

# FIRST NATIONAL ALARMCAP INCOME FUND

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Quarter Ended March 31, 2006

As at May 11, 2006

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 unaudited consolidated financial statements and accompanying notes of the Fund for the period ended March 31, 2006. Results are reported in thousands of Canadian dollars unless otherwise stated and have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP").

### Overview of the 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 commenced active operations on April 1<sup>st</sup>, 2005. The Fund was created to acquire substantially all of the assets and shares of Microtec Enterprises Inc. ("Microtec") and substantially all of the assets of Securex Master Limited Partnership ("Securex"). Microtec, founded in 1989 in Quebec City, Quebec, is one of the largest full-service security alarm monitoring companies in Canada with some 90,000 subscribers as at March 31, 2006. Securex, founded in 1994 and based in Calgary, Alberta, with dealers across Canada, is an alternative credit and bundled service provider to independent alarm company dealers with approximately 16,000 subscribers.

The Fund's Class A trust units trade on the Toronto Stock Exchange under the symbol FNA.UN.

### Basis of MD&A

Since the Fund began operations in the second quarter of 2005, there are no comparative results for the first quarter of 2005 against which the discussion and analysis of results can be made. Nevertheless, unaudited *pro forma* financial statements of the Fund as at December 31, 2004 were included in the Information Circular of Microtec Enterprises Inc. dated May 13, 2005. Management's expectations for the three-month period ended March 31, 2006 were drawn from these 2004 *pro forma* results although no *pro forma* statements for such three-month period were prepared. The analysis below therefore compares the actual March 31, 2006 quarterly results against the prior quarter ended December 31, 2005 and against such expectations.

### Consolidation of Units

The Class A trust units and the Class B trust units were consolidated on a 4-to-1 basis effective on December 16, 2005 and consequently, all references to numbers of units in this MD&A refer to the numbers of units after such consolidation.

### Forward-Looking Statements

This MD&A contains forward-looking statements. All statements other than statements of historical fact contained in this MD&A are forward-looking statements. Holders of units of the Fund ("Unitholders") can identify many of these statements by looking for words such as "believe", "expects", "will", "intends", "projects", "anticipates", "estimates", "would", "could", "likely", "plans", "forecasts", "continues" or similar words or the negative thereof. There can be no assurance that the plans, intentions or expectations on which these forward-looking statements are based will occur. Forward-looking statements are subject to risks, uncertainties and assumptions, including those discussed elsewhere in this MD&A. Although the Fund, First National AlarmCap Trust (the "Trust"), First National AlarmCap LP ("AlarmCap LP") and First National AlarmCap GP Inc. ("AlarmCap GP" and, together with AlarmCap LP, the "AlarmCap Group") believe that the expectations represented in these forward-looking statements are reasonable, there can be no assurance that those expectations will prove to be correct. Risks which could affect future results and could cause results to differ materially from those expressed in the forward-looking statements contained herein can be found in the Section "Risk Factors".

The information contained in this MD&A identifies additional factors that could affect the operating results and performance of the Fund, the Trust, AlarmCap LP and AlarmCap GP. We urge you to carefully consider those factors.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this MD&A are made as of the date of this MD&A and none of the Fund, the Trust, AlarmCap LP or AlarmCap GP undertake any obligation to publicly update or revise such forward-looking statements to reflect new information, subsequent events, results, circumstances or otherwise.

## Supplemental Disclosure

Reference to "EBITDA" in this document is to earnings before interest, taxes, depreciation and amortization. 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 is not a defined term under Canadian GAAP but is determined by the Fund as EBITDA less subscriber replacement costs, interest on debt and sustaining capital expenditures. Management believes that Distributable Cash is a 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.

## Financial Highlights (for the first 4 quarters of operation)

The following table presents selected financial information regarding the financial results of the Fund for the last four quarters of operation. More detailed 2005 financial information is contained in the audited consolidated financial statements and accompanying notes of the Fund for the period ended December 31, 2005. For 2006, additional information is contained in the unaudited consolidated financial statements and accompanying notes of the Fund for the period ended March 31, 2006.

(in thousand of dollars, except amounts per Unit)

	Q1-2006	Q4-2005	Q3-2005	Q2-2005	Total 9 months- 2005
	\$	\$	\$	\$	\$
<b>Monitoring revenues</b>	7,453	7,663	7,798	7,764	23,225
<b>Installation revenues</b>	546	507	532	578	1,617
<b>Total revenues</b>	7,999	8,170	8,330	8,342	24,842
<b>Monitoring expenses</b>	715	777	844	822	2,443
<b>Customer service expenses</b>	1,050	1,054	1,114	1,038	3,206
<b>Installation, sales and marketing expenses</b>	557	573	479	514	1,566
<b>Gross margin</b>	5,677	5,766	5,893	5,968	17,627
<b>EBITDA</b>	4,149	4,332	4,417	4,476	13,225
<b>Net income</b>	1,226	2,304	785	1,056	4,145
<b>Distributions</b>	1,924	1,917	1,933	1,975	5,825
<b>Cash flows from operating activities</b>	3,476	2,802	2,658	3,725	9,185
<b>Earnings per Unit</b>	0.194	0.368	0.126	0.185	0.683
<b>Distributions per Class A Unit</b>	0.325	0.328	0.331	0.381	1.040
<b>Distributions per Class B Unit</b>	0.250	0.252	0.252	0.249	0.753
<b>Total assets</b>	115,027	115,309	114,894	116,692	115,309
<b>Total long-term debts</b>	48,500	48,500	48,405	48,399	48,500
<b>Unitholders' equity</b>	56,762	56,777	56,376	57,524	56,777

## **Consolidated Statement of Income**

### Revenues

#### *Monitoring and Services:*

AlarmCap LP's revenues consist primarily of recurring payments under written contracts initially entered into for a long term with automatic yearly renewals after the initial term for the monitoring, maintenance and repair of security systems installed in client homes and businesses. The monitoring services are offered 24 hours a day, seven days a week, primarily through state-of-the-art, Underwriter's Laboratories of Canada (ULC) listed monitoring centres.

Revenues from monitoring and services for the first quarter ended March 31, 2006 were \$7,453,000, which were lower than the expectations of management and lower than those of last year's fourth quarter. Of the total monitoring and service revenues, \$7,167,000, or 96.2%, came from monitoring revenues and the balance of \$ 286,000 from service revenues. The difference in revenues compared to the previous quarter and to expectations stems from higher than expected attrition and lower revenues from service calls and patrol and guard response services. Recurring Monthly Revenues ("RMR") as at March 31, 2006 were nevertheless unchanged from December 2005, as a result of the acquisition of a customer accounts representing \$24,000 RMR at the end of the quarter.

#### *Installation:*

Installation revenues for the first quarter ended March 31, 2006 were \$546,000. These installation revenues were generated mainly from activation fees and equipment sold to new customers. These revenues were lower than the expectations of management but nevertheless higher than in the last quarter of 2005. AlarmCap Group sales resources were dedicated to smaller commercial projects instead of traditional industrial projects in 2005. In the first quarter of 2006, the AlarmCap Group began to devote resources to the industrial market with the expectation that these revenues will increase in the second quarter of 2006.

### Operating Expenses

Operating expenses fall into these three major 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, Ottawa, Toronto, Edmonton and Vancouver while customer service centres are offered in Quebec, Montreal and, in some cases, directly through the Dealers. Those services are supported by a network of repair technicians, authorized dealers and associated dealers in Vancouver, Edmonton, Calgary, Ottawa, Toronto and throughout Quebec Province;
- 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 accounts of the Fund and its subsidiaries.

For the period, total operating expenses amounted to \$3,850,000 or 48.1% of total revenues.

#### *Monitoring and Customer Service*

Monitoring and customer service expenses were lower than anticipated at \$1,765,000 or 22.1% of total revenue and were also lower than in the last quarter of 2005. The decrease was due to the restructuring that was made in 2005 at the monitoring stations.

### *Installation, Sales and Marketing Expenses:*

Installation, sales and marketing expenses totalled \$557,000. Those expenses relate to installation revenues. Sales and marketing expenses were significantly higher than expected in the first quarter due to the start-up costs of the new internal sales force being launched to improve internal sales.

### *Gross Margin*

Gross margin was \$5,677,000, or 71.0% of total revenues, somewhat lower than initial expectations as explained above.

### *General and Administrative Expenses*

General and administrative expenses were \$1,528,000, slightly higher than the expectations of management. These amounts represent 19.1% of total revenues. These costs were higher, in the first quarter of 2006, mainly because of remuneration paid to the Executive Chairman of the Board and the President and Chief Executive Officer who were not remunerated by the AlarmCap Group in 2005.

### EBITDA

For the first quarter ended March 31, 2006, EBITDA was \$4,149,000 or 51.9% of total revenue. This was lower than management's expectations.

### Amortization of Subscriber Accounts, Property and Equipment

Total amortization expenses were \$2,204,000 (including \$122,000 of amortization of deferred financing costs presented in the interest on debt section). Amortization of the subscriber accounts were lower than the expectations of management as a result of a valuation of the asset purchase price allocation and assets purchased that was completed after the end of the 2005 year and presented in the audited consolidated financial statements for 2005. Subsequent to the valuation, amortization of the Microtec subscriber accounts is now calculated at a 12% declining-balance rate and amortization of the Securex subscriber accounts is now calculated at a 10% declining-balance rate.

### Interest Expense and Amortization of Long-Term Assets

Interest expense of \$719,000 (net of \$122,000 of amortization of deferred financing expenses) was slightly higher than anticipated. To protect the Fund against an increase in bank interest rates, the AlarmCap Group entered into interest-rate swap agreements on its long term debt of \$45,000,000 pursuant to the Credit Agreement entered into with two banks. These agreements fixed the interest rate at 4.82 % until April 2006; at 5.50% until April 2007; and at 6.00% until March 17, 2008. The average effective rate is 5.50%.

### Net Income

The net income was \$1,226,000 or \$0.19 per unit, which exceeded management's expectations. The difference was primarily due to the change in amortization previously discussed.

### **Subscriber Growth and Retention**

AlarmCap Group's RMR attrition rate, for the first quarter, exceeded management's expectations at 12.5% as compared to a target of 10%. However, total RMR has not declined during the first quarter of 2006 as compared to the end of December 2005 as a result of the acquisition mentioned in below.

RMR Attrition represents the gross RMR lost as a result of cancellations, reduced by cancellation guarantees as a percentage of the total recurring revenues during the period.

Effective March 30, 2006, AlarmCap Group acquired customer accounts generating an RMR of \$24,000 in the Montreal area, as part of its regular acquisition program.

## Liquidity and Capital Resources

As at March 31, 2006 the Fund had cash and cash equivalents of \$747,000, a decrease of \$925,000 compared to December 31, 2005.

Total assets as at March 31, 2006 were \$115,027,000. Total assets were almost the same as at December 31, 2005.

Total liabilities of \$58,265,000 were primarily comprised of the long-term debt of \$48,500,000 of which \$45,000,000 arose from the Credit Agreement and \$3,500,000 from the term note which has been re-financed, as per the Subsequent Events section.

The acquisition debt represents the amount due for the acquisition of the customer list of 6386695 Canada Inc. completed March 30, 2006.

Unitholders' equity as at March 31, 2006 was \$56,762,000.

For the quarter ended March 31, 2006, cash flows from operating activities was \$3,476,000, mostly related to the net income and to the amortization.

Investing activities were of \$2,477,000. This amount results mainly from the investments in subscriber accounts for \$2,356,000. Capital expenditures amounted to \$121,000 for the quarter.

Financing activities represented \$1,924,000 which were distributions to Unitholders.

### Cash Available for Distributions and Distributions

(in thousands of dollars, except amounts per Unit)	Q1-2006	Q4-2005	Q3-2005	Q2-2005	Total 9 months 2005
		\$	\$	\$	\$
<b>EBITDA</b>	<b>4,149</b>	<b>4,332</b>	<b>4,417</b>	<b>4,476</b>	<b>13,225</b>
Less :					
Interest on debt	(719)	(732)	(739)	(693)	(2,164)
Sustaining capital expenditures	0	162	(142)	(20)	-
Subscriber replacement costs	(1,680)	(1,853)	(1,953)	(1,631)	(5,437)
<b>Cash available for distributions</b>	<b>1,750</b>	<b>1,909</b>	<b>1,583</b>	<b>2,132</b>	<b>5,624</b>
Cash available for distributions per Unit	0.277	0.305	0.253	0.374	0.926
<b>Distributions declared</b>	<b>1,924</b>	<b>1,917</b>	<b>1,933</b>	<b>1,975</b>	<b>5,825</b>
Distributions declared per Unit	0.305	0.307	0.309	0.346	0.959
Weighted average units outstanding during the period (in thousands)	6,324	6,254	6,254	5,703	6,072

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 RMR and Distributable Cash at current levels. To maintain RMR, the Fund replaces RMR 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 price increases and the sale of new value-added services to its existing subscriber base.

In the first quarter of 2006, cash available for distributions was lower than the distributions declared by \$174,000. This is mainly due to the actual 2006 attrition rate which was 12.5% compared to the 10% targeted attrition rate expected by management. The Fund was adversely effected by the loss of two wholesale monitoring customers representing the loss of \$5,400 in RMR. This one time event decreased the Fund's distributable cash by \$300,000

in the quarter as additional cash had to be allocated to replace the lost revenues. This increased the subscriber replacement cost by \$320,000. The AlarmCap Group continues to strive to bring down the attrition rate to 10% by focusing on customer service in the restructured customer service departments and with new customer retention programs and strategies. In addition recruitment costs were higher than expected as a result of the start-up and development of the internal sales force in the first quarter.

## Distributions Declared

During the period ended March 31, 2006, the Fund declared the following cash distributions:

### Class A Trust Units:

Period	Record Date	Payment Date	Distribution per Unit	Total \$
January 2006	January 31, 2006	February 28, 2006	0.10833	495,560
February 2006	February 28, 2006	March 31, 2006	0.10833	495,560
March 2006	March 31, 2006	April 30, 2006	0.10833	495,560
			<u>0.32499</u>	<u>1,486,680</u>

### Class B Trust Units:

Period	Record Date	Payment Date	Distribution per Unit	Total \$
January 2006	January 31, 2006	February 28, 2006	0.08333	145,833
February 2006	February 28, 2006	March 31, 2006	0.08333	145,833
March 2006	March 31, 2006	April 30, 2006	0.08333	145,833
			<u>0.24999</u>	<u>437,499</u>
<b>Total distribution as at March 31, 2006</b>				<b><u>1,924,179</u></b>

## Contractual Obligations

(in thousands of dollars)

	March 31, 2006 (unaudited) \$	December 31, 2005 (audited) \$
Bank term loan <sup>(a)</sup>	45,000	45,000
Term note <sup>(b)</sup>	3,500	3,500
	<u>48,500</u>	<u>48,500</u>

(a) The bank term loan has a maximum authorized amount of \$45,000,000, matures on March 2008 and bears interest at rates varying from 0.50% to 1.00% above the prime rate and from 1.75% to 2.25% above the bankers' acceptances depending on a financial ratio on a monthly basis. These interest rates do not factor in the hedging derivative financial instruments.

The interest expense in the income statement is accounted for at the loan's effective rate of 5.50% which factors in the hedging financial instruments.

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

The Credit Agreement contains certain covenants. In addition, the Fund is committed to maintaining certain financial ratios. As at March 31, 2006, the Fund was in compliance with these ratios.

(b) The term note in favour of Securex matures on April 28, 2009 and bears interest at 9%. See the "Subsequent Events" section.

## Financial Instruments

In accordance with its risk management strategy, the Fund uses derivative financial instruments to manage interest rate exposures. Derivative financial instruments consist mainly of interest-rate swap agreements. The Fund does not use derivative financial instruments for trading or speculative purposes.

The Fund enters into interest-rate swap agreements to reduce the impact of fluctuating interest rates on financial commitments.

These swaps are accounted for using the accrual method. Under this method, unrealized gains or losses are not recognized and net payments due or receivable on the derivative financial instruments are accrued as an adjustment to interest expense in the consolidated statement of income.

As at March 31, 2006, the interest-rate swap agreements were detailed as follows:

(in thousands of dollars)

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

## Subsequent Events

On April 13, 2006, the Fund completed the previously announced private placement through Wellington West Capital Inc. ("Wellington West"), as agent, pursuant to which Wellington West placed, by way of private placement, Series A 9% Secured Subordinate Debentures of the Fund (the "Debentures") in the aggregate principal amount of \$5,000,000 (the "Offering"). The Debentures mature on April 13, 2011. The net proceeds of the offering, after commission and legal fees of \$367,000, were used to retire a subordinated debt of the Fund in favour of Securex in the aggregate amount of \$3,500,000 (plus any accrued and unpaid interest thereon) with the balance to be used to indirectly acquire security alarm monitoring accounts through AlarmCap LP and for working capital.

On April 30, 2006, the holders of the Class A trust units having received distributions from the Fund equal to \$0.325 per Class A trust unit per quarter for a period of four consecutive quarters, a Distribution Priority Termination Event occurred and the Distribution Priority in favour of the holders of the Class A trust units over the holders of the Class B trust units terminated. In addition, holders of the Class B trust units have since that date the right to exchange their Class B trust units for Class A trust units on the basis of one (1) Class A trust unit for each Class B trust unit.

## Off-Balance Sheet Arrangements

The Fund's off-balance sheet arrangements consist of operating leases. Operating leases are for facilities with market terms and do not have associated escalating rents that materially impact the financial statements.

## Related Party Transaction

During the period, the Fund entered into transactions with companies controlled by Unitholders who are also officers of the AlarmCap Group. 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 financial statements as follows:

Monitoring and customer service expenses	169
Interest on debt including amortization of deferred financing costs	78
Accounts receivable	99

A demand note amounting to \$202,000, bearing interest at 9%, is payable to an entity controlled by an officer of the AlarmCap Group.

A term note amounting to \$3,500,000 is also payable to an entity controlled by an officer of the AlarmCap Group. The term note was paid April 13, 2006 (see the "Subsequent Events" section).

A note payable amounting to \$700,000, bearing interest at 12% without any specific terms of repayment was payable to an officer of the AlarmCap Group as at December 31, 2005. On January 1, 2006 the Fund issued, by way of a private placement, 70,000 Class A trust units valued at \$683,000 to settle the note payable.

### Outstanding Unit Data

An unlimited number of Class A trust units and Class B trust units of the Fund may be issued pursuant to the Fund Declaration of Trust. Each Unit is transferable and, subject to certain priorities of Distributable Cash flow and special distributions given to the Class A trust units over the Class B trust units, represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains (other than net realized capital gains distributed to redeeming Unitholders) or other amounts, and in the net assets of the Fund in the event of termination or winding-up of the Fund. The Units are not subject to future calls or assessments and entitle the holders thereof to one vote for each whole Unit held at all meetings of Unitholders. Except under certain circumstances, the Units have no conversion, retraction, redemption or pre-emptive rights. The holders of Class A trust units had priority over the holders of Class B trust units of the Fund to Distributable Cash payable in respect of each Unit which exceeds \$0.07916 per Unit but is less than \$0.10834 per Unit (the "**Distribution Priority**"), which limits may be adjusted from time to time in order to reflect a subdivision or a consolidation of Units. The Distribution Priority remained in effect until such time as the holders of the Class A trust units have received aggregate distributions (which includes all forms of distributions other than the described below) paid by the Fund to the holders of the Class A trust units over a fiscal quarter which are equal to \$0.325 per Fund Unit for a period of four (4) consecutive fiscal quarters (the "**Distribution Priority Termination Event**"), which limit may be adjusted from time to time in order to reflect a subdivision or a consolidation of Units. Upon the occurrence of the Distribution Priority Termination Event, the holders of Class B trust units of the Fund shall, at the option of each holder of Class B trust units of the Fund, have the right to exchange their Class B trust units for Class A trust units on the basis of one (1) Fund Unit for one (1) Class B trust unit of the Fund. On April 30, 2006, the holders of the Class A trust units having received distributions from the Fund equal to \$0.325 per Class A trust unit per quarter for a period of four consecutive quarters, a Distribution Priority Termination Event occurred and the Distribution Priority in favour of the holders of the Class A trust units over the holders of the Class B trust units terminated. Consequently, the holders of the Class B trust units now have the right to exchange their Class B trust units for Class A trust units on the basis of one (1) Class A trust unit for each Class B trust unit.

As at March 31, 2006, 4,574,401 Class A trust units and 1,750,000 Class B trust units were outstanding.

Under the Fund's Phantom Unit Plan which is subject to Unitholders' approval, phantom units can be granted to certain trustees of the Trust and the Fund and certain directors and officers of the AlarmCap Group. 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 10% of the number of units outstanding at any time. As at March 31, 2006, 12,500 phantom units were awarded under the plan subject to Unitholders' approval of the plan.

## Accounting Policies

Since the Fund began its activities in 2005, all adopted accounting policies are disclosed in the December 2005 audited consolidated financial statements. No new accounting policies were adopted during the first quarter of 2006.

### Use of Estimates

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

### Property, Plant and Equipment

Property, plant and equipment are 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 net of revenues from the initial subscription. 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 method and rates below:

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

### 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, 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 assets and liabilities of the reporting unit.

### Depreciation 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.

### Disclosure Controls and Procedures

As defined in Multilateral Instrument 52-109, disclosure controls and procedures means controls and other procedures designed to provide reasonable assurance that the material financial and non-financial information required to be disclosed is recorded, processed, summarized and reported to management and disclosed on a timely basis in accordance with securities legislation.

The Fund has designed and evaluated the effectiveness of its disclosure controls and procedures, as defined, and concluded that they were effective as of the end of the period covered by this report.

## **Risks and Uncertainties**

The following are certain factors relating to the business of the Fund which the Unitholders or potential Unitholders should carefully consider. The following information is a summary only of certain risk factors and is qualified in its entirety by reference to, and must be read in conjunction with, the detailed information appearing elsewhere in this MD&A. These risks and uncertainties are not the only ones facing AlarmCap Group and the Fund. Additional risks and uncertainties not presently known to AlarmCap Group or the Fund, or that AlarmCap Group or the Fund currently deems immaterial, may also impair the operations of AlarmCap Group or the Fund. If any such risks actually occur, the business, financial condition, or liquidity and results of operations of AlarmCap Group could be materially adversely affected and the ability of the Fund to make distributions on the Units could be adversely affected.

### **Risks Related to Business of AlarmCap Group**

#### *Ability to Maintain Profitability and Manage Growth*

There can be no assurances that AlarmCap Group's business and growth strategy will enable AlarmCap Group to achieve or sustain profitability in the future. The AlarmCap Group's future operating results will depend on a number of factors, including (i) the efficiency and effectiveness of the AlarmCap Group's marketing programs, (ii) the AlarmCap Group's ability to continuously improve its service to achieve new and enhanced customer benefits, better quality service and reduced costs, (iii) the AlarmCap Group's ability to successfully identify and respond to emerging trends in the security industry, (iv) the level of competition in the security industry and (v) the ability to manage attrition level.

There can be no assurance that the AlarmCap Group will be able to effectively manage its growth, and any failure to do so could have a material adverse effect on the AlarmCap Group's business, financial condition, liquidity and results of operations.

#### *Competition*

The security industry is highly competitive and highly fragmented. The AlarmCap Group competes with larger companies, as well as smaller regional and local companies, in all of its operations. Furthermore, new competitors are continuing to enter the security industry and the AlarmCap Group may encounter additional competition from such future industry new comers. Certain of the AlarmCap Group's current competitors have, and new competitors may have, greater financial resources than the AlarmCap Group. In addition, other security services companies have adopted as strategy similar to the AlarmCap Group's that entails the aggressive purchase of security monitoring accounts through acquisitions of portfolios of subscriber accounts. Some of these companies may be willing to offer higher prices than the AlarmCap Group is prepared to offer to purchase security subscriber accounts. The effect of such competition may be to reduce the volume of sales and the purchase opportunities available to the AlarmCap Group, thus increasing the price paid by the AlarmCap Group for security subscriber accounts, which would adversely affect the AlarmCap Group's cash distributions and its results of operations.

#### *Securex Asset Purchase Agreement*

The Securex Asset Purchase Agreement contained certain customary representations and warranties and related indemnities. The representations and warranties are to survive the closing of the transaction contemplated by the Securex Asset Purchase Agreement for a period of three years. There can be no assurances of recovery by the Alarm Group from Securex for breaches of such representations and warranties, given that there can be no assurance that the assets or financial resources of Securex will be sufficient to satisfy such obligations.

#### *Expansion*

The success of the AlarmCap Group's planned expansion will depend upon many factors, including the ability of the AlarmCap Group to access capital, find suitable acquisition candidates, maintain acceptable Alarm Account creation costs and attrition rates and control of operating costs. There can be no assurance that the AlarmCap

Group will be able to grow or achieve its planned expansion. Such risks, if they materialize, could have a material adverse effect on the AlarmCap Group's business, financial condition, liquidity and results of operations.

### *Industry Risk and Economic Sensitivity*

The AlarmCap Group's business is impacted by the health of the economy in the regional markets in which the AlarmCap Group operates and as such the AlarmCap Group's financial results are sensitive to consumer confidence and the level of unemployment, among other factors. Although the AlarmCap Group cannot specifically correlate the impact of macro-economic conditions on its sales activities, the AlarmCap Group believes that a decline in economic conditions in Canada or in any of the regions in which the AlarmCap Group operates may result in decreased demand for the products/services that it sells and, to the extent that this decline continues or increases in severity, the AlarmCap Group's business, financial condition, liquidity and results of operations could be materially adversely affected.

### *Dependence on Key Personnel*

The Fund's success will be substantially dependent on the continued services of senior management of the AlarmCap Group. The loss of the services of one or more key members of senior management of the AlarmCap Group could adversely affect the AlarmCap Group's financial results. In this connection, Mr. Michel Gosselin resigned as Chief Financial Officer in 2005 and Mr. Paul-René Lacroix left the employment of the AlarmCap Group as interim Chief Financial Officer on April 28, 2006. In addition the AlarmCap Group's continued growth depends on the ability of the AlarmCap Group to attract and retain skilled managers and employees and the ability of its personnel to manage the AlarmCap Group's growth. The inability to attract and retain key personnel could have and adverse effect on the AlarmCap Group's business, financial condition, liquidity and results of operations.

### *Dependence on Dealers*

The Fund's success will be substantially dependent on the Dealers of the AlarmCap Group. The loss of some key Dealers of the AlarmCap Group could adversely affect the AlarmCap Group's financial results. In addition the AlarmCap Group's continued growth depends on the ability of the AlarmCap Group to attract and retain Dealers. The inability to attract and retain Dealers could have and adverse effect on the AlarmCap Group's business, financial condition, growth and results of operations.

### *Technological Risk*

Technology in the security industry and in the telecommunications industry evolves continually and, while AlarmCap Group intends to attempt to keep abreast of changing technology, there is no assurance that the AlarmCap Group's products, or its services, will continue to be competitive.

### *Effectiveness and Efficiency of Advertising Expenditures*

The AlarmCap Group's future growth and profitability will be dependent in part on the effectiveness and efficiency of the AlarmCap Group's advertising expenditures, including the ability of the AlarmCap Group to (i) create greater awareness of the AlarmCap Group's products and services, (ii) determine the appropriate creative message and media mix for future advertising expenditures, and (iii) effectively manage advertising costs in order to maintain acceptable operating margins. There can be no assurance that the AlarmCap Group will experience benefits from advertising expenditures in the future. In addition, no assurance can be given that the AlarmCap Group's planned advertising expenditures will result in increased sales, will generate sufficient levels of product and service awareness or that the AlarmCap Group will be able to manage such advertising expenditures on a cost-effective basis.

### *Increase in Interest Rates*

One of the factors that may influence the price of the Class A trust units in public trading markets will be the annual cash-on-cash return from distributions of the Fund on the Class A trust units compared to cash-on-cash returns on other financial instruments. Thus an increase in market interest rates will result in higher cash-on-cash return on other financial instruments, which could adversely affect the market price of the Class A trust units.

## *Labour Relations*

None of the AlarmCap Group's employees are unionized and the AlarmCap Group is of the opinion that its relations with its employees are good. A deterioration of its labour relations could negatively impact its operating results.

## *Risk of Liability from Operations*

The nature of the services provided by AlarmCap Group potentially exposes it to greater risks of liability for employee acts or omissions or system failures that may be inherent in other businesses. Most of Microtec's alarm monitoring agreements and other agreements pursuant to which AlarmCap Group sells its products and services contain provisions limiting liability to subscribers in an attempt to reduce this risk. Also, AlarmCap Group benefits from Insurance coverage. However, in the event of litigation with respect to such matters, there can be no assurance that these limitations will be enforced, and the costs of such litigation could have an adverse effect on AlarmCap Group.

## *Possible Adverse Effect of False Alarm" Ordinances*

According to American industry sources, approximately 95% of alarm activations that result in the dispatch of police or fire department personnel are not emergencies, and thus are "false alarms". Significant concern has arisen in certain municipalities about this high incidence of false alarms. This concern could cause a decrease in the likelihood or timeliness of police response to alarm activations and thereby decrease the propensity of consumers to purchase or maintain security monitoring services.

A number of municipalities have considered or are considering adopting various measures aimed at reducing the number of false alarms. Such measures include: (i) subjecting monitoring companies to fines or penalties for transmitting false alarms, (ii) licensing individual security systems and the revocation of such licences following a specified number of false alarms, (iii) imposing fines on security subscribers for false alarms, (iv) imposing limitations on the number of times the police will respond to alarms at a particular respond. Enactment of such measures could adversely affect AlarmCap Group future business and operations.

## *Possible Adverse effect of Futures Government Regulations: Risks of Litigation*

AlarmCap Group's operations are subject to a variety of laws, regulations and licensing requirements of federal, provincial, municipal authorities and Underwriter's Laboratories of Canada. The loss of such licences, or the imposition of conditions to the granting or retention of such licences, could have a material adverse effect on AlarmCap Group. AlarmCap Group believes that it is in material compliance with applicable laws and regulations requirements.

AlarmCap Group's advertising and sales practices to a certain extent are regulated by consumer protection legislation. Such legislation includes restrictions on the manner in which AlarmCap Group may promote the sale of its security systems and the obligation of AlarmCap Group to provide purchasers of its security systems with certain rescission rights. While AlarmCap Group believes that it has complied with this legislation in all material respects, there can be no assurance that such legislation was violated in connection with the solicitation of AlarmCap Group existing subscriber Alarm Accounts, particularly with respect to accounts acquired from third parties, or that no such violation will occur in the future.

## *Insurance*

The AlarmCap Group maintains insurance coverage in respect of its potential liabilities, including theft, fire damage, accidental loss of value of its assets and personal injury, in amounts, with such insurers, and on such terms as it considers appropriate, taking into account all relevant factors. However, there are certain types of losses, generally of a catastrophic nature, such as earthquakes and floods, that may be uninsurable or not economically insurable. The AlarmCap Group will use its discretion in determining amounts, coverage limits and deductibility provisions of insurance, with a view to maintaining appropriate insurance coverage on the AlarmCap Group's assets and the business at a reasonable cost and on suitable terms. This may result in insurance coverage that, in the event of a substantial loss, would not be sufficient to pay the full current market value or current replacement cost of the AlarmCap Group's lost investment. Certain factors also might make it unattractive to use insurance proceeds to replace the property after such property has been damaged or destroyed. Under

such circumstances, the insurance proceeds received by the AlarmCap Group might not be adequate to restore its economic position with respect to such property. There are no assurances that the AlarmCap Group's insurance coverage will continue to be available to it on reasonable terms, including reasonable premium, deductible and co-insurance requirements or that the AlarmCap Group's insurer will not disclaim coverage of any future claim. The AlarmCap Group's business, financial condition, liquidity and results of operations could be materially adversely affected if any of the foregoing developments were to occur.

## **Risks Related to the Structure of the Fund**

### *Dependence on Operations*

The Fund is an unincorporated open-ended, limited purpose trust which will be entirely dependent on the operations and the assets acquired from Microtec and Securex as a result of the Microtec Asset Closing and the Securex Asset Closing, respectively. Cash distributions to holders of Class A trust units will be dependent on, among other things, the ability of the Fund to make cash distributions in respect of the Class A trust units, which, in turn, is dependent on AlarmCap LP, the owner of the assets of Microtec and Securex, making cash distributions. In the conduct of its business, AlarmCap LP pays expenses and incurs debt and obligations to third parties. These expenses, debts and obligations could impact the ability of AlarmCap LP to produce positive operating results. The ability of AlarmCap LP or the Fund to make cash distributions or other payments or advances further is subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities.

### *Credit Facilities and Restrictive Covenants*

AlarmCap LP will have third party debt service obligations under the Credit Agreement. The degree to which AlarmCap LP is leveraged could have important consequences to the Unitholders or potential Unitholders, including: (i) a portion of the AlarmCap Group's cash flow from operations will be dedicated to the payment of the principal of and interest on the indebtedness, thereby reducing funds available for future operations and distribution to the Fund, (ii) AlarmCap Group's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited. AlarmCap LP's ability to make scheduled payments of principal and interest on, or to refinance, its indebtedness will depend on its future operating performance and cash flow, which are subject to prevailing economic conditions, prevailing interest rate levels, and financial, competitive, business and other factors, many of which are beyond its control. These factors might inhibit the AlarmCap Group from refinancing the indebtedness at all or on favourable terms, which could have a negative impact on the Fund's ability to make distributions on its Units.

### *Cash Distributions Are not Guaranteed and Will Fluctuate with the Business Performance*

Although the Fund intends to distribute the cash distributions received in respect of the Class A trust units, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Class A trust units, there can be no assurance regarding the amounts of income to be generated by the AlarmCap Group's business or ultimately distributed to the Fund. The actual amount distributed in respect of the Units is not guaranteed and will depend upon numerous factors, including the AlarmCap Group's profitability, its ability to sustain EBITDA margins and the fluctuations in the AlarmCap Group's working capital and capital expenditures, all of which are susceptible to a number of risks.

### *Nature of Class A Trust Units*

Securities like the Class A trust units are hybrids in that they share certain attributes common to both equity securities and debt instruments. The Class A trust units do not represent a direct investment in the AlarmCap Group's business. Unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions. The Class A trust units represent a fractional interest in the Fund. The price per Fund Unit is a function of anticipated distributable income.

The Class A trust units are not “deposits” within the meaning of the Canada Deposit Insurance Corporations Act (Canada) and are not insured under the provisions of that Act or any other legislation. Furthermore, the Fund is not a trust company and, accordingly, is not registered under any trust and loan company legislation as it does not carry on or intend to carry on the business of a trust company.

#### *Distribution of Securities on Redemption or Termination of the Fund*

Upon redemption of Units or termination of the Fund, the Trustees may distribute the Exchange Notes (i.e., together, the Series 2 Exchange Notes and the Series 3 Exchange Notes issued from time to time in exchange for the Series 1 Notes, the Series 2 Notes and the Series 3 Notes of First National AlarmCap Trust issued pursuant to the note indenture made as of March 16, 2005, between such Trust, as Issuer, and CIBC Mellon Trust Company, as Indenture Trustee (the “Trust Notes”)the Trust Notes or the Trust Units directly to the Unitholders, subject to obtaining all required regulatory approvals. There is currently no market for the Exchange Notes, the Trust Notes or the Trust Units. In addition, Exchange Notes, Trust Notes and Trust Units are not freely tradable or listed on any stock exchange. The Exchange Notes so distributed may not be qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education saving plans, depending upon the circumstances at the time. The Trust Notes and the Trust Units would not be qualified investments for such plans.

#### *Restrictions on Potential Growth*

The payout by AlarmCap LP of substantially all of its operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of such funds could limit the future growth of AlarmCap LP and the related cash flow to the Fund.

#### *Unitholder Liability*

The Fund Declaration of Trust provides that no holder of Class A trust units will be subject to any liability whatsoever to any person in connection with a holding of Class A trust units. However, there remains a risk, which is considered by the Fund to be remote in the circumstances, that a holder of Class A trust units could be held personally liable, despite such statement in the Fund Declaration of Trust, for the obligations of the Fund to the extent that claims are not satisfied out of the assets of the Fund. It is intended that the affairs of the Fund will be conducted to seek to minimize such risk wherever possible.

#### *Dilution of Existing Holders of Class A Trust Units*

The Fund Declaration of Trust authorizes the Fund to issue an unlimited number of Class A trust units for that consideration and on those terms and conditions as shall be established by the Trustees without the approval of any holders of Class A trust units. The holders of Class A trust units will have no pre-emptive rights in connection with such further issues.

#### *Investment Eligibility and Foreign Property*

There can be no assurance that the Class A trust units will continue to be qualified investments for registered retirement savings plans, deferred profit sharing plans, registered retirement income funds and registered education savings plans of that the Class A trust units will not be foreign property under the Tax Act. The Tax Act imposes penalties for the acquisition or holding of non-qualified or ineligible investments and on excess holdings of foreign property.

#### *Income Tax Matters*

There can be no assurance that Canadian federal income tax laws and administrative policies respecting the treatment of mutual fund trusts will not be changed in a manner which adversely affects the holders of Class A trust units. If the Fund ceases to qualify as a “mutual fund trust” under the Tax Act, the income tax considerations described herein under the heading “Certain Canadian Federal Income Tax Considerations” would be materially and adversely different in certain respects.

The Fund Declaration of Trust provides that a sufficient amount of the Fund's net income and net realized capital gains will be distributed each year to holders of Class A trust units in order to eliminate the Fund's liability for tax under Part 1 of the Tax Act. Where such amount of net income and net realized capital gains of the Fund in a taxation year exceeds the cash available for distribution in the year, such excess net income and net realized capital gains will be distributed to holders of Class A trust units in the form of additional Class A trust units.

Holders of Class A trust units will generally be required to include an amount equal to the fair market value of those Class A trust units in their taxable income, in circumstances when they do not directly receive a cash distribution.

### *Debt*

In order to finance the acquisition of the assets of Microtec and Securex as well as the implementation of the income trust structure, AlarmCap LP has taken on debt. Amounts paid in principal and interest may impair the Funds ability to make cash distributions.