

## MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year ended December 31, 2007

**Dated April 28, 2008**

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, 2007 compared with the operating results for the year ended December 31, 2006. The MD&A should be read in conjunction with the Audited Consolidated Financial Statements for the year-ended December 31, 2007.

### **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, and timing of product introductions, competition, and the ability of Telehop to attract and retain key employees. Readers are cautioned not to place undue reliance on forward-looking statements as various factors could cause actual future results, conditions or events to differ materially from expectations or estimates expressed in the forward-looking statements.



## Management's Discussion and Analysis Index

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## 1. CORE BUSINESS, VISION AND STRATEGY

### Core Business

Telehop (the Company) 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’s core network resides in Toronto, Ontario, with virtual points-of-presence in major cities across Canada. We earn our revenues from the access to, and the use of, our telecommunications network and infrastructure. We sell one type of service which is packaged in different forms which includes casual calling, subscriptions and wholesale.

#### *Casual Calling*

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 telephone bills at Telehop’s discounted rates. Telehop has entered into Billing & Collection Agreements with a number of major Local Exchange Carriers (“LECs”) across Canada.

#### *Subscriptions*

Equal Access – The Company is a provider of “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.

BroadTalk – The Company 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.

Virtual Card – The Company offers a virtual calling card such 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.

High-speed Internet – The Company is a reseller of high-speed internet service that can match the quality and speed of any of the larger incumbent high-speed internet providers in Canada, while offered at a much lower price.

#### *Wholesale*

Telehop’s wholesale service is based on trading bulk minutes worldwide with high volume users who wish to carry their calls through our network. These high volume users often repackage the minutes purchased from us at discounted rates with their own unique services which are then sold to their customers.

## **Vision and Strategy**

Our vision is to become one of Canada's leading alternative telecommunications service providers that offer the greatest value proposition to all Canadians for all their telecommunications needs. Our strategy for growth is to increase its customer base by developing new services and product mixes that meet the evolving needs of Canadian consumers.

Telehop has thrived from its traditional long-distance services by focusing on providing the best value to its customers. However, the Company acknowledges that competing technologies have entered into the telecommunications space and it is addressing this changing trend by embracing new technologies that will offer even more value and convenience to its customers. In addition, market pressures continue to drive long-distance rates lower as the Company must adopt same to ensure customer retention. This trend is consistent with any mature market and we acknowledge the need to become more innovative and even more efficient in order to preserve its competitive position.

One major direction the Company is committing to is its voice-over-internet-protocol (VOIP) strategy. The Company will be devoting a significant amount of resources in the near future in developing an attractive VOIP solution that will help diversify its existing portfolio of services and protect its competitive position as industry trends have indicated an upward migration of customers over to VOIP services. VOIP technology has many useful applications as voice and data can be transmitted through an IP network that can support high volumes of traffic at a substantially lower cost compared to traditional circuit switched connections.

Globalization has become a necessity for every Canadian company to stay competitive and the Company has taken advantage of this trend through various outsourcing initiatives that they have recently started to contribute to cost efficiencies.

## **2. KEY PERFORMANCE INDICATORS (KPI's) AND NON-GAAP MEASURES**

We measure the success our strategy through a number of key performance indicators, which are outlined below. The following key performance indicators are not measurements in accordance with GAAP and should not be used as an alternative to net income or any other measure of performance under GAAP.

### *Gross Margin*

Gross margin is determined by deducting all telecommunications-related expenses from operating revenues. Telecommunications expenses include fixed and variable carrier costs, billing and collections charges to local exchange carriers and support costs for all telecommunications facilities. Gross margin is an indicator of the company's profit directly tied to its services before general operating expenses.

### *Calls and Minutes*

Calls and minutes are determined by the number of calls and minutes that have been completed by customers through the Company's network, which are tracked through call detail records. This indicator is a measure of how well the Company has increased overall volume in customer usage of its network.

### *Average Revenue per Minute (ARPM)*

Average revenue per minute is determined by dividing total operating revenues by total number of minutes completed. This indicator serves to measure how well the company has maintained or increased its long-distance rates per minute.

### *EBITDA*

Earnings before interest, taxes, depreciation and amortization (EBITDA) is a standard used in the telecommunications industry to assist in understanding and comparing operating results. The Company believes that this measure is important in assessing its profitability before the impact of depreciation and amortization and non-operating factors. EBITDA is also a useful measure of the Company's ability to service debt, invest in capital equipment or distribute dividends to its shareholders. EBITDA is not defined by GAAP and should be used as a supplement and not a substitute for the Company's results of operations.

Interest expense as reported in the consolidated financial statements have been included in EBITDA for our purposes since they are not interest related to debt servicing but expenses incurred as part of normal course of business.

### **3. CAPABILITY TO DELIVER**

#### *Management Capabilities*

Our experienced management team is our most important resource as it builds the foundation of our business strategies and provides the necessary leadership across the organization to ensure we execute on our short- and long-term goals. Our employees are the ones who make things happen as they operate as a cohesive group and have adapted to changes and challenges that we have encountered.

We take pride in our ethnic employee base as we have representation from over 30 countries. Our mosaic cultural base is fluent in over 50 languages combined; this is a clear competitive advantage in how we treat our customers.

#### *Operating Capabilities*

We deploy an advanced and reliable switch network and database management system that provides us with real-time information on call data and quality, which allows for timely decision-making. Telehop has data systems in place to answer seizure reporting (ASR), call detail and financial analysis and real-time fraud and call quality controls. We also have a proprietary call rating and billing system that allows us to fully control our billing processes and be able to customize billing to our customers' needs.

We employ a very competent technical team that is capable of developing new products and services that are critical to our strategic goals. The development and deployment of VOIP products in the coming year is a testament of what they are capable of achieving and we are confident that this team will deliver us the technologies that will distinguish us from our competitors.

Our support team is our face to our customers and they have the capability to communicate to them the value that Telehop delivers. Our multi-lingual ethnic support team provides our customers with the language of choice for them to receive the proper support.

Marketing is a key component of our business, as the diverse marketing team we maintain knows how to penetrate key ethnic markets across Canada and is capable of reaching to targeted communities using the most effective marketing channels.

#### *Financing Capabilities*

Telehop currently has no bank debt and has built sufficient cash to allow for future expansions. Our strong working capital is adequate to meet all of our commitments, obligations and capital requirements such that no additional financing is required in the foreseeable future.

With \$2.9 million in cash, we have the flexibility to invest into new strategic initiatives, including potential acquisitions. We believe that this is a crucial part of our growth and we intend to set out a plan to effectively deploy our capital resources to drive shareholder value.

#### 4. PERFORMANCE SUMMARY

<b>Consolidated Highlights</b> <i>(\$ Thousands)</i>	<b>2007</b>	<b>2006</b>	<b>% Change</b>
<b>Consolidated Income Statement</b>			
Operating revenues	17,984	21,055	-14.6%
Gross margin	7,429	9,306	-20.2%
Gross margin %	41.3%	44.2%	-6.6%
Operating costs	7,245	7,866	-7.9%
Operating income	183	1,440	-87.3%
EBITDA	674	1,860	-64.0%
Other income	165	126	31.0%
Net income	173	1,024	-83.1%
Earnings per share - basic	0.01	0.08	-87.5%
Earnings per share - diluted	0.01	0.08	-87.5%
<b>Consolidated Statement of Cash Flows</b>			
Cash provided by operating activities	334	2,314	-85.6%
Cash used by investing activities	(265)	(407)	34.9%
Cash provided by financing activities	34	39	-12.8%
<b>Other Measures</b>			
Minutes (thousands)	378,689	376,472	0.6%
Calls (thousands)	92,997	90,893	2.3%
Average revenue per minute (ARPM)	0.048	0.056	-14.3%

#### Overall Performance

In 2007, we anticipated continuing market pressures that forced many long-distance service providers, including Telehop, to reduce their long-distance rates. In addition, aggressive marketing tactics launched by local exchange carriers (LECs) adversely impacted our revenues as some customers migrated over to the “home phone” packages offered by other carriers. To remain competitive, we needed to reduce average revenue per minute (ARPM) by 14.3%. Despite these challenges, the company managed to maintain its calls and minutes volume due to providing better value to our customers from the reduction of ARPM, and our commitment to high call quality and customer service.

Our results reflect the same challenges currently faced by most telecommunications long-distance providers but we feel that we can weather this negative trend by focusing on our customers’ needs and investing into new technologies that complement our existing services. This approach will help us become less vulnerable to market driven factors. Our strong financial position, supported by our strong cash position, has helped us weather through the challenges during the year as we make the necessary operational changes to steer us back to higher profitability and a new direction for growth.

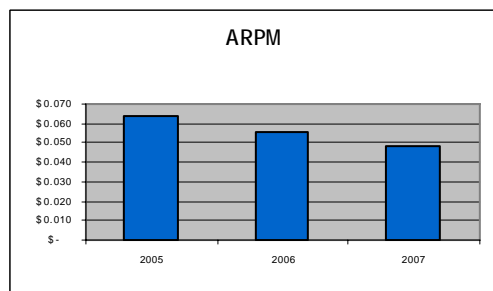
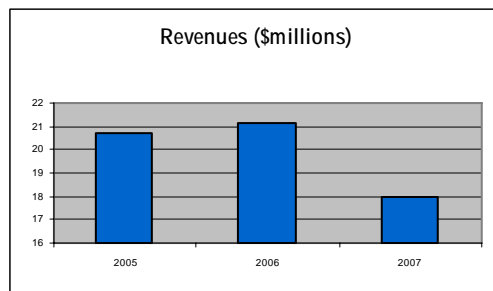
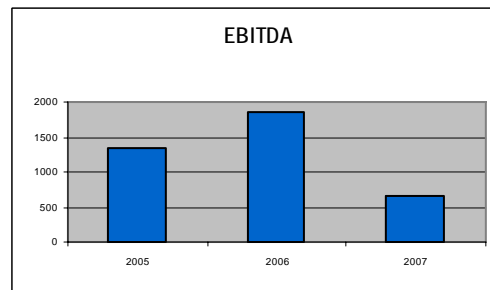
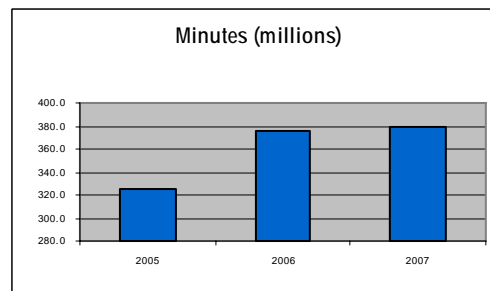
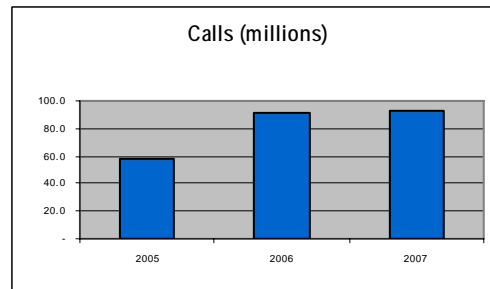
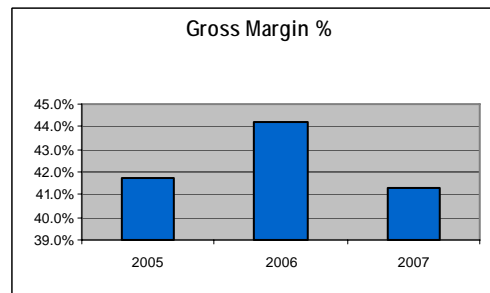
We endured a challenging year in 2007 as we reacted to market pressures by further reducing our ARPM by 14.3% in order to remain competitive and preserve customer retention. This was a necessary step to place our customers first as we made efforts to provide them with the highest level of value and service.

The decline in ARPM had a direct impact on gross margin which declined to 41.3% from 44.2% a year ago. We made effort to reduce our telecommunications cost and to ensure gross margin remain above 40%.

Despite the decline in ARPM, calls and minute have remained steady in 2007 compared to a year ago. Calls increased by 2.3% and minutes increased slightly by 0.6%. The decline in ARPM made a positive contribution to maintaining calls and minutes.

The decline in revenues by 14.6% resulted in the decline in EBITDA of \$1.2 million to \$0.7 million compared to \$1.9 million a year ago.

The Company maintains an optimistic view for the future as we are committed to bringing new value proposition to our customers through the launch of our VOIP strategy. We will continue to drive further efficiencies across the organization in order to reduce our overall cost structure.



## 6. RESULTS FROM OPERATIONS

### *Selected Annual Information*

The following selected consolidated financial information has been derived from and should be read in conjunction with the consolidated financial statements for Telehop for the year ended December 31, 2007, and its annual consolidated financial statements for previous years.

<i>(\$ Thousands except per share amounts)</i>	<b>2007</b>	<b>2006</b>	<b>Change</b>	<b>% Change</b>
Operating revenues	17,984	21,055	(3,071)	-14.6%
Gross margin	7,429	9,306	(1,877)	-20.2%
Gross margin %	41.3%	44.2%	-2.9%	-6.6%
Operating Expenses	7,245	7,866	(621)	-7.9%
General and administration	3,221	3,110	111	3.6%
Marketing and selling	2,581	3,479	(898)	-25.8%
Development and technical	952	845	107	12.7%
Amortization	462	421	41	9.7%
EBITDA (1)	645	1,860	(1,215)	-65.3%
Operating income	183	1,440	(1,257)	-87.3%
Income before income taxes	349	1,566	(1,217)	-77.7%
Income taxes	176	542	(366)	-67.5%
Net income	173	1,024	(851)	-83.1%
Earnings per share - basic	0.01	0.08	(0.07)	-87.5%
Earnings per share - diluted	0.01	0.08	(0.07)	-87.5%

(1) EBITDA is a non-GAAP measure. See section 2 for detailed explanation.

### *Operating Revenues*

Consolidated operating revenues declined by \$3.1 million or 14.6%. This was mainly attributed to the 14.3% decline in ARPM which was driven primarily by market pressures.

### *Gross Margin*

Gross margin declined by 2.9% as a percentage of operating revenues to 41.3% compared to 44.2% a year ago. However, 1.1% of the decline was attributed to the CRTC rate adjustment that was recognized in gross margin in 2006 (no rate adjustments were issued in 2007). The remaining 1.8% decline was due to overall decline in ARPM; resulting in an overall gross margin decline of \$1.9 million compared to 2006.

### *Operating Expenses*

General & administration expenses increased by \$0.1 million or 3.6% which was mainly attributed to the increase in legal expenses incurred from various non-recurring events such as the provision of \$50,000 for the settlement of a dispute with a former executive and consulting costs totalling \$103,688 pertaining to a strategic review initiative launched in the fourth quarter of 2007.

Marketing and selling expenses decreased by \$0.9 million or 25.8%. The Company made significant efforts to improve its rate of return on marketing costs in proportion to operating revenues. This required an ongoing analysis and re-alignment of marketing costs by markets and distribution channels to achieve a better rate of return.

Development and technical support expenses increased by \$0.1 million or 12.7% compared to last year. This increase was mainly driven by costs totalling \$114,345 for the re-designing of the Company's websites and the development of a social networking platform for our existing customers.

Amortization expenses increased by 9.7% compared to 2006. The increase was mainly attributed to cumulative enhancements made to our internally developed data management system and the purchase of soft phone licenses late in 2006.

#### *EBITDA and Operating Income*

EBITDA decreased to \$0.7 million from \$1.9 million and operating income decreased to \$0.2 million from \$1.4 million compared to last year. The decline was mainly attributed to the overall decline in ARPM which resulted in the decrease in gross margin by \$1.9 million, which had a direct negative impact on EBITDA and operating income.

#### **Quarterly Results and Review of Fourth-Quarter Performance**

(\$ thousands except per share)	2006					2007				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
<b>Operating revenues</b>	5,020	5,108	5,430	5,497	21,055	4,930	4,562	4,275	4,216	17,983
<b>EBITDA</b>	512	426	532	390	1,860	396	487	102	(340)	645
<b>Operating income (loss)</b>	390	341	427	281	1,439	281	365	(8)	(455)	183
<b>Net income (loss)</b>	263	221	287	253	1,024	196	256	3	(282)	173
<b>Earnings (loss) per share</b>										
<b>Basic</b>	0.02	0.02	0.02	0.02	0.08	0.02	0.02	-	(0.03)	0.01
<b>Diluted</b>	0.02	0.02	0.02	0.02	0.08	0.02	0.02	-	(0.02)	0.02

#### **Selected Fourth Quarter Information**

( thousands except KPI's)	Q4-06	Q4-07	\$Change	%Change
<b>Operating revenues</b>	5,497	4,216	(1,281)	-23.3%
<b>Gross Margin</b>	2,408	1,800	(608)	-25.2%
<b>Gross margin %</b>	43.8%	42.7%	-1.1%	-2.5%
<b>Operating expenses</b>	2,127	2,255	(128)	-6.0%
General and administration	770	989	219	28.4%
Marketing and selling	997	744	(253)	-25.4%
Development and technical	246	403	157	63.8%
<b>EBITDA</b>	390	(340)	(730)	-187.2%
<b>Operating income (loss)</b>	281	(455)	(736)	-261.9%
<b>Key performance indicators</b>				
ARPM	0.087	0.071	(0.016)	-18.4%
Calls (thousands)	27,352	18,101	(9,251)	-33.8%
Minutes (thousands)	108,707	84,908	(23,799)	-21.9%

#### *Operating Revenues*

Operating revenues for the fourth quarter of 2007 declined by \$1.3 million or 23.3% compared to the same period last year. The decline was mainly attributed to the 18.4% decline in ARPM in the fourth quarter of 2007 compared to the same period last year, and the decline in calls and minutes by 33.8% and 21.9% respectively. These factors were primarily market driven as the Company needed to reduce ARPM to maintain

its competitive position. The decline in calls and minutes were a result of a 10.8% reduction in average unique users.

### *Gross Margin*

Gross margin declined by \$0.6 million or 25.2% compared to the same quarter last year. The decline was directly attributed to the 18.4% decline in ARPM due to market pressures.

### *Operating Expenses*

General and administration expenses in the fourth quarter of 2007 increased by 28.4% to \$1.0 million from \$0.8 million compared to the same period last year. The increase was mainly due to non-recurring expenses including \$103,608 in corporate consulting costs related to strategic review initiatives.

Marketing and selling expenses decreased by 25.4% to \$0.7 million compared to the same period last year. The decrease reflected management's efforts to streamline various marketing costs that were not generating acceptable rates of return.

Development and technical expenses increased by 63.8% to \$0.4 million compared to the same period last year. The increase was primarily attributed to costs totalling \$114,345 related to the revamping of our corporate websites and the development of a social networking platform for our customers.

### *5-YEAR FINANCIAL DATA*

	<b>2007</b>	2006	2005	2004	2003
<b>Operating Revenues</b>	<b>17,983,269</b>	21,055,434	20,725,070	15,325,613	15,587,884
<b>Net income</b>	<b>172,748</b>	1,024,182	611,065	284,983	930,672
<b>Net income per share</b>	<b>0.01</b>	0.08	0.05	0.02	0.08
<b>Diluted net income per share</b>	<b>0.01</b>	0.08	0.05	0.02	0.08
<b>Total assets</b>	<b>7,174,048</b>	7,502,775	5,232,753	5,195,255	5,138,923
<b>Total liabilities</b>	<b>2,939,074</b>	3,208,000	2,001,166	2,589,634	2,953,446
<b>Shareholders' equity</b>	<b>4,246,640</b>	4,225,725	3,231,587	2,605,621	2,185,477
<b>Dividends declared per-share</b>	<b>\$ 0.02</b>	\$ 0.01	\$ -	\$ -	\$ -
<b>Book value per share</b>	<b>\$ 0.31</b>	\$ 0.33	\$ 0.26	\$ 0.21	\$ 0.18

## **7. LIQUIDITY & CAPITAL RESOURCES**

Liquidity risk arises from our general funding needs and in the management of our assets and liabilities. We manage liquidity risk to maintain sufficient liquid financial resources to fund our balance sheet and meet our commitments and obligations in the most cost-effective manner possible.

The following aggregated information outlines our contractual obligations and other commitments to provide an understanding of our short- and long-term liquidity and capital resource requirements.

<b>Contractual Obligations and Other Commitments</b>				
	<b>Total</b>	<b>Within 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>
Long-term debt	-	-	-	-
Operating lease obligations	759,664	197,997	561,667	-
Capital lease obligations	72,910	19,443	53,467	-
Purchase obligations	-	-	-	-
Other long-term obligations	-	-	-	-
<b>Total</b>	<b>832,574</b>	<b>217,440</b>	<b>615,134</b>	<b>-</b>

### *Operating Leases*

We have long-term operating lease agreements for our corporate office and switch facility, both of which expire in 2011.

### *Capital Leases*

We have a capital lease agreement for a voice recognition system purchased to support and increase productivity at our call centre. The capital lease includes a purchase option and expires in 2011.

### *Capital Expenditures*

We expect to incur capital expenditures of approximately \$485,000 in 2008 on network upgrades, equipment pertaining to our VOIP strategy and for the support of existing operations.

### *Pension Plan*

The Company offers defined benefit pension plans to its executive employees. 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. The fair value of the pension plan assets is determined using current market rates. As of December 31, 2007, there is a plan deficit of \$111,388 which mainly consists of unamortized past service costs of \$138,075. The unamortized past service costs are reduced annually over the average remaining service life of 11 years through annual contributions of \$7,973 by the Company.

### **Sources and Uses of Cash**

The Company's cash flows from operating, investing and financing activities, as presented in the consolidated statements of cash flows, are summarized in the following table:

(thousands except ratios)	<b>2007</b>	<b>2006</b>	<b>\$Change</b>	<b>% Change</b>
Cash provided by operating activities	334	2,314	(1,980)	-86%
Cash used in investing activities	(265)	(407)	142	-35%
Cash provided by financing activities	34	39	(5)	-13%
<b>Increase (decrease) in cash</b>	<b>103</b>	<b>1,946</b>	<b>(1,843)</b>	<b>-95%</b>
Cash and cash equivalents	2,882	2,779	103	4%
Current assets	6,137	6,335	(198)	-3%
Current liabilities	2,848	3,208	(360)	-11%
Working capital	3,289	3,127	162	5%
Current ratio	2.2	2.0	n/a	9%

All of our liquidity needs have been met through cash generated from operations. This is due to the fact that the Company has no long debt and maintains a strong working capital ratio. Cash provided by operating

activities decreased by \$2.0 million, which was mainly due to \$0.8 million decrease in net income and \$1.0 million related to timing in accounts payable management in 2006.

Cash used in investing activities decreased by \$142,123 which was attributed to the reduction of purchases of telecommunications equipment by \$114,627. The major outlays during the year were \$69,452 in telecommunications equipment and \$52,635 in enhancements to our database management system.

Cash provided by financing activities were \$33,798 which was consistent with the prior year. This was due to the fact that the issuance of common shares of \$164,500 offset the dividend paid of \$127,035.

We believe that the Company's existing cash of \$2.9 million and cash generated from operations will be sufficient to meet all capital and other cash requirements in 2008.

## **8. OFF-BALANCE SHEET ARRANGEMENTS AND RELATED PARTY TRANSACTIONS**

### *Off-Balance Sheet Arrangements*

The Company may from time to time enter into forward foreign exchange contracts ("Forwards") or foreign exchange options contracts ("Options") to mitigate its foreign currency exposure on expenses incurred for its operations. The Forwards obligate the Company to buy US dollars with Canadian dollars in the future at pre-determined exchange rates. The Options provide the right to exercise an option that will allow the Company to purchase US dollars with Canadian dollars in a pre-determined future period at pre-determined exchange rates.

As of December 31, 2007, the Company did not hold any Forwards or Options.

### *Related Party Transactions*

- (i) The Company is recovering overpayments from prior years and a one-time salary adjustment of \$12,000 from the Chairman. The balance is being repaid through bi-weekly instalments which began in June, 2007. As of December 31, 2007, the outstanding balance receivable is \$76,489, which is included in accounts receivable.
- (ii) Development costs totalling \$114,345 were expensed during the year to a company owned by an employee of the Company. The amount was recorded based on the exchange value and was included in development and technical expenses.

## **9. CRITICAL ACCOUNTING ESTIMATES AND CHANGES IN ACCOUNTING POLICIES**

### **Critical Accounting Estimates**

The significant accounting policies are contained in note 2 to the consolidated financial statements. Certain of these policies require management to make critical accounting estimates because of their subjective or complex nature and materially different amounts could be reported under different conditions or using different assumptions. We have discussed the development, selection and application of our key accounting policies, and critical accounting estimates and assumptions, with our audit committee, and it has reviewed the disclosures described in this section.

The following critical accounting estimates and assumptions made by management are discussed to provide an understanding of how they affect the amounts reported in the consolidated financial statements.

### *Allowance for Doubtful Accounts*

The valuation of allowance for doubtful accounts is managed on a monthly basis where provisions are applied at various percentages for accounts receivable categorized by risk. These percentages may change in the future when new conditions or trends arise.

### *Depreciation and Amortization*

We depreciate and amortize our tangible and intangible assets based on management's best estimate of the useful lives of various assets using the straight-line method.

### *Stock-based Compensation*

We account for stock-based compensation in accordance with the fair value recognition provisions of GAAP. Such provisions require stock-based compensation expense to be measured at the grant date based on the fair value of the award and is recognized as an expense over the vesting period. Determining the fair value of stock-based awards requires judgment which includes estimating the expected life of the options, the expected volatility of our shares and the expected dividend yield. To estimate the fair value of stock-based awards, we use the Black-Scholes model.

### *Revenue Recognition*

The Company earns its revenues from access to, and usage of, its telecommunications network. It recognizes revenues on an accrual basis and includes an estimate of revenues earned but not billed (due to timing in our billing cycle). The estimate is based on data obtained from our switch system.

### *Employee Future Benefits*

The cost of providing benefits through our defined benefit pension plans 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 the employees. These assumptions require a complex degree of judgment and are independently determined by an external actuary.

### *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 consolidated financial statements. Management must exercise judgment in determining whether future tax assets are recognized only to the extent that it is more likely than not that the future tax assets will be realized.

## **Changes in Accounting Policies**

Effective January 1, 2007, the Company adopted five new accounting standards that were issued by the Canadian Institute of Chartered Accountants ("CICA"): *Comprehensive Income* ("Section 1530"), *Hedges* ("Section 3865"), *Financial Instruments – Recognition and Measurement* ("Section 3855"), *Equity* ("Section 3251"), and *Financial Instruments – Disclosure and Presentation* ("Section 3861"). These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. These accounting policy changes were adopted on a prospective basis with no restatement of prior period financial statements. Please refer to note 3 of the consolidated financial statements for a detailed discussion of each of these changes.

## **Capitalization**

As at April 28, 2008 the Company had 13,363,500 common shares outstanding and 355,000 share options, which are exercisable at prices ranging between \$0.32 and \$0.80 per share at varying times before December, 2012.

## **10. BUSINESS OUTLOOK**

### *Core Business*

Our core business will continue to face market pressures as we expect to see a continuing decline in ARPM in 2008. Our first line of defense is to continue to deliver value and provide the highest quality of service to our customers as these efforts cannot be compromised. We anticipate a reduction in ARPM; however, we believe we can compensate against this negative trend through cost reduction efforts by driving down customer acquisition costs; expanding on our outsourcing relationships in more cost-effective countries; further streamlining of marketing and other operating costs and combining product synergies that add value to our customers.

### *VOIP Strategy*

We believe we are at a crossroads in the telecommunications industry where traditional services meet new technological advances. We are seeing an increasing trend in the popularity of VOIP users in the market place and believe that this trend is only in its infancy. Telehop plans on capitalizing on its VOIP intellectual property and capabilities by taking a more focused approach in 2008, as we plan on launching a number of VOIP initiatives that will provide significant value and conveniences to Canadian consumers. Some of the VOIP initiatives we expect to release in 2008 include VOIP home phones which would replace traditional home phones, VOIP soft phones, IP television and mobile VOIP devices. We expect this initiative will have an adverse impact on short-term profitability as we plan on incurring up to approximately \$1.0 million in operating costs to launch this strategy in the coming year.

We believe that a VOIP strategy is critical to the Company's future as we feel that VOIP applications have more potential than just transmission of voice data. We feel that adoption of this technology by Canadian consumers will accelerate in the coming years and Telehop will be at the forefront in serving this growing market.

### *Advanced Wireless Services Spectrum*

Telehop has applied for a bidding position in the advanced wireless services spectrum auction process. This process allows a participant to bid on a selected city or region in Canada based on a point system. The successful bidder would have exclusive distribution rights for wireless services in the selected city or region. The auction commences on May 27, 2008. We are evaluating various options and strategies as we seek to acquire a strategic market in the wireless sector. This could significantly increase the value of our Company as we would be adding an asset of strategic value to our business.

### *Strategic Review*

We communicated in October, 2007 that we engaged Orion Securities to advise the Company on its strategic alternatives which included a potential sale of the Company. This process is still in progress as we are

reviewing various options that have been brought forward to the Board of Directors. In the interest of all shareholders, we feel that we need to see this process through to determine which option best provides the most value to our shareholders.

#### *Dividend Policy*

A dividend has been issued in each of the last two years. A dividend for 2008 may be declared following an evaluation of the Company's position later in the year.

## **11. RISKS AND RISK MANAGEMENT**

The following areas summarize the principal risks and uncertainties that could affect Telehop's future business results.

#### *Competition*

Telecommunications providers are continually increasing the range of services they offer as well as lowering their long-distance rates to become more competitive. Telehop intends on mitigating these risks through offering more innovative solutions that will remove itself from the price sensitive market, and further reduce its cost structure in anticipation of future price declines.

#### *Technology*

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. Telehop is investing into various VOIP technologies and plans on releasing them in the market as part of its strategy to be at the forefront of new technological changes in the telecommunications industry.

#### *Regulatory*

Regulatory changes issued by the Canadian Radio and Telecommunications Commission (CRTC) could have a material adverse impact on Telehop's procedures, costs and revenues. The company is federally regulated by the CRTC and Industry Canada. The CRTC regulates certain tariff charges in which Telehop pays to certain local carrier exchanges and may issue changes which may have a material unfavourable impact on the Company's financial results. To mitigate these risks, we monitor industry developments very closely through industry advisors and prepare

#### *Management Team*

Telehop operates with a small management team that strives to oversee all aspects of operations, and by calling upon the services of financial, industry and technology experts in areas when deemed appropriate.

The replacement of our management team members may have an adverse impact on operating results as their experience and skills may be difficult to find and match in the event of a management change. However, we encourage all team members to document each of their key tasks and responsibilities as a means of mitigating this risk.

### *Niche Company*

As a niche telecommunications long-distance provider serving primarily ethnic communities, we do not at this time have the full diversification in services compared to other larger telecommunications companies. Therefore, we are exposed to unforeseen changes in the long-distance market which could adversely affect the Company's future financial results. We mitigate these risks by taking steps toward being a more diversified company by offering not only long-distance services but as a provider of all telecommunications services. Our VOIP strategy is our initial step towards that goal.

### *VOIP Patents*

There have been legal disputes over the impropriety of the use of VOIP technology by some prominent marketers of VOIP products and services. The original patent holder(s) of VOIP technology may in the future take legal action against any distributor or marketer of VOIP products and services without legal consent by the patent holder(s). Telehop is a distributor of VOIP technology, and not a developer. We do not believe we will be committing any patent violation acts as licensing fees would be incurred to use such technology. However, legal risks exist as the extent in which we are using VOIP technology may be challenged in the future.

### *Foreign Exchange*

We transact in U.S. currencies with various carriers when incurring telecommunications expenses. Volatility in the currency markets can have an adverse impact on the Company's financial results. These risks are mitigated by two measures. We collect revenues from wholesale services in U.S. currencies and, therefore, there is a natural hedge against related telecommunications expenses that are transacted in U.S. currency. We also utilize a hedging strategy through foreign exchange options and forward contracts in an effort to control volatility in the currency markets.

### *Credit*

The Company is subject to credit risk through accounts receivables, which consists of amounts represented by the large number of subscription services customers in which we bill directly, and amounts owed from various LEC's from casual calling revenues.

More than 50% of the Company's accounts receivables are owed by a few LECs across Canada. The LEC's provide billing and collection services on our behalf through billing and collections agreements. We mitigate our credit risks from this group of LECs by purchasing from them long-distance services which offset at least 50% of the accounts receivables.