Board of Directors. The committee periodically meets with management and the external and internal auditors to discuss the results of the external and internal examinations and matters having an impact on financial information.

The external auditors appointed by the shareholders, Samson Bélair/Deloitte & Touche s.e.n.c.r.l., Chartered Accountants, are responsible for making an independent examination of the consolidated financial statements in accordance with Canadian Generally Accepted Auditing Standards and to issue an opinion on the statements. The external auditors have free access to the Audit Committee, with or without the presence of management. Their report follows.

Louis Audet
President and Chief Executive Officer

Pierre Gagné
Senior Vice-President and Chief Financial Officer

Montréal, October 26, 2010

# Auditors' report

## To the shareholders of COGECO Inc.

We have audited the consolidated balance sheets of COGECO Inc. as at August 31, 2010 and 2009 and the consolidated statements of income (loss), comprehensive income (loss), retained earnings and cash flows for the years then ended. These 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 financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian Generally Accepted Accounting Principles.

Samson Bélair/Deloitte & Touche s.e.n.c.r.l.[1]

Montréal, October 26, 2010

[1] Chartered accountant auditor permit No. 10800

# Consolidated statements of income (loss)

| Years ended August 31,<br>*(In thousands of dollars, except per share data)* | **2010**<br>**$** | 2009<br>$<br>(restated) |
|---|---|---|
| **Revenue** | **1,321,694** | 1,252,794 |
| Operating costs | **802,355** | 737,300 |
| **Operating income before amortization** | **519,339** | 515,494 |
| Amortization (note 4) | **259,457** | 256,627 |
| **Operating income** | **259,882** | 258,867 |
| Financial expense (note 5) | **65,499** | 70,421 |
| Reduction of withholding and stamp tax contingent liabilities (note 6) | **–** | (16,130) |
| Impairment of goodwill and intangible assets (note 7) | **–** | 399,648 |
| **Income (loss) before income taxes and the following items** | **194,383** | (195,072) |
| Income taxes (note 8) | **31,664** | 58,686 |
| Losses (gains) on dilution resulting from the issuance of shares by a subsidiary | **(26)** | 48 |
| Non-controlling interest | **106,481** | (174,792) |
| **Net income (loss)** | **56,264** | (79,014) |

| | | |
|---|---|---|
| **Earnings (loss) per share** (note 9) | | |
| Basic | **3.36** | (4.73) |
| Diluted | **3.35** | (4.73) |

# Consolidated statements of comprehensive income (loss)

| Years ended August 31, | **2010** | 2009 |
|---|---|---|
| *(in thousands of dollars)* | **$** | $ |
| | | (restated) |
| **Net income (loss)** | **56,264** | (79,014) |
| **Other comprehensive income (loss)** | | |
| Unrealized gains on derivative financial instruments designated as cash flow hedges, net of income tax expense of $294,000 ($751,000 in 2009) and non-controlling interest of $1,038,000 ($888,000 in 2009) | **496** | 429 |
| Reclassification to financial expense of unrealized losses (gains) on derivative financial instruments designated as cash flow hedges, net of non-controlling interest of $3,664,000 (income tax expense of $694,000 and non-controlling interest of $3,405,000 in 2009) | **1,751** | (1,635) |
| Unrealized gains (losses) on translation of a net investment in self-sustaining foreign subsidiaries, net of non-controlling interest of $25,308,000 ($7,621,000 in 2009) | **(12,081)** | 3,640 |
| Unrealized gains (losses) on translation of long-term debts designated as hedges of a net investment in self-sustaining foreign subsidiaries, net of non-controlling interest of $19,778,000 ($2,241,000 in 2009) | **9,440** | (1,070) |
| | **(394)** | 1,364 |
| **Comprehensive income (loss)** | **55,870** | (77,650) |

# Consolidated statements of retained earnings

| Years ended August 31, | **2010** | 2009 |
|---|---|---|
| *(In thousands of dollars)* | **$** | $ |
| | | (restated) |
| **Balance as reported, beginning of year** | **211,922** | 295,808 |
| Changes in accounting policies (note 1 B)) | **(7,894)** | (7,405) |
| **Balance as restated, beginning of year** | **204,028** | 288,403 |
| Net income (loss) | **56,264** | (79,014) |
| Excess of price paid for the acquisition of subordinate voting shares over the value attributed to the incentive share units at issuance | **(430)** | – |
| Dividends on multiple voting shares | **(737)** | (590) |
| Dividends on subordinate voting shares | **(5,956)** | (4,771) |
| **Balance, end of year** | **253,169** | 204,028 |

# Consolidated balance sheets

| As at August 31, *(In thousands of dollars)* | **2010** **$** | 2009 $ (restated) |
|---|---|---|
| **Assets** | | |
| Current | | |
| Cash and cash equivalents (note 16 C)) | **35,842** | 39,458 |
| Accounts receivable | **74,560** | 66,076 |
| Income taxes receivable | **45,400** | 5,228 |
| Prepaid expenses and other | **14,189** | 14,805 |
| Future income tax assets (note 8) | **6,133** | 4,275 |
| | **176,124** | 129,842 |
| Investments | **739** | 739 |
| Fixed assets (note 10) | **1,328,866** | 1,305,769 |
| Deferred charges (note 11) | **27,960** | 24,062 |
| Intangible assets (note 12) | **1,042,998** | 1,047,774 |
| Goodwill (note 12) | **144,695** | 153,695 |
| Derivative financial instruments | **5,085** | 4,236 |
| Future income tax assets (note 8) | **18,189** | 4,011 |
| | **2,744,656** | 2,670,128 |
| **Liabilities and shareholders' equity** | | |
| **Liabilities** | | |
| Current | | |
| Bank indebtedness (note 13) | **2,328** | 416 |
| Accounts payable and accrued liabilities | **248,775** | 255,281 |
| Income tax liabilities | **558** | 41,358 |
| Deferred and prepaid revenue | **45,602** | 33,877 |
| Derivative financial instrument | **1,189** | – |
| Current portion of long-term debt (note 13) | **2,329** | 44,706 |
| Future income tax liabilities (note 8) | **78,267** | – |
| | **379,048** | 375,638 |
| Long-term debt (note 13) | **952,741** | 1,019,258 |
| Derivative financial instrument | **–** | 2,168 |
| Deferred and prepaid revenue and other liabilities | **12,234** | 12,900 |
| Pension plans liabilities and accrued employee benefits (note 17) | **10,568** | 10,453 |
| Future income tax liabilities (note 8) | **238,699** | 234,710 |
| | **1,593,290** | 1,655,127 |
| Non-controlling interest | **769,731** | 682,879 |
| Commitments, contingencies and guarantees (note 19) | | |
| **Shareholders' equity** | | |
| Capital stock (note 14) | **119,527** | 119,159 |
| Contributed surplus | **3,005** | 2,607 |
| Retained earnings | **253,169** | 204,028 |
| Accumulated other comprehensive income (note 15) | **5,934** | 6,328 |
| | **381,635** | 332,122 |
| | **2,744,656** | 2,670,128 |

On behalf of the Board of Directors,

**Jan Peeters**
Director

**Pierre L. Comtois**
Director

# Consolidated statements of cash flows

| Years ended August 31, *(In thousands of dollars)* | **2010** **$** | 2009 $ (restated) |
|---|---|---|
| **Cash flow from operating activities** | | |
| Net income (loss) | **56,264** | (79,014) |
| Adjustments for: | | |
| Amortization (note 4) | **259,457** | 256,627 |
| Amortization of deferred transaction costs and discounts on long-term debt | **3,913** | 2,641 |
| Reduction of withholding and stamp tax contingent liabilities (note 6) | **–** | (16,130) |
| Impairment of goodwill and intangible assets (note 7) | **–** | 399,648 |
| Future income taxes | **70,915** | 2,562 |
| Non-controlling interest | **106,481** | (174,792) |
| Losses (gains) on dilution resulting from the issuance of shares by a subsidiary | **(26)** | 48 |
| Foreign exchange gain on unhedged net investment and long-term debt | **–** | (4,154) |
| Stock-based compensation | **2,621** | 2,140 |
| Loss on disposal and write-offs of fixed assets | **2,932** | 169 |
| Other | **(338)** | 543 |
| | **502,219** | 390,288 |
| Changes in non-cash operating items (note 16 A)) | **(76,883)** | 30,416 |
| | **425,336** | 420,704 |
| **Cash flow from investing activities** | | |
| Acquisition of fixed assets (note 16 B)) | **(309,752)** | (273,733) |
| Increase in deferred charges | **(11,069)** | (10,773) |
| Business acquisition and related adjustments (note 2) | **–** | (75) |
| Other | **168** | 469 |
| | **(320,653)** | (284,112) |
| **Cash flow from financing activities** | | |
| Increase (decrease) in bank indebtedness | **1,912** | (9,886) |
| Net repayments under the Term Facilities and Term Revolving Facilities | **(71,843)** | (264,334) |
| Issuance of long-term debt, net of discounts and transaction costs | **–** | 551,502 |
| Repayments of long-term debt and settlement of derivative financial instruments | **(3,914)** | (392,360) |
| Increase in deferred transaction costs | **(5,810)** | – |
| Issuance of subordinate voting shares (note 14) | **353** | 957 |
| Acquisition of subordinate voting shares held in trust under the Incentive Share Unit Plan (note 14) | **(1,049)** | (325) |
| Dividends on multiple voting shares | **(737)** | (590) |
| Dividends on subordinate voting shares | **(5,956)** | (4,771) |
| Issuance of shares by a subsidiary to non-controlling interest | **481** | 964 |
| Acquisition by a subsidiary from non-controlling interest of subordinate voting shares held in trust under the Incentive Share Unit Plan (note 14) | **(2,008)** | – |
| Dividends paid by a subsidiary to non-controlling interest | **(18,384)** | (15,771) |
| | **(106,955)** | (134,614) |
| **Effect of exchange rate changes on cash and cash equivalents denominated in a foreign currency** | **(1,344)** | 8 |
| **Net change in cash and cash equivalents** | **(3,616)** | 1,986 |
| Cash and cash equivalents, beginning of year | **39,458** | 37,472 |
| **Cash and cash equivalents, end of year** | **35,842** | 39,458 |

See supplemental cash flow information in note 16.

# Notes to the consolidated financial statements

Years ended August 31, 2010 and 2009

## Nature of operations

COGECO Inc. (the "Company") is a Canadian public company whose shares are listed on the Toronto Stock Exchange ("TSX"). The Company is engaged in Cable Television, High Speed Internet ("HSI"), Telephony and other telecommunications services to its residential and commercial customers in Canada and in Portugal through Cogeco Cable Inc. and in Radio broadcasting through Cogeco Diffusion Inc.

## 1. Significant accounting policies

The consolidated financial statements are prepared in conformity with Canadian Generally Accepted Accounting Principles ("GAAP").

### A) Consolidation principles

The consolidated financial statements include the accounts of the Company and its subsidiaries, as well as those of variable interest entities for which the Company is the primary beneficiary. Business acquisitions are accounted for under the purchase method and operating results are included in the consolidated financial statements as of the date of the acquisition of control. Other investments are recorded at cost.

Business segments and percentages of interest in the main subsidiaries are as follows:

| Segment | Principal subsidiaries | Percentage of interest<br>% | Voting rights<br>% |
|---|---|---|---|
| Cable | Cogeco Cable Inc. | 32.3 | 82.7 |
| Other | Cogeco Diffusion Inc. | 100.0 | 100.0 |

### B) Recent accounting pronouncements and changes in accounting policies

### Adopted during fiscal 2010

### i. Goodwill and intangible assets

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Handbook Section 3064, *Goodwill and intangible assets*, replacing Section 3062, *Goodwill and other intangible assets* and Section 3450, *Research and development costs*. The new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill remained unchanged from the standards included in the previous Section 3062. The new section was applicable to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008, with retroactive application. The adoption of Section 3064 resulted in the elimination of the deferral of new service launch costs which are now recognized as operating costs when they are incurred. Reconnect and additional service activation costs are capitalized up to an amount not exceeding the revenue generated by the reconnect activity. Consequently, the Company adjusted opening retained earnings on a retroactive basis and the prior period comparative figures have been restated. The adoption of this new section had the following impacts on the Company's consolidated financial statements:

**Consolidated statement of income (loss)**

| *Increase (decrease)*<br>*(in thousands of dollars)* | Year ended<br>August 31, 2009<br>$ |
|---|---|
| Operating costs | 16,519 |
| Amortization of deferred charges | (14,373) |
| Future income tax expense | (605) |
| Non-controlling interest | (1,052) |
| Net income | (489) |

**Consolidated balance sheets**

| *Increase (decrease)*<br>*(in thousands of dollars)* | August 31, 2009<br>$ | September 1, 2008<br>$ |
|---|---|---|
| Deferred charges | (34,551) | (32,405) |
| Future income tax liabilities | (10,229) | (9,624) |
| Non-controlling interest | (16,428) | (15,376) |
| Retained earnings | (7,894) | (7,405) |

## ii. Financial instrument disclosures

In 2009 the Canadian Accounting Standards Board ("AcSB") amended CICA Handbook Section 3862, *Financial instruments – disclosures*, to require enhanced disclosures about the relative reliability of the data, or inputs, that an entity uses in measuring the fair values of its financial instruments. The new requirements are effective for annual financial statements for fiscal years ending after September 30, 2009. The adoption of this amendment did not have any impact on the classification and measurement of the Company's financial instruments. The new disclosures pursuant to this amendment are included in note 18 of the Company's consolidated financial statements.

# Adopted during fiscal 2009

## iii. Capital disclosures and financial instruments

Effective September 1, 2008, the Company adopted the CICA Handbook Section 1535, *Capital disclosures*, Section 3862, *Financial instruments – disclosures* and Section 3863, *Financial instruments – presentation*.

### Capital disclosures

Section 1535 of the CICA Handbook requires that an entity disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences for non-compliance. These new disclosures are included in note 18.

### Financial instruments

Section 3862 on financial instrument disclosures requires the disclosure of information about the significance of financial instruments for the entity's financial position and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, gains and losses, and circumstances in which financial assets and financial liabilities are offset.

The adoption of these standards did not have any impact on the classification and measurement of the Company's financial instruments. The new disclosures pursuant to these new sections are included in note 18.

## iv. General standards of financial statement presentation

The CICA amended Section 1400 of the CICA Handbook, *General standards of financial statement presentation*, to include a requirement for management to make an assessment of the entity's ability to continue as a going concern when preparing financial statements. These changes, including the related disclosure requirements, were adopted by the Company on September 1, 2008 and had no impact on the consolidated financial statements.

## v. Credit risk and fair value of financial assets and financial liabilities

On January 20, 2009, the Emerging Issues Committee ("EIC") of the Canadian AcSB issued EIC Abstract 173, *Credit risk and fair value of financial assets and financial liabilities*, which establishes guidance requiring an entity to consider its own credit risk as well as the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC-173 is applicable to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009 and was applicable to the Company for its second quarter of fiscal 2009 with retrospective application to the beginning of the 2009 fiscal year, without restatement of prior periods. The adoption of this new abstract during the second quarter of 2009 had no significant impact on the consolidated balance sheet at September 1, 2008.

## Future accounting pronouncements

### vi. Harmonization of Canadian and international accounting standards

In March 2006, the AcSB of the CICA released its new strategic plan, which proposed to abandon Canadian GAAP and effect a complete convergence to the International Financial Reporting Standards ("IFRS") for Canadian publicly accountable entities. This plan was confirmed in subsequent exposure drafts issued in April 2008, March 2009 and October 2009. The changeover will occur no later than fiscal years beginning on or after January 1, 2011. Accordingly, the Company's first interim consolidated financial statements presented in accordance with IFRS will be for the three-month period ending November 30, 2011, and its first annual consolidated financial statements presented in accordance with IFRS will be for the year ending August 31, 2012.

IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosure requirements. The Company has established a project team including representatives from various areas of the organization to plan and complete the transition to IFRS. This team reports periodically to the Audit Committee, which oversees the IFRS implementation project on behalf of the Board of Directors. The Company is assisted by external advisors as required.

The Company's project for the transition from Canadian GAAP to IFRS is progressing according to the established plan and the Company expects to meet its target date for migration.

### vii. Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the CICA issued Handbook Section 1582, *Business combinations*, which replaces Section 1581 of the same name, and Sections 1601, *Consolidated Financial Statements* and 1602, *Non-controlling interests*, which together replace Section 1600, *Consolidated Financial Statements*. These new sections harmonize significant aspects of Canadian accounting standards with the IFRS that will be mandated for publicly accountable entities with fiscal years beginning on or after January 1, 2011.

Section 1582 requires that all business acquisitions be measured at the fair value of the acquired entity at the acquisition date even if the business combination is achieved in stages, or if less than 100% of the equity interest in the acquiree is owned at the acquisition date, and expands the definition of a business subject to an acquisition. The section also establishes new guidance on the measurement of consideration given and the recognition and measurement of assets acquired and liabilities assumed in a business combination. Furthermore, under this new guidance, acquisition costs, which were previously included as a component of the consideration given, and any negative goodwill resulting from the allocation of the purchase price, which was allocated as a reduction of non-current assets acquired under the previous standard, will be recorded in earnings in the current period. This new section will be applied prospectively and will only impact the Company's consolidated financial statements for future acquisitions concluded in periods subsequent to the date of adoption.

Sections 1601 and 1602 dealing with consolidated financial statements require an entity to measure non-controlling interest upon acquisition either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The new sections also require non-controlling interest to be presented as a separate component of shareholders' equity.

The new standards will apply as of the beginning of the first annual reporting period beginning on or after January 1, 2011, with simultaneous early adoption permitted. Early adoption may reduce the amount of restatement required upon conversion to IFRS. The Company has elected not to early-adopt these sections, and in light of the harmonization of Canadian and International accounting standards taking effect at that same date, these sections will not be applicable to the Company.

### viii. Multiple deliverable revenue arrangements

In December 2009, the EIC issued a new abstract concerning multiple deliverable revenue arrangements, EIC-175, *Multiple deliverable revenue arrangements*, which amended EIC-142, *Revenue arrangements with multiple deliverables*. EIC-175 requires a vendor to allocate arrangement consideration at the inception of the arrangement to all deliverables using the relative selling price method, thereby eliminating the use of the residual value method. The amendment also changes the level of evidence of the standalone selling price required to separate deliverables when more objective evidence of the selling price is not available. EIC-175 should be adopted prospectively to revenue arrangements entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011, with early adoption permitted. The Corporation is currently evaluating the option to early-adopt this EIC in fiscal 2011.

## C) Revenue recognition

The Company considers revenue to be earned as services are rendered, provided that ultimate collection is reasonably assured. The Company earns revenue from several sources. The recognition of revenue from the principal sources is as follows:

- Revenue from Cable Television, HSI, Telephony and other telecommunications services are recognized when services are rendered;
- Revenue generated from sales of home terminal devices is recorded as equipment revenue upon activation of services as management considers the sale of home terminal devices as a single unit of accounting of a multiple element arrangement;
- Installation revenue is deferred and amortized over the average life of a customer's subscription for residential customers, not exceeding four years, and over the term of the contract for business customers. Management considers that installation revenue is part of a multiple

element arrangement and has no standalone value. Accordingly, installation revenue is deferred and amortized at the same pace as revenue from Cable Television, HSI, Telephony and other telecommunications services are earned;
- Advertising revenue is recognized when aired;
- Promotional offers are accounted for as deductions from revenue when customers take advantage of such offers.

Amounts received or invoiced that do not comply with these criteria are accounted for as deferred and prepaid revenue.

## D) Fixed assets

Fixed assets are recorded at cost. During construction of new assets, direct costs plus a portion of overhead costs are capitalized. Financial expenses during construction are expensed in the year in which they are incurred. Amortization is recorded mainly on a straight-line basis over the estimated useful lives over the following periods:

| | |
|---|---|
| Buildings | 10 to 40 years |
| Cable systems | 4 to 15 years |
| Broadcasting, programming and production equipment | 3 to 20 years |
| Home terminal devices | 3 to 5 years |
| Rolling stock and equipment under capital leases | 5 years |
| Other equipment | 2 to 10 years |
| Leasehold improvements | Lease term |

The Company reviews, when a triggering event occurs, the carrying value of its fixed assets by comparing the carrying amount of the asset or group of assets to the expected future undiscounted cash flows to be generated by the asset or group of assets. An impairment loss is recognized when the carrying amount of an asset or group of assets held for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposal. The impairment loss is measured as the amount by which the asset or group of assets' carrying amount exceeds its fair value.

Legal obligations associated with site restoration costs on the retirement of property are recognized in the period in which they can be reasonably estimated based on currently available information. The obligations are initially measured at fair value and an equal amount is recorded to fixed assets. Over time, the discounted asset retirement obligations accrete due to the increase in the fair value resulting from the passage of time. This accretion amount is charged to operating costs. The initial costs are depreciated over the useful lives of the related fixed assets or the remaining leasehold engagements when applicable. The Company's subsidiary, Cogeco Cable Inc., does not record an asset retirement obligation in connection with its cable systems as the Company's subsidiary expects to renew all of its agreements with utility companies to access their support structures in the future, making the retirement date relating to these assets undeterminable.

## E) Deferred charges

Deferred charges include reconnect and additional service activation costs and transaction costs. Reconnect and additional service activation costs are capitalized up to a maximum amount not exceeding the revenue generated by the reconnect activity. Reconnect and additional service activation costs are amortized over the average life of a customer's subscription, not exceeding four years. Transaction costs on the revolving loan and the swingline facility are amortized over the term of the related financing on a straight-line basis.

## F) Intangible assets

Intangible assets with finite useful lives, such as customer relationships, are recorded at cost and amortized on a straight-line basis over the average life of a business customer's subscription, which is eight years. The Company reviews, when a triggering event occurs, the carrying value of its intangible assets with finite useful lives by comparing the carrying amount of the asset or group of assets to the expected future undiscounted cash flows to be generated by the asset or group of assets. An impairment loss is recognized when the carrying amount of an asset or group of assets held for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposal. The impairment loss is measured as the amount by which the asset or group of assets' carrying amount exceeds its fair value. Any impairment loss is charged to earnings in the period in which the loss is incurred.

Intangible assets with indefinite useful lives, such as customer base and broadcasting licences, are not amortized, but tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. In conducting impairment testing, the Company compares the carrying value to the sum of the expected future discounted cash flows. When the impairment test indicates that the carrying amount of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to the excess. Any impairment loss is charged to earnings in the period in which the loss is incurred.

## G) Goodwill

Goodwill represents the difference between the price paid and the fair value attributed to tangible and intangible assets upon the acquisition of cable and telecommunications systems and radio broadcasting stations. Goodwill is not amortized but tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. Goodwill is tested for impairment using a two step approach. The first step consists of determining whether the fair value of the reporting unit to which goodwill is assigned exceeds the net carrying value of that reporting unit, including goodwill. In the event that the net carrying amount exceeds the fair value, a second step is performed in order to determine the amount of the impairment loss. The impairment loss is measured as the amount by which the carrying amount of the reporting unit's goodwill exceeds its fair value. Any impairment loss is charged to earnings in the period in which the loss is incurred. The Company uses the discounted cash flow method to determine the fair value of reporting units.

## H) Income taxes

Income taxes are accounted for under the asset and liability method. Under this method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements' carrying amounts of existing assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Future income tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax asset will be realized.

## I) Stock-based compensation

The Company measures stock options granted to employees based on the fair value at the grant date by using the binomial pricing model and a compensation expense is recognized on a straight-line basis over the vesting period, which is three to five years, with a corresponding increase in contributed surplus. When the stock options are exercised, capital stock is credited by the sum of the consideration received and the related portion previously recorded in the contributed surplus.

The Company measures incentive share units granted to employees based on the fair value of the Company's subordinate voting shares at the date of grant and a compensation expense is recognized over the vesting period, which is three years less one day, with a corresponding increase in contributed surplus.

The Deferred Share Unit Plans of the Company and its subsidiary, Cogeco Cable Inc., are recognized as a compensation expense and as an accrued liability as of the date units are awarded to officers. The accrued liability is re-measured at the end of each reporting period, until settlement, using the shares' trading price at the closing date of the reporting period.

## J) Employee future benefits

Pension costs, recorded in operating costs, related to the defined contribution pension plan and the collective registered retirement savings plans are equivalent to the contributions that the Company is required to pay in exchange for services rendered by employees.

Pension costs for defined benefit pension plans are determined using actuarial methods and are funded through contributions determined in accordance with the projected benefit method prorated on service. Pension expense is charged to operating costs and includes:

- The cost of pension benefits provided in exchange for employees' services rendered during the year;
- The amortization of past service costs and amendments over the expected average remaining service life of the active employee group covered by the plans, which is eight to eleven years; and
- The interest cost of pension obligations, the expected return on pension fund assets and the amortization of cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the benefit obligation or fair value of plan assets over the expected average remaining service life of the active employee group covered by the plans, which is eight to eleven years. The Company uses the fair value of plan assets to evaluate plan assets for the purpose of calculating the expected return on plan assets.

## K) Non-monetary transactions

In the normal course of its business, the Company enters into non-monetary transactions under which goods and services are acquired in exchange for advertising or other services. Non-monetary transactions with commercial substance, which would otherwise be payable in cash, are accounted for at their fair value.

## L) Foreign currency translation

Financial statements of self-sustaining foreign subsidiaries are translated into Canadian dollars using the exchange rate in effect at the balance sheet date for asset and liability items, and using the average exchange rates during the period for revenue and expenses. Adjustments arising from this translation are deferred and recorded in the foreign currency translation adjustment in accumulated other comprehensive income, and are included in income only when a reduction in the investment in these foreign subsidiaries is realized.

Other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rates prevailing at the balance sheet date for monetary items and at the transaction date for non-monetary items. Revenue and expenses are translated at the average exchange rates prevailing during the period except for transactions being hedged, which are translated using the terms of the hedges. Amounts payable or receivable on cross-currency swap agreements, all of which are used to hedge foreign currency debt obligations, are recorded concurrently with the unrealized gains and losses on the obligations being hedged. Other foreign exchange gains and losses are recognized as financial expense, except for unrealized foreign exchange gains and losses on foreign-denominated long-term debt that is designated as a hedge of a net investment in self-sustaining foreign subsidiaries, which are included in the foreign currency translation adjustment in accumulated other comprehensive income, net of income taxes and non-controlling interest.

## M) Financial instruments

### Classification, recognition and measurement

All of the Company's financial assets are classified as held-for-trading or loans and receivables. The Company has classified its cash and cash equivalents as held-for-trading. Held-for-trading assets and liabilities are carried at fair value on the consolidated balance sheet, with changes in fair value recorded in the consolidated statements of income. Accounts receivable have been classified as loans and receivables. All of the Company's financial liabilities are classified as other liabilities, except for the cross-currency swap and interest rate swap agreements. Loans and receivables instruments and all financial liabilities are carried at amortized cost using the effective interest rate method. The Company has determined that none of its financial assets are classified as available-for-sale or held-to-maturity.

### Transaction costs

Transaction costs are capitalized on initial recognition and presented as a reduction of the related financing, except for transaction costs on the revolving loans and the swingline facilities, which are presented as deferred charges. These costs are amortized over the term of the related financing using the effective interest rate method, except for transaction costs on the revolving loans and the swingline facilities, which are amortized over the term of the related financing on a straight-line basis.

### Derivative financial instruments and hedge accounting

The Company uses cross-currency swap and interest rate swap agreements as derivative financial instruments to manage risk in fluctuation in interest and foreign exchange rates related to its long term debt. All derivatives are measured at fair value with changes in fair value recorded in the consolidated statements of income unless they are effective cash flow hedging instruments. The changes in fair value of cash flow hedging derivatives are recorded in other comprehensive income, to the extent effective, until the variability of cash flows relating to the hedged asset or liability is recognized in the consolidated statements of income. Any hedge ineffectiveness is recognized in the consolidated statements of income immediately. Accordingly, the Company’s cross-currency swap and interest rate swap agreements must be measured at fair value in the consolidated financial statements. Since these cross-currency swap and interest rate swap agreements are used to hedge cash flows on Senior Secured Notes Series A denominated in US dollars and a portion of Euro-denominated loans outstanding under the Term Revolving Facility, and previously the Term Facility, the changes in fair value are recorded in other comprehensive income. The Company does not hold or use any derivative financial instruments for speculative purposes. Net receipts or payments arising from cross-currency and interest rate swap agreements are recognized as financial expense.

### Embedded derivatives

All embedded derivatives that are not closely related to the host contracts are measured at fair value, with changes in fair value recorded in the consolidated statements of income. At August 31, 2010 and 2009, there were no significant embedded derivatives or non-financial derivatives that require separate fair value recognition on the consolidated balance sheets.

## N) Cash and cash equivalents

Cash and cash equivalents include cash and highly liquid investments that have an original maturity of three months or less.

## O) Use of estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, contingent assets and liabilities and revenue and expenses during the reporting year. Significant areas requiring the use of management estimates relate to the determination of pension plan liabilities and accrued employee benefits, the determination of accrued liabilities, the determination of allowance for doubtful accounts, the determination of the fair value of assets acquired and liabilities assumed in business combinations, the evaluation of the carrying amount of home terminal devices, the useful lives of assets for amortization, the determination of future cash flows for the purpose of impairment testing on fixed assets, goodwill and intangible assets with finite and indefinite useful lives, the discount rate used for the purpose of impairment testing on goodwill and intangible assets with indefinite useful lives, the provision for income taxes and determination of future income tax assets and liabilities and utilization thereof, and the determination of the fair value of financial instruments, including all derivative financial instruments. Actual results could differ from these estimates.

# 2. Business acquisition and related adjustments

## Fiscal 2009 adjustments related to a fiscal 2008 business acquisition

During fiscal 2009, management of the Company’s subsidiary, Cogeco Cable Inc., has finalized the allocation of the purchase price of the acquisition of Cogeco Data Services Inc. (“CDS”). The final allocation resulted in an increase in future income tax assets of $420,000 as well as a decrease in future income tax liabilities of $302,000. The net impact of these adjustments combined with an increase in acquisition costs of $75,000, reduced goodwill by $647,000 at August 31, 2009 (see note 12 B)).

# 3. Segmented information

The Company's activities are divided into two business segments: Cable and other. The Cable segment is comprised of Cable Television, HSI, Telephony and other telecommunications services, and the other segment is comprised of radio and head office activities, as well as eliminations. The Cable segment's activities are carried out in Canada and in Europe.

The principal financial information per business segment is presented in the table below:

| | Cable | | Other and eliminations | | Consolidated | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | **2010** | 2009 | **2010** | 2009 |
| *(in thousands of dollars)* | **$** | $ | **$** | $ | **$** | $ |
| | | (restated) | | (restated) | | (restated) |
| Revenue | **1,281,376** | 1,217,837 | **40,318** | 34,957 | **1,321,694** | 1,252,794 |
| Operating costs | **771,280** | 709,961 | **31,075** | 27,339 | **802,355** | 737,300 |
| Operating income before amortization | **510,096** | 507,876 | **9,243** | 7,618 | **519,339** | 515,494 |
| Amortization | **258,871** | 256,077 | **586** | 550 | **259,457** | 256,627 |
| Operating income | **251,225** | 251,799 | **8,657** | 7,068 | **259,882** | 258,867 |
| Financial expense | **64,904** | 69,709 | **595** | 712 | **65,499** | 70,421 |
| Reduction of withholding and stamp tax contingent liabilities | – | (16,130) | – | – | – | (16,130) |
| Impairment of goodwill and intangible assets | – | 399,648 | – | – | – | 399,648 |
| Income taxes | **29,018** | 56,800 | **2,646** | 1,886 | **31,664** | 58,686 |
| Losses (gains) on dilution resulting from the issuance of shares by a subsidiary | **(26)** | 48 | – | – | **(26)** | 48 |
| Non-controlling interest | **106,481** | (174,792) | – | – | **106,481** | (174,792) |
| Net income (loss) | **50,848** | (83,484) | **5,416** | 4,470 | **56,264** | (79,014) |
| Total assets | **2,702,819** | 2,630,912 | **41,837** | 39,216 | **2,744,656** | 2,670,128 |
| Fixed assets | **1,325,077** | 1,302,238 | **3,789** | 3,531 | **1,328,866** | 1,305,769 |
| Intangible assets | **1,017,658** | 1,022,434 | **25,340** | 25,340 | **1,042,998** | 1,047,774 |
| Goodwill | **144,695** | 153,695 | **–** | – | **144,695** | 153,695 |
| Acquisition of fixed assets(1) | **309,049** | 278,021 | **844** | 476 | **309,893** | 278,497 |

(1) Includes capital leases that are excluded from the consolidated statements of cash flows.

The following tables set out certain geographic market information based on clients' locations:

| *(in thousands of dollars)* | **2010** **$** | 2009 $ |
|---|---|---|
| **Revenue** | | |
| Canada | **1,133,938** | 1,019,702 |
| Europe | **187,756** | 233,092 |
| | **1,321,694** | 1,252,794 |

| *(In thousands of dollars)* | **2010** **$** | 2009 $ |
|---|---|---|
| **Fixed assets** | | |
| Canada | **1,098,760** | 1,015,298 |
| Europe | **230,106** | 290,471 |
| | **1,328,866** | 1,305,769 |
| **Intangible assets** | | |
| Canada | **1,042,998** | 1,047,774 |
| Europe | **–** | – |
| | **1,042,998** | 1,047,774 |
| **Goodwill** | | |
| Canada | **116,243** | 116,243 |
| Europe | **28,452** | 37,452 |
| | **144,695** | 153,695 |

# 4. Amortization

| *(in thousands of dollars)* | **2010** **$** | 2009 $ (restated) |
|---|---|---|
| Fixed assets | **243,931** | 235,772 |
| Deferred charges | **10,750** | 10,534 |
| Intangible assets | **4,776** | 10,321 |
| | **259,457** | 256,627 |

# 5. Financial expense

| *(in thousands of dollars)* | **2010** **$** | 2009 $ |
|---|---|---|
| Interest on long-term debt | **63,048** | 68,486 |
| Foreign exchange losses (gains) | **(988)** | 497 |
| Amortization of deferred transaction costs | **2,398** | 1,629 |
| Other | **1,041** | (191) |
| | **65,499** | 70,421 |

## 6. Reduction of withholding and stamp tax contingent liabilities

At the date of acquisition, the Company's indirect Portuguese cable subsidiary, Cabovisão – Televisão por Cabo, S.A. ("Cabovisão"), recorded contingent liabilities for withholding and stamp taxes relating to fiscal years prior to its acquisition by the Company's subsidiary. At that date, the amount accrued represented management's best estimate based on the information available at that time. Management reviews its estimates periodically to take into consideration payments made relating to these contingencies as well as newly available information which would allow the Company's subsidiary to improve its previous estimate. During fiscal 2009, Cabovisão received reports from the Portuguese tax authorities with respect to some of the items included in the contingent liabilities. Accordingly, management has revised its estimate of the contingent liabilities to reflect the new information available in these reports, and has determined that a reduction of €10.3 million, equivalent to $16.1 million, of the amounts previously accrued was required in order to reflect management's best estimate.

## 7. Impairment of goodwill and intangible assets

| | **2010** | 2009 |
|---|---|---|
| *(in thousands of dollars)* | **$** | $ |
| Impairment of goodwill | **–** | 339,206 |
| Impairment of intangible assets | **–** | 60,442 |
| | **–** | 399,648 |

During the second quarter of fiscal 2009, the competitive position of Cabovisão in Portugal further deteriorated due to the continuing difficult competitive environment and recurring intense promotions and advertising initiatives from competitors in the Portuguese market. In accordance with applicable accounting standards, management considered that the continued customer, local currency revenue and operating income before amortization decline, were more severe and persistent than expected, resulting in a decrease in the value of the Company's subsidiary's investment in the Portuguese subsidiary. As a result, the Company's subsidiary tested goodwill and all long-lived assets for impairment at February 28, 2009.

Goodwill is tested for impairment using a two step approach. The first step consists of determining whether the fair value of the reporting unit to which goodwill is assigned exceeds the net carrying amount of that reporting unit, including goodwill. In the event that the net carrying amount exceeds the fair value, a second step is performed in order to determine the amount of the impairment loss. The impairment loss is measured as the amount by which the carrying amount of the reporting unit's goodwill exceeds its fair value. The Company's subsidiary completed its impairment tests on goodwill and concluded that goodwill was impaired at February 28, 2009. As a result, an impairment loss of $339.2 million was recorded in the second quarter of fiscal 2009. Fair value of the reporting unit was determined using the discounted cash flow method. Future cash flows were based on internal forecasts and consequently, considerable management judgement was necessary to estimate future cash flows. Significant future changes in circumstances could result in further impairments of goodwill.

Intangible assets with finite useful lives, such as customer relationships, must be tested for impairment by comparing the carrying amount of the asset or group of assets to the expected future undiscounted cash flows to be generated by the asset or group of assets. The impairment loss is measured as the amount by which the asset or group of assets' carrying amount exceeds its fair value. Accordingly, the Company's subsidiary completed its impairment test on customer relationships at February 28, 2009, and determined that the carrying value of customer relationships exceeded its fair value. As a result, an impairment loss of $60.4 million was recorded in the second quarter of fiscal 2009.

At August 31, 2010 and 2009, the Company's subsidiary tested the value of goodwill for impairment and concluded that no impairment existed.

# 8. Income taxes

| (in thousands of dollars) | 2010<br>$ | 2009<br>$<br>(restated) |
|---|---|---|
| Current | **(39,251)** | 56,124 |
| Future | **70,915** | 2,562 |
| | **31,664** | 58,686 |

The following table provides the reconciliation between income taxes at the Canadian statutory federal and provincial income tax rates and the consolidated income tax expense:

| (in thousands of dollars) | 2010<br>$ | 2009<br>$<br>(restated) |
|---|---|---|
| Income (loss) before income taxes | **194,383** | (195,072) |
| Combined income tax rate | **31.45%** | 32.48% |
| Income taxes at combined income tax rate | **61,133** | (63,359) |
| Adjustments for losses or income subject to lower or higher tax rates | **(9,779)** | (1,442) |
| Decrease in future income taxes as a result of decrease in substantively enacted tax rates | **(29,782)** | – |
| Decrease in income tax recovery arising from the non-deductible impairment of goodwill | **–** | 89,890 |
| Utilization of pre-acquisition tax losses | **4,432** | 6,142 |
| Income taxes arising from non-deductible expenses | **878** | 644 |
| Effect of foreign income tax rate differences | **6,117** | 25,366 |
| Other | **(1,335)** | 1,445 |
| Income taxes at effective income tax rate | **31,664** | 58,686 |

The following table shows future income taxes resulting from temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for tax purposes, as well as tax loss carryforwards:

| (in thousands of dollars) | 2010<br>$ | 2009<br>$<br>(restated) |
|---|---|---|
| Fixed assets | **(87,688)** | (84,557) |
| Deferred charges | **(6,415)** | (7,165) |
| Intangible assets | **(134,030)** | (148,201) |
| Deferred and prepaid revenue | **5,659** | 6,630 |
| Share issuance costs | **858** | 1,755 |
| Partnership income | **(78,258)** | – |
| Non-capital loss and other tax credit carryforwards | **2,833** | 1,819 |
| Other | **4,397** | 3,295 |
| Net future income tax liabilities | **(292,644)** | (226,424) |
| Financial statement presentation | | |
| Current future income tax assets | **6,133** | 4,275 |
| Long-term future income tax assets | **18,189** | 4,011 |
| Current future income tax liabilities | **(78,267)** | – |
| Long-term future income tax liabilities | **(238,699)** | (234,710) |
| Net future income tax liabilities | **(292,644)** | (226,424) |

As at August 31, 2010, the Company's Canadian subsidiaries had accumulated federal and provincial income tax losses amounting to approximately $9,442,000, the benefits of which have been recognized in these financial statements. These losses expire as follows:

| | 2027 | 2030 |
|---|---|---|
| *(in thousands of dollars)* | $ | $ |
| | 2,675 | 6,767 |

The Company's indirect subsidiary, Cabovisão, also has income tax losses amounting to approximately €84,949,000 ($114,809,000), the benefits of which have not been recognized in these financial statements. These losses may be used to reduce future years' taxable income. In accordance with the Portuguese Companies Income Tax Code ("CIRC"), tax losses incurred in a financial year can be carried forward and deducted from taxable profits of one or more of the following six taxation years for tax losses incurred before 2010 and for the following four taxation years for tax losses incurred in 2010 and beyond. However, the CIRC provides for certain exceptions whereby the general rule stated above ceases to apply. One such exception is that tax losses cannot be deducted if the ownership of at least 50% of the social capital changes from the moment when the tax losses were generated, unless a request is filed before such change in the ownership takes place, subject to approval by the Portuguese tax authorities. To this effect, a request for preservation of tax losses for the years preceding the 2006 taxation year was filed by Cabovisão on July 28, 2006 and approved by the Portuguese tax authorities on November 25, 2009. As part of their review, the Portuguese tax authorities have audited Cabovisão's tax returns for the 2003, 2004 and 2005 taxation years, which have resulted in notices of assessment to reduce tax losses by €7.3 million, €29.6 million and €17.1 million, respectively. However, Cabovisão does not agree with the assessments and has initiated legal proceedings against the Portuguese tax authorities. In accordance with current legislation, tax returns are subject to review and correction by the tax authorities during a four-year period. These periods can be extended or suspended when there are tax losses, tax benefits granted, tax inspections, claims or appeals in progress. Consequently, Cabovisão's tax returns for the taxation years 2006 to 2010 are still subject to review by the tax authorities and therefore, the amount of available tax losses could be significantly reduced based on past experience. These losses expire as follows:

| | 2011 | 2012 | 2014 | 2015 |
|---|---|---|---|---|
| *(in thousands of dollars)* | $ | $ | $ | $ |
| | 31,143 | 48,964 | 21,154 | 13,548 |

# 9. Earnings (loss) per share

The following table provides the reconciliation between basic and diluted earnings (loss) per share:

| | **2010** | 2009 |
|---|---|---|
| *(in thousands of dollars, except number of shares and per share data)* | **$** | $ |
| | | (restated) |
| Net income (loss) | **56,264** | (79,014) |
| Weighted average number of multiple voting and subordinate voting shares outstanding | **16,726,135** | 16,704,962 |
| Effect of dilutive stock options(1) | **10,681** | – |
| Effect of dilutive subordinate voting shares held in trust under the Incentive Share Unit Plan(2) | **67,837** | – |
| Weighted average number of diluted multiple voting and subordinate voting shares outstanding | **16,804,653** | 16,704,962 |
| **Earnings (loss) per share** | | |
| Basic | **3.36** | (4.73) |
| Diluted | **3.35** | (4.73) |

(1) In 2010 and 2009, 32,382 stock options were excluded from the calculation of diluted earnings (loss) per share as the exercise price of the options was greater than the average share market price of the subordinate voting shares. Furthermore, in 2009, the weighted average dilutive potential number of subordinate voting shares, which were antidilutive, amounted to 8,757.

(2) In 2009, the weighted average dilutive potential number of subordinate voting shares, which were antidilutive, amounted to 51,648.

## 10. Fixed assets

| *(in thousands of dollars)* | **2010**<br>**$** | 2009<br>$ |
|---|---|---|
| **Cost** | | |
| Land | **6,589** | 4,315 |
| Buildings | **52,925** | 48,187 |
| Cable systems | **1,966,175** | 1,881,224 |
| Broadcasting, programming and production equipment | **46,826** | 48,872 |
| Home terminal devices | **352,555** | 307,751 |
| Rolling stock and equipment under capital leases | **17,960** | 18,152 |
| Other equipment | **68,178** | 50,099 |
| Leasehold improvements | **24,566** | 22,430 |
| | **2,535,774** | 2,381,030 |
| **Accumulated amortization** | | |
| Buildings | **14,108** | 12,850 |
| Cable systems | **925,151** | 843,901 |
| Broadcasting, programming and production equipment | **23,136** | 25,663 |
| Home terminal devices | **203,162** | 160,796 |
| Rolling stock and equipment under capital leases | **11,048** | 7,729 |
| Other equipment | **25,177** | 20,491 |
| Leasehold improvements | **5,126** | 3,831 |
| | **1,206,908** | 1,075,261 |
| | **1,328,866** | 1,305,769 |

## 11. Deferred charges

| *(in thousands of dollars)* | **2010**<br>**$** | 2009<br>$<br>(restated) |
|---|---|---|
| Reconnect and additional service activation costs | **20,813** | 20,930 |
| Transaction costs | **6,701** | 3,122 |
| Other | **446** | 10 |
| | **27,960** | 24,062 |

## 12. Goodwill and other intangible assets

| *(in thousands of dollars)* | **2010**<br>**$** | 2009<br>$ |
|---|---|---|
| Customer relationships | **28,106** | 32,882 |
| Broadcasting licences | **25,120** | 25,120 |
| Customer base | **989,772** | 989,772 |
| | **1,042,998** | 1,047,774 |
| Goodwill | **144,695** | 153,695 |
| | **1,187,693** | 1,201,469 |

## A) Intangible assets

During fiscal 2010, intangible asset variations were as follows:

| (in thousands of dollars) | **Customer relationships** $ | **Broadcasting licences** $ | **Customer base** $ | **Total** $ |
|---|---|---|---|---|
| Balance, beginning of year | **32,882** | **25,120** | **989,772** | **1,047,774** |
| Amortization | **(4,776)** | **–** | **–** | **(4,776)** |
| Balance, end of year | **28,106** | **25,120** | **989,772** | **1,042,998** |

During fiscal 2009, intangible asset variations were as follows:

| (in thousands of dollars) | Customer relationships $ | Broadcasting licences $ | Customer base $ | Total $ |
|---|---|---|---|---|
| Balance, beginning of year | 101,490 | 25,120 | 989,772 | 1,116,382 |
| Amortization | (10,321) | – | – | (10,321) |
| Impairment (note 7) | (60,442) | – | – | (60,442) |
| Foreign currency translation adjustment | 2,155 | – | – | 2,155 |
| Balance, end of year | 32,882 | 25,120 | 989,772 | 1,047,774 |

At August 31, 2010 and 2009, the Company and its subsidiaries, Cogeco Cable Inc. and Cogeco Diffusion Inc., tested the value of customer base and broadcasting licences for impairment and concluded that no impairment existed.

## B) Goodwill

During fiscal years 2010 and 2009, goodwill variation was as follows:

| (in thousands of dollars) | **2010** $ | 2009 $ |
|---|---|---|
| Balance, beginning of year | **153,695** | 487,805 |
| Business acquisition and related adjustments (note 2) | **–** | (647) |
| Recognition of pre-acquisition tax losses | **(4,432)** | (6,142) |
| Impairment (note 7) | **–** | (339,206) |
| Foreign currency translation adjustment | **(4,568)** | 11,885 |
| Balance, end of year | **144,695** | 153,695 |

On November 25, 2009, the Company's subsidiary, Cabovisão, received approval to its request for preservation of tax losses for the taxation years preceding the 2006 taxation year. Accordingly, the Company's subsidiary, Cogeco Cable Inc., has adjusted its allocation of the purchase price to reflect the recognition of additional tax losses incurred prior to the acquisition, in an amount not exceeding management's best estimate of the level of pre-acquisition tax losses that will be realized. This adjustment has reduced goodwill by approximately $4.4 million in the year ended August 31, 2010. Pending resolution of the litigations for taxation years 2003 to 2005 mentioned in note 8, the Company will review its estimate periodically to reflect currently available information and any additional recognition of pre-acquisition tax losses will be recorded as a reduction of goodwill.

At August 31, 2010 and 2009, the Company's subsidiary, Cogeco Cable Inc., tested the value of goodwill for impairment and concluded that no impairment existed.

# 13. Long-term debt

| (in thousands of dollars) | Maturity | Interest rate % | **2010 $** | 2009 $ |
|---|---|---|---|---|
| **Parent company** | | | | |
| Term Revolving Facility [a)] | 2013 | – | **–** | – |
| Term Facility [b)] | – | – | **–** | 9,382 |
| Obligations under capital lease | 2013 | 9.29 | **72** | 91 |
| **Subsidiaries** | | | | |
| Term Revolving Facility [c)] | | | | |
| Revolving loan — €90,000,000 (€nil in 2009) | 2014 | 2.63[(1)(2)] | **121,635** | – |
| Term Facility [d)] | | | | |
| Term loan — €nil (€78,413,625 in 2009) | – | – | **–** | 122,674 |
| Term loan — €nil (€17,358,700 in 2009) | – | – | **–** | 27,142 |
| Revolving loan — €nil (€40,000,000 in 2009) | – | – | **–** | 62,792 |
| Senior Secured Notes Series B [e)] | 2011 | 7.73 | **174,738** | 174,530 |
| Senior Secured Notes [f)] | | | | |
| Series A – US$190 million | 2015 | 7.00 | **201,387** | 206,606 |
| Series B | 2018 | 7.60 | **54,609** | 54,576 |
| Senior Secured Debentures Series 1 [g)] | 2014 | 5.95 | **297,379** | 296,860 |
| Senior Unsecured Debenture [h)] | 2018 | 5.94 | **99,806** | 99,786 |
| Obligations under capital leases | 2013 | 6.73 – 9.93 | **5,429** | 9,496 |
| Other | 2011 | – | **15** | 29 |
| | | | **955,070** | 1,063,964 |
| Less current portion | | | **2,329** | 44,706 |
| | | | **952,741** | 1,019,258 |

(1) Interest rate on debt at August 31, 2010, including the applicable margin.
(2) On January 21, 2009, the Company's subsidiary, Cogeco Cable Inc., entered into a swap agreement with a financial institution to fix the floating benchmark interest rate with respect to a portion of Euro-denominated loans outstanding under the Term Revolving Facility, and previously the Term Facility, for a notional amount of €111.5 million which has been reduced to €95.8 million on July 28, 2009 and to €69.6 million on July 28, 2010. The interest swap rate to hedge the Euro-denominated loans has been fixed at 2.08% until the maturity of the swap agreement on July 28, 2011. In addition to the interest swap rate of 2.08%, the Company's subsidiary will continue to pay the applicable margin on these Euro-denominated loans in accordance with the Term Revolving Facility.

a) On July 7, 2010, the Company entered into a new Term Revolving Facility of up to $100 million with a group of financial institutions led by a large Canadian bank, which will now act as agent for the banking syndicate. This new Term Revolving Facility replaces the Company's $50 million Term Facility coming to maturity on December 14, 2011. The Term Revolving Facility of up to $100 million includes a swingline limit of $7.5 million, is extendable by additional one-year periods on an annual basis, subject to lenders' approval, and if not extended, matures three years after its issuance or the last extension, as the case may be. The Term Revolving Facility is composed of two tranches of $50 million each, one being subject to the completion of the acquisition of Corus Entertainment Inc.'s Québec radio stations (refer to note 22 for further details). The Term Revolving Facility can be repaid at any time without penalty. The Term Revolving Facility is indirectly secured by a first priority fixed and floating charge and a security interest on substantially all present and future real and personal property and undertaking of every nature and kind of the Company and certain of its subsidiaries, excluding the capital stock and assets of the Company's subsidiary, Cogeco Cable Inc., and guaranteed by its subsidiaries excluding Cogeco Cable Inc. Under the terms and conditions of the credit agreement, the Company must comply with certain restrictive covenants. Generally, the most significant restrictions are related to permitted investments, dividends on multiple and subordinate voting shares and reimbursement of long-term debt as well as incurrence and maintenance of certain financial ratios primarily linked to the operating income before amortization, financial expense, total indebtedness and shareholders' equity. The Term Revolving Facility bears interest, at the Company's option, on bankers' acceptance, LIBOR in Euros or in US dollars, bank prime rate or US base rate plus the applicable margin, and commitment fees are payable on the unused portion. At August 31, 2010, the Company was in compliance with all of its covenants.

b) The Term Facility of $50 million was fully repaid on July 7, 2010. The Term Facility, including a swingline limit of $5 million, was renewable on an annual basis, subject to lenders' approval, and if not renewed would have matured three years after its issuance or the last renewal, as the case may be. The Term Facility was secured by all assets of COGECO Inc. and its subsidiaries, excluding the capital stock and assets of Cogeco Cable Inc. and guaranteed by its subsidiary, Cogeco Diffusion Inc. Under the terms and conditions of the amended and restated credit agreement, the Company had to comply with certain restrictive covenants, including the requirement to maintain certain financial ratios. The Term Facility bore interest, at the Company's option, on bankers' acceptance, LIBOR, EURIBOR, bank prime rate or US base rate plus the applicable margin, and commitment fees were payable on the unused portion. At August 31, 2009, the Company was in compliance with all of its covenants.

c) The Company's subsidiary, Cogeco Cable Inc., benefits from a new $750 million Term Revolving Facility with a group of financial institutions led by two large Canadian banks, which became effective on July 12, 2010, and replaced the Corporation's $862.5 million

Term Facility coming to maturity on July 28, 2011. This new Term Revolving Facility has an option to be increased up to $1 billion subject to lenders' participation. The Term Revolving Facility is available in Canadian, US or Euro currencies and includes a swingline of $25 million available in Canadian or US currencies. The Term Revolving Facility may be extended by additional one-year periods on an annual basis, subject to lenders' approval, and, if not extended, matures four years after its issuance or the last extension, as the case may be. The Term Revolving Facility can be repaid at any time without penalty. The Term Revolving Facility requires commitment fees, and interest rates are based on bankers' acceptance, LIBOR in Euros or in US dollars, bank prime rate loan or US base rate loan plus the applicable margin. The Term Revolving Facility is indirectly secured by a first priority fixed and floating charge on substantially all present and future real and personal property and undertaking of every nature and kind of the Corporation and certain of its subsidiaries, and provides for certain permitted encumbrances, including purchased money obligations, existing funded obligations and charges granted by any subsidiary prior to the date when it becomes a subsidiary, subject to a maximum amount. The provisions under this facility provides for restrictions on the operations and activities of the Company's subsidiary, Cogeco Cable Inc. Generally, the most significant restrictions relate to permitted investments and dividends on multiple and subordinate voting shares, as well as incurrence and maintenance of certain financial ratios primarily linked to operating income before amortization, financial expense and total indebtedness. At August 31, 2010, the Company's subsidiary, Cogeco Cable Inc., was in compliance with all of its covenants.

d) The Term Facility of a remaining amount of $862.5 million was fully repaid on July 12, 2010 and was composed of four tranches: a first tranche, a revolving loan for an amount of $700 million available in Canadian, US or Euro currencies; a second tranche, a swingline of $25 million available in Canadian or US currencies; a third tranche of a remaining amount of $112.5 million, fully drawn, available in Canadian currency, and a fourth tranche of €17,358,700 fully drawn. The Term Facility was repayable on July 28, 2011, except for the third tranche of €104,551,500; €15,682,725 of which was repaid on July 28, 2009 in addition to a repayment of €10,455,150 on July 28, 2008; the remainder of which was repayable as follows: €26,137,875 on July 28, 2010 and the balance on July 28, 2011. Earlier repayments could have been made without penalty. The Term Facility required commitment fees, and interest rates were based on bankers' acceptance, LIBOR, EURIBOR, bank prime rate loan or US base rate loan plus the applicable margin. The Term Facility was indirectly secured by a first priority fixed and floating charge on substantially all present and future real and personal property and undertaking of every nature and kind of the Corporation and certain of its subsidiaries, and provided for certain permitted encumbrances, including purchased money obligations, existing funded obligations and charges granted by any subsidiary prior to the date when it becomes a subsidiary, subject to a maximum amount. The provisions under these facilities provided for restrictions on the operations and activities of the Corporation. Generally, the most significant restrictions were related to permitted investments and dividends on multiple and subordinate voting shares, as well as incurrence and maintenance of certain financial ratios primarily linked to the operating income before amortization, financial expense and total indebtedness. At August 31, 2009, the Corporation was in compliance with all of its covenants.

e) The Senior Secured Notes Series B are senior secured obligations and rank equally and rateably with all existing and future senior indebtedness. These notes are indirectly secured by a first priority fixed and floating charge and a security interest on substantially all present and future real and personal property and undertaking of every nature and kind of the Company's subsidiary, Cogeco Cable Inc., and certain of its subsidiaries. The notes are redeemable at the Company's subsidiary option at any time, in whole or in part, prior to maturity, at 100% of the principal amount plus a make-whole premium. The Senior Secured Notes Series B mature on October 31, 2011 and have an interest coupon rate of 7.73% per annum, payable semi-annually.

f) On October 1, 2008, the Company's subsidiary, Cogeco Cable Inc., issued US$190 million Senior Secured Notes Series A maturing October 1, 2015, and $55 million Senior Secured Notes Series B maturing October 1, 2018, net of transaction costs of $2.1 million, for net proceeds of $255 million. The Senior Secured Notes Series B bear interest at the coupon rate of 7.60% per annum, payable semi-annually. Cogeco Cable Inc., has entered into cross-currency swap agreements to fix the liability for interest and principal payments on the Senior Secured Notes Series A in the amount of US$190 million, which bear interest at the coupon rate of 7.00% per annum, payable semi-annually. Taking into account these agreements, the effective interest rate on the Senior Secured Notes Series A is 7.24% and the exchange rate applicable to the principal portion of the US dollar-denominated debt has been fixed at $1.0625. The Senior Secured Notes are senior secured obligations and rank equally and rateably with all existing and future senior indebtedness. These notes are indirectly secured by a first priority fixed and floating charge and a security interest on substantially all present and future real and personal property and undertaking of every nature and kind of Cogeco Cable Inc., and certain of its subsidiaries. The notes are redeemable at the Company's subsidiary, option at any time, in whole or in part, prior to maturity, at 100% of the principal amount plus a make-whole premium.

g) On June 9, 2009, the Company's subsidiary, Cogeco Cable Inc., completed, pursuant to a public debt offering, the issue of $300 million Senior Secured Debentures Series 1, net of discounts and transactions costs of $3.3 million, for net proceeds of $296.7 million. The Senior Secured Debentures Series 1 are redeemable at the Company's subsidiary, option, in whole or in part, at the greater of par value or the Canada bond yield plus 0.875%. These debentures mature on June 9, 2014 and bear interest at 5.95% per annum, payable semi-annually. These debentures are indirectly secured by a first priority fixed and floating charge and a security interest on substantially all present and future real and personal property and undertaking of every nature and kind of Cogeco Cable Inc., and certain of its subsidiaries.

h) On March 5, 2008, the Company's subsidiary, Cogeco Cable Inc., issued a $100 million Senior Unsecured Debenture by way of a private placement, subject to usual market conditions. The debenture bears interest at a fixed rate of 5.936% per annum, payable semi-annually. The debenture matures on March 5, 2018 and is redeemable at the Company's subsidiary, option at any time, in whole or in part, prior to maturity, at 100% of the principal amount plus a make-whole premium.

i) Principal repayments due on long-term debt for the next five years, excluding those under capital leases, are as follows:

| | 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter |
|---|---|---|---|---|---|---|
| *(in thousands of dollars)* | $ | $ | $ | $ | $ | $ |
| | 13 | 175,002 | – | 421,635 | – | 357,635 |

j) Minimum payments due under capital leases total $6,032,000 of which $531,000 represents financial expense, and are as follows:

| | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|
| *(in thousands of dollars)* | $ | $ | $ | $ |
| | 2,909 | 2,209 | 873 | 41 |

# 14. Capital stock

## Authorized

*Unlimited number of:*

*Preferred shares of first and second rank*, could be issued in series and non-voting, except when specified in the Articles of Incorporation of the Company or in the Law.

*Multiple voting shares*, 20 votes per share.

*Subordinate voting shares*, 1 vote per share.

## Issued

| | **2010** | 2009 |
|---|---|---|
| *(in thousands of dollars, except number of shares)* | **$** | $ |
| 1,842,860 multiple voting shares | **12** | 12 |
| 14,959,338 subordinate voting shares (14,942,470 in 2009) | **121,347** | 120,994 |
| | **121,359** | 121,006 |
| 71,862 subordinate voting shares held in trust under the Incentive Share Unit Plan (56,449 in 2009) | **(1,832)** | (1,847) |
| | **119,527** | 119,159 |

During the year, subordinate voting shares transactions were as follows:

| | | **2010** | | 2009 |
|---|---|---|---|---|
| | **Number of shares** | **Amount** | Number of shares | Amount |
| *(in thousands of dollars, except number of shares)* | | **$** | | $ |
| Balance, beginning of year | **14,942,470** | **120,994** | 14,897,586 | 120,037 |
| Shares issued for cash under the employee stock purchase plan and the stock option plan | **16,868** | **353** | 44,884 | 957 |
| Balance, end of year | **14,959,338** | **121,347** | 14,942,470 | 120,994 |

During fiscal year 2010, the Company issued 16,868 subordinate voting shares (43,708 shares in 2009) pursuant to its Employee Stock Option Plan for a cash consideration of $353,000 ($936,000 in 2009). During fiscal 2009, 1,176 subordinate voting shares were issued pursuant to its Employee Stock Purchase Plan for a cash consideration of $21,000.

During the year, subordinate voting shares held in trust under the Incentive Share Unit Plan transactions were as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | **Number of shares** | **Amount** | Number of shares | Amount |
| *(in thousands of dollars, except number of shares)* | | **$** | | $ |
| Balance, beginning of year | **56,449** | **1,847** | 38,747 | 1,522 |
| Subordinate voting shares acquired | **41,571** | **1,049** | 17,702 | 325 |
| Subordinate voting shares distributed to employees | **(26,158)** | **(1,064)** | – | – |
| Balance, end of year | **71,862** | **1,832** | 56,449 | 1,847 |

## Stock-based plans

The Company and its subsidiary, Cogeco Cable Inc., offer for the benefit of their employees and those of certain of their subsidiaries, Employee Stock Purchase Plans and Stock Option Plans for certain executives. Under these plans, no more than 10% of the outstanding subordinate voting shares are available. Furthermore, the Company and its subsidiary offer Incentive Share Unit Plans for senior executive and designated employees.

### Stock purchase plans

The Company and its subsidiary, Cogeco Cable Inc., offer, for the benefit of their employees and those of their subsidiaries, Employee Stock Purchase Plans, which have been modified effective January 1st, 2010. The new plans are accessible to all employees up to a maximum of 7% of their base annual salary and the Company and its subsidiary contributes 25% of the employee contributions. The subscriptions are made monthly and employee shares are purchased on the stock market. Prior to January 1st, 2010, the plans were accessible to all employees up to a maximum of 5% of their annual salary. The subscription date was December 31 and the subscription price was based on the average market price of the share of the last five business days of November less 10%.

### Stock option plans

The Company and its subsidiary, Cogeco Cable Inc., offer for the benefit of certain executives Stock Option Plans. Under the plans' conditions, the minimum purchase price at which options are granted is not less than the fair value of such shares at the time the option is granted. Options granted after September 1st, 2009, vest 20% per year beginning one year after such options are granted and are exercisable over ten years. Prior to September 1st, 2009, options granted vest at the rate of 20% per year beginning the day such options are granted and are exercisable over ten years, except for conditional stock options granted in 2007, which vested equally over a period of three years beginning one year after the day such options were granted and are exercisable over ten years.

A total of 1,545,700 subordinate voting shares are reserved for the purpose of COGECO Inc.'s Stock Option Plan. Under the plan, the following options were granted by the Company and are outstanding as at August 31:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | **Options** | **Weighted average exercise price** | Options | Weighted average exercise price |
| | | **$** | | $ |
| Outstanding, beginning of year | **79,250** | **27.71** | 123,758 | 25.55 |
| Exercised | **(16,868)** | **20.95** | (43,708) | 21.40 |
| Forfeited / cancelled | **–** | **–** | (800) | 37.50 |
| Outstanding, end of year | **62,382** | **29.54** | 79,250 | 27.71 |
| Exercisable, end of year | **62,382** | **29.54** | 79,250 | 27.71 |

At August 31, 2010, the range of exercise prices, the weighted average exercise price and the weighted average remaining contractual life of COGECO Inc.'s options are as follows:

| | Options outstanding | | | Options exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | **Number outstanding** | **Weighted average remaining contractual life (years)** | **Weighted average exercise price** | **Number exercisable** | **Weighted average exercise price** |
| $ | | | **$** | | **$** |
| 20.95 | **30,000** | **1.13** | **20.95** | **30,000** | **20.95** |
| 37.50 | **32,382** | **0.14** | **37.50** | **32,382** | **37.50** |
| | **62,382** | **0.62** | **29.54** | **62,382** | **29.54** |

During fiscal years 2010 and 2009, no stock options were granted to employees by COGECO Inc.

A total of 2,400,000 subordinate voting shares are reserved for the purpose of Cogeco Cable Inc.'s Stock Option Plan. Under the plan, the following options were granted by Cogeco Cable Inc. and are outstanding as at August 31:

| | | **2010** | | 2009 |
|---|---|---|---|---|
| | **Options** | **Weighted average exercise price** | Options | Weighted average exercise price |
| | | **$** | | $ |
| Outstanding, beginning of year | **716,745** | **30.37** | 834,724 | 28.55 |
| Granted | **66,174** | **32.08** | 153,381 | 33.85 |
| Exercised | **(17,911)** | **26.88** | (28,785) | 22.24 |
| Forfeited / cancelled | **(48,248)** | **37.08** | (242,575) | 27.27 |
| Outstanding, end of year | **716,760** | **30.16** | 716,745 | 30.37 |
| Exercisable, end of year | **507,811** | **28.28** | 432,246 | 27.45 |

At August 31, 2010, the range of exercise prices, the weighted average exercise price and the weighted average remaining contractual life of Cogeco Cable Inc.'s options are as follows:

| | Options outstanding | | | Options exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | **Number outstanding** | **Weighted average remaining contractual life (years)** | **Weighted average exercise price** | **Number exercisable** | **Weighted average exercise price** |
| $ | | | **$** | | **$** |
| 7.05 | **2,300** | **2.13** | **7.05** | **2,300** | **7.05** |
| 15.70 to 16.80 | **44,285** | **3.17** | **16.43** | **44,285** | **16.43** |
| 21.50 to 26.63 | **311,333** | **5.32** | **25.29** | **279,638** | **25.14** |
| 28.95 to 34.46 | **270,868** | **7.58** | **32.02** | **129,715** | **31.04** |
| 36.10 to 45.59 | **6,144** | **6.79** | **41.08** | **2,774** | **41.67** |
| 49.82 | **81,830** | **7.15** | **49.82** | **49,099** | **49.82** |
| | **716,760** | **6.25** | **30.16** | **507,811** | **28.28** |

During fiscal year 2010, Cogeco Cable Inc. granted 66,174 stock options (153,381 in 2009) with an exercise price ranging from $31.82 to $38.86 ($28.95 to $34.46 in 2009), of which 33,266 stock options (29,711 in 2009) were granted to COGECO Inc.'s employees. In fiscal 2010, the Company's subsidiary, Cogeco Cable Inc., cancelled 10,398 conditional stock options (18,800 in 2009) as yearly financial objectives by the Portuguese subsidiary, Cabovisão, were not achieved. Furthermore, on April 6, 2009, 206,180 stock options were cancelled of which 112,662 were still conditional.

The Company and its subsidiary, Cogeco Cable Inc., recorded compensation expense for options granted on or after September 1, 2003. As a result, a compensation expense of $868,000 ($1,371,000 in 2009) was recorded for the year ended August 31, 2010.

The weighted average fair value of each option granted by Cogeco Cable Inc. was estimated on the grant date for purposes of determining stock-based compensation expense using the binomial option pricing model based on the following assumptions:

| | **2010** | 2009 |
|---|---|---|
| | **%** | % |
| Expected dividend yield | **1.49** | 1.40 |
| Expected volatility | **29** | 29 |
| Risk-free interest rate | **2.67** | 4.22 |
| Expected life in years | **4.8** | 4.0 |

The fair value of stock options granted by Cogeco Cable Inc. for the year ended August 31, 2010 was $8.12 ($8.74 in 2009) per option.

For the purpose of compensation expense, stock-based compensation costs are amortized to expense on a straight-line basis over the vesting period, which is three to five years.

### Incentive share unit plan

Effective October 13, 2006 and October 29, 2009, the Company and its subsidiary, Cogeco Cable Inc., established senior executive and designated employee Incentive Share Unit Plans ("ISU Plan"s) which, in effect, replace the Performance Unit Plans. According to the plans, senior executives and designated employees periodically receive a given number Incentive Share Units ("ISUs") which entitled the participant to receive subordinate voting shares of the Company or its subsidiary after three years less one day from the date of grant. During the year, 41,571 and 63,666 (17,702 and nil in 2009) ISUs were granted to the participants in connection with the ISU Plans by the Company and its subsidiary, respectively. The Company and its subsidiary establishe the value of the compensation related to the units granted based on the fair value of the subordinate voting shares at the date of grant and a compensation expense is recognized over the vesting period, which is three years less one day. Two trusts were created for the purpose of purchasing these shares on the stock exchange in order to guard against stock price fluctuation. The Company and its subsidiary instructed the trustees to purchase 41,571 and 62,436 (17,702 and nil in 2009) subordinate voting shares of the Company and its subsidiary respectively on the stock market. These shares were purchased for cash considerations of $1,049,000 and $2,008,000 ($325,000 and nil in 2009) and are held in trusts for participants until they are completely vested. The trusts, considered as variable interest entities, are consolidated in the Company's financial statements with the value of the acquired shares presented as subordinate voting shares held in trust under the ISU Plans in reduction of capital stock or non-controlling interest. A compensation expense of $1,300,000 ($504,000 in 2009) was recorded related to these plans.

Under the ISU Plan, the following ISUs were granted by the Company and are outstanding as at August 31:

| | 2010 | 2009 |
|---|---|---|
| Outstanding, beginning of year | **55,757** | 38,747 |
| Granted | **41,571** | 17,702 |
| Distributed | **(25,466)** | (692) |
| Outstanding, end of year | **71,862** | 55,757 |

Under Cogeco Cable Inc.'s ISU Plan, the following ISUs were granted and are outstanding as at August 31:

| | 2010 | 2009 |
|---|---|---|
| Outstanding, beginning of year | **–** | – |
| Granted | **63,666** | – |
| Distributed | **(5,027)** | – |
| Forfeited / Cancelled | **(1,230)** | – |
| Outstanding, end of year | **57,409** | – |

## Deferred share unit plans

The Company and its subsidiary, Cogeco Cable Inc., established Deferred Share Unit Plans ("DSU Plans") to assist in the attraction and retention of qualified individuals to serve on the Board of Directors ("Board") of the Company and its subsidiary. Each existing or new member of the Board may elect to be paid a percentage of the annual retainer in the form of deferred share units ("DSUs") with the balance, if any, being paid in cash. The number of DSUs that a member is entitled to receive is based on the average closing price of the subordinate shares on the Toronto Stock Exchange for the twenty consecutive trading days immediately preceding the date preceding by one day the date of grant. Dividend equivalents are awarded with respect to DSUs in a member's account on the same basis as if the member was a shareholder of record of subordinate shares on the relevant record date, and the dividend equivalents are credited to the individual's account as additional DSUs. DSUs are redeemable upon an individual ceasing to be a member of the Board or in the event of the death of the member. During the year, 6,987 and 4,422 (11,113 and 6,282 in 2009) deferred share units were issued to the participants in connection with the DSU Plans by the Company and its subsidiary, respectively. A compensation expense of $668,000 ($265,000 in 2009) was recorded related to these plans.

Under COGECO Inc.'s DSU Plan, the following DSUs were issued and are outstanding as at August 31:

| | 2010 | 2009 |
|---|---|---|
| Outstanding, beginning of year | **17,244** | 5,930 |
| Issued | **6,987** | 11,113 |
| Dividend equivalents | **285** | 201 |
| Redeemed | **(2,886)** | – |
| Outstanding, end of year | **21,630** | 17,244 |

Under Cogeco Cable Inc.'s DSU Plan, the following DSUs were issued and are outstanding as at August 31:

| | **2010** | 2009 |
|---|---|---|
| Outstanding, beginning of year | **10,000** | 3,586 |
| Issued | **4,422** | 6,282 |
| Dividend equivalents | **169** | 132 |
| Redeemed | **(3,736)** | – |
| Outstanding, end of year | **10,855** | 10,000 |

# 15. Accumulated other comprehensive income

| | | | **2010** | | | 2009 |
|---|---|---|---|---|---|---|
| | **Translation of a net investment in self-sustaining foreign subsidiaries** | **Cash flow hedges** | **Total** | Translation of a net investment in self-sustaining foreign subsidiaries | Cash flow hedges | Total |
| *(in thousands of dollars)* | **$** | **$** | **$** | $ | $ | $ |
| Balance, beginning of year | **7,634** | **(1,306)** | **6,328** | 5,064 | (100) | 4,964 |
| Other comprehensive income (loss) | **(2,641)** | **2,247** | **(394)** | 2,570 | (1,206) | 1,364 |
| Balance, end of year | **4,993** | **941** | **5,934** | 7,634 | (1,306) | 6,328 |

# 16. Statements of cash flows

## A) Changes in non-cash operating items

| | **2010** | 2009 |
|---|---|---|
| *(in thousands of dollars)* | **$** | $ |
| Accounts receivable | **(9,998)** | (903) |
| Income taxes receivable | **(40,510)** | (1,648) |
| Prepaid expenses and other | **(206)** | (1,570) |
| Accounts payable and accrued liabilities | **3,443** | 11,918 |
| Income tax liabilities | **(40,688)** | 20,565 |
| Deferred and prepaid revenue and other liabilities | **11,076** | 2,054 |
| | **(76,883)** | 30,416 |

## B) Fixed assets

During the year, fixed asset acquisitions amounted to $309,893,000 ($278,497,000 in 2009), $141,000 ($4,764,000 in 2009) of which were acquired through capital leases. Disbursements for the acquisition of fixed assets totalled $309,752,000 ($273,733,000 in 2009).

## C) Cash and cash equivalents

Cash and cash equivalents consist of:

| *(in thousands of dollars)* | **2010** **$** | 2009 $ |
|---|---|---|
| Cash | **35,842** | 23,760 |
| Cash equivalents[(1)] | **–** | 15,698 |
| | **35,842** | 39,458 |

(1) At August 31, 2009, term deposit of €10,000,000, bearing interest at 0.67%, maturing on September 14, 2009.

## D) Other information

| *(in thousands of dollars)* | **2010** **$** | 2009 $ |
|---|---|---|
| Financial expense paid | **63,264** | 63,862 |
| Income taxes paid | **43,037** | 37,210 |

# 17. Employee future benefits

The Company and its Canadian subsidiaries offer their employees contributory defined benefit pension plans, a defined contribution pension plan or collective registered retirement savings plans. With respect to the last two plans, the Company and its subsidiaries' obligations are limited to the payment of the monthly employer's portion. Expenses related to these two plans amounted to $4,712,000 in fiscal 2010 ($4,038,000 in 2009).

The Company and its subsidiaries sponsor a defined benefit pension plan for the benefit of its employees and a separate defined benefit pension plan for the benefit of its senior executives, which provide pensions based on the number of years of service and the average salary during the employment of each participant. In addition, the Company and its subsidiaries offer senior executives a supplementary pension plan. The Company measures plan assets at fair value and the accrued benefit obligation as at August 31 of each year for all plans. The most recent actuarial valuation for the pension plan for the benefits of the employees was as at August 31, 2009 and the next required valuation will be as at August 31, 2010. For the senior executive plans, the most recent actuarial valuation was as at August 31, 2008, and the next required valuations will be as at August 31, 2011.

The total cash amount paid or payable for employee future benefits for all plans, consisting of cash contributed by the Company and its subsidiaries to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to its defined contribution plans, totalled $8,200,000 for the year ended August 31, 2010 ($6,519,000 in 2009).

The following table provides a reconciliation of the change in the plan benefit obligations and plan assets at fair value and a statement of the funded status as at August 31:

| *(in thousands of dollars)* | **2010** **$** | 2009 $ |
|---|---|---|
| **Accrued benefit obligation** | | |
| Accrued benefit obligation, beginning of year | **36,880** | 32,713 |
| Current service cost | **1,616** | 1,638 |
| Past service cost | **208** | 672 |
| Interest cost | **2,390** | 2,082 |
| Contributions by plan participants | **395** | 359 |
| Benefits paid | **(1,360)** | (1,548) |
| Actuarial loss on obligation | **4,147** | 964 |
| Accrued benefit obligation, end of year | **44,276** | 36,880 |
| **Plan assets at fair value** | | |
| Plan assets at fair value, beginning of year | **17,913** | 16,799 |
| Actual return (loss) on plan assets | **715** | (178) |
| Contributions by plan participants | **395** | 359 |
| Employer contributions | **4,066** | 2,481 |
| Benefits paid | **(1,360)** | (1,548) |
| Plan assets at fair value, end of year | **21,729** | 17,913 |
| **Funded status** | | |
| Plan assets at fair value | **21,729** | 17,913 |
| Accrued benefit obligation | **44,276** | 36,880 |
| Plan deficit | **22,547** | 18,967 |
| Unamortized actuarial losses | **(12,777)** | (8,705) |
| Unamortized past service cost | **(990)** | (880) |
| Net accrued benefit liability | **8,780** | 9,382 |

The accrued benefit liability is included in the Company's balance sheet under "Pension plans liabilities and accrued employee benefits".

| *(in thousands of dollars)* | **2010** **$** | 2009 $ |
|---|---|---|
| **Defined benefit pension costs** | | |
| Current service cost | **1,616** | 1,638 |
| Past service cost | **208** | 672 |
| Interest cost | **2,390** | 2,082 |
| Actual loss (return) on plan assets | **(715)** | 178 |
| Actuarial loss on obligation | **4,147** | 964 |
| Cost before adjustments to recognize the long-term nature of employee future benefits | **7,646** | 5,534 |
| Difference between past service cost and amortization of past service cost | **(110)** | (594) |
| Difference between expected return and actual return or loss on plan assets | **(500)** | (1,279) |
| Difference between actuarial loss and amortization of net actuarial loss | **(3,572)** | (555) |
| Net benefit cost | **3,464** | 3,106 |

Plan assets consist of:

| | **2010** **%** | 2009 % |
|---|---|---|
| Equity securities | **54** | 53 |
| Debt securities | **45** | 46 |
| Other | **1** | 1 |
| Total | **100** | 100 |

The significant weighted average assumptions used in measuring the Company's pension and other obligations are as follows:

| | **2010** | 2009 |
|---|---|---|
| | **%** | % |
| **Accrued benefit obligation** | | |
| Discount rate | **5.50** | 6.25 |
| Rate of compensation increase | **3.25** | 4.50 |
| **Defined benefit pension costs** | | |
| Discount rate | **6.25** | 6.00 |
| Expected long-term rate of return on plan assets | **6.75** | 6.75 |
| Rate of compensation increase | **4.50** | 4.50 |

# 18. Financial and capital management

## A) Financial management

Management's objectives are to protect Cogeco Inc. and its subsidiaries against material economic exposures and variability of results, and against certain financial risks including credit risk, liquidity risk, interest rate risk and foreign exchange risk.

### Credit risk

Credit risk represents the risk of financial loss for the Company if a customer or counterparty to a financial asset fails to meet its contractual obligations. The Company is exposed to credit risk arising from the derivative financial instruments, cash and cash equivalents and trade accounts receivable, the maximum exposure of which is represented by the carrying amounts reported on the balance sheet.

Credit risk from the derivative financial instruments arises from the possibility that counterparties to the cross-currency swap and interest rate swap agreements may default on their obligations in instances where these agreements have positive fair values for the Company. The Company reduces this risk by completing transactions with financial institutions that carry a credit rating equal to or superior to its own credit rating. The Company assesses the creditworthiness of the counterparties in order to minimize the risk of counterparties default under the agreements. At August 31, 2010, management believes that the credit risk relating to its swaps is minimal, since the lowest credit rating of the counterparties to the agreements was A.

Cash and cash equivalents consist mainly of highly liquid investments, such as money market deposits. The Company has deposited the cash and cash equivalents with reputable financial institutions, from which management believes the risk of loss to be remote.

The Company is also exposed to credit risk in relation to its trade accounts receivable. In the current global economic environment, the Company's credit exposure is higher but it is difficult to predict the impact this could have on the Company's accounts receivable balances. To mitigate such risk, the Company continuously monitors the financial condition of its customers and reviews the credit history or worthiness of each new major customer. At August 31, 2010, no customer balance represents a significant portion of the Company's consolidated trade receivables. The Company establishes an allowance for doubtful accounts based on specific credit risk of its customers by examining such factors as the number of overdue days of the customer's balance outstanding as well as the customer's collection history. The Company believes that its allowance for doubtful accounts is sufficient to cover the related credit risk. The Company has credit policies in place and has established various credit controls, including credit checks, deposits on accounts and advance billing, and has also established procedures to suspend the availability of services when customers have fully utilized approved credit limits or have violated existing payment terms. Since the Company has a large and diversified clientele dispersed throughout in its market area in Canada and Portugal, there is no significant concentration of credit risk. The following table provides further details on the Company's accounts receivable balances:

| | **2010** | 2009 |
|---|---|---|
| *(in thousands of dollars)* | **$** | $ |
| Trade accounts receivable | **76,243** | 75,044 |
| Allowance for doubtful accounts | **(8,531)** | (17,261) |
| | **67,712** | 57,783 |
| Other accounts receivable | **6,848** | 8,293 |
| | **74,560** | 66,076 |

The following table provides further details on trade accounts receivable, net of allowance for doubtful accounts. Trade accounts receivable past due is defined as amount outstanding beyond normal credit terms and conditions for the respective customers. A large portion of Cogeco Cable Inc.'s customers are billed in advance and are required to pay before their services are rendered. The Company considers amount outstanding at the due date as trade accounts receivable past due.

| | **2010** | 2009 |
|---|---|---|
| *(in thousands of dollars)* | **$** | $ |
| Net trade accounts receivable not past due | **46,291** | 43,136 |
| Net trade accounts receivable past due | **21,421** | 14,647 |
| | **67,712** | 57,783 |

## Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages liquidity risk through the management of its capital structure and access to different capital markets. It also manages liquidity risk by continuously monitoring actual and projected cash flows to ensure sufficient liquidity to meet its obligations when due. At August 31, 2010, the available amount of the Company's Term Facilities was $668.6 million. Management believes that the committed Term Facilities will, until their maturities in July 2013 and July 2014, provide sufficient liquidity to manage its long-term debt maturities and support working capital requirements.

The following table summarizes the contractual maturities of the financial liabilities and related capital amounts:

| | 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ |
| Bank indebtedness | 2,328 | – | – | – | – | – | 2,328 |
| Accounts payable and accrued liabilities | 248,775 | – | – | – | – | – | 248,775 |
| Long-term debt(1) | 13 | 175,002 | – | 421,635 | – | 357,635 | 954,285 |
| Derivative financial instruments | | | | | | | |
| Cash outflows (Canadian dollar) | – | – | – | – | – | 201,875 | 201,875 |
| Cash inflows (Canadian dollar equivalent of US dollar) | – | – | – | – | – | (202,635) | (202,635) |
| Obligations under capital leases(2) | 2,909 | 2,209 | 873 | 41 | – | – | 6,032 |
| | 254,025 | 177,211 | 873 | 421,676 | – | 356,875 | 1,210,660 |

(1) Principal excluding obligations under capital leases.
(2) Including interest.

The following table is a summary of interest payable on long-term debt (excluding interest on capital leases) that are due for each of the next five years and thereafter, based on the principal and interest rate prevailing on the current debt at August 31, 2010 and their respective maturities:

| | 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ |
| Interest payments on long-term debt | 58,871 | 47,598 | 45,343 | 40,482 | 24,300 | 28,910 | 245,504 |
| Interest payments on derivative financial instruments | 18,130 | 14,614 | 14,614 | 14,614 | 14,614 | 1,218 | 77,804 |
| Interest receipts on derivative financial instruments | (16,449) | (14,184) | (14,184) | (14,184) | (14,184) | (1,182) | (74,367) |
| | 60,552 | 48,028 | 45,773 | 40,912 | 24,730 | 28,946 | 248,941 |

## Interest rate risk

The Company is exposed to interest rate risks for both fixed interest rate and floating interest rate instruments. Fluctuations in interest rates will have an effect on the valuation and collection or repayment of these instruments. At August 31, 2010, all of the Company's long-term debt was at fixed rate, except for the Company's Term Facilities. However, on January 21, 2009, the Company's subsidiary, Cogeco Cable Inc., entered into a swap agreement with a financial institution to fix the floating benchmark interest rate with respect to a portion of the Euro-denominated loans outstanding under the Term Revolving Facility, and previously the Term Facility, for a notional amount of €111.5 million which has been reduced to €95.8 million on July 28, 2009 and to €69.6 million on July 28, 2010. The interest swap rate to hedge the Euro-denominated loans has been fixed at 2.08% until the maturity of the swap agreement on July 28, 2011. In addition to the interest swap rate of 2.08%, the Company's subsidiary will continue to pay the applicable margin on the revolving loans in accordance with the Term Revolving Facility. The Company's subsidiary elected to apply cash flow hedge accounting on this derivative financial instrument. The sensitivity of the Company's annual financial expense to a variation of 1% in the interest rate applicable to the Term Revolving Facilities is approximately $0.3 million based on the current debt at August 31, 2010 and taking into consideration the effect of the interest rate swap agreement.

## Foreign exchange risk

The Company is exposed to foreign exchange risk related to its long-term debt denominated in US dollars. In order to mitigate this risk, the Company has established guidelines whereby currency swap agreements can be used to fix the exchange rates applicable to its US dollar denominated long-term debt. All such agreements are exclusively used for hedging purposes. Accordingly, on October 2, 2008, the Company's subsidiary, Cogeco Cable Inc., entered into cross-currency swap agreements to set the liability for interest and principal payments on its US$190 million Senior Secured Notes Series A issued on October 1, 2008. These agreements have the effect of converting the US interest coupon rate of 7.00% per annum to an average Canadian dollar interest rate of 7.24% per annum. The exchange rate applicable to the principal portion of the debt has been fixed at $1.0625. The Company's subsidiary elected to apply cash flow hedge accounting on these derivative financial instruments.

The Company is also exposed to foreign exchange risk on cash and cash equivalents, bank indebtedness and accounts payable denominated in US dollars or Euros. At August 31, 2010, cash and cash equivalents denominated in US dollars amounted to US$13,613,000 (US$5,555,000 at August 31, 2009) while accounts payable denominated in US dollars amounted to US$15,850,000 (US$14,997,000 at August 31, 2009). At August 31, 2010, Euro-denominated cash and cash equivalents amounted to €187,000 (bank indebtedness of €299,000 at August 31, 2009) while there were no accounts payable denominated in Euros (€26,000 at August 31, 2009). Due to their short-term nature, the risk arising from fluctuations in foreign exchange rates is usually not significant. The impact of a 10% change in the foreign exchange rates (US dollar and Euros) would change financial expense by approximately $0.2 million.

Furthermore, Cogeco Cable Inc.'s net investment in self-sustaining foreign subsidiaries is exposed to market risk attributable to fluctuations in foreign currency exchange rates, primarily changes in the values of the Canadian dollar versus the Euro. This risk is mitigated since the major part of the purchase price for Cabovisão was borrowed directly in Euros. At August 31, 2010, the net investment amounted to €182,104,000 (€183,220,000 at August 31, 2009) while long-term debt denominated in Euros amounted to €90,000,000 (€135,772,000 at August 31, 2009). The exchange rate used to convert the Euro currency into Canadian dollars for the balance sheet accounts at August 31, 2010 was $1.3515 per Euro compared to $1.5698 per Euro at August 31, 2009. The impact of a 10% change in the exchange rate of the Euro into Canadian dollars would change financial expense by approximately $0.5 million and other comprehensive income by approximately $4 million net of non-controlling interest of $8.4 million.

## Fair value

Fair value is the amount at which 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 estimated at a specific point in time, by discounting expected cash flows at rates for debts of the same remaining maturities and conditions. These estimates are subjective in nature and involve uncertainties and matters of significant judgement, and therefore, cannot be determined with precision. In addition, 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 settled. The Company has determined the fair value of its financial instruments as follows:

a) The carrying amount of cash and cash equivalents, accounts receivable and accounts payable and accrual liabilities approximates fair value because of the short-term nature of these instruments.

b) Interest rates under the terms of the Company's Term Revolving Facilities and Term Facilities are based on bankers' acceptance, LIBOR, EURIBOR, bank prime rate loan or US base rate loan plus the applicable margin. Therefore, the carrying value is considered to represent fair value for the Term Revolving Facilities and Term Facilities.

c) The fair value of the Senior Secured Debentures Series 1, Senior Secured Notes Series A and B and Senior Unsecured Debenture are based upon current trading values for similar financial instruments.

d) The fair values of obligations under capital leases are not significantly different from their carrying amounts.

The carrying value of all the Company's financial instruments approximates fair value, except as otherwise noted in the following table:

| | | **2010** | | 2009 |
|---|---|---|---|---|
| | **Carrying amount** | **Estimated fair value** | Carrying amount | Estimated fair value |
| *(in thousands of dollars)* | **$** | **$** | $ | $ |
| Long-term debt | **955,070** | **1,050,783** | 1,063,964 | 1,126,449 |

In accordance with CICA Handbook Section 3862, *Financial instruments – disclosures*, all financial instruments recognized at fair value on the consolidated balance sheet must be classified based on the three fair value hierarchy levels, which are as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
- Level 3: inputs that are not based on observable market date (unobservable inputs).

The Company considers that its derivative financial instruments are classified as Level 2 under the fair value hierarchy. The fair value of derivative financial instruments is estimated using valuation models that reflect projected future cash flows over contractual terms of the derivative financial instruments and factor observable in external markets data, such as interest and currency exchange rate curves.

## B) Capital management

The Company's objectives in managing capital are to ensure sufficient liquidity to support the capital requirements of its various businesses, including growth opportunities. The Company manages its capital structure and makes adjustments in light of general economic conditions, the risk characteristics of the underlying assets and the Company's working capital requirements. Management of the capital structure involves the issuance of new debt, the repayment of existing debts using cash generated by operations and the level of distribution to shareholders.

The capital structure of the Company is composed of shareholders' equity, bank indebtedness, long-term debt and assets or liabilities related to derivative financial instruments.

The provisions under the Term Facilities provide for restrictions on the operations and activities of the Company. Generally, the most significant restrictions relate to permitted investments and dividends on multiple and subordinate voting shares, as well as incurrence and maintenance of certain financial ratios primarily linked to the operating income before amortization, financial expense and total indebtedness. At August 31, 2010 and 2009, the Company was in compliance with all of its debt covenants and was not subject to any other externally imposed capital requirements.

The following table summarizes certain of the key ratios used by management to monitor and manage the Company's capital structure:

| | **2010** | 2009 (restated) |
|---|---|---|
| Net indebtedness(1) / shareholders' equity | **2.4** | 3.1 |
| Net indebtedness(1) / operating income before amortization | **1.8** | 2.0 |
| Operating income before amortization / financial expense | **7.9** | 7.3 |

(1) Net indebtedness is defined as the total of bank indebtedness, principal on long-term debt and obligations under derivative financial instruments, less cash and cash equivalents.

# 19. Commitments, contingencies and guarantees

## Commitments

### Lease agreements and other long-term contracts

As at August 31, 2010, the Company and its subsidiaries are committed under lease agreements and other long-term contracts to make annual payments as follows:

| *(in thousands of dollars)* | 2011<br>$ | 2012<br>$ | 2013<br>$ | 2014<br>$ | 2015<br>$ | Thereafter<br>$ |
|---|---|---|---|---|---|---|
| Lease agreements | 19,081 | 17,370 | 16,130 | 15,948 | 15,514 | 32,775 |
| Other long term contracts | 10,206 | 8,243 | 5,398 | 1,154 | 750 | 3,000 |
| | 29,287 | 25,613 | 21,528 | 17,102 | 16,264 | 35,775 |

### Licence conditions

According to radio licences' conditions, Cogeco Diffusion Inc. is committed to contribute for the benefit of Canadian artists, minimum annual amounts of $150,000 beginning September 1, 2003 and $120,000 beginning September 1, 2004 for a total amount of $1,890,000 over a period of seven years. As at August 31, 2009, the remaining amount to be contributed was $53,000.

## Contingencies

The Company and its subsidiaries are involved in matters involving litigation arising out of the ordinary course and conduct of its business. Although such matters cannot be predicted with certainty, management does not consider the Company's exposure to litigation to be significant to these financial statements.

## Guarantees

In the normal course of business, the Company and its subsidiaries enter into agreements containing features that meet the criteria of a guarantee including the following:

### Stamp taxes and withholding taxes

During fiscal 2008 and 2010, the Company's subsidiary, Cogeco Cable Inc., issued letters of credit amounting to €1.7 million and €4.2 million to guarantee the payment by Cabovisão of stamp taxes for the 2000 through 2002 years and withholding taxes for the years 2004 and 2005 assessed by the Portuguese tax authorities, which are all currently being challenged by Cabovisão. Even though the principal amounts in dispute are fully recorded in the books of its subsidiary Cabovisão, the Company's subsidiary, Cogeco Cable Inc., may be required to pay the amounts following final judgements, up to a maximum aggregate amount of €5.9 million ($7.9 million), should Cabovisão fail to pay such required amounts.

### Business acquisitions and asset disposals

In connection with the acquisition or sale of a business or assets, in addition to possible indemnification relating to failure to perform covenants and breach of representations and warranties, the Company's subsidiaries, Cogeco Cable Inc. and Cogeco Diffusion Inc., have agreed to indemnify the seller or the purchaser against claims related to events that occurred prior to the date of acquisition or sale. The term and amount of such indemnification will sometimes be limited by the agreement. The nature of these indemnification agreements prevents the Company from estimating the maximum potential liability required to be paid to guaranteed parties. In management's opinion, the likelihood that a significant liability will be incurred under these obligations is low. The Company has purchased directors' and officers' liability insurance with a deductible per loss. At August 31, 2010 and 2009, no liability has been recorded associated with these indemnifications.

### Long-term debt

Under the terms of the Senior Secured Notes, the Company's subsidiary, Cogeco Cable Inc., has agreed to indemnify the other parties against changes in regulations relative to withholding taxes and costs incurred by the lenders due to changes in laws. These indemnifications extend for the term of the related financings and do not provide any limit on the maximum potential liability. The nature of the indemnification agreement prevents the Company from estimating the maximum potential liability it could be required to pay. At August 31, 2010 and 2009, no liability has been recorded associated with these indemnifications.

### Employees and contractuals indemnification agreements

The Company's subsidiary, Cogeco Diffusion Inc., indemnifies certain of its on-air hosts against charges, costs and expenses as a result of any lawsuit, resulting from judicial or administrative proceedings in which they are named as defending party and arising from the performance of their services. The claims covered by such indemnification are subject to statutory or other legal limitation periods. The nature of the indemnification agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to beneficiaries of such indemnification agreements. The Company has purchased employees' and contractual's liability insurance with a deductible per loss. At August 31, 2010 and 2009, no liability has been recorded associated with these indemnifications.

# 20. Non-monetary transactions

During fiscal year 2010, the Company's subsidiaries, Cogeco Cable Inc. and Cogeco Diffusion Inc., have entered into non-monetary transactions. An amount of $6,670,000 ($6,634,000 in 2009) of revenue and $6,354,000 ($6,973,000 in 2009) of operating costs were recorded.

# 21. Governmental assistance

In 2010, the Company's subsidiary Cogeco Cable Inc., recorded tax credits related to research and development costs in the amount of $921,000. These credits were accounted for as a reduction of the fixed assets for an amount of $842,000 and as a reduction of operating costs for an amount of $79,000.

## 22. Subsequent event

On April 30, 2010, The Company has concluded an agreement with Corus Entertainment Inc. to acquire all of its Québec radio stations for $80 million in cash, subject to customary closing adjustments and conditions, including approval by the Canadian Radio-television and Telecommunications Commission (the "CRTC"). On June 30, 2010, the Company submitted its transfer application for approval to the CRTC. A public hearing took place on September 28 and 29, 2010, and the transaction is expected to close during the first half of fiscal 2011.

## 23. Comparative figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

# Three-year financial highlights

| Years ended August 31,<br>*(In thousands of dollars, except RGU growth and per share data)* | **2010**<br>**$** | 2009[1]<br>$ | 2008[1][2]<br>$ |
|---|---|---|---|
| **Operations** | | | |
| Revenue | **1,321,694** | 1,252,794 | 1,108,900 |
| Operating income from continuing operations before amortization[3] | **519,339** | 515,494 | 431,913 |
| Operating income from continuing operations | **259,882** | 258,867 | 214,329 |
| Impairment of goodwill and intangible assets | **–** | 399,648 | – |
| Income (loss) from continuing operations | **56,264** | (79,014) | 42,177 |
| Loss from discontinued operations | **–** | – | (18,057) |
| Net income (loss) | **56,264** | (79,014) | 24,120 |
| Adjusted net income[3][4] | **46,644** | 36,406 | 34,268 |
| **Cash flow** | | | |
| Cash flow from operating activities from continuing operations | **425,336** | 420,704 | 381,482 |
| Cash flow from operations from continuing operations[3] | **502,219** | 390,288 | 345,779 |
| Capital expenditures and increase in deferred charges | **320,962** | 289,270 | 245,343 |
| Free cash flow[3] | **181,257** | 101,018 | 100,436 |
| **Financial condition** | | | |
| Fixed assets | **1,328,866** | 1,305,769 | 1,261,610 |
| Total assets | **2,744,656** | 2,670,128 | 3,027,076 |
| Indebtedness[5] | **961,354** | 1,064,542 | 1,166,523 |
| Shareholders' equity | **381,635** | 332,122 | 413,621 |
| **RGU growth** | **287,111** | 175,364 | 231,209 |
| **Per share data**[6] | | | |
| Income (loss) from continuing operations per share | **3.36** | (4.73) | 2.53 |
| Loss from discontinued operations per share | **–** | – | (1.08) |
| Earnings (loss) per share | **3.36** | (4.73) | 1.45 |
| Adjusted earnings per share[3][4] | **2.79** | 2.18 | 2.06 |
| Weighted average number of outstanding shares | **16,726,135** | 16,704,962 | 16,648,926 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 of the Management's Discussion and Analysis for more details.
(2) Includes the results of Cogeco Data Services Inc. since the date of acquisition of control by Cogeco Cable on July 31, 2008.
(3) The indicated terms do not have standardized definitions prescribed by Canadian Generally Accepted Accounting Principles ("GAAP") and therefore, may not be comparable to similar measures presented by other companies. For further details, please consult the "Non-GAAP financial measures" section on page 40 of the Management's Discussion and Analysis.
(4) In addition to the adjustments described in the "Non-GAAP financial measures" section on page 40, net income for the 2008 fiscal year has been adjusted to remove the loss from discontinued operations of $18.1 million and income tax adjustments of $7.9 million related to the reduction of Canadian federal income tax rates net of non-controlling interest.
(5) Indebtedness is defined as the total of bank indebtedness, principal on long-term debt and obligations under derivative financial instruments.
(6) Per multiple and subordinate voting share.

# Investor information

## Consolidated capitalization

| As at August 31, *(In thousands of dollars)* | **2010** **$** | 2009[1] $ | 2008[1] $ |
|---|---|---|---|
| Indebtedness[2] | **961,354** | 1,064,542 | 1,166,523 |
| Shareholders' equity | **381,635** | 332,122 | 413,621 |
| Total | **1,342,989** | 1,396,664 | 1,580,144 |

(1) Certain comparative figures have been reclassified to conform to the current year's presentation. Financial information has been restated to reflect the application of the CICA Handbook Section 3064. Please refer to the "Critical accounting policies and estimates" section on page 11 of the Management's Discussion and Analysis for more details.
(2) Indebtedness is defined as the total of bank indebtedness, principal on long-term debt and obligations under derivative financial instruments.

## Credit ratings of Cogeco Cable

On October 6, 2010, Dominion Bond Rating Service ("DBRS") confirmed their rating on the Senior Secured Debentures and Notes of Cogeco Cable to BBB (low). Obligations rated in the "BBB" category are in the fourth highest category and are regarded as of adequate credit quality, where the degree of protection afforded interest and principal is considered acceptable, but the entity is fairly susceptible to adverse changes in financial and economic conditions, or there may be other adverse conditions present which reduce the strength of the entity and its rated securities.

On October 1, 2010, Fitch Ratings ("Fitch") upgraded the Issuer Default Rating ("IDR") of Cogeco Cable Inc. to BBB- from BB+ and confirmed their rating on the Senior Secured Debentures and Notes to BBB-, one notch above the corporate credit ratings of BB+. Obligations rated in the "BBB" category are regarded as of good credit quality, where the capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category.

On June 24, 2010, Standard & Poor's Ratings Services ("S&P") maintained their rating on the Senior Secured Debentures and Notes of Cogeco Cable to BBB–, two notches above the corporate credit ratings of BB to reflect very high recovery prospects of first lien secured issues. Obligations rated in the "BBB" category are in the fourth highest category and are regarded as investment-grade. Such obligations show adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation. The ratings may be modified by the addition of a plus (+) or minus (–) sign to show relative standing within the major rating categories. S&P has assigned a recovery rating of "1" to Cogeco Cable's credit facility and other senior secured first-priority debt. The "1" recovery rating indicates expectations of very high recovery (90%-100%) of principal in the event of payment default.

The table below shows Cogeco Cable's credit ratings:

| As at August 31, 2010 | **DBRS** | **Fitch** | **S&P** |
|---|---|---|---|
| Senior secured notes and debentures | **BBB (low)** | **BBB–** | **BBB–** |

# Share information

| As at August 31, 2010 | | Registrar / Transfer agent |
|---|---|---|
| Number of multiple voting shares (20 votes per share) outstanding | **1,842,860** | Computershare Trust Company of Canada |
| Number of subordinate voting shares (1 vote per share) outstanding | **14,959,338** | 100 University Avenue, 9th Floor |
| | | Toronto, ON M5J 2Y1 |
| Stock exchange listing | The Toronto Stock Exchange | Tel.: 514-982-7555<br>Tel.: 1 800-564-6253 |
| Trading symbol | CGO | Fax: 416-263-9394 |

# Dividend policy

The Company declared an annual eligible dividend of $0.40 per share during fiscal 2010 composed of quarterly eligible dividends of $0.10 per share (quarterly eligible dividends of $0.08 per share totalling $0.32 per share, on an annual basis, was paid in fiscal 2009) to the holders of subordinate voting shares and multiple voting shares. The declaration, amount and date of any future dividend will continue to be considered and approved by the Board of Directors of the Company based upon the Company's financial condition, results of operations, capital requirements and such other factors as the Board of Directors, at its sole discretion, deems relevant. There is therefore no assurance that dividends will be declared, and if declared, their amount and frequency may vary.

# Trading statistics

| Quarters ended | **Nov. 30** | **Feb. 28** | **May 31** | **Aug. 31** | **2010 Total** |
|---|---|---|---|---|---|
| *(in dollars, except subordinate voting share volumes)* | **$** | **$** | **$** | **$** | |
| The Toronto Stock Exchange | | | | | |
| High | **27.73** | **33.90** | **35.00** | **32.99** | |
| Low | **20.05** | **26.05** | **26.50** | **27.25** | |
| Close | **26.40** | **33.35** | **27.99** | **31.25** | |
| Volume (shares) | **873,624** | **952,883** | **1,098,897** | **1,071,767** | **3,997,171** |

| Quarters ended | Nov. 30 | Feb. 28 | May 31 | Aug. 31 | 2009 Total |
|---|---|---|---|---|---|
| *(in dollars, except subordinate voting share volumes)* | $ | $ | $ | $ | |
| The Toronto Stock Exchange | | | | | |
| High | 34.85 | 26.50 | 25.20 | 23.00 | |
| Low | 17.99 | 17.50 | 20.61 | 19.32 | |
| Close | 20.25 | 22.65 | 22.51 | 20.06 | |
| Volume (shares) | 785,569 | 1,378,391 | 789,855 | 758,302 | 3,712,117 |

# Cable sector customer statistics

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Homes passed | | | |
| **Canada** | **1,593,743** | 1,565,145 | 1,531,611 |
| **Portugal**(1) | **905,359** | 905,129 | 895,923 |
| Total | **2,499,102** | 2,470,274 | 2,427,534 |
| Homes connected(2) | | | |
| **Canada** | **979,590** | 944,634 | 933,838 |
| **Portugal** | **269,194** | 269,022 | 308,553 |
| Total | **1,248,784** | 1,213,656 | 1,242,391 |
| Revenue-generating units | | | |
| **Canada** | **2,350,577** | 2,159,863 | 1,991,908 |
| **Portugal** | **828,772** | 732,375 | 724,966 |
| Total | **3,179,349** | 2,892,238 | 2,716,874 |
| Basic Cable service customers | | | |
| **Canada** | **874,505** | 864,805 | 857,094 |
| Penetration as a percentage of homes passed | **54.9%** | 55.3% | 56.0% |
| **Portugal** | **260,267** | 259,480 | 296,135 |
| Penetration as a percentage of homes passed | **28.7%** | 28.7% | 33.1% |
| Total | **1,134,772** | 1,124,285 | 1,153,229 |
| HSI service customers | | | |
| **Canada** | **559,057** | 515,052 | 473,467 |
| Penetration as a percentage of Basic Cable(3) | **66.2%** | 62.0% | 57.7% |
| **Portugal** | **163,187** | 143,614 | 159,301 |
| Penetration as a percentage of Basic Cable(3) | **62.7%** | 55.3% | 53.8% |
| Total | **722,244** | 658,666 | 632,768 |
| Digital Television service customers | | | |
| **Canada** | **559,418** | 498,398 | 441,746 |
| Penetration as a percentage of Basic Cable(3) | **64.8%** | 58.5% | 52.4% |
| **Portugal** | **159,852** | 102,753 | 24,452 |
| Penetration as a percentage of Basic Cable(3) | **61.4%** | 39.6% | 8.3% |
| Total | **719,270** | 601,151 | 466,198 |
| Telephony service customers | | | |
| **Canada** | **357,597** | 281,608 | 219,601 |
| Penetration as percentage of Basic Cable(3) | **44.4%** | 36.1% | 30.5% |
| **Portugal** | **245,466** | 226,528 | 245,078 |
| Penetration as percentage of Basic Cable(3) | **94.3%** | 87.3% | 82.8% |
| Total | **603,063** | 508,136 | 464,679 |

(1) Cogeco Cable is currently assessing the number of homes passed.
(2) Represents the sum of Basic Cable service customers and HSI and Telephony service customers who do not subscribe to the Basic Cable service.
(3) Calculated on the basis of the systems where the service is offered.

# Board of Directors and corporate management

## Board of Directors

★ **JAN PEETERS**
Montréal (Québec)
President and Chief Executive Officer
Board Chair
Olameter Inc.
Board Chair

★ **LOUIS AUDET**, Eng., MBA
Westmount (Québec)
President and Chief Executive Officer
COGECO Inc. and Cogeco Cable Inc.
Director

★ **MARIO BERTRAND**
Monaco
Managing Partner of OMC Ltd
Chief Executive Officer of Just for Laugh Group
Director

●▲ **ANDRÉ BROUSSEAU**, B.A., B.PED., L.PÉD.L.
Trois-Rivières (Québec)
Corporate Director
Director

●◆ **PIERRE L. COMTOIS**, B. SC., COM., ADM. A.
Montréal (Québec)
Vice-Chairman of the Board and Chief Investment Officer
Optimum Asset Management Inc.
Director

▲◆ **PAULE DORÉ**
Montréal (Québec)
Corporate Director
Director

●▲★ **CLAUDE A. GARCIA**, B.A., B. COM.
Montréal (Québec)
Corporate Director
Director

◆★ **DAVID MCAUSLAND**, B.C.L., LL.B.
Beaconsfield (Québec)
Partner
McCarthy Tétrault
Director

**Legend :**
● Member of the Audit Committee
▲ Member of the Human Resources Committee
◆ Member of the Corporate Governance Committee
★ Member of the Strategic Opportunities Committee

## Corporate management

**LOUIS AUDET**
President and Chief Executive Officer

**PIERRE GAGNÉ**
Senior Vice President and Chief Financial Officer

**CHRISTIAN JOLIVET**
Vice President, Chief Legal Officer and Secretary

**YVES MAYRAND**
Vice President, Corporate Affairs

**ALEX TESSIER**
Vice President and Treasurer

# Corporate information

**HEAD OFFICE**
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Suite 1700
Montréal (Québec)
H3B 0B3
Tel.: 514-764-4700
Fax: 514-874-2625
www.cogeco.ca

**ANNUAL MEETING**
The Annual Shareholders Meeting will be held at 4 p.m. on Wednesday, December 15, 2010, at the Stock Exchange Tower, 800 Square Victoria, 4th floor, Montréal (Québec).

**AUDITORS**
Samson Bélair/Deloitte & Touche, s.e.n.c.r.l.
1 Place Ville Marie
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Montréal (Québec)
H3B 4T9

**LEGAL COUNSEL**
Fraser Milner Casgrain LLP
1 Place Ville Marie
Suite 3900
Montréal (Québec)
H3B 4M7

**QUARTER ENDS**
November, February, May

**YEAR-END**
August 31

# Inquiries

The Annual Report, Annual Information Form and Quarterly Reports are available in the Investor Relations section of the Company's website (www.cogeco.ca) or upon request by calling 514-764-4700.

Des versions françaises du rapport annuel, de la notice annuelle et des rapports trimestriels sont disponibles à la section Relations avec les investisseurs du site Internet de la Compagnie (www.cogeco.ca) ou sur demande au 514-764-4700.

## Investors and analysts

For financial information about the Company, please contact the Department of Finance.

## Shareholders

For any inquiries other than a change of address, financial information or a change of registration of shares, please contact the Legal Affairs Department of the Company.

## Duplicate communications

Some shareholders may receive more than one copy of publications such as Quarterly Reports and the Annual Report. Every effort is made to avoid such duplication. Shareholders who receive duplicate mailings should advise Computershare Trust Company of Canada.

# Whistleblowing procedures regarding accounting, internal accounting controls or auditing matters

## Ethics Line

In July 2010, COGECO Inc. made available an anonymous and secure Ethics Line for its employees or the employees of any of its subsidiaries and other individuals to report any perceived or actual instances of violations of the Code of Ethics (including complaints regarding accounting, internal accounting controls and audit matters). The Ethics Line is comprised of two toll-free telephone lines as well as a secure web site (see details below). The COGECO Inc. Ethics Line is operated by a specialized external provider that is independent of COGECO Inc. All reports submitted through the Ethics Line will be examined by the Senior Director, Internal Audit or the Vice President, Chief Legal Officer and Secretary. Individuals will be protected from dismissal or retaliation of any kind for reporting in good faith.

By telephone:

In Canada (toll-free): 1-877-706-2640
In Portugal (toll-free): 800-827-692

Web site of ClearView Connects: http://www.clearviewconnects.com

# Subsidiaries and operating units

## Cable sector

**COGECO CABLE INC.**
5 Place Ville Marie
Suite 1700
Montréal (Québec) H3B 0B3
Tel.: 514-764-4700
Fax: 514-874-2625
www.cogeco.ca

**J. FRANÇOIS AUDET**
Vice President, Telecommunications

**DENIS BÉLANGER**
Vice President, Special Advisor, Technology Development

**ANDRÉ BERGEVIN**
Vice President, Control

**TONY P. CICIRETTO**
Senior Vice President, Enterprise Services and
President, Cogeco Data Services

**JACQUES GRAVEL**
Vice President, Network Services

**JULES GRENIER**
Vice President, Sales and Customer Services,
Residential Services, Canada

**RENÉ GUIMOND**
Vice President, Development, New Media

**MONIQUE LACHARITÉ**
Vice President, Procurement and credit / collection

**ANNE MEZEI**
Vice President, Human Resources

**CLAUDETTE PAQUIN**
Vice President, Programming and Community Relations

**RON A. PERROTTA**
Vice President, Marketing and Strategic Planning

**LOUISE ST-PIERRE**
Senior Vice President, Residential Services

**ALEX TESSIER**
Vice President and Treasurer

**MARTINHO TOJO**
Senior Vice President and General Manager of Cabovisão

## Other

**COGECO DIFFUSION INC.**
5 Place Ville Marie
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Tel.: 514-764-4700
Fax: 514-874-2625
www.cogeco.ca

**RICHARD LACHANCE**
Vice President, Cogeco Diffusion Inc.

**MONIQUE LACHARITÉ**
Vice President, Control and administration

**RYTHME FM NETWORK**
**ANDRÉ ST-AMAND**
Vice President, Programming

**105.7 RYTHME FM**
Laval/Montréal (Québec)
**JEAN-LUC MEILLEUR**
General Manager

**91.9 RYTHME FM**
Québec (Québec)
**JEAN-PAUL LEMIRE**
General Manager

**93.7 RYTHME FM**
Estrie (Québec)
**ANDRÉ DAVID**
General and Sales Manager

**100.1 RYTHME FM**
Mauricie (Québec)
**SYLVIE LALIBERTÉ**
General and Sales Manager

**FM 93**
Québec (Québec)
**JEAN-PAUL LEMIRE**
General Manager

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