

ANNUAL REPORT 2005



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LIST OF DIRECTORS

Hersh Spiegelman
Chairman

Ruth Bartholomeusz
President & COO

Bryan Ceresne (1)(2)

Celia Denov (2)

Daniel Kayfetz (1)(2)

Barry Dixon (1)

Larry Cyna

(1) Audit Committee

(2) Compensation Committee

CORPORATE PROFILE

Telehop Communications Inc. is a full-service long-distance provider operating within the telecommunications industry. Its main operations involve Flat Rate or Hop long distance telephone services (currently marketed to the southern Ontario Golden Horseshoe and Montreal communities), Wholesale services, Equal Access long distance services worldwide, Casual Calling services, Virtual Calling Card services and Toll Free services.

CORPORATE DATA

Auditors

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1167 Caledonia Road, Toronto,
Ontario M6A 2X1*

Transfer Agents and Registrar

*Equity Transfer Services Inc.
120 Adelaide St. West, Suite 420
Toronto, Ontario M5H 4C3*

Bankers

*Bank of Nova Scotia
York Commercial Banking Centre
625 Cochrane Drive, Suite 200
Markham, Ontario L3R 9R9*

Legal Counsel

*Stikeman, Graham, Keeley & Spiegel LLP.
220 Bay St. Suite 700
Toronto, Ontario M5J 2W4*

Share Listing/Ticker symbol

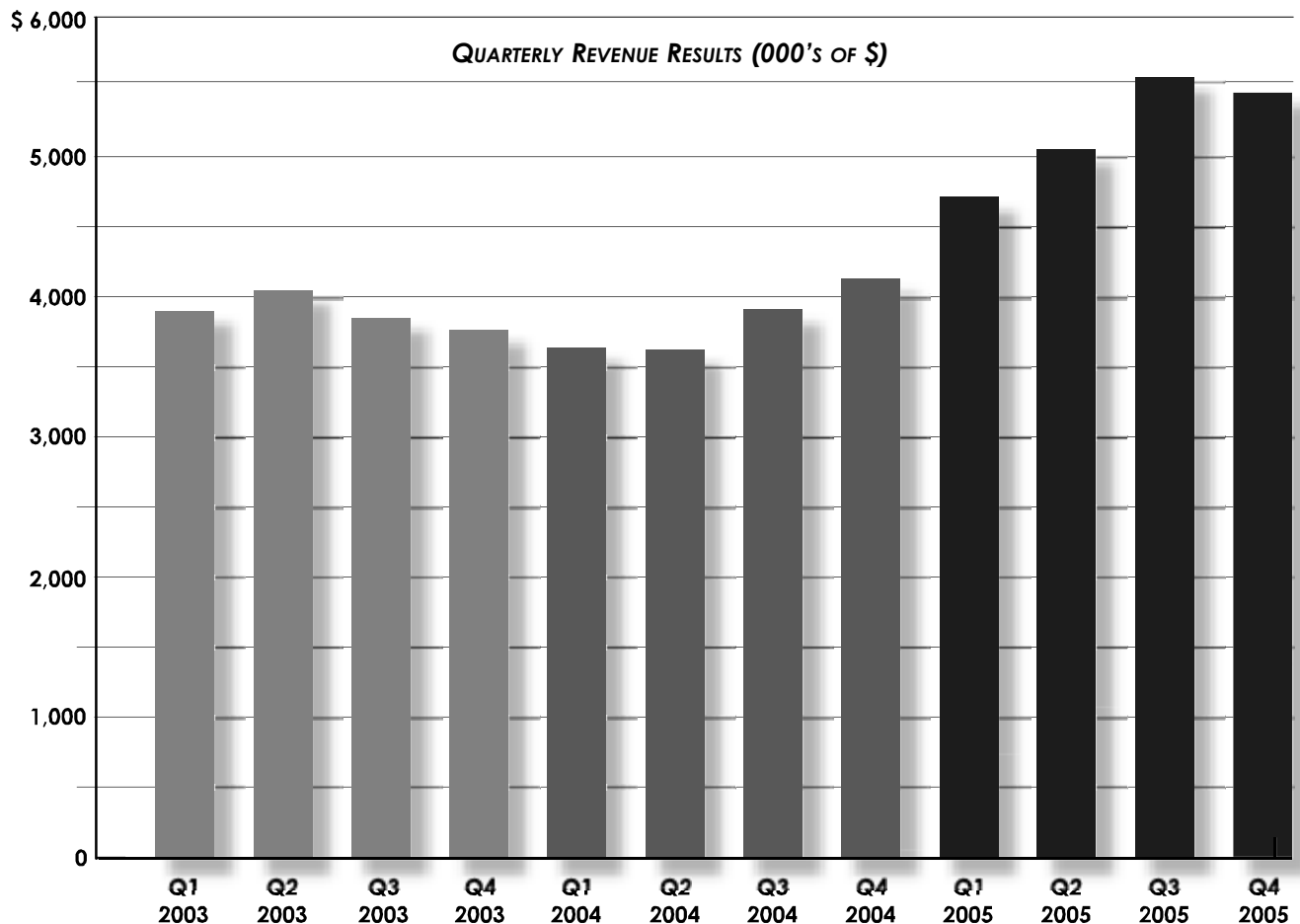
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FINANCIAL HIGHLIGHTS

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Sales	\$ 20,817,340	\$ 15,325,613	\$ 15,587,884
Income before income taxes	978,147	550,106	1,477,153
Net income	611,065	284,983	930,672
Earnings per common share:			
Basic	\$ 0.05	\$ 0.02	\$ 0.08
Diluted	\$ 0.05	\$ 0.02	\$ 0.08
Total Assets	5,232,753	5,206,337	5,138,923
Shareholders' equity	3,231,587	2,605,621	2,185,477
Equity per common share	\$ 0.26	\$ 0.21	\$ 0.18



PRESIDENT'S LETTER

It is my pleasure to report that your Company has continued its growth trend since our last report, and Telehop was successful in profitably growing its business in the year 2005. The Company has achieved significant growth; both in total minutes of long distance traffic, number of calls through our switch platform and also in revenues and profits in a year that saw most major telecom companies face declining long distance revenues in spite of increased traffic.

Our financial achievements in 2005 included:

- A 114.4% increase in net earnings to \$ 611,065 from \$284,983
- A 35.8% increase in revenues to \$ \$20,817,340 from \$15,325,613
- A 35.3% increase in working capital to \$2,119,119 from \$1,566,243
- A 24.0% increase in shareholder's equity to \$3,231,586 from \$2,605,621
- Maintaining a debt-free balance sheet

Our 2005 operational achievements included:

- Increasing overall traffic through our network by 213.9% to 64,966,898 individual calls from 20,695,532 calls
- Increasing the overall minutes processed through our network by 109.8% to 326,190,091 minutes from 155,454,693 minutes
- Increased the number of 'direct dial' subscription customers by 255%
- Increased 'direct dial' call revenue by 322%
- The new branded "10-10-100" 'dial-around' service grew the number of its unique users approximately six-fold
- The new net-based Telehop proprietary real-time management and control system was essentially completed and installed

Telehop has continued to be successful in internally financing this growth in traffic and performance, and currently has significant free cash resources and no debt on the Company balance sheet. This financial strength will enable your Company to pursue new opportunities as they arise.

We look forward to this trend continuing for the current 2006 year, and our traffic numbers for the year to date show a continuation of this trend despite the deliberate reduction of our presence in the wholesale telecom market in the latter half of 2005. We are continuing to work on expanding our loyal monthly retail subscription customer base whilst simultaneously, offering the new branded "10-10-100" Dial Around service to our traditional Dial Around customers.

I would personally like to thank all our staff, customers and shareholders for your continued support that has enabled Telehop to position itself in the telecommunications industry as a significant and credible participant. I will personally endeavor to ensure that your Company continues this trend, going forward both in 2006 and in the future.

Sincerely,



Ruth Bartholomeusz
President and Chief Operating Officer

May 2, 2006

TELEHOP'S STRATEGY

Telehop Communications Inc.'s strategy is to attract and retain customers by offering significant savings over the telecom costs offered by the major competitors in the North American telecommunications market, whilst delivering Bell quality service to its customers. Telehop maintains its profitability by identifying and catering to specific, targeted niche markets, and controls on its operating and administrative costs.

DESCRIPTION OF BUSINESS

Telehop is a full-service long distance provider operating within the telecommunications industry and is registered with the Canadian Radio-television and Telecommunications Commission ("CRTC") as a licensed Class "A" Telecom Carrier. Telehop currently employs 46 people.

Telehop's core network resides in Toronto, Ontario, with virtual points-of-presence in major cities across Canada.

The core network utilizes SS7 (signaling system 7) with circuit switched TDM (Time Division Multiplexing) connections and supports the latest in Voice Over Internet Protocol ("VOIP") technologies, including broadband telephony. The SS7 Signaling system allows Telehop to enhance service and feature delivery in terms of call quality and connection time to its end-users. In addition, network interconnections, voice-data convergence and interoperability with other carriers all depend on SS7. Telehop continues to strive to offer the highest quality of service to its customers by using the best telecommunications technology available.

Telehop has data systems in place for pre-emptive maintenance, ASR (Answer Seizure Ratio) reporting and online fraud management systems that serve as real-time quality control tools for calls made out of our switch and network health statistics.

Telehop's main service offerings include its "HOP" long distance telephone services (currently marketed to the southern Ontario 'Golden Horseshoe' and the Metropolitan Montreal communities), Wholesale Services, Equal Access long distance services worldwide, Casual Calling services, Virtual Calling Card services, "1-800" Toll Free services, BroadTalk service that allows customers to place calls to anywhere in the world from anywhere in the world using the BroadTalk gateway and a high-speed Internet connection and Directory Assistance services to its customer base through casual calling. This Directory Assistance service offers operator-assisted Directory Assistance through the use of 10-10-620. In Q1 of 2005 Telehop launched its 10-10-100 service in Ontario, a second casual calling service based on per-minute billing. Telehop plans to roll out the 10-10-100 services to the west coast of Canada over the first two quarters of 2006.

Telehop's Casual Calling services are extensively advertised in print and broadcast media in approximately 19 different languages, under the brand names "10-10-620" and "10-10-100". Telehop's extensive media coverage makes use of smart slogans that include "Talk More, Pay Less"; "Call the world for \$1" and "Hundreds of ways to save". Telehop's advertising campaign is based on the principal of "Speaking to the communities in their own language".

Telehop also offers "1+" direct access long distance across most cities in Canada that allows customers to dial long-distance without having to dial any prefixes other than the 1+ or 011+. Telehop is focusing on building its brand and has launched the 1+ service under the brand name WorldTalk. Telehop, as the parent brand, is promoting itself as the Smart Alternative.

Telehop is interconnected with major carriers in Canada, the United States, and other global carriers for domestic and international worldwide terminations. Telehop uses diverse carriers and routes for its traffic to ensure the highest level of redundancy and reliability.

The range of long-distance services provided by Telehop Communications Inc. is outlined as follows:

"HOP" SERVICE

Telehop is one of the pioneers of unlimited long distance calling within an area covering most of the population base of Southern Ontario and Metropolitan Montreal.

By maintaining switches at numerous points-of-presence in individual towns in its "Superhop" area, Telehop uses its own proprietary network and gateway switches to provide unlimited long distance telephone calls within the Greater Toronto Area and Metropolitan Montreal for a fixed monthly fee. A caller calls a local access telephone number that acts as a gateway to the Company's system and then enters the number to be called. Using intelligent routing of the call, this call is then completed as a free local call, which would otherwise have been a long distance toll call. This service replaces a customer's monthly variable long distance charges within the Superhop area, with a lower fixed monthly fee. This service is also bi-directional, in that anybody within the "Superhop" areas can call the Telehop Superhop customer free, by first dialing a local access number. Telehop's system does not require its customers to use a PIN number because of the sophisticated authentication tools built into its system.

"10-10-620" AND "10-10-100" CASUAL CALLING SERVICES

Telehop's Casual Calling services allow any user to access Telehop's long distance Equal Access network from most telephones across Canada, without having to subscribe to the service, or pay any monthly fees. The dial-around service or casual calling service allows a user to bypass or 'dial around' their existing long-distance provider on any call by entering the digits "10-10-620" or "10-10-100" before making a call, without having to switch carriers. Any calls made using Telehop's "10-10-620" and "10-10-100" Casual Calling services appear on the customers' regular, monthly local telephone bill at Telehop's discounted rates. Telehop has entered into Billing & Collection Agreements with a number of major Local Exchange Carriers ("LECs") across Canada.

EQUAL ACCESS SERVICE

Telehop's other major activity is providing "Equal Access" long distance services worldwide to its residential and business customers.

The term "Equal Access" refers to a long distance service that offers equal ease of access to all customers. This allows Telehop customers to directly dial long distance calls on Telehop's network using the normal '1+' or '011+' dialing pattern.

Telehop has been an Equal Access long distance provider since 1994.

WHOLESALE SERVICES

Telehop's Wholesale Service is based on trading bulk minutes worldwide with other similar carriers through its switching infrastructure. Wholesale customers use Telehop's network to carry their calls to any part of the world at discounted rates. Telehop's state-of-the-art gateways provide global connectivity to its switching centers that could be located anywhere in the world.

The incremental revenues generated by its wholesale sales channel provide the Company with more purchasing power when negotiating with other network providers and hence allows it to offer ultra competitive retail rates at a profit.

One of the main areas differentiating Telehop from its competition is the ability to provide its customers automated call detail data, including a complete billing service to its retail agents and wholesale resellers. The Company's strategy is not only to offer its end-users a broad array of products, but to also offer its key customers access to the Company's scalable automated infrastructure. Through its Wholesale Services website, the Company and its independent sales agents and resellers have almost real-time Internet access to billing records, instantaneous order entry and processing capabilities.

VIRTUAL CALLING CARD SERVICE

The Telehop Virtual Calling Card is unique in that a customer does not need to acquire or purchase a physical card from a vendor or a convenience store. The user pre-pays the virtual card for a maximum dollar amount of long distance calling, and then the pre-paid Virtual Card can be easily replenished on the telephone or on the Internet. The Telehop Virtual Card account holders can also impose dollar limits and/or calling restrictions on their own cards. This is a useful tool for employers or families to control their long distance costs by setting predetermined spending limits on card users.

The user of a Telehop Virtual Calling Card can use this card from their home or office, or from any phone in North America, to call anywhere in the world at Telehop's standard discounted rates. The service is targeted at both corporate and residential sectors and is offered as a value-added service to our customers.

TOLL FREE SERVICE

Telehop is a reseller of Toll Free services. The Toll Free numbers 1-800, 1-855, 1-877 & 1-866 are offered to customers and billed at Telehop's discounted rates based on usage.

Telehop also offers its customers a worldwide, outbound toll free number, which allows them the ability to terminate a North American Toll Free number on any telephone in any country in the world.

BROADTALK SERVICE

Telehop is a reseller of Voice over Internet Protocol service, branded as BroadTalk. This service allows any customer that has access to a high-speed Internet connection to place calls to anywhere in the world from anywhere in the world using the BroadTalk gateway and a regular phone. The service is targeted at both corporate and residential sectors and is offered as a value-added service to our customers with very competitive calling rates.

DIRECTORY ASSISTANCE SERVICE

Telehop is a reseller of Directory Assistance service through casual calling. This service offers operator-assisted directory assistance to users that dial 00-10-620-0. The charges appear on the customer's regular monthly phone bill at discounted rates that are 50% below normal directory assistance rates.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year ended December 31, 2005

Dated April 27, 2006

Management's Discussion and Analysis ("MD&A") is intended to help shareholders, analysts and other readers understand the dynamics of Telehop Communications Inc.'s ("Telehop") business and the key factors underlying its financial results. It explains trends in Telehop's financial condition and operating results for the year ended December 31, 2005 compared with the operating results for the year ended December 31, 2004. The MD&A should be read in conjunction with the Audited Consolidated Financial Statements for the year-ended December 31, 2005.

FORWARD-LOOKING STATEMENTS

The consolidated financial statements and information and analysis in the management's discussion and analysis necessarily includes amounts and conclusions based on informed judgments and estimates of the expected effects of current events and transactions with appropriate consideration as to materiality. In addition, in preparing the financial information, management must interpret the requirements described above, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information.

Certain statements in the MD&A also constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause the results, performance or achievements of Telehop to be materially different from those expressed or implied by such statements. Such factors include, amongst others, the following: general economic and business conditions, demographic changes, regulation, major technology changes, timing of product introductions, competition, and the ability of Telehop to attract and retain key employees.

This MD&A is comprised of three sections:

- **HIGHLIGHTS**
- **OVERALL PERFORMANCE**
- **OUTLOOK**

MANAGEMENT'S DISCUSSION AND ANALYSIS

HIGHLIGHTS

Market conditions in 2005 continued with the 2004 trend where new service providers continued to enter the telecommunications industry, particularly in the long distance sector. New technologies and strong consumer demand continues to attract niche market service providers, generally putting pressure on selling prices and costs as companies strive to maintain market share and profit margins.

Notwithstanding, in the year ended December 31, 2005, Telehop continued to increase its market share and substantially penetrated new markets. Revenues from 2004 to 2005 increased by \$5.5 million. This increase was achieved through ongoing aggressive marketing efforts and the continuing strength of our wholesale operations which allowed us to negotiate more favourable rates with our major global carriers. This is a significant achievement in the face of increased competition.

Key developments for Telehop's 2005 year were:

- A significant increase in long-distance traffic of 110% in the total number of minutes carried and 214% in the total number of calls over 2004 traffic.
- A 36% increase in revenue, achieved in a year when industry trends continued to report declines in wireline long distance revenue and increasing wireless revenues.
- Maintenance of telecom costs as a percentage of revenue in spite of increased pressure on revenue per minute. This was achieved by close attention to detail using its advanced proprietary management information system Telehop successfully maintained its largest individual operating cost at 58% for 2004 and 2005. This equates to an increase in gross profit of approximately \$2.2 million in 2005.
- Strong working capital of \$2.1 million with no long-term debt. The reduction in cash was primarily due to the earlier reduction in accounts payable by \$598,560 in anticipation of a conversion of our accounting system on January 1, 2006. Hence, this reduction was only a timing issue; otherwise, the cash balance would have been approximately \$1.7 million. New capital expenditures foreseen for the year 2006 should be comfortably financed from internally generated cash flow.
- The successful launch of a new per-minute casual calling service, "10-10-100", in Ontario in early 2005.
- A return on equity of 21%, a 75% improvement over 2004

OVERALL PERFORMANCE

The Canadian landscape continued to exhibit explosive growth in the wireless segment with an increase of 17.5% at the end of 2004. The wireline segment, on the other hand, continued to exhibit a decline in revenues. As in 2004, competition in the casual calling arena continued to be fierce.

In 2005, Telehop's main focus was to build on its revenues by increasing its market share through its casual calling services and through acquisition of equal access customers. Over the year 2005, Telehop increased its number of 'direct dial' subscription customers by 255% resulting in a 'direct dial' call revenue increase of 322% from January 2005 to December 2005. 2005 was also a year where Telehop saw its newly branded "10-10-100" 'dial-around' service grow the number of its unique users approximately six-fold from January 2005 to December 2005 with only a 6% decrease in unique users of Telehop's branded "10-10-620" dial around service.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Telehop's unique strengths include its efficiencies with respect to successful targeted marketing to specific niche markets. In addition, low infrastructure costs combined with no long-term debt enable Telehop to stay competitive. Its ultimate strength is in its employees with Telehop enjoying an extremely low attrition rate and an employee base, which is skilled and experienced. This enables Telehop to dynamically respond to fluctuating market situations and gives it the capability to translate direction to action in short time. Telehop continues to see the declining revenue per minute as a challenge to growth and will continue to focus on the addition of complementary value-added services that will enable it to derive greater revenue and greater profitability per customer. Furthermore, Telehop plans to work on creating a package that encompasses market needs to encourage loyalty.

OPERATING RESULTS

For the year ended December 31, 2005 the overall financial and operating condition of the Company improved with specific regard to growing a more profitable revenue base and diversification of its product portfolio over the previous year.

The key factors were:

- A healthy mix of retail and wholesale revenues with a net improvement in gross margin of approximately \$2.2 million over 2004
- Maintenance of telecom costs as a percentage of revenue of 58%, which is consistent with 2004
- A decrease in general and administration costs of 1.1% as a percentage of revenue over the previous year
- A return on equity of 21%, a 75% increase from 2004. This was a result of Telehop's ability to finance its operations entirely from equity and retained earnings.
- Improvement in working capital from 1.63 in 2004 to 2.10 in 2005 - a net improvement of \$0.55 million.

All these factors are described in detail below.

Most of the Canadian telecom Companies continued to show a trend towards declining long distance revenues in spite of modest increases in traffic through their systems. Due to a global oversupply of capacity, the per-minute rates for long distance traffic have shown steady declines over the past few years.

In 2005, Telehop's focus was to increase its retail revenues. Telehop was successful in increasing its total traffic minutes by 110% or 170 million minutes over 2004 ending the year with a total of 326.2 million minutes. The total number of calls also increased significantly with 44.3 million calls more than in 2004, translating to a 214% increase over the previous year, for a total of 65.0 million calls in 2005 versus 20.7 million calls in 2004. Telehop saw a decrease in revenues per minute from 10 cents per minute in 2004 to 6 cents per minute in 2005. This was attributed to an intentional increase in wholesale traffic that brings in lower revenues per minute. However, this strategy has allowed Telehop to significantly increase its purchasing power with its major global carriers.

REVENUE

Total revenue in 2005 increased substantially over 2004, with an increase of \$5.5 million. This increase in revenue was attributed to significant increases in Telehop's "subscription" customer base as well as increased wholesale revenues.

MANAGEMENT'S DISCUSSION AND ANALYSIS

CARRIER CHARGES AND OPERATING COSTS

(\$ thousands)			Variance		Revenue %	
	2005	2004	\$	%	2005	2004
Revenue	20,817	15,326	5,491	35.8	100.0	100.0
Telecom costs	12,082	8,810	3,272	37.1	58.0	57.5
Gross profit	8,735	6,516	2,219	34.1	42.0	42.5
Operating costs	7,335	5,522	1,813	32.8	35.2	36.0
EBITDA *	1,400	994	406	40.8	6.7	6.5
Depreciation	419	435	(16)			
Interest	3	9	(6)			
Taxes	367	265	102			
Net Income	611	285	326			
EPS	\$ 0.05	\$ 0.02				
Diluted EPS	\$ 0.05	\$ 0.02				

* Earnings before Interest, Taxes, Depreciation and Amortization. EBITDA is a measure that has no standardized meaning prescribed by Canadian GAAP and is considered a non-GAAP measure. Therefore, the measure may not be comparable to similar measures presented by other issuers. This measure is described and presented in the MD&A, in order to provide shareholders and potential investors with additional information regarding the Company's liquidity and ability to generate funds to finance its operations.

TELECOM COSTS

In spite of a 110% increase in minutes and a 214% increase in the total number of calls carried, Telehop's total telecom costs remained flat as a percentage of revenue for the years 2005 and 2004.

Fixed telecom costs decreased by 1% of revenue in 2005 over 2004. This is attributed to optimum and effective utilization of the network.

Telehop's proprietary 'Telehop Management System' software provides management with real-time information which enables more intelligent call routing and costing, allowing management detailed information by destination.

Telehop's increase in minutes has added to its improved base business, enabling it to negotiate better bulk rates with its major global carriers.

OPERATING COSTS

GENERAL & ADMINISTRATION COSTS increased by \$0.66 million in 2005, representing a 1.1% decrease as a percentage of revenue over 2004. This decrease is attributed to the implementation of revised compensation structures for management as well as improved efficiencies within the company.

MARKETING AND SELLING EXPENSES increased in 2005 by \$1.0 million or 0.8% as a percentage of revenue over 2004, from \$2.5 million in 2004 to \$3.5 million in 2005. This increase in marketing and selling costs contributed significantly to the increase in revenues in 2005 of \$5.5 million, with increased market share in competitive markets and strong market penetration in new target markets across Canada. The increase in marketing expenditures was primarily due to the launch of a new casual calling service, "10-10-100", in Ontario as well as the launch of an aggressive campaign to acquire equal access subscribers across Canada.

MANAGEMENT'S DISCUSSION AND ANALYSIS

DEVELOPMENT AND TECHNICAL SUPPORT increased by \$0.09 million and remained flat as a percentage of revenue at 3% in 2005 and 2004. The main reason for the increase includes the expensing of the majority of software development done in the current year.

FINANCIAL SUMMARY

	2005	2004
Total revenue	20,817,340	15,325,613
Income	978,147	550,106
Net income	611,065	284,983
Net income per share	0.05	0.02
Diluted net income per share	0.05	0.02
Total assets	5,232,753	5,195,255
Total liabilities	2,001,166	2,589,634
Shareholders' equity	3,231,587	2,605,621
Return on equity	21%	12%

SUMMARY OF QUARTERLY RESULTS

	2004					2005				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
	(\$ thousands)									
Revenue	3,643	3,624	3,921	4,138	15,326	4,720	5,062	5,571	5,464	20,817
EBITDA*	412	(19)	363	238	994	284	108	257	751	1,400
Income	306	(130)	244	130	550	173	4	150	651	978
Net income	190	(90)	145	40	285	110	3	96	402	611
Earnings per share										
Basic	0.02	(0.01)	0.01	0.00	0.02	0.01	0.00	0.01	0.03	0.05
Diluted	0.02	(0.01)	0.01	0.00	0.02	0.01	0.00	0.01	0.03	0.05

* Earnings before Interest, Taxes, Depreciation and Amortization. EBITDA is a measure that has no standardized meaning prescribed by Canadian GAAP and is considered a non-GAAP measure. Therefore, the measure may not be comparable to similar measures presented by other issuers. This measure is described and presented in the MD&A, in order to provide shareholders and potential investors with additional information regarding the Company's liquidity and ability to generate funds to finance its operations.

Telehop's revenues show an increase over each corresponding quarters of 2004. This reflects the combination of successful marketing efforts and the rollout of new services across Canada. The last quarter in 2005 showed an increase of \$1.3 million or 32% over the comparable quarter in 2004.

LIQUIDITY

At the present time Telehop has sufficient cash on hand, and anticipates that it will continue to generate sufficient cash from its normal, ongoing business to fund any working capital and/or normal course capital expenditures for the foreseeable future.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Total capital lease obligations of \$14,363 will be repaid within the next 12 months. Total operating lease commitments are as follows:

2006	147,457
2007	177,984
2008	177,984
2009	177,984
2010	177,984
Thereafter	156,324
	<u>1,015,717</u>

The Company continues to operate under its infrastructure lease, which includes premises and facilities.

Telehop currently has no bank debt, other long-term debt or any other off-balance sheet arrangements. At year end the Company had \$0.83 million cash in the bank and the working capital ratio was 2.1:1.

CASH FLOW

In 2005 the Company generated cash from operating activities of \$55,037, up from cash generated from operating activities of \$19,968 in 2004.

The Company has adequate working capital to fund fiscal 2006 and foresees no requirement for outside financing at this point in the normal course.

The Company estimates that it currently has sufficient capacity to significantly expand the traffic through its system without incurring any major capital expenditures in the foreseeable future. Management views the keys to expanding traffic as being continued targeted marketing and careful and selective expense management.

At the end of 2005, Telehop had a cash balance of \$832,735 and accounts receivable of \$3,156,492 compared to cash of \$1,262,491 and accounts receivables of \$2,541,509 at the end of 2004. Total current assets at the end of 2005 were \$4,051,078, which remained flat from \$4,063,905 in 2004. The reduced cash balance in 2005 of \$429,756 over 2004 is mainly the result of the earlier reduction in accounts payable by \$598,560 in anticipation of a conversion of our accounting system on January 1, 2006. This was to ensure that we had sufficient time to correct any system problems related to the issuance of cheques. No problems were encountered after the conversion.

Book value of Property, plant and equipment and intangible assets increased by \$50,325 after applying depreciation and amortization of \$419,522 for the year giving total assets of \$5,232,753 in 2005 compared to \$5,195,255 in 2004. The increase is attributed mainly to acquisition of communication equipment to keep pace with new technology.

Cash was used to pay corporate taxes amounting to \$314,661 and reducing accounts payable by \$598,560. This resulted in total current liabilities of \$1,931,959 in 2005, decreasing from 2004 by \$565,703, while total current assets decreased marginally by \$12,827, effectively improving the working capital by \$552,876 over 2004.

Working capital at the end of 2005 totaled \$2.1 million, a 35% improvement of \$552,876 from the 2004 working capital of \$1.6 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS

CHANGES IN ACCOUNTING POLICIES

The company accounts for stock-based compensation in accordance with the CICA Handbook Section 3870, "Stock-based Compensation & Other Stock-based Payments". Section 3870 requires that all stock-based awards made to employees and non-employees be measured and recognized using a fair value based method, such as Black-Scholes option pricing model. Previously the standard encouraged the use of a fair value based method for all awards granted to employees but only required the use of a fair value based method for direct awards of stock, stock appreciation rights, and awards that call for settlement in cash or other assets.

Beginning January 1, 2004, the Company adopted the recommendations of the revised Section 3870, and has applied the recommendations of this section retroactively without restatement of prior periods. As a result, opening retained earnings as at January 1, 2004 has been decreased to reflect the expensing of the fair value of \$16,763 and \$85,597 for options granted to employees in 2002 and 2003 respectively

PENSION PLAN

The Company offers defined benefit pension plans to its executive employees. The pension plan expense for defined benefits plans is determined using the projected method pro-rated on years of service. The pension plan expense includes:

- Cost of pension plan benefits provided in exchange for employees' service rendered during the period;
- Amortization of prior service costs and amendments on a straight line basis over the expected average remaining service life of the employees covered by the plan; and
- Interest cost of pension plan 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 projected benefit obligation of fair value of plan assets over the expected average remaining service life of the employee group covered by the plans.

The Company values pension plan assets at fair value, which is determined using current market value rates. Net benefit cost recognized in 2005 \$70,990 (2004 - \$68,141)

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The valuation of the allowance for doubtful accounts is managed on a monthly basis where provisions are applied at various percentages for accounts receivable categorized by risk.

FOURTH QUARTER 2005

Telehop's revenue for the three months ended December 31, 2005 was \$5,464,998 compared with \$4,137,897 in the same period in 2004. Net income in the 2005 fourth quarter increased by \$362,257 from \$39,852 (\$0.00 per share) in 2004, to \$402,109 (\$0.05 per share) in 2005 as a result of sustained marketing and cost control focus. Telehop's revenue increase of \$1,327,101 or 32% in the fourth quarter of 2005 over the fourth quarter of 2004 was due to the success in marketing efforts in gaining market share and penetrating new markets.

Telehop's total long distance traffic processed by the Company for Q4 in 2005 showed significant growth over the comparable quarter in 2004. The total long distance traffic for Q4 in 2005 increased to 86.7 million minutes in 18.5 million calls, versus a total of 48.9 million minutes in 6.6 million calls in the same quarter of 2004. This was attributed to

MANAGEMENT'S DISCUSSION AND ANALYSIS

the increase in wholesale traffic over 2004.

Telehop's total telecom costs increased from \$2.5 million in Q4 of 2004 to \$2.9 million in Q4 of 2005. This represented a decrease of 8% as a percentage of revenues over the comparative quarter and is attributable to aggressive cost control efforts realized through optimum network utilization. Fixed costs increased marginally from \$344,427 in Q4 of 2004 to \$423,758 in Q4 of 2005, a 0.05% decrease as a percentage of revenue in 2005 to 7.8% of revenue versus 8.3% of revenue in 2004.

General & administration costs for Q4 in 2005 increased by \$210,936 over Q4 of 2004 with the percentage to revenue remaining flat over 2004.

Marketing and selling costs for Q4 in 2005 increased by \$243,428 over Q4 of 2004. Marketing costs in Q4 of 2005 were \$821,823 from \$578,395 in Q4 of 2004 representing an increase of 1.1% as a percentage of revenue in Q4 of 2005 over Q4 of 2004; to 15.0% in Q4 of 2005 from 13.9% in Q4 of 2004. This increase contributed significantly to the 32% increase in revenue.

CAPITALIZATION

As of April 22, 2006 the Company had 12,437,000 common shares outstanding and 1,289,500 common share purchase options, which are exercisable at prices ranging between \$0.20 and \$0.37 per share at varying times before June 24, 2010.

RISK RELATED BUSINESS

You should carefully consider the following risk factors as well as the information included in this Report together with our consolidated financial statements and the related notes in evaluating our business and prospects.

The increase in range of services offered by our competitors could adversely impact our business. Telecommunications providers are continually increasing the range of services they offer. This trend may lead to a greater ability among our competitors to provide a comprehensive range of telecommunications services, which could lead to a reduction in demand for our services. Moreover, new services introduced by competitors could reduce the number of our current or potential customers.

Our business is dependent upon our ability to keep pace with the latest technological changes. The market for our services is characterized by rapid change and technological improvements. Failure to respond in a timely and cost-effective way to these technological developments could result in serious harm to our business and operating results. We have derived, and we expect to continue to derive, a substantial portion of our revenues from providing telecommunications services that are based upon today's leading technologies and that are capable of adapting to future technologies. Our success will depend, in part, on our ability to afford the cost of acquiring new hardware and software associated with new technologies, develop and market service offerings that have significant customer demand, respond in a timely manner to the technological advances of our customers, evolving industry standards and changing client preferences.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Other factors include:

- long distance telecommunications market and the economic conditions generally.
- fluctuations in demand for our services.
- reductions in the prices of services offered by our competitors.
- costs of integrating technologies or businesses that we add.
- the timing of expansion into new markets, both domestically and internationally.

OUTLOOK

Telehop expects to continue increasing its market share through effective niche marketing. In 2006, Telehop is placing increased focus on increasing profitability and providing added value to its shareholders.

This will be done by

- Increasing profitable revenue growth - by offering services that are in demand to new and existing customers, continuing to expand our footprint across Canada, and reaching new niche market through specialized campaigns and affinity programs
- Increasing operating margins through:
 - maintaining tight controls on overhead costs.
 - dedicated network monitoring and optimization.
 - using our purchasing power to leverage telecommunications savings.

In summary, Telehop expects to see increased profitability through the year continuing the trend set in 2005. In addition, Telehop expects that its 2006 capital expenditure and customer acquisition marketing programs will be financed out of cash flow, although these expenditures could accelerate depending on market conditions or any acquisitions or other business opportunities that may arise.

MANAGEMENT'S REPORTING RESPONSIBILITY

The accompanying consolidated financial statements of Telehop Communications Inc. and its subsidiaries are the responsibility of management and have been approved by the Board of Directors.

Management in conformity with Canadian generally accepted accounting principles has prepared the financial statements. The financial statements include some amounts that are based on best estimates and judgments. Financial information used elsewhere in the annual report is consistent with that in the financial statements.

Management of the Company and its subsidiaries, in furtherance of the integrity and objectivity of data in the financial statements, has developed and maintains a system of internal accounting controls. Management believes that this system of internal accounting controls provides reasonable assurance that, financial records are reliable and form a proper basis for preparation of financial statements and, that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the financial statements in this annual report principally through its audit committee. The audit committee reviews the Company's annual consolidated financial statements and recommends their approval to the Board of Directors. The shareholders' auditors have full access to the audit committee, with and without management being present.

These financial statements have been examined by the shareholders' auditors, Schwartz Levitsky Feldman LLP., and their report is presented below.



Ruth Bartholomeusz
President & COO



Glenn Reinecke
Interim Controller

AUDITOR'S REPORT

To the Directors and Shareholders of
Telehop Communications Inc.

We have audited the consolidated balance sheet of Telehop Communications Inc. as at December 31, 2005 and the consolidated statements of income, retained earnings and cash flows for the year 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 audit.

We conducted our audit 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 December 31, 2005 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 2004 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated April 15, 2005.

"SCHWARTZ LEVITSKY FELDMAN LLP"

Chartered Accountants

Toronto, Ontario
March 24, 2006

CONSOLIDATED BALANCE SHEET

December 31, 2005 and 2004 2005 2004

ASSETS

CURRENT

Cash and cash equivalents	\$ 832,735	\$ 1,262,491
Accounts receivable	3,156,492	2,541,509
Prepaid expenses and deposits	61,851	104,665
Income taxes recoverable	-	155,240
	4,051,078	4,063,905

PROPERTY, PLANT AND EQUIPMENT (Note 4)	854,430	696,124
INTANGIBLES (Note 5)	327,245	435,226
	\$ 5,232,753	\$ 5,195,255

LIABILITIES

CURRENT

Accounts payable and accrued liabilities	\$ 1,884,722	\$ 2,483,282
Income taxes payable	32,874	-
Obligations under capital lease (Note 6)	14,363	14,380
	1,931,959	2,497,662

FUTURE INCOME TAX LIABILITY (Note 3)	69,207	77,043
OBLIGATIONS UNDER CAPITAL LEASE (Note 6)	-	14,929
	2,001,166	2,589,634

SHAREHOLDERS' EQUITY

CAPITAL STOCK (Note 7)	1,200,419	1,200,419
CONTRIBUTED SURPLUS (Note 7(b))	154,819	139,918
RETAINED EARNINGS	1,876,349	1,265,284
	3,231,587	2,605,621
	\$ 5,232,753	\$ 5,195,255

APPROVED BY THE BOARD



Barry Dixon
Director



Bryan Ceresne
Director

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, 2005 and 2004	2005	2004
REVENUE	\$ 20,817,340	\$ 15,325,613
EXPENSES		
Telecom costs	12,082,369	8,810,329
General and administration	3,200,786	2,537,185
Marketing and selling	3,537,118	2,476,841
Development and technical support	596,853	506,809
Amortization expense	419,522	435,178
Interest expense	2,545	9,165
	19,839,193	14,775,507
INCOME BEFORE INCOME TAXES	978,147	550,106
INCOME TAX EXPENSE (Note 3)	367,082	265,123
NET INCOME FOR THE YEAR	\$ 611,065	\$ 284,983
EARNINGS PER SHARE (Note 9)	\$ 0.05	\$ 0.02
DILUTED EARNINGS PER SHARE (Note 9)	\$ 0.05	\$ 0.02

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended December 31, 2005 and 2004	2005	2004
Balance at beginning of year as previously reported	\$ 1,265,284	\$ 1,082,661
Adjustments on adoption of new accounting standard (Note 2)	-	(102,360)
Balance at beginning of year as restated	1,265,284	980,301
Income for the year	611,065	284,983
Balance end of year	\$ 1,876,349	\$ 1,265,284

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2005 and 2004	2005	2004
CASH FLOW PROVIDED BY (USED FOR)		
OPERATING ACTIVITIES		
Net income for the year	\$ 611,065	\$ 284,983
Adjustments for non-cash items:		
Amortization expense	419,522	435,178
Future income tax liability	(7,836)	48,466
Stock compensation (Note 7(b))	14,901	63,261
	1,037,652	831,888
Changes in working capital items :		
Accounts receivable	(614,983)	(254,414)
Prepaid expenses	42,814	(71,428)
Accounts payable and accrued liabilities	(598,560)	44,462
Income taxes recoverable	188,114	(530,540)
Cash provided by operating activities	55,037	19,968
INVESTING ACTIVITIES		
Acquisitions of property, plant and equipment	(469,847)	(330,681)
Acquisition of intangibles	-	(107,248)
Cash used for investing activities	(469,847)	(437,929)
FINANCING ACTIVITY		
Capital lease financing	(14,946)	(23,035)
Issuance of common shares	-	71,900
Cash provided by/(used for) financing activities	(14,946)	48,865
NET (DECREASE)/INCREASE IN CASH POSITION	(429,756)	(369,096)
CASH POSITION, BEGINNING OF YEAR	1,262,491	1,631,587
CASH POSITION, END OF YEAR	\$ 832,735	\$ 1,262,491

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Interest paid	\$ 47,396	\$ 80,085
Interest earned	\$ (44,851)	\$ (70,920)
Income taxes paid	\$ 314,661	\$ 859,750

1. NATURE OF BUSINESS

Telehop Communications Inc. is a full-service long distance provider operating within the telecommunications industry and is registered with the Canadian Radio-television and Telecommunications Commission ("CRTC") as a licensed Class 'A' Telecom Carrier.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following policies:

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany transactions and accounts have been eliminated on consolidation. Subsidiaries are as follows:

Telehop Communications Inc.

International Telehop Network Systems Inc.

Telehop Long Distance Services Limited.

Telehop Long Distance Limited.

Card Tel Corp.

Telehop Agencies Inc.

Telehop Global Israel Inc.

Telehop Premium Business Services Inc.

Telehop Rebillers Limited.

Ten-Ten-Six-Twenty Ltd.

The Friend Network Inc.

The Friend Network Services Inc.

Worldhop. Com. Inc.

MEASUREMENT UNCERTAINTY

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The valuation of the allowance for doubtful accounts, recoverability of intangible assets, and specific telecom accruals are the key areas where management employs the use of estimates and assumptions. Given the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

For purposes of the consolidated financial statements, cash and cash equivalents is defined as cash and short-term deposits having a maturity of three months or less.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY, PLANT AND EQUIPMENT

When events or changes in circumstances indicate the carrying amount of a long-lived asset may not be recoverable, an impairment loss is recognized when the carrying amount of those assets exceeds the sum of the undiscounted future cash flows related to them. The impairment loss is included in the statement of income (loss) and the carrying value of the asset is reduced to its fair value as determined by the sum of the discounted future cash flows related to those assets.

Property, plant and equipment are recorded at cost and are amortized based on the estimated useful lives of the assets using the straight-line method over the following periods:

Telecom equipment	- 5 years
Automobile	- 5 years
Furniture and equipment	- 5 years
Leasehold improvements	- 5 years
Telecom switch	- 7 years
Computer software	- 5 years

INTANGIBLE ASSETS

Intangible assets comprise costs for an internally developed computer software system that manages telephone call data management and billing, with an enhanced accounting and financial reporting module. Intangible assets are amortized over their estimated useful life on a straight-line basis over 5 years. Management reviews the intangible assets for amortization and useful life annually and also for impairment whenever events or changes in circumstances indicate that full recoverability is questionable. Management measures any potential impairment by comparing the carrying value to the undiscounted amounts of expected future cash flows.

TRANSLATION OF FOREIGN CURRENCIES

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet dates. Revenues and expenses are translated at exchange rates prevailing during the period. Translation gains and losses are reflected in net income and have been disclosed in Note 10.

POST-EMPLOYMENT BENEFITS

The cost of providing benefits through defined benefit pensions is actuarially determined and recognized in earnings using the projected benefits method pro-rated on service. Differences arising from plan amendments, changes in assumptions and experience gains and losses are recognized in earnings over the expected average remaining service life of employees. The cost of providing benefits through defined contribution pension plans is charged to earnings when contributions become payable.

Actuarial gains and losses that fall outside a corridor defined as the greater of (a) 10% of the accrued benefit obligation and (b) 10% of the fair market value of the plan assets at the beginning of the year are amortized over the average remaining service period of active employees on a straight-line basis. The expected return on plan assets is based on the fair value of plan assets.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

INCOME TAXES

The Company uses the asset and liability method for accounting for income taxes which requires the establishment of future tax assets and liabilities, as measured by substantively enacted tax rates, for all temporary differences caused when tax bases of assets and liabilities differ from those reported in the financial statements. Future 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. Future tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

REVENUE RECOGNITION

The Company records revenue from retail and wholesale services at the time of customer usage primarily based upon minutes of use. The Company recognizes revenues on the accrual basis and includes an estimate of revenues earned but not billed. Revenue is only recognized where there is reasonable assurance of collection. Royalty revenue is received monthly in arrears and accrued in the applicable month it is earned.

The Company makes a provision for bad debts using management's best estimate. The provision is netted against accounts receivable. The provision is reviewed on a regular basis by management.

STOCK OPTION PLAN AND CHANGE IN ACCOUNTING POLICY

The Company has an employee stock option plan, which is described in Note 7.

The Company accounts for stock-based compensation in accordance with the CICA Handbook Section 3870, "Stock-based Compensation & Other Stock-based Payments". Section 3870 requires that all stock-based awards made to employees and non-employees be measured and recognized using a fair value based method, such as the Black-Scholes option pricing model. Previously the standard encouraged the use of a fair value based method for all awards granted to employees but only required the use of a fair value based method for direct awards of stock, stock appreciation rights, and awards that call for settlement in cash or other assets.

Beginning January 1, 2004, the Company adopted the recommendations of the revised Section 3870, and has applied the recommendations of this Section retroactively without restatement of prior periods. As a result, opening retained earnings as at January 1, 2004 has been decreased to reflect the expensing of the fair value of \$16,763 and \$85,597 for options granted to employees in 2002 and 2003 respectively.

Refer to Note 7(a) for additional disclosure on stock-based compensation.

EARNINGS PER SHARE

The Company uses the treasury stock method of calculating the dilutive effect of options on earnings per share, whereby any proceeds obtained upon exercise of options is assumed to be used to purchase common shares at the average market share price during the period, except in the instance where such a calculation would be anti-dilutive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

GUARANTEES

In 2003 the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants' Accounting Guideline 14, "Disclosure of Guarantees". In the normal course of business, the Company has guaranteed a portion of the residual values of certain assets under operating leases with expiry dates between June 2004 and November 2006, for the benefit of the lessor, the carrying value of which are \$NIL (2004 \$NIL). If the Company elects not to purchase or release the assets at the end of their respective lease term, then the Company must, under certain conditions, compensate the lessor for a portion of any shortfall between the fair value and the residual value. The maximum exposure in respect of these guarantees is approximately \$5,000.

3. INCOME TAXES

INCOME TAX EXPENSE

The income tax expense for the years ended December 31, is as follows:

	2005	2004
Current	\$ 374,918	\$ 216,655
Future	(7,836)	48,468
	\$ 367,082	\$ 265,123

FUTURE INCOME TAX ASSETS AND LIABILITIES

Future income tax assets and liabilities as at December 31, 2005 and 2004 were as follows:

	2005	2004
Future income tax liability		
Accounting base of property, plant and equipment in excess of tax value	\$ (69,207)	\$ (87,638)
Losses available for carry forward	-	8,495
Other	-	2,100
Net future income tax (liability)/asset	\$ (69,207)	\$ (77,043)
Long-term	(69,207)	\$ 77,043)

RECONCILIATION OF PROVISIONS TO STATUTORY RATES

The reconciliation of income taxes at Canadian statutory rates to the provision for income taxes is as follows:

	2005	2004
Income before income taxes	\$ 978,147	\$ 550,106
Approximate applicable statutory tax rate	36.12%	36.12%
Income taxes at statutory tax rates	353,307	198,698
Adjustment to prior year's provision		
Non-deductible amounts	7,757	23,688
Other	6,018	42,737
	\$ 367,082	\$ 265,123

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. PROPERTY, PLANT AND EQUIPMENT

	2005			2004		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telecom equipment	\$ 1,222,463	\$ 619,192	\$ 603,271	\$ 920,602	\$ 430,491	\$ 490,111
Telecom switch	938,139	938,139	-	938,139	878,600	59,539
Computer software	253,892	72,947	180,945	95,694	56,598	39,096
Leasehold improvements	162,698	124,936	37,762	156,268	92,707	63,561
Furniture and equipment	91,969	65,317	26,652	88,611	53,172	35,439
Automobile	12,889	7,089	5,800	12,889	4,511	8,378
	\$ 2,682,050	\$ 1,827,620	\$ 854,430	\$ 2,212,203	\$ 1,516,079	\$ 696,124

The gross amount and net book value of property, plant and equipment under capital lease as at December 31, 2005 is \$42,324 and \$16,930 respectively (2004: \$114,713 and \$60,383). Amortization expense for the year-end December 31, 2005 is \$311,541 (2004: \$338,838). Amortization of property, plant and equipment under capital lease for the year-end December 31, 2005 is \$8,465 (2004: \$22,942).

5. INTANGIBLES

	2005			2004		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Internally Developed Software	\$ 540,029	\$ 212,784	\$ 327,245	\$ 540,029	\$ 104,803	\$ 435,226

Intangible assets comprise costs for an internally developed computer software system that manages the telephone call data management and billing, with an enhanced accounting and financial reporting module. Amortization expense for the year end December 31, 2005 is \$107,981 (2004: \$96,340).

6. OBLIGATIONS UNDER CAPITAL LEASE

The Company has entered into leases for certain equipment that have been capitalized. The leases that exist at December 31, 2005 bear interest at a rate of 6%. The minimum future lease payments are as follows:

	2005	2004
2005	-	16,498
2006	14,929	15,388
Total minimum lease payments	14,929	31,886
Less amount representing imputed interest of approximately 6%	566	2,577
Present value of obligations under capital lease	14,363	29,309
Current portion - due within one year	14,363	14,380
Long-term obligations under capital lease	\$ -	\$ 14,929

Interest expense for the year end December 31, 2005 is \$2,545 (2004 \$9,165)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. SHAREHOLDERS' EQUITY

Authorized

An unlimited number of common shares

Issued and outstanding

The changes in common shares for 2005 and 2004 are as follows:

	2005		2004	
	No. of Shares	Amount	No. of Shares	Amount
Balance, beginning of year	12,437,000	\$ 1,200,419	12,077,500	\$ 1,096,164
Issued on exercise of employee stock options (Note 7(a))	-	-	359,500	104,255
Balance, end of year	12,437,000	\$ 1,200,419	12,437,500	\$ 1,200,419

(A) STOCK OPTIONS

The Company's employee stock option plan ("ESOP") authorized the Company to reserve 1,800,000 common shares of the Company for issuance in accordance with the terms of the ESOP. Options granted vest over a period not exceeding five years and the purchase price is payable in full at the time the options are exercised.

The following table presents information concerning stock options granted under the Company's stock option plan:

	2005		2004	
	Number of options	Weighted Average Exercise Price	Number of options	Weighted Average Exercise Price
Options outstanding, beginning of year	1,089,500	\$ 0.24	1,444,000	\$ 0.23
Options granted	200,000	0.34	5,000	0.32
Options exercised			(359,500)	0.20
Options cancelled			-	-
Options outstanding, end of year	1,289,500	\$ 0.26	1,089,500	\$ 0.24
Options exercisable, end of year	1,164,500	\$ 0.25	996,167	\$ 0.23

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. SHAREHOLDERS' EQUITY (continued)

(A) STOCK OPTIONS (CONTINUED)

The following table summarizes information about stock options outstanding at December 31, 2005:

Weighted Average Exercise Price	Options Outstanding		Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Exercise Price
\$ 0.20	784,500	1.53 years	784,500	\$ 0.20
\$ 0.30	100,000	4.96 years	37,500	\$ 0.30
\$ 0.32	5,000	4.16 years	5,000	\$ 0.32
\$ 0.35	300,000	2.72 years	300,000	\$ 0.35
\$ 0.37	100,000	4.96 years	37,500	\$ 0.37
	1,289,500	2.85 years	1,164,500	\$ 0.23

All options were below market value at the time of granting.

The Company has evaluated the fair value of all options granted during the past four years using the Black-Scholes option pricing model with the noted assumptions:

	December 31, 2005 Weighted Average	December 31, 2004 Weighted Average
Estimated fair value at the date of grant for options granted in the period	\$0.18 - \$0.19	\$ 0.25
Assumptions utilized:		
Risk-free interest rate	3.29%	3.82%
Expected volatility	75%	104%
Expected life of the options	5 years	5 years
Dividend Yield	0%	0%

(B) CONTRIBUTED SURPLUS

In addition to the adjustment arising from the adoption of the new accounting policy relating to stock options discussed in Note 2, the Company issued 200,000 options at an exercise price of \$0.30 and \$0.37 in 2005. The Black-Scholes model has been used to determine the present value of these options, and to record the compensation expense, which is based on the vesting period of the options. The impact of this option issue on contributed surplus for the year ended December 31, 2005 was \$14,901 (2004 - \$63,261).

The following is a continuity of accumulated stock based compensation expense for the year ended December 31, 2005:

	2005	2004
Balance December 31, 2003	\$ 139,918	\$ 6,652
Stock-based compensation expense during the year	14,901	63,261
Change in accounting policy - note 2	-	102,360
Allocated to share capital on exercise of options during the year	-	(32,355)
Balance December 31, 2004	\$ 154,819	\$ 139,918

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. EMPLOYEE BENEFIT PLANS

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

	Registered Pension Plans	
	2005	2004
Change in benefit obligations		
Projected benefit obligation, beginning of year	\$ 243,875	\$ -
Current service cost	44,577	41,467
Interest cost	19,962	14,121
Actuarial (gains) losses	-	-
Benefit payments	-	-
Employee contributions	-	-
Prior service costs	-	188,287
Benefit obligation, end of year	308,414	243,875
Change in fair value of plan assets		
Fair value of plan assets, beginning of year	-	-
Return on plan assets	6,102	-
Benefit payments	-	-
Employer contributions	105,912	-
Employee contributions	49,578	-
Fair value of plan assets, end of year Comprised of 100% mutual Funds	161,592	-
Funded status (plan deficit)	(146,822)	(243,875)
Unamortized net actuarial (gain) loss	-	-
Unamortized past service costs	163,181	175,734
Unamortized transitional (asset) obligation	-	-
Valuation allowance	-	-
Accrued benefit asset (liability)	16,359	(68,141)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. EMPLOYEE BENEFIT PLANS (continued)

The table below shows the net benefit plan cost before and after recognizing its long-term nature. The recognized net benefit plan cost reflects the amount reported in the Company's statement of income and is calculated according to the Company's accounting policy.

	Registered Pension Plans	
	2005	2004
Current service cost	\$ 44,577	\$ 41,467
Interest cost	19,962	14,121
Actual return on assets	(6,102)	-
Actuarial loss on accrued benefit obligation	-	-
Elements of employee future benefit plans cost, before recognizing its long-term nature	58,437	55,588
Actuarial loss	-	-
Difference between the actual return and estimated return on plan assets	-	-
Amortization of transitional asset (obligation)	-	-
Amortization of past service cost	12,553	12,553
Amortization of net actuarial loss	-	-
Others	-	-
Adjustment to recognize long-term nature of employee future benefit plans credit	12,553	12,553
Increase in valuation allowance	-	-
Net benefit plans cost recognized	\$ 70,990	\$ 68,141

The measurement valuation date is January 1, 2005 and actuarial valuation date is January 1, 2004.

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows:

	2005	2004
Discount rate	7.5%	7.5%
Expected long-term rate of return on plan assets	7.5%	7.5%
Rate of compensation increase	5.5%	5.5%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. EARNINGS PER SHARE

The Company uses the treasury stock method of calculating the dilutive effect of options on earnings per share.

The following table sets forth the computation of basic and diluted earnings per share:

	2005	2004
Net Income	\$ 611,065	\$ 284,983
Weighted-average shares for earnings per share	12,437,000	12,304,767
Effect of dilutive securities - Employee stock options	242,887	441,680
Adjusted weighted-average shares and assumed conversions for diluted earnings per share	12,679,887	12,746,447
Earnings per share	0.05	0.02
Diluted earnings per share	0.05	0.02

10. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

CREDIT RISK

The Company is subject to credit risk through accounts receivables, which is limited by the large number of customers and their geographic dispersion across Ontario. The Company has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks, and maintains provisions for potential credit losses that are assessed on an ongoing basis.

A majority of the Company's receivables are owed by a few Local Exchange Carriers (LEC's) across Canada. These LEC's provide billing and collection services to the Company's customers through an arrangement whereby the Company is limited to a fixed percentage exposure. In mitigation, the Company purchases long distance services from these carriers for similar amounts owed at any time.

The Company is dependent in Ontario, Quebec, British Columbia, Alberta, Saskatchewan and Manitoba upon carriers to provide billing and collection services to its customers under renewable agreements. Management expects that these agreements will automatically renew.

The Company purchases long distance services from a number of carriers and does not feel there is any economic dependence on any one carrier.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of financial instruments included in current assets and current liabilities approximate their estimated fair values at December 31, 2005 and 2004, reflecting the short-term maturity and normal trade credit terms of these instruments. The carrying value of the Company's long-term obligation associated with the capital lease approximates fair value of the instrument, given prevailing interest rates for such arrangements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (continued)

FOREIGN EXCHANGE RISK

Foreign exchange risk arose because of fluctuations in exchange rates. The Company conducts a portion of its business activities in the United States. The assets, liabilities, revenues and expenses denominated in United States dollars will be affected by changes in the exchange rate between the Canadian dollar and the United States dollar.

The net foreign exchange gain for 2005 was \$13,248 (2004 \$130,363) and has been recorded in the general and administration expense.

11. COMMITMENTS

OPERATING LEASES

The future minimum payments under operating leases as at December 31, 2004 are as follows:

2006	\$ 147,457
2007	177,984
2008	177,984
2009	177,984
2010	177,984
Thereafter	156,324
	<hr/>
	\$ 1,015,717

12. SEGMENTED INFORMATION

The Company has determined that it has one reportable segment. The Company's operations are substantially all related to the provision of telecommunication services to the residential and business sectors. All assets of the business support these operations and are located in Canada.

13. COMPARATIVE FIGURES

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

PERSONAL NOTES

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