

Consolidated Financial Statements

**First National AlarmCap Income Fund**

December 31, 2007

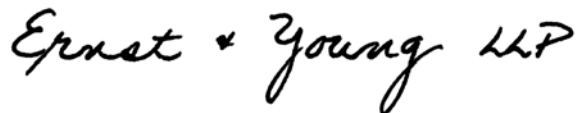
## AUDITORS' REPORT

To the Unitholders of  
**First National AlarmCap Income Fund,**

We have audited the consolidated balance sheets of **First National AlarmCap Income Fund** (the "Fund") as at December 31, 2007 and 2006 and the consolidated statements of income (loss) and comprehensive income, unitholders' equity and cash flows for the years then ended. These consolidated 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 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, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Québec City, Canada  
February 28, 2008

[except as to note 22a) which is as at  
March 10, 2008, notes 2, 12a) and 22b)  
which are as at March 17, 2008 and  
note 21a) which is as at March 25, 2008]

**First National AlarmCap Income Fund**

**CONSOLIDATED BALANCE SHEETS**

[note 2]

As at December 31  
[in thousands of dollars]

	2007	2006
	\$	\$
<b>ASSETS [note 12]</b>		
<b>Current assets</b>		
Cash	2,186	1,073
Accounts receivable	2,684	3,116
Inventories	561	607
Prepaid expenses	386	402
Interest rate swaps [note 13]	108	—
<b>Total current assets</b>	<b>5,925</b>	<b>5,198</b>
<b>Advance [note 17]</b>	<b>71</b>	<b>—</b>
<b>Property, plant and equipment [note 5]</b>	<b>1,512</b>	<b>4,525</b>
<b>Subscriber accounts [note 6]</b>	<b>66,808</b>	<b>67,812</b>
<b>Goodwill [note 7]</b>	<b>23,000</b>	<b>23,000</b>
<b>Other long-term assets [notes 4 and 8]</b>	<b>100</b>	<b>1,488</b>
<b>Future income tax assets [note 15]</b>	<b>2,050</b>	<b>—</b>
	<b>99,466</b>	<b>102,023</b>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	3,251	4,802
Distributions payable to unitholders	—	448
Unearned revenues	4,605	5,029
Other deferred revenues	—	40
Short-term portion of due to a dealer [note 9]	503	—
Short-term portion of obligations under capital leases [note 11]	93	82
<b>Total current liabilities</b>	<b>8,452</b>	<b>10,401</b>
<b>Deferred gain on interest rate swaps [notes 4 and 13]</b>	<b>—</b>	<b>352</b>
<b>Due to a dealer [note 9]</b>	<b>168</b>	<b>—</b>
<b>Other long-term liabilities</b>	<b>37</b>	<b>—</b>
<b>Deferred subscription revenues [note 10]</b>	<b>623</b>	<b>418</b>
<b>Obligations under capital leases [note 11]</b>	<b>314</b>	<b>380</b>
<b>Long-term debt [notes 4, 12, 17 and 22b)]</b>	<b>45,597</b>	<b>50,000</b>
<b>Unitholders' equity</b>	<b>44,275</b>	<b>40,472</b>
	<b>99,466</b>	<b>102,023</b>

Commitments [note 20]

Contingencies [note 21]

Subsequent events [note 22]

See accompanying notes

On behalf of the Board:

(signed) Timothy G. Whyte, Trustee

(signed) Leonard Sudermann, Trustee

**First National AlarmCap Income Fund**

**CONSOLIDATED STATEMENTS OF UNITHOLDERS'  
EQUITY**

Years ended December 31  
[in thousands of dollars]

	2007	2006
	\$	\$
<hr/>		
Unitholders' contribution <i>[note 14]</i>		
Balance, beginning of year	59,139	58,457
Future income tax recovery <i>[note 15]</i>	162	—
Issuance of units	—	682
Balance, end of year	<b>59,301</b>	59,139
<hr/>		
Cumulative net income (loss)		
Balance, beginning of year	(5,937)	4,145
Net income (loss)	5,811	(10,082)
Balance, end of year	<b>(126)</b>	(5,937)
<hr/>		
Cumulative distributions		
Balance, beginning of year	(12,730)	(5,825)
Distributions to unitholders	(2,240)	(6,905)
Balance, end of year	<b>(14,970)</b>	(12,730)
<hr/>		
Accumulated other comprehensive income <i>[note 4]</i>		
Balance, beginning of year	—	—
Transition adjustment of financial instruments	352	—
Change for the year	(282)	—
Balance, end of year	<b>70</b>	—
<b>Unitholders' equity</b>	<b>44,275</b>	40,472

*See accompanying notes*

**First National AlarmCap Income Fund**

**CONSOLIDATED STATEMENTS OF INCOME (LOSS)  
AND COMPREHENSIVE INCOME**

Years ended December 31  
[in thousands of dollars, except units and per unit amounts]

	2007	2006
	\$	\$
<b>Revenues</b>		
Monitoring and services	29,250	29,650
Installation	2,313	2,690
	<b>31,563</b>	<b>32,340</b>
<b>Expenses</b>		
Monitoring and customer service	6,961	7,425
Installation, sales and marketing	2,141	2,740
	<b>9,102</b>	<b>10,165</b>
Income before general and administrative expenses and other items	<b>22,461</b>	<b>22,175</b>
General and administrative expenses	<b>5,675</b>	<b>6,366</b>
Income before under noted items	<b>16,786</b>	<b>15,809</b>
Depreciation of property, plant and equipment and amortization of subscriber accounts <i>[notes 5 and 6]</i>	<b>8,777</b>	8,928
Amortization of monitoring vendor sales incentives	<b>(11)</b>	—
Goodwill impairment charge <i>[note 7]</i>	—	13,191
Interest on debt	<b>3,866</b>	3,570
Change in the fair value of interest rate swaps <i>[note 13]</i>	<b>222</b>	140
Loss on disposal of properties	<b>9</b>	62
	<b>12,863</b>	<b>25,891</b>
Net income (loss) before income taxes	<b>3,923</b>	<b>(10,082)</b>
Future income tax recovery	<b>(1,888)</b>	—
<b>Net income and comprehensive income (loss)</b>	<b>5,811</b>	<b>(10,082)</b>
<b>Basic and diluted earnings (loss) per unit</b>	<b>0.92</b>	<b>(1.59)</b>
<b>Weighted average number of units outstanding</b>	<b>6,324,401</b>	<b>6,324,401</b>

*See accompanying notes*

## First National AlarmCap Income Fund

### CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31  
[in thousands of dollars]

	2007	2006
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net income and comprehensive income (loss)	5,811	(10,082)
Items not affecting cash flows		
Depreciation of property, plant and equipment and amortization of subscriber accounts	8,777	8,928
Amortization of deferred subscription revenues	(69)	(36)
Amortization of monitoring vendor sales incentives	(11)	—
Goodwill impairment charge <i>[note 7]</i>	—	13,191
Amortization of other long-term assets and deferred gain	479	471
Gain on settlement of note payable	—	(18)
Change in the fair value of interest rate swaps <i>[note 13]</i>	222	140
Loss on disposal of properties	9	62
Monitoring vendor sales incentives	48	—
Future income tax recovery	(1,888)	—
	13,378	12,656
Net change in non-cash operating working capital items <i>[note 16]</i>	(1,696)	1,316
<b>Cash flows relating to operating activities</b>	<b>11,682</b>	<b>13,972</b>
<b>INVESTING ACTIVITIES</b>		
Advance	(71)	—
Additions to property, plant and equipment	(241)	(760)
Proceeds on disposal of property, plant and equipment	18	352
Increase in subscriber accounts	(6,507)	(8,211)
Increase in other long-term assets	—	(558)
<b>Cash flows relating to investing activities</b>	<b>(6,801)</b>	<b>(9,177)</b>
<b>FINANCING ACTIVITIES</b>		
Repayment of note payable	—	(3,500)
Repayment of demand note payable	—	(198)
Repayment of obligations under capital leases	(85)	(15)
Increase in deferred subscription revenue	274	298
Financing cost	(144)	—
Repayment of long-term debt	(1,125)	—
Increase in long-term debt	—	5,000
Distributions to unitholders	(2,688)	(6,979)
<b>Cash flows relating to financing activities</b>	<b>(3,768)</b>	<b>(5,394)</b>
<b>Net increase (decrease) in cash</b>	<b>1,113</b>	<b>(599)</b>
Cash, beginning of year	1,073	1,672
<b>Cash, end of year</b>	<b>2,186</b>	<b>1,073</b>
<b>Supplementary information</b>		
Interest paid	3,567	2,630

*See accompanying notes*

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### **1. DESCRIPTION OF THE FUND**

First National AlarmCap Income Fund (the "Fund") is an unincorporated, open-ended, limited purpose trust established under the laws of the Province of Alberta pursuant to a Declaration of Trust dated February 24, 2005, as amended and restated on March 4, 2005. The Fund began commercial operations on April 1, 2005.

The Fund was established to acquire substantially all the assets and shares of Microtec Enterprises Inc. ("Microtec") and all the assets of Securex Master Limited Partnership ("Securex"), two entities that provide residential and commercial remote monitoring services in Canada.

#### **2. GOING CONCERN UNCERTAINTY**

The consolidated financial statements were prepared by management in accordance with Canadian generally accepted accounting principles based on the going concern concept, which assumes the Fund will be able to generate sufficient funds to discharge its obligation during normal business operations for the foreseeable future.

Effective July 27, 2007, the Fund entered into Bank Credit Agreement Amendment #4. With this new amendment, the Fund was in compliance with its financial ratios for the second and third quarter of fiscal 2007. The Bank Credit Agreement Amendment #4 provides that the Fund shall not proceed with the repurchase of any of its units or distribute capital including distributions if there is a default, if the repurchase or payment of such distributions results in a default or if its funded debt to EBITDA ratio for any given month is equal or higher than 2.25:1. Distributed cash flow may not exceed budgeted distributions provided to and approved by the lenders on an annual basis and can only be made from cash flows from operations. The Bank Credit Agreement Amendment #4 additionally provides that, in the event the Fund fails to maintain, at the end of any given month, the required funded debt to EBITDA ratio, the Fund must apply an amount of \$450,000 per quarter for the prepayment of the bank term loan. During fiscal 2007, this ratio exceeded the 2.50:1 threshold and therefore the Fund had to repay \$1,125,000 on its Bank Term Debt. With this new Bank Credit Amendment no #4, the Fund was in compliance with its financial ratios for fiscal 2007.

As mentioned in note 22, on March 17, 2008, the Fund renewed its Bank Credit Agreement for a three-year period. Management is confident that the Fund will meet all the requirements in the future.

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### **2. GOING CONCERN UNCERTAINTY [Cont'd]**

These consolidated financial statements do not give effect to any adjustments or reclassifications of assets or liabilities that would be necessary if the Fund demonstrated an inability to continue operating as a going concern.

#### **3. SIGNIFICANT ACCOUNTING POLICIES**

##### **Basis of presentation**

The Fund's consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP").

##### **Consolidation**

These consolidated financial statements include the accounts of the Fund and those of its wholly owned subsidiaries.

##### **Use of estimates**

In preparing these consolidated financial statements, management is required to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. In management's opinion, the consolidated financial statements have been prepared using careful judgment within the reasonable limits of materiality and within the framework of the accounting policies summarized below.

##### **Revenue recognition**

Installation revenues are recognized upon completion of the installation. Revenues from remote monitoring activities and services are recognized when the services are rendered. Unearned revenues in respect of services to be rendered in the coming year are presented in current liabilities. Revenues from the initial subscription received from customers upon contract signature are recorded as deferred subscription revenues.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 3. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

##### Inventories

Inventories are valued at the lower of cost, determined using the first-in, first-out method, and replacement cost.

##### Property, plant and equipment

Property, plant and equipment are recorded at cost and depreciated over their estimated useful lives using the following methods and rates:

	Method	Rate
Buildings	Declining balance	4%
Furniture and equipment	Declining balance	20%
Computer hardware and software	Straight-line	33 1/3%
Leasehold improvements	Straight-line	lease term

##### Subscriber accounts

Subscriber accounts are initially stated at the amount of direct costs related to recruiting or acquiring subscriber contracts. Direct recruiting costs comprise costs directly related to subscriber contract execution. They primarily consist of equipment, installation and initial direct costs, such as commissions, payments to independent recruiting agents and network connection costs. Direct costs of recruiting and acquiring subscriber contracts are amortized over their estimated useful lives using the following method and rates:

	Method	Rate
Microtec subscriber accounts	Declining balance	12%
Securex subscriber accounts	Declining balance	10%

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

##### **Goodwill**

Goodwill represents the difference between the purchase price, including acquisition costs of businesses acquired and the fair value of the identifiable net assets acquired. Goodwill is tested for impairment annually or more frequently if events or circumstances indicate that the asset might be impaired. If the carrying value of a reporting unit, including the allocated goodwill, exceeds its fair value, based on a combination of valuation methods, goodwill impairment is measured as the excess of the carrying amount of the reporting unit's allocated goodwill over the implied fair value of the goodwill, based on the fair value of the identifiable assets and liabilities of the reporting unit.

##### **Other long-term assets**

Other long-term assets mainly consisted in 2006 of deferred financing costs recorded at cost and amortized on a straight-line basis over the terms of the related debt. As stated in note 4, as required with the new accounting standards on financial instruments, these transactions costs must be deducted from the related financial liabilities and amortized using the effective interest rate method over the estimated lives of these liabilities.

##### **Impairment of long-lived assets**

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use together with its residual value. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds its fair value.

##### **Other long-term liabilities**

Other long-term liabilities consist of monitoring vendor sales incentives received and are amortized using the straight-line method over the term of the agreement.

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

##### **Income taxes**

The Fund currently qualifies as a mutual fund trust for income tax purposes. The Fund has distributed all of its taxable income to unitholders and is entitled to deduct such distributions for income tax purposes. Accordingly, no provision for current income tax payable is required.

Future income taxes are accounted for using the liability method. This method requires the Trust to:

- i. Determine its temporary differences;
- ii. Determine the periods over which those temporary differences are expected to reverse; and
- iii. Apply the tax rates enacted at the balance sheet date that will apply in the periods in which the temporary differences are expected to reverse *[note 15]*.

##### **Deferred subscription revenues**

The deferred subscription revenues consisting of revenues received from the initial subscription, are amortized at 12% using the declining balance method and included in installation revenues.

##### **Leases**

Leases are classified as either capital or operating in nature. Capital leases are those that substantially transfer the benefits and risks of ownership to the lessee. Assets acquired under capital leases are amortized over their expected useful lives using the declining balance method. Obligations under capital leases are reduced by the principal portion of lease payments. The imputed interest portion of lease payments is charged to expense.

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

##### **Unit-based compensation**

As described in note 14, the Fund provides unit-based compensation under a plan in the form of grants of phantom unit awards.

The Fund uses the fair value method to account for these grants. Under this method, the fair value of unit-based awards, based on market value at the date of the grant, is recognized as compensation expense over the applicable vesting period with a corresponding increase in contributed surplus. Upon vesting, the amount initially recorded in contributed surplus is transferred to unitholders' contributions.

##### **Earnings per unit**

Earnings per unit are calculated based on the weighted average number of Class A and Class B trust units outstanding for the year.

Fully diluted earnings per share, calculated using the treasury stock method, take into account all items that have a dilutive effect.

The effect of the Funds' phantom units potentially exercisable on earnings per unit was anti-dilutive; therefore, basic and diluted earnings per unit are the same.

##### **Derivative financial instruments**

The Fund enters into interest rate swap agreements to reduce the impact of fluctuating interest rates on financial commitments. The Fund does not use derivative financial instruments for trading or speculative purposes. Any change in the fair value of these derivative instruments is recorded in net income.

Designation as a hedge is only allowed if, both at the inception of the hedge and throughout the life of the hedge, the changes in the fair value or cash flows of the derivative instrument are expected to substantially offset the changes in the fair value or cash flows of the hedged item.

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

##### **Derivative financial instruments [Cont'd]**

In order to qualify for hedge accounting, the Fund is required to document all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions.

The Fund had been using hedge accounting until August 2006, at which point it was discontinued.

Derivative instruments that were ineffective or that were not designated as a hedge were reported on a mark-to-market basis as a separate item in the consolidated financial statements. Any change in the fair value of these derivative instruments were recorded in income.

Realized and unrealized gains or losses associated with derivative instruments previously designated as hedges that had been terminated or had ceased to be effective prior to maturity were recognized in income as interest on debt in the period in which the underlying hedged transaction was recognized. In 2006, the unamortized portion of these realized or unrealized gains or losses were shown on balance sheet. As at January 1, 2007, the unamortized portion of \$352,000 has been reclassified to Accumulated other comprehensive income as a result of the adoption of the new accounting standards on financial instruments.

#### **4. NEW ACCOUNTING POLICIES**

On January 1, 2007, the Fund adopted the new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

The Section 1530, *Comprehensive Income*, introduces a new financial statement which shows the change in equity or net assets of an enterprise during a period from transactions and other events and circumstances from non-owner sources.

The Section 3855, *Financial Instruments – Recognition and Measurement*, and Section 3861, *Financial Instruments – Disclosure and Presentation*, require an entity to record its financial assets and liabilities at fair value at each closing date, apart from exceptions; establish rules determining when a financial asset or liability should be recognized on the balance sheet and establish specific standards for recognition and presentation of transaction costs relating to long-term debt, as well as the subsequent expensing thereof.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 4. NEW ACCOUNTING POLICIES [Cont'd]

The adoption of these standards requires classifying all of the Fund's financial assets and liabilities in categories for which clearly defined rules determine the standards to be applied. However, the rules may differ when a different regulatory treatment is applied.

The Fund has implemented the following classification:

- Cash and cash equivalents are classified in the "Financial assets held for trading" category. They are presented at their fair value and the gains/losses arising on the revaluation at the end of each period are included in net income.
- Accounts receivable and advance are classified in the "Loans and receivables" category. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. For the Fund, the measured amount generally corresponds to cost.
- Bank loans, accounts payable and accrued liabilities, distributions payable to unitholders, due to a dealer, obligations under capital leases and long-term debt are classified in the "Other financial liabilities" category. They are initially presented at their fair value. Subsequent measurements are at cost, net of amortization, using the effective interest rate method. For the Fund, that value generally represents cost.

These new standards had to be applied without restatement of prior period amounts. Upon initial application, all adjustments to the carrying amount of financial assets and liabilities were recognized as an adjustment to the opening balance of cumulative net income or accumulated other comprehensive income, depending on the classification of existing financial assets and liabilities.

Section 3855 also provides guidelines for the accounting of transaction costs incurred from issuance of debt instruments. These transaction costs must be deducted from financial liabilities and amortized using effective interest rate method over estimated life of the related liabilities.

The Section 3865, *Hedges*, specifies the criteria under which hedge accounting may be applied, how hedge accounting should be performed under permitted hedging strategies and the required disclosures. Since the Fund ceased using hedge accounting in 2006, this standard did not have an impact on the Fund for the year ended December 31, 2007, other than for the reclassification of the deferred derivative gain to accumulated other comprehensive income related to the interest rate swaps that were designated as hedges up to August 2006.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 4. NEW ACCOUNTING POLICIES [Cont'd]

The following table summarizes the adjustments made to the consolidated balance sheet as of January 1, 2007, upon the adoption.

Increase (decrease) in:

	2007
	\$
Deferred financing cost <i>[note 8]</i>	(1,058)
Deferred gain on interest rate swaps	(352)
Long-term debt	(1,058)
Accumulated other comprehensive income	352

#### Recently issued accounting standards

The CICA recently issued new *Handbook* sections that will be applied for the interim and annual financial statements starting with the first quarter of 2008. The Fund does not foresee that these new sections will have a significant impact on its results, financial position and cash flows.

The Section 1535, *Capital Disclosures*, establishes standards for the disclosure of the information about an entity's capital and how it is managed. These standards require the following disclosure:

- The objectives, policies and processes for managing capital;
- Summary quantitative data about what is managed as capital;
- Whether during the period, the entity complied with externally imposed capital requirements;
- If the entity did not comply with these requirements, the consequence of such non-compliance.

The Section 3862, *Financial Instruments – Disclosures*, modifies the disclosure requirements for financial instruments that were included in Section 3861, *Financial Instruments – Disclosure and Presentation*. The new standards require the disclosure in the financial statements that will allow the users to evaluate:

- The significance of financial instruments for the entity's financial position and performance;
- The nature and extent of risk arising from financial instruments to which the entity is exposed during the period and at the balance sheet, date and how it manages those risks.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 4. NEW ACCOUNTING POLICIES [Cont'd]

##### Recently issued accounting standards [Cont'd]

The Section 3863, *Financial Instruments – Presentation*, carries forward unchanged the presentation of the Section 3861 *Financial instruments – Disclosure and Presentation*.

The Section 3031, *Inventories*, will replace the Section 3030, *Inventories*. The new Section stipulates that the inventories must be valued at the lower of cost or net realizable value. It gives guidance on determining cost, allows the use of the retail method, prohibits the use of the last-in, first-out (LIFO) method in the future and requires the reversal of previous write-downs when there is evidence of an increase in value of the inventories. It also requires greater disclosure regarding the inventories and the cost of sale.

#### 5. PROPERTY, PLANT AND EQUIPMENT

	<u>2007</u>		<u>2006</u>	
	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Cost</u>	<u>Accumulated depreciation</u>
	\$	\$	\$	\$
Land	—	—	88	—
Buildings	—	—	3,009	207
Furniture and equipment	<b>939</b>	<b>377</b>	886	241
Computer hardware and software	<b>315</b>	<b>179</b>	233	92
Leasehold improvements	<b>575</b>	<b>149</b>	471	75
Furniture and equipment under capital leases	<b>507</b>	<b>119</b>	477	24
	<b>2,336</b>	<b>824</b>	5,164	639
Accumulated depreciation	<b>824</b>		639	
	<b>1,512</b>		4,525	

Depreciation of property, plant and equipment amounted to \$420,000 for the year ended December 31, 2007 [\$435,000 in 2006].

In 2007, the Fund acquired furniture and equipment under capital leases valued at \$30,000 [\$477,000 in 2006].

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 6. SUBSCRIBER ACCOUNTS

Cost of subscriber accounts consists of the following items:

	2007	2006
	\$	\$
Subscriber accounts	<b>89,921</b>	82,568
Accumulated amortization	<b>(23,113)</b>	(14,756)
	<b>66,808</b>	67,812

Amortization of subscriber accounts amounted to \$8,357,000 for the year [\$8,493,000 in 2006].

#### 7. GOODWILL

The Fund completed its annual goodwill impairment test. Throughout 2006, the Fund did not meet its financial expectations in terms of revenues and net income. As a result and taking into account the possible impact of the proposed Canadian income tax rule changes which received royal assent in 2007 [note 15], the Fund concluded that the carrying amount of goodwill had to be impaired by \$13,191,000 as at December 31, 2006. No impairment has been considered necessary as at December 31, 2007.

#### 8. OTHER LONG-TERM ASSETS

	2007	2006
	\$	\$
Deferred financing cost, at amortized cost [note 4]	—	1,058
Restricted cash	<b>100</b>	100
Interest rate swaps [note 13]	—	330
	<b>100</b>	1,488

Amortization of deferred financing costs amounted to \$589,000 in 2006.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 9. DUE TO A DEALER

	2007	2006
	\$	\$
Due to a dealer	671	—
Short term portion	503	—
	<u>168</u>	<u>—</u>

On December 31, 2007, the Fund acquired a list of clients from a dealer for a total of \$671,000 net of \$175,000 in unearned revenues. This acquisition is payable in eight interest-free instalments, seven of which are payable in 2008; the last is payable in March 2009.

This transaction has no monetary impact and is therefore not presented in the consolidated statement of cash flows.

#### 10. DEFERRED SUBSCRIPTION REVENUES

	2007	2006
	\$	\$
Deferred subscription revenues	736	462
Accumulated amortization	(113)	(44)
	<u>623</u>	<u>418</u>

Amortization of deferred subscription revenues amounted to \$69,000 for the year [\$36,000 in 2006].

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 11. OBLIGATIONS UNDER CAPITAL LEASES

	2007	2006
	\$	\$
Capital lease agreements pertaining to furniture and equipment, repayable in monthly instalments totalling \$10,160 including interest varying from 7.33% to 10.78% with maturities ranging from September 2011 to May 2012.	407	462
Short-term portion	93	82
	<b>314</b>	<b>380</b>
The future minimum lease payments under the capital lease agreements are:		
	\$	
2008	122	
2009	122	
2010	122	
2011	94	
2012	2	
	462	
Amount representing interest	55	
<b>Balance of the obligations</b>	<b>407</b>	

#### 12. LONG-TERM DEBT

	2007	2006
	\$	\$
Bank term loan [net of financing costs of \$183 in 2007]	40,855	45,000
Subordinated debentures [net of financing costs of \$258 in 2007]	4,742	5,000
	<b>45,597</b>	<b>50,000</b>

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 12. LONG-TERM DEBT [Cont'd]

##### (a) Bank term loan [note 22]

The bank term loan has a maximum authorized amount of \$45,000,000, matures in March 2008 and bears interest at contractual rates ranging from 0.75% to 1.75% [effective rates ranging from 0.78% to 1.78%] above the bank's prime rate and from 2.00% to 3.00% [effective rates ranging from 2.03% to 3.03%] above the bankers' acceptance rate depending on a monthly financial ratio test.

The loan is secured by a hypothec on the universality of movable and immovable current and future assets of the Fund.

The sale/leaseback of the Fund's Saint-Augustin-de-Desmaures building was finalized during the second quarter of 2007 for \$2,837,000, net of sales commissions and other charges, and the proceeds thereof have been applied against the senior bank term loan as of April 30, 2007. This transaction has no monetary impact and is therefore not presented in the consolidated statement of cash flows.

The Bank Credit Agreement contains certain covenants. In addition, the Fund is committed to maintaining certain financial ratios. As at December 31, 2007, the Fund was in compliance with all of its financial ratio requirements based on its Bank Credit Agreement Amendment #4.

##### (b) Subordinated debentures

Five-year subordinated debentures bearing interest at a contractual rate of 9.00% [effective rate of 9.49%] total \$5,000,000 and mature in April 2011 [note 17].

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 13. DERIVATIVE FINANCIAL INSTRUMENTS

The Fund entered into interest rate swap agreements to convert the bank term loan from variable to fixed interest rates. As at December 31, 2007, the interest rate swap agreements were detailed as follows:

Purpose	Fixed rate payable	Floating rate receivable	Notional	Maturity
Debt hedge	4.82% until April 2006 5.50% May 2006–April 2007 6.00% May 2007–March 2008 (effective rate 5.50%)	Bankers' acceptances +2.25%	\$45,000	March 2008

During the year 2006, the Fund ceased to designate its interest rate swaps as hedging instruments. As a result the interest rate swaps have been accounted for in the balance sheet. The fair market value amounts to \$108,000 as at December 31, 2007 [\$330,000 as at December 31, 2006 *[note 8]*].

#### 14. UNITHOLDERS' CONTRIBUTIONS

The Fund is authorized to issue an unlimited number of Class A and Class B trust units. Each unit is transferable and, subject to certain priorities of distributable cash flows and special distributions made to the Class A trust unitholders in priority to Class B trust unitholders, represents an equal undivided beneficial interest in any distributions from the Fund. Class B trust units are convertible into Class A trust units on a 1:1 basis since the distribution threshold of \$0.325 per trust unit per quarter has been reached for four consecutive quarters in 2006. The Class B trust unitholders have consequently the same rights as the Class A trust unitholders. As at December 31, 2007, the Class B trust unitholders have not used the option of conversion into Class A trust units.

	2007	2006
	\$	\$
<b>Issued and outstanding</b>		
4,574,401 Class A trust units	45,187	45,187
1,750,000 Class B trust units	17,500	17,500
Less issuance costs net of an amount of \$162 of future income taxes in 2007 <i>[note 15]</i>	(3,386)	(3,548)
	<b>59,301</b>	<b>59,139</b>

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### **14. UNITHOLDERS' CONTRIBUTIONS [Cont'd]**

Trust units were issued as follows:

##### **2006**

On January 1, 2006, the Fund issued, by way of a private placement, 70,000 Class A trust units valued at \$682,500 to settle the balance of a \$700,000 note payable resulting from the acquisition of Microtec from an officer of the Fund [note 17].

##### **Unit-based compensation**

Under the Fund's Phantom Unit Plan, phantom units can be granted to certain executives and trustees. Phantom units are granted without any monetary consideration being payable to the Fund and their vesting is entirely based on the level of achievement of certain financial performance targets measured over the cycle (as defined in the plan) beginning with the fiscal year of their grant. Upon vesting, each phantom unit is convertible into a fully paid Class A trust unit. The maximum number of phantom units which may be issued pursuant to this plan is equal to ten percent (10%) of the number of trust units outstanding at any time.

As at December 31, 2007, no phantom units had been granted [160,417 in 2006]. In 2006, no compensation expense has been considered in the statement of income since management does not believe that they will vest. As at December 31, 2007 and 2006, 160,417 phantom units were outstanding.

#### **15. INCOME TAXES**

In June 2007, the Government of Canada enacted new legislation imposing additional income taxes upon publicly traded trusts. This new legislation will not apply to AlarmCap until 2011 as it provides for a transition period for publicly traded entities that existed prior to November 1, 2006.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 15. INCOME TAXES [Cont'd]

According to this new legislation, certain distributions will not be deductible in the computation of the income for tax purposes. As a result, the Fund will be subject to tax at a rate substantially equivalent to the general corporate income tax rate beginning January 1, 2011. In October 2007, the Government of Canada announced general income tax rate reductions that will apply in the calculation of the Fund's future income taxes. These proposals received royal assent in December 2007. Consequently, in accordance with the Fund's future income taxes, the impact of these tax rate changes from 31.5% to 29.5% for 2011 and 28% for 2012 and thereafter have been applied in the periods in which the temporary differences are expected to reverse.

The Fund recognizes future income tax assets and liabilities based on temporary differences that are expected to reverse after January 1, 2011 on the basis of its structure as at the balance sheet date. The Fund does not take into consideration changes that may arise in its structure in the future.

The amount and timing of reversals of temporary differences will also depend on the Fund's future operating results, acquisitions and disposal of assets and liabilities, and distribution policy. A significant change in any of the preceding assumptions could materially affect the Fund's estimated future income tax assets.

	2007	2006
	\$	\$
<b>Components of future income taxes on a consolidated basis:</b>		
<b>Balance sheets</b>		
Tax effected temporary differences between accounting and tax basis of:		
Subscriber accounts and goodwill	1,882	—
Units' issuance cost	162	—
Other	6	—
<b>Future income tax assets</b>	<b>2,050</b>	<b>—</b>

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 15. INCOME TAXES [Cont'd]

	2007	2006
	\$	\$
<b>Statements of unitholders' equity</b>		
Increase in future income tax recovery from a change in tax status in June 2007	182	—
Decrease in future income tax recovery resulting from tax rate change in December 2007	(20)	—
<b>Future income tax recovery</b>	<b>162</b>	<b>—</b>
<b>Statements of income</b>		
Increase in future income tax recovery from a change in tax status in June 2007	2,124	—
Decrease in future income tax recovery resulting from tax rate change in December 2007	(236)	—
<b>Future income tax recovery</b>	<b>1,888</b>	<b>—</b>

#### 16. SUPPLEMENTARY CASH FLOW INFORMATION

Change in non-cash operating working capital items is as follows:

	2007	2006
	\$	\$
Accounts receivable	432	(112)
Inventories	46	9
Prepaid expenses	16	160
Accounts payable and accrued liabilities	(1,551)	1,698
Unearned revenues	(599)	(247)
Other deferred revenues	(40)	(192)
	<b>(1,696)</b>	<b>1,316</b>

Part of the change in unearned revenues was related to the acquisition of a subscriber contract for \$175,000.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 17. RELATED PARTY TRANSACTIONS

During the year, the Fund entered into transactions with companies controlled by unitholders who are also officers of the Fund. These transactions were in the normal course of business and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. These transactions were reflected in the consolidated financial statements as follows:

	2007	2006
	\$	\$
<b>Statements of income</b>		
Monitoring and customer service	50	50
General and administrative expenses	730	742
Interest on debt	—	89
<b>Balance sheets</b>		
Accounts receivable	39	—
Advance	71	—
Subscriber accounts	70	70
Accounts payable and accrued liabilities	107	303

#### 2007

A \$71,000 advance is receivable from an officer of the Fund. This advance bears no interest and has no specific terms of repayment.

#### 2006

A \$700,000 note payable to an officer of the Fund resulted from the acquisition of Microtec. On January 1, 2006, the Fund issued, by way of a private placement, 70,000 Class A trust units valued at \$682,500 to settle the balance of the note payable [note 14].

In November 2006, distributions payable to unitholders of Class B trust units totalling \$124,000 were settled against accounts payable to an entity controlled by an officer of the Fund.

These two transactions had no monetary impact and are therefore not presented in the consolidated statements of cash flows.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 17. RELATED PARTY TRANSACTIONS [Cont'd]

##### 2006 [Cont'd]

In 2006, a \$3,500,000 term note was payable to an entity controlled by an officer of Fund. This amount has been repaid out of the proceeds from the issuance of the five-year subordinated debentures bearing interest at 9% for a total amount of \$5,000,000 [note 12].

#### 18. FINANCIAL INSTRUMENTS

##### (a) Fair value

The carrying amounts of Fund's financial assets and liabilities, such as cash, accounts receivable, accounts payable and distributions payable to unitholders, approximate their fair values as at December 31, 2007 and 2006 due to their short-term maturities.

The restricted cash presented in other long-term assets is also carried at an amount indicative of fair value.

The fair value of the interest rate swaps is disclosed in note 13.

The carrying amounts of long-term debt and of the obligations under capital leases approximate their fair values since they bear interest at floating rates and current market rates, respectively.

The carrying amounts of the advance to an officer of the Fund and the amount due to a dealer approximate their fair values as at December 31, 2007.

##### (b) Credit risk

The Fund is exposed to credit risk with regard to its accounts receivable. In order to reduce this risk, the Fund performs credit evaluations of its customers. In addition, accounts receivable comprise amounts receivable from numerous customers whose individual balances are immaterial. The Fund constitutes and maintains allowances for potential losses.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

[Tabular figures are in thousands of dollars, except per unit amounts]

#### 18. FINANCIAL INSTRUMENTS [Cont'd]

##### (c) Interest rate risk

The Fund entered into interest rate swap agreements to manage interest rate risk [note 13].

#### 19. SEGMENTED INFORMATION

The Fund operates in two segments represented by Microtec and Securex divisions. The following table discloses supplementary financial information for both divisions:

	2007			2006		
	Microtec \$	Securex \$	Total \$	Microtec \$	Securex \$	Total \$
<b>Revenues</b>						
Monitoring and services	24,624	4,626	29,250	24,994	4,656	29,650
Installation	2,313	—	2,313	2,690	—	2,690
	<b>26,937</b>	<b>4,626</b>	<b>31,563</b>	<b>27,684</b>	<b>4,656</b>	<b>32,340</b>
<b>Expenses</b>						
Monitoring and customer service	6,002	959	6,961	6,464	961	7,425
Installation, sales and marketing	2,141	—	2,141	2,740	—	2,740
	<b>8,143</b>	<b>959</b>	<b>9,102</b>	<b>9,204</b>	<b>961</b>	<b>10,165</b>
Income, before general and administrative expenses and other items	<b>18,794</b>	<b>3,667</b>	<b>22,461</b>	<b>18,480</b>	<b>3,695</b>	<b>22,175</b>

Depreciation of property, plant and equipment amounted to \$410,000 in 2007 [\$422,000 in 2006] for the Fund's Microtec division and \$10,000 [\$13,000 in 2006] for its Securex division.

Amortization of subscriber accounts amounted to \$7,269,000 in 2007 [\$7,366,000 in 2006] for the Fund's Microtec division and \$1,088,000 [\$1,127,000 in 2006] for its Securex division.

## First National AlarmCap Income Fund

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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[Tabular figures are in thousands of dollars, except per unit amounts]

#### 19. SEGMENTED INFORMATION [Cont'd]

Amortization of deferred subscription revenues amounted to \$69,000 in 2007 [\$36,000 in 2006] for the Fund's Microtec division and none for its Securex division.

#### 20. COMMITMENTS

The Fund has entered into lease agreements for its place of business, some equipment and vehicles. The commitments totalled \$2,554,000, and the annual minimum rent payments for the next five years and thereafter are as follows:

	<b>2007</b>
	\$
2008	<b>490</b>
2009	<b>456</b>
2010	<b>437</b>
2011	<b>421</b>
2012	<b>399</b>
2013 and thereafter	<b>351</b>

#### 21. CONTINGENCIES

- a) On March 25, 2008, the Fund received a formal notice in relation to the change in the governance structure described below in note 22a). In the management's opinion, based on the advice and information provided by its legal counsel, the severance costs that may incur cannot be determined at this time but may be material.
- b) Furthermore, the Fund is subject to some lawsuits brought against it in the normal course of business, the outcome of which cannot be predicted with certainty. Based on the information currently available, management believes that the outcome of these lawsuits will not have a significant impact on the Fund.

## **First National AlarmCap Income Fund**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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[Tabular figures are in thousands of dollars, except per unit amounts]

#### **22. SUBSEQUENT EVENTS**

- a) On March 10, 2008, the Fund announced that the trustees of the Fund have resolved to align the governance structure of the Fund, its wholly-owned subsidiary First National AlarmCap Trust (the "Trust"), and the Trust's wholly owned subsidiary First National AlarmCap GP Inc. (the GP). Consequently, the Trust's trustees are since then Oliver Plett, Leonard Sudermann and Timothy Whyte, who are also the existing trustees of the Fund. The directors of the "GP" are George Fink, Oliver Plett, Leonard Sudermann and Timothy Whyte.
- b) On March 17, 2008, the Fund entered into Bank Credit Agreement Amendment #5. This new amendment includes modifications to its financial ratio requirements and a decrease of 0.25% in the interest rate applicable on either bank's prime rate or bankers' acceptance rate. It covers a three-year period.

The Bank Credit Agreement Amendment #5 has a maximum authorized amount of \$41,250,000, expiring in March 2011 and bearing interest at rates ranging from 0.50% to 1.75% above the bank's prime rate and from 1.75% to 3.0% above the bankers' acceptance rate depending on a monthly financial ratio test.

#### **23. COMPARATIVE FIGURES**

Certain 2006 figures have been reclassified to conform to the current year presentation.