

# Annual Report 2005

## Exchange Industrial Income Fund



**PERIMETER**

**Jasper TANK**

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**KIVALLIQ AIR**  **NUNAVUT LIFELINE**  
KEEWATIN AIR

EIF.UN

## CORPORATE PROFILE

- to provide unitholders with stable and growing cash distributions;
- to maximize unit value through on-going active management of the companies in the Fund's portfolio; and
- to continue to acquire companies or interests therein in order to expand and diversify the Fund's portfolio.



To date the Fund has acquired Perimeter Aviation, an airline operating out of Winnipeg and Thompson, Manitoba; Keewatin Air, an airline operating out of Winnipeg, Manitoba and Rankin Inlet in the territory of Nunavut; and Jasper Tank, a manufacturer of steel truck tanks located in Edmonton, Alberta.

The investment policies and operations of the Fund are subject to the control of the trustees, a majority (6) of who are independent trustees. The trustees of the Exchange Industrial Income Fund are Duncan D. Jessiman, Michael Pyle, Mark

Buller, William Wehrle, Gary Filmon, Don Streuber, Allan McLeod, Gary Buckley and Arthur Mauro.

Perimeter Aviation Maintenance Hangar



Daily operations are managed by the Fund's Chief Executive Officer, Duncan D. Jessiman and by the Fund's President, Michael Pyle.

## HIGHLIGHTS OF 2005

2005 was an exciting year for EIIF as the Fund experienced growth organically and by acquisition. Highlights included:

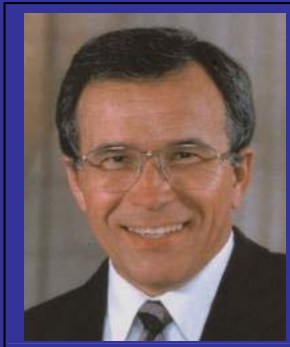
- Sales increased 190% to \$57.3 million.
- EBITDA increased 161% to \$7.0 million.
- Earnings increased 162% to \$3.1 million.
- Distributable cash per unit increased 107 % to \$2.55 per unit.
- Distributions increased by 11% from \$0.27 per quarter to \$0.10 per month.
- Completed the acquisition of Keewatin Air Limited in July.
- Completed the acquisition of Jasper Tank Ltd. in September.
- In order to assist in funding the acquisitions and organic growth, the Fund completed offerings of Fund units and debentures generating gross proceeds of \$12.5 million and \$8.3 million respectively.



\$000's (except per unit data)	2005	2004 <sup>1</sup>
<b>FINANCIAL PERFORMANCE</b>		
Revenue	57,267	19,738
EBITDA	7,021	2,688
Net earnings	3,058	1,168
per unit	1.72	1.06
Distributable cash	4,541	1,355
per unit	2.55	1.23
Distributions paid to unitholders	2,090	788
per unit	1.14	0.71
<b>FINANCIAL POSITION</b>		
Working capital	8,785	4,765
Capital assets	41,556	18,368
Total assets	74,090	29,834
Unitholder's equity	25,413	10,444

<sup>1</sup> The comparable period is for the 239 day period ended December 31, 2004, as EIIF began operations on May 6, 2004.

## CHAIRMAN'S MESSAGE



*Hon. Gary Filmon P.C., O.M. – Chairman and Trustee*

Mr. Filmon of Winnipeg, Manitoba holds an Engineering Degree from the University of Manitoba. He is Vice-Chairman of The Arctic Glacier Income Fund and has been a trustee of that income fund since 2001 and was a director of its predecessor, The Arctic Group Inc. since 2000. He is a director of Manitoba Telecom Services Inc., a director of FWS Construction Ltd., a director of Wellington West Capital Inc., a director of Canadian Natural Resources Limited and a trustee and lead independent director of Pollard Banknote Income Fund. He is also chair of the Canadian Security Intelligence Review Committee and is on the advisory board of Marsh Canada. Prior thereto he was Premier of the Province of Manitoba from 1988 to 1999. Mr. Filmon became a trustee on May 6, 2004, and will serve in that capacity until the next annual general meeting of Unitholders.

Our vision for Exchange Industrial Income Fund is to be a highly regarded income trust with a proven record for delivering above average growth through a portfolio of diversified businesses.

This unique vision will build an investment vehicle that will provide its unitholders with growing stable returns through the acquisition of strong niche companies that would, except for their size be income fund candidates on their own. We will continue to seek out companies with strong management and recognized quality products for future acquisitions. Most importantly, the Fund is focused on growing profitably, diversifying and rewarding its investors.

The interests of unitholders are represented by nine trustees, six of whom are independent trustees, and three management Trustees, Bill Wehrle, President of Perimeter Aviation, Duncan Jessiman, Chief Executive Officer of the Fund and Michael Pyle, President of the Fund. Each of the industry sectors has its own board of directors with at least one independent trustee serving as a director. The trustees oversee the operations of the Fund, provide strategic direction to the Fund's management, hold management accountable for results, approve the Fund's operating and capital budgets, approve acquisitions, review governance and ensure the integrity of reporting to unitholders. The sector boards monitor the strategic, business and financial plans of the operating entities, and the succession plan for senior management.

Our approach to corporate governance is to meet the guidelines developed by the Toronto Stock Exchange so that EIIF can list on that exchange when EIIF develops the critical mass necessary to make it beneficial to our unitholders. The trustees have established two committees for continuous monitoring of Fund activities relating to auditing procedures and good corporate governance. The audit committee is responsible for overseeing the activities

of the external auditors, Deloitte & Touche LLP, the quality and thoroughness of financial reporting and the effectiveness of internal controls in providing financial information and safeguarding assets of the Fund. All members of the audit committee are independent trustees. The compensation committee assesses senior management and Trustees performance, reviews their compensation and oversees the succession planning process.

Each trustee and officer of the Fund is a unitholder and on a combined basis own 17.4% of the Fund. In addition the independent trustees take a portion of their remuneration in units. Accordingly, our motivation and interests are aligned with the public unitholders. The credibility and experience of our board ensures competent governance. Independent directors like Arthur Mauro, Don Streuber, Alan McLeod, Gary Buckley, and Mark Buller provide the Fund with skill sets not normally available to a Fund our size. Overall, our goal as trustees is to add value to the Fund by contributing our broad experience and expertise in directing a controlled growth-oriented enterprise.

During the past year the Fund moved from quarterly distributions to monthly distributions of \$0.10. Total distributions per Unit for the year were \$1.14. Our payout ratio is 45% (56% on a fully diluted basis). We feel that this payout ratio is conservative but prudent. Your trustees will continue to monitor the performance of the Fund with the objective of delivering stable and predictable distributions to unitholders.

In closing, we are pleased with the progress the Fund has made this past year. We will continue to strive to serve the interests of the public unitholders, applying the highest standards of duty and care.

A handwritten signature in cursive script, appearing to read "Gary Filmon". The ink is dark and the signature is fluid and legible.

Hon. Gary Filmon P.C., O.M.  
Chairman of the Board of Trustees

## EIIF TRUSTEES



### *Duncan D. Jessiman Q.C. - Chief Executive Officer and Trustee*

Mr. Jessiman of Winnipeg, Manitoba holds a Bachelor of Commerce degree and a law degree from the University of Manitoba. He began his professional career 33 years ago as a lawyer at Pitblado & Hoskin where he was a partner at the time of his leaving in 1998 to join Aikins, MacAulay & Thorvaldson LLP as a partner, where he practiced in the area of corporate, commercial and securities law. Mr. Jessiman is a member of the TSX Venture Exchange Winnipeg Local Advisory Committee; former director of Consolidated Properties Ltd., a TSX listed company; former director of Geocrude Energy Inc., a TSX listed company which was taken over by Canada North West Energy Inc.; former director of Pan Cana Industries Ltd., a TSX listed company which was taken over by Geocrude Energy Inc.; former director of Enerplus Energy Services Ltd. - management company for Enerplus Resources Fund and a former director of Source Life Sciences, a junior capital company listed on the TSXV. Mr. Jessiman joined the Fund on a full-time basis on August 1, 2005. Mr. Jessiman became a trustee on March 22, 2004, and will serve in that capacity until the next annual general meeting of unitholders.



### *Michael Pyle - President, Chief Financial Officer, Trustee*

Mr. Pyle of Winnipeg, Manitoba holds an Arts degree (Economics) and a Masters of Business Administration Degree (Finance) from the University of Manitoba. He served in positions of increasing seniority culminating as President of The Arctic Glacier Income Fund (and its predecessor The Arctic Group Inc.) from 1998 to 2002. He previously worked with RoyNat Capital in Winnipeg from 1990 to 1996 and from 1997 to 1998. Mr. Pyle was employed as the Vice-President of Corporate Development for Westsun International Inc. in Winnipeg from 1996 to 1997. Mr. Pyle has been a full time employee of the Fund and its predecessor Exchange Industrial Group Ltd. (EIG) since the inception of EIG in 2002. Mr. Pyle became a trustee on March 22, 2004, and will serve in that capacity until the next annual general meeting of Unitholders.



### *William Wehrle - Trustee*

Mr. Wehrle was one of the original founders of Perimeter Aviation in 1960, and serves as Perimeter's President and Chief Executive Officer. Mr. Wehrle is also a commercial pilot with over 30,000 hours of flying experience. Mr. Wehrle became a trustee of the Fund on May 6, 2004 and will serve in that capacity until the next annual general meeting of unitholders.



### *Allan McLeod - Trustee*

Allan McLeod is the President and Chief Executive Officer of Tribal Councils Investment Group of Manitoba Ltd. and its group of wholly owned subsidiaries, including Arctic Beverages Limited, First Canadian Health Management Corporation, Rupertsland Holdings Inc., and First Nations Financial Services Inc. Allan also holds this position for the Radisson Hotel Winnipeg Downtown, First Canadian Fuels Ltd., and First Canadian Water & Infrastructure Inc. He is also a Director of Big Freight Systems Inc. and Bieber Securities Inc. Besides being a trustee of EIIF, Allan is also a trustee of Westfield Real Estate Investment Trust. In 2004, Allan was the recipient of Canada's Top 40 Under 40. Mr. McLeod became trustee of the Fund on May 6, 2004 and will serve in that capacity until the next annual general meeting of the unitholders.



## IIIF TRUSTEES



### *Arthur Mauro, O.C., O.M. - Trustee*

Mr. Mauro of Winnipeg, Manitoba, is a graduate of the University of Manitoba with Bachelor of Arts, Bachelor of Laws, and Master of Laws Degrees. He was appointed Chairman of the Royal Commission on Northern Transportation in 1967, and established the Transportation and Communication Law course at the University of Manitoba Faculty of Law and lectured on this subject from 1967 to 1969. Both in his law practice and in business, he sat on the boards of directors of a number of major Canadian corporations, including Investors Group Inc., Great-West Life Assurance Co., Montreal Trust, Federal Industries, Andersen Consulting Advisory Board, Canadian Airlines International Ltd., Atomic Energy of Canada Limited, Canadian Pacific Hotels and United Grain Growers. He is the former Chairman and Chief Executive Officer of Investors Group Inc. and was Chancellor of the University of Manitoba from 1992 to 2001. He is a founding director of the Business Council of Manitoba. Currently, Mr. Mauro is Chairman of the Winnipeg Airports Authority Inc. and is a director of Fort Chicago Energy Management Inc. He also served as counsel to the law firm of Aikins, MacAulay & Thorvaldson LLP until September 30, 2003. Mr. Mauro became a trustee on May 6, 2004, and will serve in that capacity until the next annual general meeting of unitholders.



### *Donald Streuber, C.A. - Trustee - Chairman of the Audit Committee*

Mr. Streuber of Winnipeg, Manitoba, is President and CEO of Bison Transport Inc. Bison is one of Canada's largest truckload carriers of freight and has been recognized as one of Canada's 50 best managed companies for the last 9 years. Mr. Streuber received his C.A. designation in 1985 and has been a lecturer and conference speaker for the Canadian Institute of Chartered Accountants and served on their Professional Development Committee. Mr. Streuber is also the Chairman of Monarch Industries Limited and Chairman of Providence College and Seminary. Mr. Streuber became a trustee of the Fund on May 6, 2004, and will serve in that capacity until the next annual general meeting of Unitholders.



### *Mark Buller - Trustee*

Mr. Buller has served in increasingly senior positions within Kitchen Craft of Canada Limited from 1987 to 1999 when the company joined the Omega Group headquartered in Iowa, USA. Mr. Buller served as President and CEO of the Omega Group of Companies until such companies were acquired by Fortune Brands in April, 2002. Subsequent to that date, he served as the President and CEO of Kitchen Craft of Canada Limited. Mr. Buller resigned from his positions with Kitchen Craft of Canada Limited effective January 1, 2003. Mr. Buller is president and chief executive officer of Norcraft Companies, a company which manufactures cabinets and operates one plant in Canada and five plants in the U.S. Mr. Buller became a trustee on March 22, 2004, and will serve in that capacity until the next annual general meeting of unitholders.



### *Gary Buckley - Trustee- Chairman of Compensation Committee*

Mr. Buckley of Winnipeg, Manitoba, holds a Bachelor of Commerce from the University of Alberta. Mr. Buckley has been involved in the hotel and hospitality industry since 1983. Since 1998, Mr. Buckley has been the co-owner and operator of the Elkhorn Resort & Conference Center in Clear Lake, Manitoba. Mr. Buckley is also the largest shareholder of Genesis Hospitality, which owns various hotel properties in Manitoba and Ontario. Mr. Buckley also owns other commercial and residential properties. Mr. Buckley became a trustee on May 6, 2004, and will serve in that capacity until the next annual general meeting of unitholders.

## EIIF SUBSIDIARIES



Perimeter Aviation Ltd. was the first acquisition of EIIF in May of 2004. The company operates a diverse airline focusing in four main business segments 1) Scheduled Passenger and Freight Service 2) Medical Evacuation Services 3) Charters and 4) Flight Training School. It services small communities across Manitoba, but specializes in First Nation Communities in Eastern and Northern Manitoba. The company has a limited number of types of aircraft in order to maximize the efficiency of the operation. The core of the fleet is the 19 seat Metroliner twin engine aircraft which is designed to carry a combination of passengers and freight. The company also operates a number of smaller Beech twin engine aircraft for the flight training school, courier work and to fit into landing strips which are too short to accommodate the Metroliner. The company has approximately 425 employees and had sales of \$46 million in 2005.



Keewatin Air was the second acquisition of EIIF in July of 2005. The company operates an airline similar to Perimeter in the market segments it serves (with the exception of the Flight Training School). Keewatin's focus however is the Medical Evacuation Services. The company has a long term contract with the Government of the Nunavut territory of Canada to provide all of its air medical evacuations. It has a significant presence in Rankin Inlet where it has a hanger, office and staff accommodation facilities. It also operates a scheduled business in the Nunavut region as well as from Rankin Inlet to Winnipeg. It has a fleet of King Air 200 aircraft which are used in the medical side of the business. It also operates a number of leased PC12 Pilatus single engine aircraft in its scheduled and charter operations. Keewatin has approximately 75 employees and has annual revenues of approximately \$14 million



New Perimeter Aviation and Keewatin Air Head Office



Jasper Tank was the most recent acquisition of the Fund in September of 2005. The company is a custom manufacturer of truck-mounted or pull-type tanks. The company specializes in custom design tanks with advanced plumbing, hydraulics and pressurization systems. The tanks are used in a number of industries, but the main focus of the customer base is the oil field service business. It is located in Edmonton, and operates from a 40,000 sq foot facility in the Acheson Industrial Park. It has approximately 60 employees and has annual sales of approximately \$ 13 million.



Crude Hauler & Tandem Pup

## CEO and President Message

The year 2005 was an exciting one for EEIF. We were able to deliver on all parts of our business model. Our initial acquisition, Perimeter delivered greater than anticipated growth and strong profitability. We were able to close the acquisition of two other companies. Keewatin Air was purchased in July and expanded the geographic coverage of our aviation business from the Arctic Circle to the Northern United States. The acquisition of Jasper Tank in August provided the Fund with diversification, not only in terms of business sector, but also in terms of geography with its location in Alberta. We completed separate offerings of Fund units and debentures to finance the acquisitions and the growth at Perimeter.

EEIF was built on the premise that there are established profitable companies in Canada, and perhaps abroad where the owner is looking to sell and there is no insider or strategic buyer readily available. We believe that many of these companies have the right attributes for our income fund structure, and that by creating a diverse pool of investee companies, we will create a stable base from which to pay our distributions. In addition, by providing access to capital and a renewed enthusiasm for the business under the new management, the opportunity for growth is enhanced.



Perimeter Aviation proved to be a strong example of this strategy. While it operated in the aviation business which is not known for its suitability as an income trust, it proved to be a very apt candidate for our first acquisition. Perimeter serviced a very defined market in Manitoba which was not susceptible to swings in the economy. It provided an essential service to many communities which could not be reached by any means other than air travel and it was the low cost provider of this service. It had consistently generated sales in excess of \$20 million and delivered a dependable bottom line. When EEIF purchased the company, and brought in the Tribal Council Investment Group (TCIG) not only as an investor, but as a part of the marketing team, sales began to grow more quickly. Subsequently when the financial distress of a competitor opened the door for a more rapid expansion, the in depth industry knowledge of the Wehrle family combined with the access to capital available from EEIF allowed the company to take advantage of this opportunity. Sales grew to \$46 million from \$29.9 million



in 2004 (approximately \$10.2 million of this 2004 total was while the company was still owned by the vendors).

Rapid growth like that experienced by Perimeter does not come without its challenges. Expanding the fleet of aircraft is not only capital intensive, but is also time consuming. Suitable aircraft have to be sourced, inspected, purchased and overhauled before they can go into service. Under perfect circumstances it will take several months to put a plane in service. Perimeter needed many aircraft. While it purchased 8 additional aircraft in 2005 and another in the first quarter of 2006 it simply did not have the necessary capacity to look after the needs of its customers. Perimeter solved this problem by chartering the services of other carriers both from within Manitoba and outside of the Province. These charters solved the capacity shortfall but were much more expensive than Perimeter operating its own fleet. Margins were compressed as a result of these charters especially in the second half of the year when most of the expense was incurred.

Perimeter believes that it now has the necessary capacity, and when the balance of the additional aircraft go into service in the second quarter of 2006 the need for these charters should be eliminated. The increase in the fleet has brought on the need for additional infrastructure to maintain the aircraft and manage the larger enterprise. Perimeter has invested in facilities in Thompson, expanded its facilities at the airport in Winnipeg and purchased a storage facility on Ferry Road adjacent to the airport. When the new facilities are complete in early 2006, they will not only be sufficient for Perimeter's enhanced



requirements, but will also allow for Keewatin to operate from the same location.

The Keewatin acquisition was deemed to be a strategic fit with Perimeter. Its relationship with its major customer, the Nunavut health department, remains strong. Since



acquisition, a significant amount of management's time has been expended on determining the right aircraft for the right job. With the increased interest in the north from governments, mining companies and the scientific community, activity in the north should increase over the next number of years. The ability to grow Keewatin's business will depend on developing services that can take advantage of the opportunities. At the time of acquisition the company had 3 King Airs and 3 Pilatus aircraft. Since then the company has acquired an additional King Air for medical services. In addition the company is chartering a Metro 23 from Perimeter to do longer routes with bigger loads than was previously possible with the Pilatus aircraft. Management is looking into ways of achieving synergies within the airline sector, always being cognizant of the distinctive cultures and customer bases of the companies. The move of the Keewatin operations from the Avitat site on the west side of the airport to the facilities on the east side where Perimeter is located should enable synergies to be realized.



In September of 2005 the Fund acquired Jasper Tank. At the time of acquisition, the owner, Rick Klein, indicated a preference to retire from active day to day management. The Fund recruited what it hoped to be a suitable replacement for Mr. Klein. However, during the initial few months it became apparent for a number of reasons that the relationship would not work. Having a good relationship with Rick Klein greatly assisted the Fund as he stepped back into manage the company while a new executive was found. Blair Bondar was hired in December 2005 and began working full time in early 2006. Blair's ability to work with people and get the most from them has led to a significant increase in productivity at Jasper Tank. With what is happening in Alberta and especially as it relates to the oil industry we foresee good opportunities for sales growth; however this has to be tempered with concerns about the stability of our workforce which is necessary to produce our product and maintain strong margins. To date the Company has shown an ability to deliver a greater number of units than in previous years. If it can maintain this trend then the Fund can expect to see increased profitability from Jasper Tank.

The Fund in its vision has determined that growth of and in itself is not a prerequisite. However the vision of acquiring good companies and allowing them to grow under a new fiscal arrangement has led to very significant growth, especially in employment. At the time of the acquisition of Perimeter there were 275 employees and

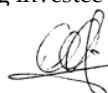
now there are approximately 425 employees and with the addition of Keewatin and Jasper, the Fund has over 550 employees. One of the objectives of the Fund is to be an employer of choice for young, dynamic people who want to grow their careers in our businesses. We will do this by developing a culture that rewards and recognizes the extra efforts of our employees.

The acquisition of Keewatin and Jasper has allowed the Fund to increase the number of full time employees located in the EIIF offices. With only Perimeter generating cash flow we were reticent to increase overhead at the Fund level. We now have 5 full time employees at the Fund giving us the critical mass to oversee the operations of our existing investments as well as examine future acquisition opportunities. We are very careful however to not put the Fund in a position where we need to do a deal. Rather, we need to be in a position to act quickly when the right opportunity presents, or to be patient when conditions warrant. The need for this flexibility was never more evident than in the fall of last year when The Federal Government announced that it was considering changes to the way income trust vehicles are taxed. The market for new offerings dried up over night and unit values declined significantly.

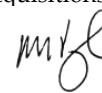
Our earnings and distributable cash grew significantly in 2005. After tax earnings reached \$3.1 million dollars, up 162% from the previous year. Earnings per unit increased to \$1.72 basic and 1.48 fully diluted, increases of 62% and 64% respectively. Distributable cash grew at a greater rate. Distributable cash per unit was \$2.55 per unit basic and \$2.02 fully diluted which was an increase of 107% and 104 %.

Actual distributions were also increased in 2005. In the first 6 months of the year quarterly distributions of \$0.27 per unit (annual rate of \$1.08 per unit) were made. In September the Fund moved to monthly distributions of \$0.10 per unit (annual rate of \$1.20 per unit). Even with this increase our payout ratio was a modest 45%, 56% fully diluted. The internal growth opportunities at Perimeter in particular have required a significant investment. We have retained the excess distributable cash to assist in funding the capital expenditures and increased working capital required. We regularly assess the need for capital internally and re-examine the level of our distributions. While it is our intention to maintain a conservative payout ratio, we expect that when it is considered prudent to do so it will rise from current levels.

We continue to look for opportunities both within our existing investee companies and in new acquisitions.



Duncan Jessiman, CEO



Mike Pyle, President

# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

April 17, 2006

This Management's Discussion and Analysis should be read in conjunction with the audited consolidated financial statements ("Consolidated Financial Statements") of Exchange Industrial Income Fund ("EIIIF" or "the Fund") for the year ended December 31, 2005. Results are reported in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

## FORWARD LOOKING STATEMENTS

This quarterly report contains forward looking statements. The use of any of the words anticipate, continue, estimate, expect, may, will, project, believe and similar expressions are intended to identify forward looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking statements. Management believes that the expectations reflected in those forward looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward looking statements included in this report should not be unduly relied upon. These statements are made as of the date of this report and the Fund assumes no obligation to update or revise them, either publicly or otherwise to reflect new events, information or circumstances.

## NON-GAAP FINANCIAL MEASURES

EBITDA and distributable cash are not recognized measures under Canadian GAAP. EBITDA is defined as earnings before interest, taxes, depreciation and amortization. EBITDA is a performance measure utilized by many investors to analyze the cash available for distribution from operations before allowance for debt service, capital expenditures and income taxes. It is also used to compare the distributable cash of other income funds and companies. Distributable cash is a performance measure used to summarize the funds available to unitholders of an income fund. Investors are cautioned that EBITDA and distributable cash should not be viewed as an alternative to measures that are recognized under Canadian GAAP such as net income, or cash from operations. EIIIF's method of calculating EBITDA and distributable cash may differ from that of other income funds and therefore may not be comparable to measures utilized by them.

## ADDITIONAL INFORMATION

Additional information relating to EIIIF is on SEDAR at [www.sedar.com](http://www.sedar.com)

## 1. SUMMARY OF FINANCIAL RESULTS

\$000,000's (except per unit data)	2005	2004 <sup>1</sup>
Revenue	57,267	19,738
EBITDA	7,021	2,688
Earnings	3,058	1,168
Earnings per unit:		
Basic	1.72	1.06
Diluted	1.48	0.9
Total assets	74,090	29,834

<sup>1</sup> The comparable period is for the 239 day period ended December 31, 2004, as EIIIF began operations on May 6, 2004.

## HIGHLIGHTS OF 2005

2005 was an exciting year for EIIIF as the Fund experienced growth organically and by acquisition. Highlights included:

- Sales increased 190% to \$57.3 million. EBITDA increased 161% to \$7.0 million.
- Earnings increased 162% to \$3.1 million.
- Completed the acquisition of Keewatin Air Limited in July.
- Completed the acquisition of Jasper Tank in September.
- Experienced significant organic growth in Perimeter resulting in:
  - Acquisition of the non-aircraft assets from a northern competitor in April.
  - Acquisition of 8 additional aircraft.
  - Test marketing a Dash 8 on charter from another air carrier in several markets.
  - The demand for this product exceeded expectations and Perimeter applied for the 705 license required to operate the aircraft in the fourth quarter of 2005.
- In order to assist in funding the acquisitions and organic growth, the Fund completed offerings of Fund units and debentures generating gross proceeds of \$12.5 million and \$8.3 million respectively.

# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

## 2. OVERVIEW

### EIIF

Exchange Industrial Income Fund is an unincorporated, open-ended, limited purpose trust created on March 22, 2004 by a Declaration of Trust made under, and governed by, the laws of the Province of Manitoba. The Fund was initially created to acquire Perimeter Aviation Ltd. ("Perimeter"). Perimeter operates an airline that services northern communities in Canada. It is the Fund's mandate to pursue investments in profitable, well-established companies with strong cash flows operating in niche markets in Canada and/or the United States. The objectives of the Fund are (i) to provide Unitholders with stable and growing cash distributions, payable monthly; (ii) to maximize unit value through on-going active management of the companies that the Fund invests in, and (iii) the continuing acquisition of additional companies or interests therein in order to expand and diversify the Fund's investments.

The Fund's reportable business segments are strategic business units that offer different products and services. The Fund has two reportable business segments: aviation and manufacturing. The aviation segment provides airline services to communities in Manitoba and Nunavut. The manufacturing segment produces specialized tanks for the transportation industry.

### ACQUISITIONS

Since the Fund was formed it has made the following strategic acquisitions:

- May 6, 2004: The Fund acquired 100% of the shares of Perimeter Aviation Limited (Perimeter) for aggregate consideration of \$17,215,000. The Fund also acquired 100% of the assets of Inland Fuels Ltd. (Fuels) for aggregate consideration of \$785,000. Perimeter is a regional airline operating out of its own terminal at the Winnipeg International Airport. It provides regular scheduled passenger airline service, medevac operations and cargo services to locations in Northern Manitoba. It also operates a contract and charter service, as well as a flight training school.
- April 20, 2005: Perimeter closed the purchase of certain real estate and fueling facilities acquired from an insolvent competitor for aggregate consideration of \$2,780,959. The most significant asset acquired was an operating base in Thompson (hangar, freight storage and terminal facilities).

- July 8, 2005: Perimeter acquired 100% of the shares of Keewatin Air Limited and Nunavut Lifeline Ltd, comprising the business known as "Keewatin" for aggregate consideration of \$5,072,088. Keewatin operates an airline and medevac business that services communities in Manitoba and Nunavut. Nunavut Lifeline operates a business that provides exclusive nursing and related services to Keewatin.
- September 1, 2005: The Fund acquired 100% of the shares of 398496 Alberta Inc., and certain assets owned by 745152 Alberta Ltd., comprising the business known as "Jasper Tank" for aggregate consideration of \$10,714,668. Jasper Tank is a manufacturer in Spruce Grove, Alberta, that specializes in custom tanks for the transportation industry.

## 3. KEY PERFORMANCE INDICATORS

### DISTRIBUTABLE CASH

EIIF generated distributable cash of \$4.5 million in 2005 which is an increase of 235% over 2004. The 2004 results are for a 239 day period from the Fund's inception to its December 31st year-end. The 2005 results include 12 full months of operation. On a per unit basis, distributable cash increased 107% over 2004 to \$2.55 per unit. Fully diluted distributable cash increased 104% to \$2.02 per unit.

\$000's (except per unit data)	2005	2004 <sup>1</sup>
Earnings before income tax	3,483	1,415
Depreciation & amortization	2,181	792
Interest expense	1,357	481
EBITDA	7,021	2,688
Interest on bank debt	579	150
Interest on debentures	678	293
Maintenance CapEx	1,087	882
Cash taxes	136	8
Distributable cash	4,541	1,355
Distributable cash per unit		
Basic	2.55	1.23
Diluted	2.02	0.99
Distributions declared	1.14	0.71

<sup>1</sup> The comparable period is for the 239 day period ended December 31, 2004, as EIIF began operations on May 6, 2004.

# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

## DISTRIBUTIONS AND PAYOUT RATIO

Actual distributions in 2005 totaled \$2.1 million or \$1.14 per unit. The Fund made quarterly distributions of \$.27 in March and June of 2005, with a distribution of \$.20 in August. Thereafter, a distribution of \$.10 per month was made. The \$1.14 per unit represents a payout ratio of 45% or 56% when calculated on a fully diluted basis.

The payout ratio is conservative but is considered prudent based on the investment required to take advantage of the growth opportunity experienced by our aviation division. In addition to the \$1.1 million in maintenance capital expenditures, approximately \$14.1 million was invested to grow the aviation division. Enhanced working capital

levels were also required to finance higher accounts receivable and inventory levels.

The level of distributions is examined on an ongoing basis by the Trustees of the Fund. Should the distributable cash generated exceed the requirements for re-investment in organic growth opportunities, the level of distributions will be re-evaluated.

The current distribution rate is \$1.20 per unit per annum. Management expects the Fund will generate sufficient cash in 2006 to meet or exceed this distribution rate.

The amounts and record dates of the distributions were:

Month(s)	Record date	Distributions	
		Per unit	Amount
January – March	March 29, 2005	\$ 0.27	\$ 339,170
April – June	June 28, 2005	0.27	347,251
July – August	August 29, 2005	0.20	394,448
September	September 30, 2005	0.10	248,415
October	October 31, 2005	0.10	248,415
November	November 30, 2005	0.10	256,036
December	December 31, 2005	0.10	256,607
<b>2005 Total</b>		<b>\$ 1.14</b>	<b>\$ 2,090,342</b>

Months	Record date	Distributions	
		Per unit	Amount
May – June	June 30, 2004	0.17	174,250
July – September	September 30, 2004	0.27	276,750
October – December	December 31, 2004	0.27	336,909
<b>2004 Total</b>		<b>\$ 0.71</b>	<b>\$ 787,909</b>

## 4. ANALYSIS OF OPERATIONS

\$000's	2005			
	Aviation	Mfg	Fund <sup>2</sup>	Consol
Revenue	52,924	4,343	-	57,267
Expenses <sup>1</sup>	46,331	3,566	349	50,246
<b>Total assets</b>	<b>6,593</b>	<b>777</b>	<b>(349)</b>	<b>7,021</b>

\$000's	2004 <sup>3</sup>			
	Aviation	Mfg	Fund <sup>2</sup>	Consol
Revenue	19,738	-	-	19,738
Expenses <sup>1</sup>	16,979	-	71	17,050
<b>Total assets</b>	<b>2,759</b>	<b>-</b>	<b>(71)</b>	<b>2,688</b>

- <sup>1</sup> Expenses excludes amortization and interest expense.
- <sup>2</sup> Fund is not a separate reportable segment. Fund includes expenses incurred at head office that are not allocated to the segments and is presented for reconciliation purposes.
- <sup>3</sup> The comparable period is for the 239 day period ended December 31, 2004.

## REVENUE

Revenue reached \$57.3 million in 2005. This is an increase of 190% over the 2004 revenue of \$19.7 million. This increase is explained by (i) the inclusion of 12 months' operations from Perimeter versus 239 days in 2004; (ii) the inclusion of Keewatin from July 8, 2005; (iii) the inclusion of Jasper Tank from September 1, 2005; and (iv) strong organic growth within the Perimeter operation.



# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

EIIF acquired Perimeter and completed its Initial Public Offering on May 6, 2004. As a result, the 2004 results for EIIF only include Perimeter for the 239 day period between May 6 and the December 31st year-end. The 2005 EIIF results include 12 months of operation. Perimeter had revenue of \$10.2 million in the first 126 days of 2004, bringing its total 2004 revenue while under private and EIIF ownership to \$29.9 million.

Perimeter revenues for the twelve months ended December 31, 2005 grew by \$16.1 million or 54% over the same period in 2004. Scheduled service (passengers and freight) increased by 58%. Medevac and charters grew by 107% and 58% respectively. All other revenues (parts, sales, third party maintenance and flight training) declined by 60% as the company focused on servicing its own aircraft and its core operations.

The increase in Perimeter's sales can be attributed to four main areas: (1) the Tribal Councils Investment Group (TCIG) marketing program; (2) the cessation of Skyward Aviation which was previously a competitor in several market segments; (3) an increase in the size of Perimeter's fleet and the acquisition of Skyward group (non-aircraft) assets in Northern Manitoba; and (4) a fuel surcharge implemented August 1, 2005.

\$000's	126 days to May 5 2004 <sup>1</sup>	239 days to Dec 31 2004 <sup>2</sup>	Year to Dec 31 2004 <sup>3</sup>	Year to Dec 31 2005 <sup>4</sup>
Revenue	10,146	19,738	29,884	46,099
EBITDA	1,109	2,688	3,797	6,036
EBITDA %	10.9%	13.7%	12.7%	13.1%

<sup>1</sup> Perimeter revenue - previous ownership

<sup>2</sup> Perimeter revenue - EIIF ownership

<sup>3</sup> Perimeter 12 month revenue - combined ownership

<sup>4</sup> Perimeter 12 month revenue - EIIF ownership

## EBITDA

EBITDA for 2005 grew by 161% to \$7.0 million from the \$2.7 million generated in 2004. The aviation segment generated EBITDA of \$6.6 million while the manufacturing segment generated EBITDA of \$0.8 million. The Fund had expenses of \$0.4 million.

The aviation segment is made up of Perimeter and Keewatin, which contributed \$6 million and \$0.6 million respectively. The Perimeter EBITDA contribution to EIIF of \$6 million is an increase over 2004 of 122%. The period included in EIIF results in 2004 however, is only for the period from EIIF's purchase of the company on May 6 to the December year-end. To more accurately compare the EBITDA generated by Perimeter in 2005, it is necessary to

compare like periods. Accordingly, the chart below compares the twelve month periods for 2004 and 2005.

The EBITDA generated in Perimeter has increased in line with the increase in sales. EBITDA margin is relatively consistent with 2004, at 13.1% versus 12.7%. The EBITDA margin has been affected both positively and negatively by several factors. EBITDA margins have been strengthened by increased utilization of Perimeter's fleet (more hours flown per plane) and higher load factors. There have been downward pressures on margins as a result of two principal factors. Firstly, in order to meet customer demand on a timely basis, Perimeter has chartered service from other airlines. The cost of utilizing these charters is significantly higher than when Perimeter utilizes its own fleet. Perimeter has also test marketed a Dash 8 aircraft in certain communities in the second half of 2005. The Dash 8 is a much larger aircraft, with up to 37 seats, than Perimeter normally operates with the Metro (up to 19 seats). The Dash 8 has met with solid market acceptance and the company will acquire one in the first quarter of 2006. It has applied for the necessary license to operate this class of aircraft. It is expected that the license will be granted in second or third quarter of 2006.

Perimeter has also purchased a total of eight other aircraft to increase its fleet in 2005. These planes are all expected to be in service by the second quarter of 2006. The cost of these charters will be significantly reduced in the first half of 2006 and should be essentially eliminated by the third quarter of 2006.

Secondly, there has been an increase in the cost of aviation fuel in 2005. There was an additional spike in the late third and fourth quarter as a result of Hurricane Katrina. This spike has now subsided, although prices remain high by historical standards. Perimeter implemented a fuel surcharge in August of 2005, based on the prices at that time. It was not sufficient to cover the costs during the spike. Perimeter continues to monitor fuel prices and should prices remain high, a further increase may be required. Keewatin's results during this period were essentially inline with previous year's results.

Jasper Tank has operated as expected and its results are in line with previous periods under private ownership. EBITDA was negatively impacted by a purchase price adjustment for work in progress. This adjustment increased the value of the work in progress at September 1, 2005 by \$147,000. This adjustment carried through the income statement in 2005, which resulted in an increase in cost of sales. When this adjustment is normalized, EBITDA increases from \$0.8 million to \$0.9 million and the EBITDA margin increases from 17.9% to 21.3%.

# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

## 5. SUMMARY OF QUARTERLY RESULTS

For the seven most recent quarters

\$000,000's (except per unit data)	2005				2004		
	Q4	Q3	Q2	Q1	Q4	Q3	Q2 <sup>1</sup>
Revenue	20,668	16,209	11,599	8,791	7,271	7,794	4,673
EBITDA	1,415	2,261	1,941	1,404	1,027	922	739
Net earnings	320	1,059	996	683	491	311	366
Distributable cash	1,136	1,342	1,145	918	340	318	697
Earnings per unit:							
Basic	0.13	0.51	0.79	0.54	0.40	0.30	0.36
Diluted	0.13	0.43	0.62	0.45	0.34	0.28	0.28
Distributable cash per unit:							
Basic	0.45	0.65	0.91	0.74	0.27	0.31	0.68
Diluted	0.39	0.51	0.70	0.58	0.25	0.27	0.48

<sup>1</sup> Results for quarter 2, 2004 only includes the 55 days ended June 30, 2004.

## 6. REVIEW OF Q4 2005 RESULTS

Sales in the fourth quarter climbed to \$20.7 million from \$7.3 million in 2004. The addition of Keewatin to EEIF contributed \$3.4 million and the addition of Jasper added 3.6 million over 2004 levels. The balance of the increase was generated by growth in Perimeter whose sales climbed from \$7.3 million to \$13.7 million.

EBITDA increased from \$1.0 million to \$1.4 million. Jasper contributed \$0.6 million, Keewatin broke even and Perimeter contributed \$1.1 million. Expenses at the Fund level reduced EBITDA by \$0.3 million.

Net earnings declined from \$0.5 million in 2004 to \$0.3 million in 2005. Net earnings were \$0.13 per unit basic and fully diluted compared to \$0.40 and \$0.34 respectively in 2004.

At Perimeter the decline in profitability in the fourth quarter, both in absolute terms and expressed as a % of sales, is the result of a number of factors.

Fuel prices which had increased throughout the year spiked significantly for the two month period following Hurricane Katrina. Fuel prices declined significantly in December and thereafter. The average cost of jet fuel for southern locations (i.e. non winter road locations) was approximately 17% higher in the fourth quarter than it was on average for the full year, or than it was for the month of December. A fuel price surcharge was implemented in August of 2005, however it was not large enough to offset the level of increase experienced in the

fourth quarter. While fuel prices are still high by historical standards they are well below the October and November fuel prices. A fare increase of approximately 6% was enacted in April of 2006.

Maintenance costs on the aircraft are not incurred on a straight line basis throughout the year. The fourth quarter was an expensive quarter for aircraft maintenance. The increased utilization of the aircraft during 2005 vs. previous years resulted in an increased number of required heavy maintenance inspections on the aircraft. This in turn increased not only the maintenance expense, but also the costs of third party charters which were required to replace the aircraft that were in for inspections. Approximately 40% of the total cost of third party charters was incurred in the fourth quarter. Both of these issues will be rectified through an expanded fleet, which will enable the maintenance work to be completed on a more even basis throughout the year, and will reduce and ultimately eliminate the need for chartered capacity.

Keewatin's operations are centered in the far north and are generally more seasonal than Perimeter's operations. The fourth quarter is historically the worst quarter of the year and the results are inline with prior years.

Jasper sales are in line with the prior year and with expectations. The accounting treatment of the purchase price has resulted in a reduction of both earnings and EBITDA. The work in progress adjustment of \$147,000 increased fourth quarter cost of sales by this amount. As well, the amortization of intangible assets decreased earnings an additional \$230,000 in the fourth quarter.

# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

## 7. LIQUIDITY & CAPITAL RESOURCES

### LIQUIDITY

As at December 31, 2005 the Fund has net working capital of \$8.8 million or a current ratio of 1.8 to 1. The Fund through its subsidiaries has authorized lines of credit of \$2.25 million. Approximately \$1.5 million of this amount was drawn in one subsidiary and all but \$0.1 million was offset by cash in the Fund and its other subsidiary companies.

### OUTSTANDING UNITS & DEBENTURES

#### Units

	Date Issued	# of Units
Units outstanding at December 31, 2004		1,256,187
Units issued for converted debentures	various	138,440
Units issued for TCIG commissions	June 28, 2005	14,160
Units issued to trustees and employees	June 28, 2005	2,655
Units purchased in secondary public offering	July 8, 2005	568,100
Units issued to employees	July 8, 2005	35,659
Units issued to Keewatin vendors	July 8, 2005	34,146
Units purchased in private placement	September 1, 2005	369,334
Units issued to Jasper vendors	September 1, 2005	95,238
Units issued in private placement	September 14, 2005	47,333
Units purchased by employees	December 22, 2005	1,825
Units issued to trustees	December 22, 2005	3,000
Total units outstanding at December 31, 2005		2,566,077

#### Convertible Debentures

##### 9% SENIOR SECURED, MAY 7, 2009 MATURITY, CONVERTIBLE AT \$9.00

(thousands, par value)

Debentures outstanding at December 31, 2004	\$	5,000
Debentures issued		-
Debentures converted into units		(1,246)
Total convertible debentures outstanding at December 31, 2005		3,754

##### 8% SENIOR SECURED, JULY 8, 2010 MATURITY, CONVERTIBLE AT \$11.50

(thousands, par value)

Debentures outstanding at December 31, 2004	\$	-
Debentures issued July 8, 2005		5,325
Debentures converted into units		-
Total convertible debentures outstanding at December 31, 2005		5,325

##### 8% SENIOR SECURED, SEPTEMBER 1, 2010 MATURITY, CONVERTIBLE AT \$13.25 (thousands, par value)

Debentures outstanding at December 31, 2004	\$	-
Debentures issued September 1, 2005		2,068
Debentures issued September 14, 2005		432
Debentures converted into units		-
Total convertible debentures outstanding at December 31, 2005		2,500

### CAPITAL RESOURCES

As at December 31, 2005 the Fund and its subsidiaries had undrawn availability on its revolving credit facility of \$4.9 million. The aviation division has completed most of the capital investment required to meet the current level of demand. Approximately \$4 million of the undrawn facility has been allocated to the completion of the new engine shop and office building at Perimeter as well as to the purchase of a Dash 8 aircraft in the first quarter of 2006.

# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

## CONTRACTUAL OBLIGATIONS

(thousands)

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1 – 3 years	4 - 5 years	After 5 years
Long-term debt	\$ 20,138	\$ -	\$ 20,138	\$ -	\$ -
Operating Leases	2,617	1,571	494	84	468
Total contractual obligations	22,755	1,571	20,632	84	468

## 8. RELATED PARTY TRANSACTIONS

The Fund enters into transactions with 2811065 Manitoba Ltd, which is owned by a trustee of the Fund. These transactions are in the normal course of operations and at market terms and conditions.

During the year ended December 31, 2005, the Fund purchased \$2,692,527 of fuel (2004 - \$1,207,287), paid \$136,700 in aircraft lease expenses (2004 - \$91,133) and received \$133,333 in rent revenues from 2811065 Manitoba Ltd (2004 - \$55,916). The receivable from 2811065 Manitoba Ltd. at December 31, 2005 is \$383,605 (2004 - (\$540,094)).

The Fund has a marketing agreement with TCIG, whose President is a trustee of the Fund. The agreement is in the normal course of operations and at market terms and conditions. The compensation to TCIG is conditional on the annual increase in sales. During the year December 31, 2005, the Fund paid commissions of \$365,000 (2004 - \$87,468). The payable to TCIG at December 31, 2005 is \$300,000 (2004 - \$87,468).

## 9. ACCOUNTING POLICIES AND ESTIMATES

### CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Estimates are deemed critical when a different estimate could have reasonably been used or changes in accounting estimates are reasonably likely to occur from period to period and these different estimates would have a material impact on the Fund's consolidated balance sheet, results of operations, or statement of cash flows.

The significant areas requiring the use of management estimates are disclosed in note 2 of the notes to the consolidated financial statements. The Fund's management believes that the following accounting estimates are critical as described above.

### Business Combination

The Fund's acquisitions have been accounted for using the purchase method of accounting. Under the purchase method, the acquiring company adds to its balance sheet the estimated fair values of the acquired company's assets and liabilities. There are various assumptions made when determining the fair values of the acquired company's assets and liabilities. The most significant assumptions, and those requiring the most judgment, involve the estimated fair values of intangible assets. The intangible assets acquired that require critical accounting estimates are customer contracts and customer relationships. To determine the fair value of these intangible assets, the Fund adopted the excess earning method. This valuation technique values the intangible assets based on the capitalization of the earnings which are calculated to be in excess of what a reasonable amount of earnings would be on the tangible assets used to generate the earnings associated with the intangible asset. Significant assumptions include, amongst others, the determination of projected revenues, cash flows, customer retention rates, discount rates, and anticipated average income tax rates.

### Goodwill Impairment

Goodwill is not amortized and is assessed for impairment at least annually. Any potential goodwill impairment is identified by comparing the fair value of the business to its carrying value. A goodwill impairment loss would be recognized to the extent that the carrying value of goodwill exceeds the implied fair value. Fair value of goodwill is estimated in the same manner that the Fund uses to determine fair value upon the acquisition of a business. Significant assumptions include, amongst others, the determination of normalized earnings and earnings multiples.

### Engine Overhaul Provision

The purpose of the engine reserve is to ensure that the cost to overhaul an engine and to perform the hot section inspection is expensed evenly over the period that the engine is used. An amount is accrued for every hour flown. The accrual rate is set so that when the expenditure is incurred, the liability approximates the amount of the required expenditure. To calculate the accrual rate, management estimates the cost to perform a standard



# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

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overhaul and hot section inspection on the engine and divides this by the time before overhaul on the engine. The accrual rate is reviewed annually to ensure that the costs have not changed significantly.

## CHANGES IN ACCOUNTING POLICIES

### Variable Interest Entities

Effective January 1, 2005, the Fund adopted the Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 15, Consolidation of Variable Interest Entities ("VIEs"). VIEs are entities in which equity investors do not have controlling financial interest or the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by other parties. Accounting Guideline 15 requires the consolidation of VIEs by its primary beneficiary, which is the party who receives the majority of the expected residual returns (losses). The adoption of this guideline did not have any impact on the Fund's consolidated financial statements.

### Fully Diluted Earnings per Unit

During 2005, the Fund revised its methodology for calculating diluted earnings per unit. As a result of this revision, the calculation of diluted earnings per unit adds the dilutive effect of the convertible debentures to earnings, gross of taxes. Previously the dilutive effect was added back to earnings, net of taxes. All comparative figures in the annual report have been restated for this revision in methodology. The effect of this revision for the year ended December 31, 2005 is a \$0.12 increase to fully diluted earnings per unit (2004 - \$0.10).

## 10. DISCLOSURE CONTROLS

### Effectiveness of disclosure controls and procedures

Management has established and maintained disclosure controls and procedures for the Fund in order to provide reasonable assurance that material information relating to the Fund is made known to management in a timely manner and that information required to be disclosed by the Fund is reported within the time periods prescribed by applicable securities legislation. The disclosure controls and procedures established by management have not been in place for a sufficient period of time for management to evaluate the effectiveness of these controls and procedures, as at the date of this annual report.

## 11. BUSINESS RISKS

### Risk Management

EIIF and its subsidiaries are subject to a number of business risks. These risks relate to the structure of the Fund and to the operation of the subsidiary companies.

### Interest Rates

The Fund has outstanding net secured bank debt of \$20.3 million that bears interest at a floating rate. A one-percentage point increase in average interest rates would cost the Fund approximately \$203,000 per annum. The convertible debentures have fixed interest rates which are not affected by changes in rates. The Fund is examining alternatives with its lenders to fix the rate on all or a portion of its floating rate debt. The Fund paid out 45% of its distributable cash in 2005 (56% if calculated on a fully diluted basis). Management believes that this relatively low payout ratio mitigates the risk of increasing interest rates.

### Fuel Prices

Fuel is a very significant cost component in the operation of the aviation segment. Each \$0.01 increase in the average cost of fuel increases the operating costs of the segment by approximately \$140,000. A fuel surcharge was implemented in August of 2005, and most contracts contain automatic escalator clauses. While most of the travel by Perimeter and Keewatin customers is not discretionary (i.e. for medical or other necessary reasons) and overland travel from and to many of the communities serviced is only possible for brief periods of the year over winter roads, if prices were to escalate significantly it may impact demand for services. Secondly, if the competitive environment was to change, and the companies were unable to pass these increased costs on to the customer, future profits would be negatively impacted.

The Jasper Tank operation acts somewhat as a hedge to increasing fuel prices. Increased oil prices increase the demand for Jasper's products as additional wells are brought into production. A significant decline in the price of oil could reduce revenues at Jasper.

### Competition

All of the Fund's subsidiaries are market leaders in their respective geographical markets. The Fund recognizes that there are threats in the operating environment, which will challenge the segments' ability to sustain their market leadership positions.

The aviation segment currently focuses on niche markets in Manitoba and Nunavut. The aviation sector would be exposed to downside earnings risk if a well capitalized competitor were to startup operations in the niche markets

# MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

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where Perimeter and Keewatin currently operate. This risk factor is mitigated by Perimeter's relationship with TCIG, which enables Perimeter to focus on its customers' demands.

Jasper currently has a production backlog due to customer demand. It recognizes that the high demand for its products and the strong market creates the risk that new entrants may enter the market. In order to maintain positive customer relationships and a loyal customer base, Jasper is continuously working with the customer to ensure that their needs are met.

## Key Personnel

The success of the Fund is dependent on a number of key senior employees both at the Fund level and at the Fund's subsidiary level. The loss of any one of these key employees would impair the Fund's ability to operate at its optimum level of performance. Management recognizes this dependency and is in the process of developing a strong second level of managers that would be able to fill the void if a key employee departed.

## Tax Related Risks

The income of the Fund and its subsidiaries are taxed under Canadian Tax laws which could be changed at any time. These changes may be negative to the treatment of mutual fund trusts which could materially change the treatment of the earnings of the Fund, its unitholders or its subsidiaries. Such changes could also affect the overall demand for mutual fund trust units in the public markets which in turn could place severe limitations on EIIF's ability to make future acquisitions.

As set out in interest rates above, EIIF pays out a relatively low ratio of its distributable cash. Should there be modest changes to the tax treatment of mutual fund trusts, EIIF has flexibility to deal with them with this surplus cash flow.

## Capital Markets

One of the objectives of the Fund is continuing acquisition of additional companies or interests therein in order to expand and diversify the Fund's investments. The ability to execute this objective is dependent on the Fund's ability to raise funds in the capital market. If the capital markets desire for mutual fund trust investments were to significantly decrease, the Fund would have difficulty in executing its acquisition objective.

## 12. OUTLOOK

EIIF continues to examine acquisition opportunities both within and outside of the aviation and manufacturing sectors. In late 2005 there was considerable uncertainty in the income trust marketplace brought on to a large extent by the Federal Government's decision to place a moratorium on advance tax rulings for income trusts and the Government's decision to consider changes to the tax treatment of income trusts. This uncertainty led to lower unit prices and higher yield expectations. This problem was eliminated in late 2005 when the Federal Government announced it would not be making changes to the taxation of trusts, and the market strengthened. Accordingly, EIIF is again active in sourcing and evaluating acquisition opportunities.

EIIF intends to maintain a strong balance sheet and as such, when a suitable target is found and approved by the trustees of the Fund, it will be funded through the issuance of additional units or convertible debentures as well as the use of a prudent level of funded debt.

## Perimeter

Perimeter has experienced significant growth in all of its core business sectors (scheduled service, medevac and charter). It has experienced an increase in market share as a result of the closure of its largest competitor, Skyward Aviation, as well as through the marketing efforts of TCIG. Perimeter does expect new competition in certain geographic markets and market segments as other companies attempt to capture markets that were previously serviced by Skyward Aviation. Management believes that Perimeter is well equipped to deal with any new competition which may arise.

Perimeter experienced significant capacity shortfalls which it solved by chartering the services of other air carriers while it expanded its own fleet. Perimeter purchased 8 additional aircraft during 2005, which when all are in service (expected to be Q2 of 2006) will go along way to solving the capacity concerns. The company also completed the test operation of a larger Dash 8 aircraft in certain communities. The test was successful, as the aircraft received significant market acceptance and proved to be suitable for operation in the short gravel strips serviced by Perimeter. Perimeter has applied for a 705 license required to operate this larger class of aircraft and intends to acquire its own Dash 8 in early 2006. The requirement for third party charters is expected to decline throughout the first half of 2006, and be essentially eliminated by the third quarter. This should in turn put positive pressure on margins

## MANAGEMENT'S DISCUSSION & ANALYSIS

of Operating Results and Financial Position for the year ended December 31, 2005

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Perimeter has also invested in additional hangers in Thompson and Rankin Inlet in the current year. It has also expanded one of its hangars at the Winnipeg Airport. Construction of an additional building at the Winnipeg Airport commenced in the 4<sup>th</sup> quarter of 2005. It was completed in Q1 of 2006. This building will house an expanded engine overhaul facility as well as much needed office and training facilities. Keewatin will also be moving into this facility during 2006. In addition, a building adjacent to the airport on Ferry Road was also acquired to provide for additional parts and record storage. Continued growth in the freight business may require a further expansion of the Winnipeg Airport facilities in 2006.

Fuel prices remain high, although they have declined somewhat from the levels experienced after Hurricane Katrina. Perimeter initiated a fuel surcharge in August of 2005. Should fuel prices rise further, this surcharge may need to be increased. A fare increase of 6% was implemented April 1, 2006.

### Keewatin

Keewatin operations remain stable. The company's core business is the medevac operation, which is under long term contract with the Nunavut Government. This portion of Keewatin's business is serviced with a fleet of King Air twin engine aircraft. The medevac business continues to grow, and Keewatin purchased an additional King Air in December 2005. It will go into service in Q2 of 2006.

Keewatin utilizes leased PC-12 Pilatus single engine aircraft in its scheduled and charter operations. It is currently examining a number of alternatives to this aircraft to insure that the fleet make up is appropriate.

Keewatin will be leaving its current leased premises and taking up space in the expanded facilities operated by Perimeter at the Winnipeg Airport. It will remain as a separate operating entity.

As a result of increasing fuel costs, Keewatin implemented a fare increase for its scheduled and chartered operations in August of 2005. Further adjustment to fares is under consideration. The contract with the Government of Nunavut for medevac services contains an escalator clause to deal with fuel price increases.

### Jasper Tank

The Alberta economy is strong and the demand for Jasper Tank products remains high. Management is examining alternatives to increase capacity and take advantage of the market opportunities.

Financial Statements of

**EXCHANGE INDUSTRIAL INCOME FUND**

For the Year Ended December 31, 2005



## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of Exchange Industrial Income Fund for the year ended December 31, 2005 and all information in this annual report are the responsibility of management. Financial information contained elsewhere in the annual report is consistent with that shown in the consolidated financial statements. The consolidated financial statements were prepared by management in accordance with Canadian generally accepted accounting principles, applied on a consistent basis. The significant accounting policies, which management believes are appropriate for the Fund, are described in note 2 to the consolidated financial statements.

Management is responsible for the integrity and objectivity of the consolidated financial statements. Estimates are necessary in the preparation of these statements and, based on careful judgments, have been properly reflected. Management has established systems of internal control which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, and to produce reliable accounting records for the preparation of financial information.

The Fund's independent auditors, Deloitte & Touche, LLP have been appointed by the unitholders to audit the financial statements and express an opinion thereon.

The board of trustees is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The board of trustees carries out this responsibility principally through its audit committee, composed entirely of outside and unrelated trustees. The audit committee meets regularly with financial management of the Fund and with the independent auditor to discuss internal controls, audit matters, financial reporting issues and reports to the board of trustees thereon. The audit committee also reviews and approves the consolidated financial statements for inclusion in the annual report. The independent auditor has full and free access to the audit committee.

April 17, 2006

**Duncan D. Jessiman**  
Chief Executive Officer

**Michael C. Pyle**  
President and  
Chief Financial Officer

## AUDITORS' REPORT

### To the Unitholders Exchange Industrial Income Fund

We have audited the consolidated balance sheets of Exchange Industrial Income Fund as at December 31, 2005 and 2004, and the consolidated statements of operations and cumulative earnings, and cash flows for the year ended December 31, 2005 and the 239 day period ended December 31, 2004. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the year ended December 31, 2005 and the 239 day period ended December 31, 2004 in accordance with Canadian generally accepted accounting principles.

*Deloitte & Touche LLP.*  
Chartered Accountants

Winnipeg, Manitoba  
April 17, 2006

## CONSOLIDATED BALANCE SHEETS

(amounts in thousands of dollars, except for per unit information)

	December 31 2005	December 31 2004
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and short-term deposits	\$ -	\$ 305
Accounts receivable	11,531	4,289
Inventory	7,720	3,132
Prepaid expenses	469	643
Future income tax (Note 13)	705	104
	<b>20,425</b>	<b>8,473</b>
CAPITAL ASSETS (Note 4)	41,556	18,368
DEFERRED CHARGES (Note 5)	1,258	651
INTANGIBLE ASSETS (Note 6)	498	-
GOODWILL (Note 3 and 7)	10,353	2,342
	<b>\$ 74,090</b>	<b>\$ 29,834</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Bank indebtedness	\$ 129	\$ -
Accounts payable and accrued expenses	11,110	3,595
Deferred revenue	401	112
	<b>11,640</b>	<b>3,707</b>
LONG-TERM DEBT (Note 9)	20,138	7,200
CONVERTIBLE DEBENTURES (Note 10)	10,809	4,662
ENGINE OVERHAUL ACCRUAL (Note 2(k))	1,017	809
FUTURE INCOME TAX (Note 13)	5,073	3,011
	<b>48,677</b>	<b>19,389</b>
<b>UNITHOLDERS' EQUITY</b>		
Trust units (Note 11)	23,178	9,688
Convertible debentures - equity component (Note 10)	887	377
Cumulative earnings	4,226	1,168
Cumulative distributions (Note 12)	(2,878)	(788)
	<b>25,413</b>	<b>10,445</b>
	<b>\$ 74,090</b>	<b>\$ 29,834</b>

Approved on behalf of the trustees by:

Duncan Jessiman, Trustee

Donald Streuber, Trustee

## CONSOLIDATED STATEMENTS OF OPERATIONS AND CUMULATIVE EARNINGS

(amounts in thousands of dollars, except for per unit information)

	Year ended December 31 2005	239 day period ended December 31 2004
REVENUE	\$ 57,267	\$ 19,738
EXPENSES		
Direct operating	41,482	14,288
General and administrative	8,563	2,692
Capital taxes	201	70
Interest	1,357	481
Depreciation and amortization	2,181	792
	53,784	18,323
EARNINGS BEFORE INCOME TAXES	3,483	1,415
INCOME TAX EXPENSE (Note 13)		
Current	(88)	7
Future	513	240
	425	247
NET EARNINGS FOR THE PERIOD	\$ 3,058	\$ 1,168
Cumulative earnings, beginning of period	1,168	-
CUMULATIVE EARNINGS, END OF PERIOD	\$ 4,226	\$ 1,168
EARNINGS PER UNIT (Note 14)		
Basic	\$ 1.72	\$ 1.06
Diluted	\$ 1.48	\$ 0.90

## CONSOLIDATED STATEMENT OF CASH FLOWS

(amounts in thousands of dollars, except for per unit information)

	Year ended December 31 2005	239 day period ended December 31 2004
<b>OPERATING ACTIVITIES</b>		
Net earnings for the period	\$ 3,058	\$ 1,168
Items not affecting cash:		
Depreciation and amortization	2,181	792
Accretion of interest on convertible debentures	100	38
Trust units issued for services	213	67
Engine overhaul accrual	(67)	(101)
Future income tax	289	240
	5,774	2,204
Changes in non-cash operating working capital items:		
Accounts receivable	(2,841)	(400)
Inventory	(2,391)	(481)
Prepaid expenses	430	(316)
Accounts payable and accrued charges	3,736	572
Deferred revenue	4	(71)
	4,712	1,508
<b>FINANCING ACTIVITIES</b>		
Repayment of debt	(3,251)	(531)
Proceeds from long-term debt, net of issuance costs	12,590	6,728
Proceeds from issuance of convertible debentures, net of issuance costs	7,251	4,673
Proceeds from issuance of trust units, net of issuance costs	10,376	6,521
Cash distributions to unitholders	(2,090)	(788)
	24,876	16,603
<b>INVESTING ACTIVITIES</b>		
Purchase of capital assets, net of disposals	(15,070)	(1,532)
Cash outflow for acquisitions, including acquisition costs	(14,437)	(9,772)
Cash (bank indebtedness) acquired in acquisitions	(515)	(3,682)
Taxes paid on recapture	-	(2,820)
	(30,022)	(17,806)
<b>NET INCREASE (DECREASE) IN CASH POSITION</b>	<b>(434)</b>	<b>305</b>
<b>CASH POSITION, BEGINNING OF PERIOD</b>	<b>305</b>	<b>-</b>
<b>CASH (BANK INDEBTEDNESS) POSITION, END OF PERIOD</b>	<b>\$ (129)</b>	<b>\$ 305</b>
<b>Supplementary cash flow information</b>		
Interest paid	\$ 973	\$ 375
Income taxes paid	\$ -	\$ -

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

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## 1. BASIS OF PRESENTATION

Exchange Industrial Income Fund (the “Fund”) is an unincorporated open-ended mutual fund trust governed by the laws of the Province of Manitoba created pursuant to a Declaration of Trust dated March 22, 2004. Each unitholder participates pro rata in any distribution from the Fund. Income tax obligations related to distributions of the Fund are the obligation of the unitholders.

The principal wholly-owned operating subsidiaries of the Fund are Perimeter Aviation Ltd. (“Perimeter”) and Jasper Tank Ltd. (“Jasper”). Keewatin Air Ltd. (“Keewatin”) and 4873999 Manitoba Ltd. are wholly owned subsidiaries of Perimeter. Through the Fund’s subsidiaries, products and services are provided in two business segments: aviation and manufacturing.

## 2. SIGNIFICANT ACCOUNTING POLICIES

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

### a) *Principles of Consolidation*

The consolidated financial statements include the accounts of the Fund, and its wholly owned subsidiaries Perimeter and Jasper. All significant inter-Fund transactions have been eliminated for purposes of these consolidated financial statements.

### b) *Revenue Recognition*

The Fund recognizes revenue principally on two types of transactions: provision of flight services and sales of tanks.

The Fund records flight revenue at the time at which tickets purchased by customers are actually utilized. Tickets sold for which the customer has not flown are reflected on the balance sheet as deferred revenue.

The Fund recognizes tank revenue when the title has been passed to the customer, which is the time the effective control of the unit and the risks and rewards of ownership have been passed to the customer. This is generally when the product is picked up by the customer. Payments received in advance, including up-front non-refundable deposits, are recorded as deferred revenue until the product is delivered to the customer.

### c) *Inventory*

Raw material inventories have been valued at the lower of cost and net realizable value. Work in progress and finished goods inventories have been valued at the cost of materials and labour, plus a provision for overhead.

### d) *Capital Assets*

Capital assets are recorded at cost less accumulated amortization. Amortization of capital assets has been recorded on a straight line basis using the following annual rates:

Buildings	5%
Aircraft	5%
Equipment	10% - 20%
Other	25% - 30%
Leasehold improvements	over term of lease



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

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e) *Deferred Charges*

The Fund has deferred charges directly associated with obtaining certain financing. These charges include closing costs as well as professional fees and other costs that are related to obtaining the financing. These costs are amortized over the life of the related debt.

f) *Impairment of Long-Lived Assets*

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate their carrying amount may not be recovered. An impairment loss is recognized when the carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is the excess of the carrying value of the asset over its fair value. No assets were determined to be impaired in 2005.

g) *Intangible Assets*

Intangible assets are recorded at cost. The Fund does not have any intangible assets with indefinite lives. Intangible assets with finite lives are amortized as follows:

Customer contract	Straight line over the life of the contract
Customer relationships	Pro rata based on expected revenues, over 6 years
Production backlog	Straight line over 3 months

h) *Goodwill*

Goodwill is recognized to the extent of the excess of the purchase price over the fair value of the underlying identifiable net assets acquired. Management reviews the carrying value of goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset may be impaired. Any excess of carrying value over the fair value will be charged to income in the period in which the impairment is determined.

i) *Income Taxes*

The Fund is a unit trust for income tax purposes and, as such, is only taxable on any taxable income not allocated to the unitholders. Income tax obligations relating to distributions from the Fund are obligations of the unitholders. Taxable income in the Fund's subsidiaries are taxed at the corporate income tax rate, while taxable income not allocated to the unitholders in the Fund entity is taxed at the highest personal income tax rate.

The Fund accounts for income taxes using the liability method of accounting for income taxes. Under this method, future income tax assets or liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying values of assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which the temporary differences are expected to reverse.

j) *Product Warranty*

The Fund records estimated product warranty costs at the time of the sale. The warranty liability is determined based on historical information from past experience.

k) *Engine Overhaul Accrual*

As revenue is earned through the operation of the aircraft, the Fund accrues for the required cost of periodic engine overhauls based on the engine hours flown.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

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## *l) Financial Instruments*

### *Credit Risk*

Credit risk arises from the potential that a counterparty will fail to perform its obligations. In addition, the Fund is exposed to credit risk from its customers. While the operations serve the Manitoba and Alberta markets, the Fund has a large number of customers, which minimizes the concentration of credit risk.

### *Foreign Currency Risk*

The foreign currency risk arises from fluctuations in foreign exchange rates, and the degree of volatility of those rates. The Fund has not use derivative instruments to reduce its exposure to foreign currency risk.

### *Interest Rate Risk*

The Fund is subject to interest rate risk due to fluctuations in the prime rate of interest and the degree of volatility of this rate. The Fund has not use derivative instruments to mitigate this risk.

### *Fair Value*

For the Fund's current financial assets and liabilities, which are subject to normal trade terms, the historical cost carrying values approximate the fair values. For the Fund's long-term debt, the historical cost carrying values approximate the fair values, since the interest rate is derived from the prime interest rate. For the Fund's convertible debentures fair value will change based on the movement in bond rates. The fair value of the embedded call option in the convertible debenture was determined using the Black Scholes Option Pricing Model.

### *Equity Settled Obligations*

In the period ended December 31, 2004, the Fund early adopted the amended recommendations of the CICA for the presentation and disclosures of financial instruments (CICA Handbook Section 3860) specifically concerning the classification of obligations that an issuer can settle by delivering its own equity instruments. The amended recommendations resulted in the Fund's convertible debentures being classified primarily as debt (Note 8).

## *m) Foreign Currency Translation*

Monetary items and non-monetary items carried at market are translated at the rate of exchange in effect at the balance sheet date. Non-monetary items carried at cost are translated at the exchange rate in effect at the date of the transaction. Revenues and expenses are translated at the average rate of the period in which they were incurred. Foreign exchange gains and losses are included in earnings.

## *n) Use of Estimates*

The preparation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of collectibility of accounts receivable, value of work in progress and finished goods, valuation of intangibles, goodwill, impairment of assets, provision for warranty, engine overhaul accrual rates, useful life for amortization, future income taxes, and deferred costs. Results as determined by actual events could differ from these estimates.

## **Adoption of new accounting pronouncements**

### *Variable Interest Entities*

Effective January 1, 2005, the Fund adopted the Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 15, Consolidation of Variable Interest Entities ("VIEs"). VIEs are entities in which equity investors do not have controlling financial interest or the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by other parties. Accounting Guideline 15 requires the consolidation of VIEs by its primary beneficiary, which is the party who receives the majority of the

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

expected residual returns (losses). The adoption of this guideline did not have any impact on the Fund's consolidated financial statements.

### 3. ACQUISITIONS

2005

#### Keewatin

On July 8, 2005, the Fund acquired 100% of the shares of Keewatin Air Ltd. and Nunavut Lifeline Ltd., comprising the business known as "Keewatin", for aggregate consideration of \$5,072. Keewatin operates from bases in Winnipeg and Rankin Inlet providing Medevac and charter services, as well as a scheduled airline. Keewatin operates the Medevac business under the trade name Nunavut Lifeline and its scheduled airline as "Kivalliq Air". The results of operations are included in the Fund's consolidated income statement since the date of acquisition.

The aggregate purchase price consists of cash and units of the Fund, as summarized below. The value of the units issued was determined based on the unit offering price pursuant to the public offering on July 8, 2005.

Cash	\$ 4,607
Issue of 34,146 units of the Fund	350
Acquisition costs	115
<b>Total consideration</b>	<b>\$ 5,072</b>

The acquisition was accounted for using the purchase method. Details of the fair values of the net assets acquired are as follows:

Fair value of assets acquired:	
Accounts receivable	\$ 3,260
Inventory	492
Prepaid expenses	254
Future income tax asset	322
Capital assets	5,611
Intangible asset	63
	<b>\$ 10,002</b>

Less fair value of liabilities assumed:

Bank indebtedness	1,115
Accounts payable and accrued expenses	1,618
Deferred revenue	45
Long-term debt	3,251
Engine overhaul accrual	275
Future income tax liability	1,478
	<b>\$ 7,782</b>

Fair value of net assets acquired	2,220
Goodwill	2,852
<b>Total purchase consideration</b>	<b>\$ 5,072</b>

The intangible asset acquired was assigned to the Medevac contract that is subject to amortization. The goodwill acquired was assigned to the Aviation division. The goodwill is not deductible for tax purposes.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

### Jasper Tank

On September 1, 2005, the Fund acquired 100% of the shares of 398496 Alberta Inc., and certain assets owned by 745152 Alberta Ltd., comprising the business known as "Jasper Tank", for an aggregate price of \$10,715. Jasper Tank is a manufacturer in Spruce Grove, Alberta, that specializes in custom tanks for the transportation industry. The results of operations are included in the Fund's consolidated income statement since the date of acquisition.

The aggregate purchase price consists of cash and units of the Fund, as summarized below. The value of the units issued for consideration to the vendors was determined based on market price.

Cash	\$ 9,672
Issue of 95,238 units of the Fund	1,000
Acquisition costs	43
<b>Total consideration</b>	<b>\$ 10,715</b>

The acquisition was accounted for using the purchase method. Details of the fair values of the net assets acquired are as follows:

#### Fair value of assets acquired:

Cash	\$ 600
Accounts receivable	1,148
Inventory	1,704
Prepaid expenses	4
Capital assets	4,129
Intangible assets	676
<b>Total</b>	<b>\$ 8,261</b>

#### Less fair value of liabilities assumed:

Accounts payable and accrued expenses	2,162
Deferred revenue	239
Future income tax liability	304
<b>Total</b>	<b>\$ 2,705</b>
<b>Fair value of net assets acquired</b>	<b>5,556</b>
Goodwill	5,159
<b>Total purchase consideration</b>	<b>\$ 10,715</b>

Of the \$675 of acquired intangible assets, \$510 was assigned to customer relationships and \$166 was assigned to the production backlog, both intangible assets are subject to amortization. The goodwill acquired was assigned to the Manufacturing division. The goodwill is not deductible for tax purposes.

### 2004

On May 6, 2004, the Fund completed an Initial Public Offering (the "IPO") of 637,500 Units, at a price of \$8.00 per Unit, for net proceeds of \$4,722, after deducting issue costs of \$378. Concurrent with the closing of the IPO, the Fund issued convertible debentures for net proceeds of \$4,673, after deducting issue costs of \$327, and entered into a term loan for net proceeds of \$6,728, after deducting financing costs of \$472.

The proceeds of the equity and debt financing were loaned to Perimeter. Perimeter in turn, acquired a 100% interest in Perimeter Aviation Ltd. ("PAL"), a 100% interest in Exchange Industrial Group Inc. ("EIG"), and the assets of Inland Fuels Ltd. (Inland).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

### Acquisition of PAL

Effective on May 6, 2004, Perimeter acquired all of the outstanding common and preferred shares of PAL, for a total consideration of \$11,276. The consideration paid consisted of the following:

Cash	\$ 9,650
Issue of 187,500 trust units of the Fund	1,500
Acquisition costs	126
<b>Total consideration</b>	<b>\$ 11,276</b>

The acquisition was accounted for using the purchase method and the results of PAL's operations have been included in the consolidated statement of operation from the date of acquisition.

Details of the consideration paid and fair values of the net assets acquired are as follows:

Fair value of assets acquired:

Cash	\$ (3,682)
Accounts receivable	3,795
Inventory	2,651
Prepaid expenses	326
Capital assets	16,639
	<b>19,729</b>

Less fair value of liabilities assumed:

Accounts payable and accrued expenses	3,015
Deferred revenue	183
Engine overhaul accrual	910
Taxes payable on recapture	2,820
Future income tax	2,667
	<b>9,595</b>

Fair value of net assets acquired	10,134
Goodwill	1,142
<b>Total purchase consideration</b>	<b>\$ 11,276</b>

The value of the trust units issued as consideration to the vendor was \$8.00 per unit, the same price at which units were offered to the public in the IPO that closed May 6, 2004. The goodwill is not deductible for tax purposes.

### Acquisition of EIG

Effective on May 6, 2004, Perimeter acquired all of the outstanding common shares of EIG, for 200,000 trust units of the Fund, which represented a total consideration of \$1,600,000. The acquisition was accounted for using the purchase method and the results of EIG's operations have been included in the consolidated statement of operations from the date of acquisition. Details of the consideration paid and the fair values of the net assets acquired are as follows:

Fair value of assets acquired:

Cash	\$ 311
Accounts receivable	94
Prepaid expenses	-
Capital assets	3
	<b>408</b>

Less fair value of liabilities assumed:

Accounts payable	8
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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

Fair value of net assets acquired	400
Goodwill	1,200
<b>Total purchase consideration</b>	<b>\$ 1,600</b>

The value of the trust units issued as consideration was \$8.00 per unit, the same price at which units were offered to the public in the IPO that closed May 6, 2004. The goodwill is not deductible for tax purposes.

### Acquisition of Inland

Effective on May 6, 2004, Perimeter acquired all of the assets of Inland, for cash consideration of \$785. The only assets acquired from Inland were fuel tanks, which have a fair value of \$785. As a result there was no goodwill recorded on this acquisition.

#### 4. CAPITAL ASSETS

	2005		
	Cost	Accumulated Amortization	Net Book Value
Land	\$ 351	\$ -	\$ 351
Buildings	13,016	510	12,506
Aircraft	25,459	1,200	24,259
Equipment	4,351	428	3,923
Other	61	13	48
Leasehold improvements	519	50	469
	<b>\$ 43,757</b>	<b>\$ 2,201</b>	<b>\$ 41,556</b>

	2004		
	Cost	Accumulated Amortization	Net Book Value
Buildings	\$ 3,646	\$ 124	\$ 3,522
Aircraft	14,060	427	13,633
Equipment	1,306	93	1,213
	<b>\$ 19,012</b>	<b>\$ 644</b>	<b>\$ 18,368</b>

Depreciation for the year ended December 31, 2005 was \$1,622 (2004 – \$644).

#### 5. DEFERRED CHARGES

	2005	2004
Financing costs	\$ 1,723	\$ 799
Less accumulated amortization	465	148
	<b>\$ 1,258</b>	<b>\$ 651</b>

Amortization for the year ended December 31, 2005 was \$318 (2004 – \$148).

#### 6. INTANGIBLE ASSETS

	2005		
	Cost	Accumulated Amortization	Net Book Value
Customer contracts	\$ 63	\$ 11	\$ 52
Customer relationships	510	64	446
Production backlog	166	166	-
	<b>\$ 739</b>	<b>\$ 241</b>	<b>\$ 498</b>

Amortization for the year ended December 31, 2005 was \$241 (2004 - nil).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

### 7. GOODWILL

	2005	2004
Goodwill, beginning of period	\$ 2,342	\$ -
Goodwill from business acquisitions (Note 3)	8,011	2,342
Goodwill, end of period	\$ 10,353	\$ 2,342

### 8. CREDIT FACILITY

The Fund has a revolving operating line of credit up to a maximum of \$2,250, bearing interest at prime plus 0.08%. The line of credit is secured by a general security agreement subject to customary terms, conditions, covenants, and other provisions for an income trust. At December 31, 2005, \$1,510 of the operating line of credit has been drawn upon (2004 - nil).

### 9. LONG-TERM DEBT

	2005	2004
Revolving term facility	\$ 20,138	\$ 7,200

The Fund entered into a three-year, interest only, revolving term facility with two Canadian chartered banks. The term facility is secured by a general security agreement subject to customary terms, conditions, covenants, and other provisions for an income trust. The facility bears interest expense at prime plus 0.08%. Interest expense during the year ended December 31, 2005 was \$579 (2004 - \$150). The principal payments in each of the next three years are: 2006 - nil; 2007 - nil; and 2008 - \$20,138.

### 10. CONVERTIBLE DEBENTURES

Series	Rate	Maturity		2005	2004
A - 2004	9%	May 6, 2009	- debt component	\$ 4,662	\$ 4,623
			- add accretion charges	59	39
			- less conversions	1,174	-
				\$ 3,547	\$ 4,662
B - 2005	8%	Jul 7, 2010	- debt component	\$ 4,914	\$ -
			- add accretion charges	31	-
			- less conversions	-	-
				\$ 4,945	\$ -
C - 2005	8%	Sep 1, 2010	- debt component	\$ 2,307	\$ -
			- add accretion charges	10	-
			- less conversions	-	-
				\$ 2,317	\$ -
Total debt component outstanding				\$ 10,809	\$ 4,662

Series	Rate	Maturity		2005	2004
A - 2004	9%	May 6, 2009	- equity component	\$ 283	\$ 377
B - 2005	8%	Jul 7, 2010	- equity component	411	-
C - 2005	8%	Sep 1, 2010	- equity component	193	-
Total equity component outstanding				\$ 887	\$ 377

The debentures are convertible, at the option of the holders, into units at a predetermined conversion price per unit. The predetermined conversion price is \$9.00 for the Series A debentures, \$11.50 for the Series B debentures, and \$13.25 for the

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

Series C debentures. The Fund has the option to settle all or a portion of the debenture obligation at maturity, through the issuance of units at a price based on the weighted average 20 day trading price for the previous days that the units traded. Since the debentures contain a conversion feature available to the holder to convert debenture principal into units of the Fund, the debenture obligation is classified partly as a debt and partly as unitholders' equity. The debt component represents the present value of interest and principal payments over the life of the convertible debentures discounted at a rate approximating the rate which would have been applicable to non-convertible secured debentures at the time the debentures were issued. The difference between the interest paid and payable on the convertible debentures and the present value of interest and principal payments over the life of the convertible debentures is accreted over the term of the debentures through periodic charges to the debt component, such that, on maturity the debt component equals the principal amount of the convertible debentures.

The debentures are secured, subordinate only to senior security, by a charge on the assets and undertakings of the Fund and subsidiaries. During the year, debentures with a face value of \$1,246 were converted into 138,440 units of the Fund. Interest expense during the year ended December 31, 2005 was \$778 (2004 – \$331).

The fair value of the associated cash flows associated with the convertible debentures and the embedded call option is \$11,595 at December 31, 2005 (2004 - \$4,800).

### 11. TRUST UNITS

The Fund's Declaration of Trust authorizes the trustees, in their discretion and from time to time, to issue an unlimited number of units. Each unit is transferable and represents an equal fractional undivided interest in any distributions from the Fund, and in any net assets of the Fund in the event of termination or winding-up of the Fund. All units have equal rights and privileges. Each unit is transferable, entitles the holder thereof to participate equally in distributions, including the distributions of net income and net realized capital gains of the Fund and distributions on termination or winding-up of the Fund, is fully paid and non-assessable and entitles the holder thereof to one vote at all meetings of unitholders for each unit held.

Trust units are redeemable any time at the option of the holder based on the redemption price as defined in the Declaration of Trust, subject to a maximum of ten thousand dollars in cash redemptions by the Fund in the same calendar month.

Units issued and outstanding are as follows:

	2005	
	Number of Units	Amount
Balance, beginning of year	1,256,187	\$ 9,688
Issued for cash and purchase consideration (net of issuance costs of \$818, less associated future income tax asset of \$287)	1,151,635	12,010
Issued upon conversion of debentures	138,440	1,268
Issued for services	19,815	212
Balance, end of year	2,566,077	\$ 23,178

	2004	
	Number of Units	Amount
Balance, beginning of period	-	\$ -
Initial issuance of units (net of issuance costs of \$378)	637,500	4,722
Issued for purchase consideration	387,500	3,100
Options exercised	62,500	500
Private placement	160,312	1,299
Issued for services	8,375	67
Balance, end of period	1,256,187	\$ 9,688

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

### 12. DISTRIBUTIONS TO UNITHOLDERS

The Fund's policy is to make distributions to unitholders equal to cash flows from operations after making allowances for debt servicing requirements, working capital, and for growth and capital expenditure requirements as deemed prudent by its board of trustees.

Cumulative distributions are as follows:

	2005	2004
Balance, beginning of the period	\$ 788	\$ -
Distributions	2,090	788
Balance, end of the period	\$ 2,878	\$ 788

Effective August 31, 2005, distribution payments changed from quarterly distributions to monthly distributions. Distributions are now made monthly to unitholders of record on the last business day of each month.

The amounts and record dates of the distributions were:

Month(s)	Record date	Distributions	
		Per unit	Amount
January – March	March 29, 2005	\$ 0.27	\$ 339
April – June	June 28, 2005	0.27	347
July – August	August 29, 2005	0.20	395
September	September 30, 2005	0.10	248
October	October 31, 2005	0.10	248
November	November 30, 2005	0.10	256
December	December 31, 2005	0.10	257
<b>2005 Total</b>		<b>\$ 1.14</b>	<b>\$ 2,090</b>

Months	Record date	Distributions	
		Per unit	Amount
May – June	June 30, 2004	0.17	174
July – September	September 30, 2004	0.27	277
October – December	December 31, 2004	0.27	337
<b>2004 Total</b>		<b>\$ 0.71</b>	<b>\$ 788</b>

### 13. INCOME TAX

a) Future income tax of the Fund relate to the following temporary differences:

	2005	2004
Current future income tax assets:		
Non-capital loss carryforward <sup>1</sup>	\$ 705	\$ 104
	\$ 705	\$ 104

<sup>1</sup>The Fund's subsidiaries non-capital losses expire in varying amounts from 2008 to 2015.

Long-term future income tax assets:		
Deferred charges	\$ 263	\$ 1
Warranty accrual	10	-
Engine overhaul accrual	368	300
	\$ 641	\$ 301

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

Long-term future income tax liabilities:		
Capital assets	\$ 5,545	\$ 3,312
Intangible assets	169	-
	\$ 5,714	\$ 3,312

Financial Statement Presentation:

	2005	2004
Current future income tax assets	\$ 705	\$ 104
Long-term future income tax liabilities	(5,073)	(3,011)

b) The Fund's income tax expense for the period is as follows:

	2005	2004
Earnings before income taxes	\$ 3,483	\$ 1,415
Reduced by:		
Earnings of the Fund subject to tax in the hands of the unitholders	(2,090)	(788)
Earnings of the Fund subject to corporate tax rate	(1,492)	(649)
Interest accretion on convertible debentures	100	38
Permanent differences	-	-
Earnings taxed at the Fund level	1	16
Tax rate	46.40%	46.40%
Income tax expense at the Fund level	1	8
Earnings of the Fund subject to Manitoba corporate tax rate	1,470	649
Reduced by:		
Permanent differences	(11)	-
Earnings taxed at the Manitoba corporate tax rate	1,459	649
Tax rate	37.12%	37.62%
Income tax expense at the operating level	542	244
Earnings of the Fund subject to Alberta corporate tax rate	22	-
Tax rate	33.62%	-
Income tax expense at the operating level	7	-
Total tax expense before rate change effect	550	252
Effect of enacted future rates on temporary differences	(125)	(4)
Income tax expense	\$ 425	\$ 248

### 14. EARNINGS PER UNIT

The computation for basic and diluted earnings per unit is as follows:

	2005	2004
Net earnings available to unitholders	\$ 3,058	\$ 1,168
Dilutive effect of convertible debentures	779	333
Diluted earnings available to unitholders	\$ 3,837	\$ 1,501
Basic weighted average number of units	1,778,118	1,103,016
Dilutive effect of:		
Convertible debentures	808,734	555,555
Average number of units outstanding – diluted basis	2,586,852	1,658,571
Earnings per unit:		
Basic	\$ 1.72	\$ 1.06
Diluted	\$ 1.48	\$ 0.90



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

During 2005, the Fund revised its methodology for calculating diluted earnings per unit. As a result of this revision, the calculation of diluted earnings per unit adds the dilutive effect of the convertible debentures to earnings, gross of taxes. Previously the dilutive effect was added back to earnings, net of taxes. The comparative period has been restated for this revision in methodology. The effect of this revision for the year ended December 31, 2005 is a \$0.12 increase to fully diluted earnings per unit (2004 - \$0.10).

### 15. SEGMENTED INFORMATION

The Fund's reportable business segments are strategic business units that offer different products and services. The Fund has two reportable business segments: aviation and manufacturing. The aviation segment provides airline services to communities in Manitoba and Nunavut. The manufacturing segment produces specialized tanks for the transportation industry.

September 1, 2005, the Fund acquired Jasper, which is the only subsidiary of the Fund in the manufacturing segment. Consequently, the results for the manufacturing segment contains only four months of operations. No comparative segmented information is presented for 2004, as there was only one operating segment in 2004.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Fund evaluates each segment's performance based on earnings before interest, income tax expense, depreciation, and amortization (EBITDA). There are no intersegment sales or transfers. Fund includes expenses incurred at head office that are not allocated to the segments and is presented as a reconciliation to enterprise revenues, EBITDA, total assets, and capital asset additions.

				2005
	Aviation	Manufacturing	Fund	Consolidated
Revenue	\$ 52,924	\$ 4,343	\$ -	\$ 57,267
EBITDA	6,593	777	(349)	7,021
Interest expense				1,357
Depreciation and amortization				2,181
Earnings before tax				3,483
Total assets	\$ 59,391	\$ 14,027	\$ 672	\$ 74,090
Capital asset additions	20,583	4,207	20	24,810
Goodwill	5,194	5,159	-	10,353

### 16. COMMITMENTS

The Fund and its subsidiaries rent premises and equipment under operating lease agreements. The minimum lease payments under these contractual obligations are as follows:

2006	\$ 1,572
2007	349
2008	145
2009	56
2010 and thereafter	495
	\$ 2,617

Perimeter has a fuel purchase agreement with 2811065 Manitoba Ltd. (see note 18). As at December 31, 2005, Perimeter is committed to purchase 556,899 litres of jet fuel at \$0.85 per litre.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands of dollars, except for per unit information)

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### 17. CONTINGENCIES

During the ordinary course of business the Fund and its subsidiaries may be made party to certain claims and become contingently liable for various matters. Management believes that adequate provisions have been recorded in the accounts where required.

### 18. RELATED PARTY TRANSACTIONS

The Fund enters into transactions with 2811065 Manitoba Ltd, which is owned by a trustee of the Fund. These transactions are in the normal course of operations and at market terms and conditions.

During the year ended December 31, 2005, the Fund purchased \$2,693 of fuel (2004 - \$1,208), paid \$137 in aircraft lease expenses (2004 - \$91) and received \$133 in rent revenues from 2811065 Manitoba Ltd (2004 - \$56). The receivable from 2811065 Manitoba Ltd. at December 31, 2005 is \$384 (2004 - (\$540)).

The Fund has a marketing agreement with Tribal Council Investment Group ("TCIG"), whose President is a trustee of the Fund. The agreement is in the normal course of operations and at market terms and conditions, except that the compensation is payable to TCIG in units rather than cash. The compensation to TCIG is conditional on the annual increase in sales. During the year ended December 31, 2005, the Fund paid commissions of \$365 (2004 - \$87). The payable to TCIG at December 31, 2005 is \$300 (2004 - \$87).

### 19. COMPARATIVE FIGURES

Certain items in the comparative consolidated financial statements have been reclassified from the financial statements previously presented to conform to the presentation of the 2005 consolidated financial statements.



# Corporate Information

## OFFICERS

**Duncan D. Jessiman**  
Chief Executive Officer

**Michael C. Pyle**  
President and Chief Financial Officer

**Edward L. Warkentin**  
Corporate Secretary

## MANAGEMENT

**Duncan D. Jessiman**  
Chief Executive Officer

**Michael C. Pyle**  
President and Chief Financial Officer

**Kenneth E. Horch**  
Director of Acquisitions

**Adam S. Terwin**  
Director of Integration

**Dianne M. Spencer**  
Manager, Compliance

## LEGAL COUNSEL

**Aikins, MacAulay & Thorvaldson LLP**  
Winnipeg, Manitoba

## AUDITORS

**Deloitte & Touche LLP**

## BANKERS

**TD Canada Trust**  
**Roynat Inc.**

## TRANSFER AGENT

**CIBC Mellon Trust Company**  
Calgary, Alberta

## STOCK EXCHANGE LISTING

**TSX Venture Exchange**  
Exchange Industrial Income Fund EIFUN

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## ANNUAL GENERAL MEETING

**Tuesday, May 23, 2006**  
10:30 a.m.

Victoria Inn Hotel & Convention Centre  
1808 Wellington Avenue  
Winnipeg, Manitoba

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