

FIRST NATIONAL ALARMCAP INCOME FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

This management discussion and analysis ("MD&A") is a review of the financial condition and results of operations of First National AlarmCap Income Fund (the "Fund"). It should be read in conjunction with the consolidated financial statements and accompanying notes of the Fund for the period ended September 30, 2005. Results are reported in thousands of Canadian dollars unless otherwise stated and have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

Background on the Commencement of the Fund

The Fund is an unincorporated, open-ended, limited purpose trust and its Class A units are listed on the Toronto Stock Exchange under the symbol "FNA.UN". It was established to acquire substantially all the assets and shares of Microtec Enterprises Inc. ("Microtec") and substantially all the assets of Securex Master Limited Partnership ("Securex").

Microtec, founded in 1989 and based in Quebec City and Montreal, is one of the largest security monitoring companies in Canada with approximately 94,000 subscribers as at September 30, 2005. Securex, founded in 1994 and based in Calgary with dealers across Canada, is an alternative credit and bundled service provider to independent alarm company dealers with approximately 16,000 subscribers.

Total assets purchased and consideration paid by the Fund was:

	Microtec	Securex	TOTAL
	\$	\$	\$
Assets purchased	83,445,000	22,000,000	105 445 000
Consideration paid			
Cash raised on issuance of 14,800,000 Class A Units of \$37,000,000 less issue costs of \$3,562,000 and less working capital of \$3,498,000	29,940,000	-	29,940,000
Cash raised from bank debt	45,000,000	-	45,000,000
Issuance of 615,384 Class A Units	1,000,000	-	1,000,000
Issuance of 2,602,177 Class A Units	6,505,000	-	6,505,000
Issuance of 7,000,00 Class B Units	-	17,500,000	17,500,000
Issuance of Promissory Notes	1,000,000	4,500,000	5,500,000
	83,445,000	22,000,000	105,445,000

Consolidated Statement of Operation

Revenues

Monitoring and Services:

Revenues from monitoring and services for the period ended September 30, 2005 were \$7,798,000, slightly higher than the last quarter with an increase of 0.4 %. Of total monitoring and service revenues, \$7,266,000 or 93% came from monitoring revenues, and the balance of \$532,000 from service revenues.

Installation:

Installation revenues for the period ended September 30, 2005 were \$532,000. These revenues decreased by 8.0% compared to the last quarter as the summer season is a lower sales period for the industry.

Operating Expenses

Operating expenses fall into the following three categories:

- Monitoring and customer service expenses include all costs associated with monitoring subscribers' premises, providing customer service and responding to calls from subscribers. Monitoring services are offered from Quebec, Montreal and Ottawa while customer service centres are offered in Quebec and Montreal. Those services are supported by a network of repair technicians, authorized dealers and associated dealers;
- Installation, sales and marketing expenses include certain equipment, installation, data entry, sales and marketing costs related to subscriber recruitment; and
- General and administrative expenses include all costs related to managing the subscriber network of the Fund and its subsidiaries.

Monitoring and Customer Service

Monitoring and customer service expenses were \$1,958,000 and 5.3% more than the previous quarter.

This increase was due to:

- The integration of the previously subcontracted Montreal monitoring station into the business;
- The closing of the Ottawa customer service centre and the integration of its activities at the Montreal centre; and
- The additional cost of technicians due to an abnormally warm summer season.

Installation, Sales and Marketing Costs:

Installation, sales and marketing costs totalled \$479,000. These expenses were 6.8% less than the previous quarter and this decrease is consistent with lower installation revenues due to the slower summer season.

General and Administrative Expenses

General and administrative expenses were \$1,476,000 and slightly lower than the prior quarter by 1.1%.

EBITDA

For the third quarter of 2005, earnings before interest, taxes, depreciation and amortization ("EBITDA") were \$4,417,000 compared to \$4,476,000 in the second quarter of 2005, due to the increase in the monitoring and customer service expenses for the quarter.

Amortization of subscriber accounts, property and equipment

Amortization expenses were \$2,772,000, and were higher than the last quarter. The increase in amortization reflects an increased investment in subscriber accounts of \$1,685,000. Additionally, third quarter 2005 amortization includes a full quarter of amortization of the assets purchased as per the June 17, 2005 transactions with Microtec in which 2,602,177 Class A Units were exchanged for assets having a fair value of \$6,505,444.

Interest expenses and amortization of long-term assets

The interest expenses of \$740,000 were \$28,000 more than the previous quarter. This increase was due to an interest swap referred to under "Financial Instruments" below and in Note 3 of the accompanying financial statements. The effective interest rate paid in the second quarter was 5.0%.

Net Income

The net income was \$785,000 or \$0.031 per unit, which is less as compared to \$1,056,000 or \$0.046 per unit in the previous quarter.

Liquidity and Capital Resources

Total assets as at September 30, 2005 amounted to \$114,894,000 as compared with \$116,692,000 as at June 30, 2005. This decrease during the quarter is mainly due to a reduction in cash and amortization of subscribers accounts exceeding newly capitalized subscriber accounts.

For the period ended September 30, 2005, cash flow from operating activities was \$2,658,000 compared to \$3,725,000 in the previous quarter. This decrease is mostly related to the net change in non-cash working capital items, specifically, an increase in current assets and a decrease in current liabilities. The increase in current assets results largely from an increase in accounts receivable balances which is consistent with the summer period. The decrease in current liabilities results mainly from the payment of professional fees incurred during the creation of the Fund which had been recorded in accounts payable. Additionally, a decrease in revenues collected in advance and other deferred revenues also contribute to the reduction of the current liabilities.

Investing activities of (\$1,937,000) mostly related to the purchase of subscriber accounts. Financing activities of (\$1,927,000) relate to the distributions to unitholders.

Non-GAAP Financial Measures

EBITDA and Distributable Cash are not earnings measures recognized by GAAP and do not have standardized meanings prescribed by GAAP. Therefore, EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. Investors are cautioned that EBITDA and Distributable Cash should not be construed as alternatives to net earnings as determined in accordance with GAAP as indicators of performance or to cash flow from operating, investing and financing activities as measures of liquidity and cash flow.

EBITDA

EBITDA is not a defined term under Canadian GAAP, but the Fund believes that presentation of EBITDA enhances an understanding of financial condition, results of operations and cash flows because EBITDA is used by the Fund to satisfy its debt service obligations, its capital expenditures

and other operational needs, as well as to provide funds for customer account growth. In addition, EBITDA is used by lenders and the investment community to determine the current borrowing capacity and to estimate the long-term value of companies with recurring cash flows from operations.

Distributable Cash

Distributable Cash is not a defined term under Canadian GAAP but is determined by the Fund as EBITDA less subscriber replacement costs, interest on debt and capital expenditures. Management believes that Distributable Cash is useful measure of performance as it provides investors with an indication of the amount of cash available for distribution to unitholders. Investors are cautioned, however, that Distributable Cash should not be construed as an alternate to using net earnings as a measure of profitability or the statement of cash flows. Furthermore, the Fund's method of calculating Distributable Cash may not be comparable to other similarly named calculations.

For the period ended September 30, 2005, the Fund declared \$0.077 per unit compared with Distributable Cash per unit of \$0.063 generated as calculated below. For the period, the Fund declared \$1,933,098 as described in the Note 5 of the accompanying financial statements.

During the third quarter, the Fund initiated the consolidation of its monitoring stations and customer service centers for cost saving purposes. EBITDA was negatively impacted by \$65,000 from the integration of the previously subcontracted Montreal monitoring station into the business and the closing of the Ottawa customer service center. These non-recurring expenses of \$65,000 are expected to enhance future efficiency. The Fund also invested \$120,000 during the quarter in capital expenditure for the improvement of its installations. This expense is expected to be financed in the fourth quarter by the sale of certain property assets. Finally, during the third quarter, the Fund saw an increase of its gross attrition from 11.75% in the second quarter to 13.20%, due to the summer moving period in the province of Quebec. The impact of this attrition increase was \$145,000 on the subscriber replacement costs. The impact of these three events was to decrease cash available for distributions from \$1,913,000 to \$1,583,000 for the third quarter of fiscal 2005. Management expects to implement other efficiency measures in the fourth quarter of fiscal 2005 and of fiscal 2006.

Distributable Income and Distributions

Periods ended September 30, 2005
(in thousands of dollars, except amounts per unit)

	3 months Ended September 30, 2005	3 months Ended June 30, 2005	6 months Ended September 30, 2005
	\$	\$	\$
EBITDA	4,417	4,476	8,893
Less :			
Interest on debt	(739)	(693)	(1,432)
Efficiency capital expenditures ^(a)	(142)	(20)	(162)
Subscriber replacement costs ^(b)	(1,953)	(1,631)	(3,584)
Cash available for distributions	1,583	2,132	3,715
Cash available for distributions per unit	0.063	0.093	0.155
Distributions declared [Note 5 to financial statements]	1,933	1,975	3,908
Distributions declared per unit	0.077	0.087	0.164
Weighted average units outstanding during the period (in thousands)	25,018	22,816	23,923

- (a) Efficiency capital expenditures are expected to increase in the future as the Fund engages in certain efficiency initiatives.
- (b) Subscriber replacement costs represent management's estimates of the costs to acquire new subscribers to replace subscribers lost through attrition. Subscriber replacement costs are necessary to maintain the Fund's recurring monthly revenues and Distributable Cash at current levels. To maintain recurring monthly revenue, the Fund replaces recurring monthly revenue reductions due to subscriber attrition by investing capital to acquire recurring monthly revenue through its Associated Dealers Network, internal sales teams, call centres, as well through the sale of new value-added services to its existing subscriber base.

Off-Balance Sheet Arrangements

As at September 30, 2005, the Fund had not entered in any significant off-balance sheet arrangements.

Related Party Transaction

The Fund is involved in the normal course of operations with a related party through common ownership. These transactions are measured at the exchange rate which is the amount of consideration established and agreed to by the related parties. As part of the Fund's purchase of the Securex accounts, a management agreement for billing and dealer management services between Securex and Securex Financial Corp. dated January 1, 2003 was assigned to the Fund.

Management fee expenses paid to Securex Financial Corp. for the period of July 1, 2005 through September 30, 2005 was \$152,000.

Financial Instruments

The Fund entered into an interest rate swap agreement of \$45 million on its long-term facility, resulting in an effective interest rate of 5.50%. The Fund entered into the swap to mitigate its exposure to variable interest rates but is exposed to fluctuations in the market value of the swap itself (see Note 3 of the accompanying financial statements).

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts presented in the financial statements and the accompanying notes, particularly as it relates to the recognition and measurement of impairments of long-term assets. Actual results could differ from those estimates, and the differences could be material. The financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality and within the framework of the accounting policies described in Note 2 of the accompanying financial statements.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost and depreciated over their estimated useful lives.

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. These consist primarily of the cost of equipment, installation costs and initial direct costs such as commissions, payments to independent recruiting agents, network connection costs and advertising and telemarketing costs. The direct costs of recruiting and acquiring subscriber contracts are amortized over their estimated useful lives using the declining balance method at a rate of 10% per annum. Revenues from initial service subscriptions received from

subscribers when the contracts are signed are deferred and amortized using the declining balance method at a rate of 10%.

Impairment of Long-Term Assets

Long-term 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 flow and residual value. If the asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value.

Income Taxes

The Fund is taxed as a “Mutual Fund Trust” for income tax purposes. Pursuant to the Declaration of Trust, the trustees intend to distribute or designate all taxable income directly earned by the Fund to unitholders of the Fund and to deduct such distributions and designations for income tax purposes. Therefore, no provision for income taxes is required.