



Income Fund

2010 Annual Report

FOREMOST INCOME FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

DECEMBER 31, 2010

The Management's Discussion and Analysis ("MD&A") of Foremost Income Fund (the "Fund"), dated March 30, 2011, should be read in conjunction with the cautionary statement regarding forward-looking statements below, the Fund's audited consolidated financial statements and notes thereto as at and for the year ended December 31, 2010 and other materials contained in this Annual Report. Additional information relating to the Fund, including the Annual Information Form ("AIF"), can be found electronically at www.sedar.com.

FORWARD-LOOKING INFORMATION

Certain statements in this release may constitute forward-looking statements involving known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Fund to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this release, such statements use words such as "anticipate", "could", "expect", "seek", "may", "intend", "will", "believe", "estimate", "plan" and similar expressions. These statements reflect management's current expectations regarding future events and operating performance and are valid only up to the date of this release. These forward-looking statements involve a number of risks and uncertainties, including: the impact of general economic conditions, industry conditions, changes in laws and regulations, increased competition, fluctuations in commodity prices and foreign exchange, and interest rates and stock market volatility. Readers are cautioned not to place undue reliance on these forward-looking statements. The Fund does not undertake any obligation to update or revise any of the forward-looking statements, except as may be required by applicable securities laws.

NON-GAAP MEASURES

Management believes three measures not defined under Canadian generally accepted accounting principles ("GAAP"), namely: Funds flow from operations, Funds flow per trust unit and book value per trust unit, are useful supplemental measures. None of these terms as presented are intended to represent cash flow from operating activities or net income or comprehensive income, nor should they be viewed as an alternative to cash flow from operating activities, net income, comprehensive income or other measures of financial performance calculated in accordance with GAAP. As well, the Fund's method of calculating these supplemental measures may not be comparable to similarly titled amounts reported by other issuers.

Used throughout this MD&A, their respective definitions and purpose are outlined below:

Funds flow from operations: defined as net income (loss) adjusted for items not involving cash and before changes in non-cash working capital. This amount is considered meaningful as it is used to assess the ability of the Fund's operations to finance working capital requirements, planned capital expenditures and trust unit distributions.

Funds flow per trust unit: determined as Funds flow from operations divided by the number of trust units outstanding at the end of the period. The Fund uses this amount as an indicator of the changes in Funds flow from operations on a per-unit basis for comparative periods and in the determination of the amount of trust unit distributions on a per-unit basis.

Book value per trust unit: determined as unitholders' equity divided by the number of trust units outstanding at the end of the period. The Fund uses this amount as an indicator of the growth or decline in unitholders' equity on a per-unit basis for comparative periods.

OVERVIEW

The Fund is an unincorporated, open-ended unit trust governed by the November 26, 2010 amended and restated Deed of Trust under the laws of the Province of Alberta. The Fund was created to effect a reorganization resulting in the indirect acquisition of the operations of Foremost Industries Income Fund. Foremost Industries Ltd., is the Administrator of the Fund.

The Fund continues to conduct its business through two limited partnerships: Foremost Universal LP ("Universal") and Foremost Industries LP ("Foremost").

The Fund currently derives all of its revenue from the Universal and Foremost operations described below:

Universal, with its focus on the oil and gas industry, consists of:

Divisions

- Universal Industries, a Lloydminster, Alberta based manufacturer of oil treating systems, shop and field storage tanks and compression equipment
- Corlac Industries ("Corlac"), a Lloydminster, Alberta based shop tank manufacturer
- Maloney Industries ("Maloney"), a Calgary, Alberta based manufacturer of oil and gas process treating equipment

Subsidiaries

- Stettler Universal Limited Partnership ("Stettler"), a Stettler, Alberta based gas separator manufacturer
- Peace Land Fabricating and Supply Ltd. ("Peace Land"), a Hythe, Alberta based shop tank manufacturer
- De-In Industries Ltd. ("De-In") a Debolt, Alberta, based shop tank manufacturer
- Brahma Compression Ltd. ("Brahma"), a manufacturer of sub-200 horsepower compressors
- Air and Gas G.P. Ltd. - ("Air and Gas G.P.") - the general partner of Air & Gas LP
- Wilco Industries Ltd. ("Wilco"), based in Neillburg, Saskatchewan, a commercial real estate holding company

During 2010, De-In manufacturing operations remained suspended with any customer requirements served by the nearby Peace Land facility. Universal continues to consider alternative products for manufacture at De-In.

During 2010, all assets, operations and sales from the Force Compression division were transferred to Brahma.

Foremost, with its focus on custom manufacturing, consists of:

- Foremost Industries, a Calgary, Alberta based manufacturer of custom equipment used for the oil and gas, construction, waterwell and mining industries

Subsidiaries

- Foremost Drilling Company, Inc., formerly Mobile Drilling Company, Inc. "Mobile", a vendor of Foremost Industries custom equipment to the U.S.
- Foremost (Cyprus) Limited, "Cyprus", a vendor of Foremost Industries custom equipment to the Russian oil and gas industry.

With its headquarters in Calgary and sales and manufacturing activities predominantly based in western Canada, the Fund's combined operations currently employ approximately 650 people.

On December 15, 2010 the Fund voluntarily delisted from the Toronto Stock Exchange.

STRATEGY

The Fund's strategy is to increase unitholder value, derived from a combination of capital appreciation and increasing trust unit distributions, on a long-term basis. The achievement of this depends on external and internal business factors supporting growth through internal operations and accretive acquisitions. The challenging market conditions and international economic uncertainty throughout 2009 & the first half of 2010 removed support for growth and created an environment of restraint and cash preservation. The Fund's response was to shift away from a growth strategy and to focus on balance sheet strength, operational efficiency, debt elimination and cash preservation. This continued strategy is expected to enable the Fund to effectively compete under current conditions and remain well positioned to capitalize on opportunities arising from competitor weakness or anticipated improvement in business conditions commencing in 2011.

The current strategy is expected to remain in place through 2011 as improvement in business conditions continue. Accordingly, the Fund will continue to identify and implement operating efficiencies, evaluate internally generated revenue opportunities, identify and sell or lease non-essential assets, and pursue accretive acquisitions. Assessment of potential accretive acquisitions will continue to employ a disciplined approach involving fit, integration and valuation.

OUTLOOK FOR 2011

The Fund currently expects the business conditions to improve steadily throughout 2011. Increasing prices of oil, stronger capital markets and increased confidence in world markets lends confidence to higher revenue levels in 2011. Employing the strategy outlined above, the Fund will continue to aggressively search for and pursue domestic and international revenue opportunities,

update existing products, evaluate new products, maintain tight control over operational expenditures and manpower levels, undertake capital expenditures necessary to maintain required productive capacity and determine trust unit distributions using quarterly business performance. The Fund believes it is in a strong position to address a sudden improvement in business conditions or accretive acquisition.

RESULTS OF OPERATIONS

The effects of the business conditions and operational responses by the Fund are found by comparing the 2010 and 2009 statements of income. The cumulative results of the steps undertaken by the Fund are found by comparing the December 31, 2010 and 2009 balance sheets. The key elements are:

- Revenues increased 32.8% as a result of improvement in the domestic heavy oil markets and increased activity in the oil sands development. Consolidated revenues were \$171.3 million versus \$129 million for 2009.
- Revenues generated outside of Canada decreased from 22.4% to 17.5% of total revenues.
- Competitive pressures generated a gross margin percentage of 19.7% as compared with 24.7% in 2009. 2010 gross profits were \$33.8 million as compared with \$31.8 million for 2009.
- Selling, general and administrative expenses decreased 4.3%, reflecting continued declines in variable expenses such as commissions and performance bonuses, reductions in discretionary programs and personnel and includes \$0.4 million of fees relating to the acquisition of Brahma and Air and Gas G.P. Selling, general and administrative expenses were \$16.8 million in 2010 and \$17.5 million for 2009.
- Strengthening of the Canadian dollar against the U.S. dollar resulted in a \$0.4 million exchange loss compared to a \$0.8 million loss in 2009.
- During the year the Fund disposed of one property in the Grand Prairie region for proceeds of \$0.3 million.
- In July, the Fund acquired 100% of the voting shares of Brahma and Air & Gas G.P. Ltd. (Brahma) for \$3.3 million. The Fund's 2010 financials include the six months of results of Brahma.
- Income before other expenses (income) increased 39.5% to \$12.7 million versus \$9.1 million for 2009.
- Net income including a \$0.4 million recovery of future income taxes was \$13.1 million compared to a \$3.9 million loss in 2009. The 2009 results include a goodwill impairment of \$13.5 million and a realized gain on forward exchange of \$0.6 million.
- Trust unit distributions, were \$0.77 per trust unit or \$16.5 million in 2010 as compared with \$0.40 per trust unit or \$8.6 million for 2009. 2010 distributions were made up of \$8.6 million paid in cash and \$7.9 million relating to a year end special distribution. The year-end special distribution was paid in accordance with the Deed of Trust that allows the Fund to distribute all taxable income to the unitholders. The special distribution was paid in the form of additional trust units; there was an immediate reconsolidation of the number of trust units outstanding. After the consolidation, each unitholder holds the same number of trust units as held before the distribution of additional trust units. The 2010 and 2009 trust unit distributions were paid from cash reserves and cash generated by operating activities. Cash generated from operations was \$1.0 million in 2010 versus \$45.2 million in 2009.
- Earnings per trust unit from operations plus the realized gain on forward exchange contracts but before goodwill impairment was \$0.61 per trust unit as compared with \$0.45 per trust unit in 2009.
- 2010 basic earnings per trust unit is \$0.61 per trust unit versus a loss of \$0.18 per trust unit for 2009.
- Funds flow from operations for 2010, calculated as net income (loss) adjusted for items not involving cash such as amortization, gains on disposals of property, plant and equipment, trust units based compensation and goodwill impairment totaled \$16.8 million versus \$14.4 million for 2009. The increase is a direct result of the higher income generated from operations.
- Cash decreased \$15.3 million to \$21.8 million at December 31, 2010 and comprises 21.4% of current assets. This decrease was generated from a combination of Funds flow from operations and significant increase in non-cash working

capital accounts. At December 31, 2009 cash on hand amounted to \$37.0 million and was 22.9% of current assets.

- Non-cash working capital accounts consist of accounts receivable, inventories, prepaid expenses, accounts payables, accrued liabilities, and deferred revenue. All of these account balances at December 31, 2010 increased relative to December 31, 2009, reflecting the impact of increased business activity.
- Working capital, defined as current assets less current liabilities increased \$3.3 million to \$74.3 million as at December 31, 2010.
- Property, plant and equipment at December 31, 2010 amounted to \$46.9 million. The decrease relative to 2009 reflects a \$4.0 million decrease from amortization plus a \$1.0 million in capital expenditures.
- No short-term or long-term bank indebtedness existed at December 31, 2010 or 2009.
- Unitholders' equity decreased from \$141.5 million at December 31, 2009 to \$129.5 million at December 31, 2010. The decrease relates primarily to the impact of an \$18.5 million adjustment to future income tax assets.

SEGMENTS - RESULTS OF OPERATIONS

UNIVERSAL

Revenue & Gross Profit

Universal's 2010 revenues were \$131.1 million compared with \$88.8 million in 2009. The increase arose principally from higher vessel and shop tank revenues. Universal's other revenue streams include gas separation equipment, field tanks, compression, parts and service. These revenue streams remained relatively flat during the year.

Gross profit during the year amounted to \$21.8 million compared with \$19.6 million in 2009. Universal gross profit continues to be affected by market pressures on selling price, shifts in product mix and cost reductions. Universal's average gross profit percentage was 16.6% of revenue in 2010 versus 22.0% in 2009. This decline is consistent with 2010 expectations. For 2011, expectations are for the gross profit percentage to improve compared to 2010. This expectation takes into account forecast 2011 product sales and no changes in the number of active manufacturing facilities.

FOREMOST

Revenue & Gross Profit

Foremost generated revenues of \$40.3 million for 2010 versus \$40.2 million for 2009 from operations. Foremost revenues are classified into five product categories; oilfield, drills, tooling and pipe, and ancillary equipment. Foremost also generates significant revenues through parts sales, service and rental programs. These products and services are used worldwide in the oil, mineral and waterwell drilling industries. All of these products are currently manufactured and distributed from the Foremost Industries facility. Each category is subject to significant fluctuations in activity and revenue. These fluctuations often require significant reallocation of manufacturing resources, skilled labour force and multi-functional facilities. Historically, at least two of these categories are active at any time and therefore the diverse product offering should collectively result in reasonably stable revenues.

Gross profit for 2010 amounted to \$12.0 million as compared with \$12.2 million for 2009. The gross profit for Foremost is and was affected by changes in product mix, sales volume, selling price, fluctuations in exchange rates between the Canadian and U.S. dollar, manufacturing cost reductions and manufacturing efficiencies. These factors combined resulted in a 2010 gross profit percentage of 29.7%, a marginal decrease over the 30.2% in 2009.

Foremost's diverse product line coupled with the high degree of customer modifications within these products can cause gross profit to vary significantly from year to year. Foremost continues to devote efforts to obtain orders for multiple units and allocate resources to higher margin products. Based on the current product mix, the 2011 gross profit percentage is expected to be similar to 2010.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses were \$16.8 million (9.8% of revenue) for the year compared with \$17.5 million (13.6% of revenue) for 2009. The \$0.7 million decrease reflects reduction in expenses that directly vary with revenues such as sales commissions and bonuses, reductions in discretionary expenses such as travel, and reductions in personnel. Current expectations, based on higher revenues in 2011 are for these expenses to increase throughout the course of the year.

Universal's selling, general and administrative expenses amounted to \$10.6 million for 2010 as compared with \$11.9 million in 2009.

The \$1.3 million decrease occurred because of the reasons outlined above.

Foremosts' 2010 selling, general and administrative expenses were \$4.4 million versus \$5.6 million in 2009. The \$1.2 million decrease also can be attributed to the reasons outlined above.

The Fund incurred general and administrative expenses in 2010 of \$1.1 million including \$0.4 million paid in consulting costs relating to the Brahma purchase. For comparative purposes the 2009 general and administrative expenses were included in Universal and Foremosts' commentary.

INTEREST

Interest expense of \$16,000 was earned in 2010 as compared with interest income of \$18,000 in 2009. The Fund used minimal amounts of its credit facility throughout 2010 and therefore did not incur any significant interest expense. The Fund's operating activities generated additional cash which was invested in short-term money market accounts. These accounts offer minimal interest rates and require significant minimum balances. Accordingly, interest income earned in the year was minimal. The Fund has not used any interest rate swap contracts or similar instruments to manage interest rate risk. Based on current cash flow forecasts, the Fund expects to generate similar levels of interest income and to not utilize its credit facility in 2011.

AMORTIZATION

Amortization was \$4.0 million in 2010 as compared with \$4.6 million for 2009. As 2010 capital expenditures were \$1.0 million and 2011 capital expenditures to maintain productive capacity are not expected to exceed \$1.0 million, the Fund expects that amortization for 2011 will be similar to 2010.

FOREIGN EXCHANGE

The Fund reported a 2010 foreign exchange loss of \$0.4 million versus a 2009 loss of \$0.8 million. At any time, the Fund generally holds a net U.S. dollar working capital position. The 2010 exchange loss is the net effect of exchange rate fluctuations on the conversion of U.S. dollar balances into Canadian dollar balances during the period and the translation of foreign currency balances held at December 31, 2010 into equivalent Canadian dollar balances. Foreign exchange gains or losses will continue as long as the U.S.-to-Canadian dollar exchange rates fluctuate. Because the majority of foreign exchange is with the U.S. dollar, operating results will be influenced by rapid and significant changes in these exchange rates. The Fund does not normally enter into foreign exchange forward contracts or similar instruments to manage this risk. However, during fiscal 2009, the Fund entered into a \$6.5 million foreign exchange forward contract to manage the foreign exchange risk associated with an international capital equipment contract. This contract closed in September 2009. The Fund did not enter into any forward contracts during 2010. Between December 31, 2010 and the date of this MD&A the Fund has not entered into any foreign exchange forward contracts.

INCOME TAXES

Pursuant to the Deed of Trust, all Canadian taxable income is distributed to unitholders and consequently there is no Canadian current income tax expense for the Fund.

Effective December 15, 2010, the Fund voluntarily delisted from the Toronto Stock Exchange, as such the Fund will continue as a flow through entity and will not be subject to Canadian corporate income tax or SIFT (specified investment flow-through tax). The future tax asset or liability associated with Canadian assets recorded on the balance sheet at December 31, 2010 has been adjusted to represent a 0% tax rate for all flow through entities. The balance of future income tax assets and liabilities relating to the flow through entities has been charged to accumulated earnings.

The Fund's foreign and Canadian corporate subsidiaries are subject to corporate income taxes based on their taxable incomes determined using each entity's applicable income tax rules and regulations. The future tax asset or liability associated with these assets recorded on the balance sheet at December 31, 2010 utilizes their respective corporate income tax rates. Repatriation of Fund's from foreign subsidiaries is also subject to applicable income tax rules and regulations.

The Fund's corporate subsidiaries follow the asset and liability method of accounting for income taxes. Under this method, the change in future income tax assets or liabilities is charged to income. Future income tax assets and liabilities are recognized for temporary differences between the accounting and tax basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. These future income tax assets or liabilities are measured using the currently enacted, or substantively enacted, tax rates and laws expected for when these differences reverse. The effect of a change in these income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

CASH LIQUIDITY AND KEY FINANCIAL RATIOS

The Fund's 2010 cash flow from operations totaled \$1.0 million, a \$44.2 million decrease over the \$45.2 million reported in 2009. That decrease is due to a higher level of operations across all business units. Funds flow from operations accounted for \$16.8 million and increases in all non-cash working capital items (accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities and deferred revenue) used \$15.8 million. Compared with 2009, the \$2.5 million increase in Funds flow from operations was offset by the \$46.6 million increase non-cash working capital items resulting in the \$44.1 million decrease. Cash reserves and the 2010 cash flow from operations was used to pay \$8.6 million of trust unit distributions, purchase \$1.0 million of property, plant and equipment purchases, purchase Brahma for \$3.3 million and repayment of \$4.1 million of bank indebtedness.

The Fund generated Funds flow from operations of \$16.8 million in 2010 versus \$14.4 million for 2009. The increase is a direct result of higher revenues and earnings from operations during 2010. Funds flow from operations is one of the key factors used to determine the amount of trust unit distributions. As a result, the quarterly trust unit distribution remained at \$0.10 per unit for all of 2010. Total trust unit distributions amounted to \$8.6 million in 2010 and 2009.

Net working capital as at December 31, 2010 was \$74.4 million, an increase of \$3.3 million over the \$71.1 million last year. The Fund's working capital and working capital ratio declined to 3.74:1 at the end of 2010 versus 4.49:1 last year due mainly to the acquisition of Brahma and the subsequent repayment of Brahma's debt. The debt-to-equity ratio increased to 0.21:1 in 2010 versus 0.14:1 in 2009 due mainly to the future income tax adjustment charged to accumulated earnings. Book value per trust unit decreased to \$6.04 at December 31, 2010 from \$6.61 at the end of 2009. The decline in book value is due solely to the write-off of the future income tax asset. Despite the marginal decline of these ratios the Fund's efforts to preserve cash and focus on efficiency ensures its ability to react quickly to the improving market conditions and consider synergistic acquisitions. Based on these ratios, the Fund also believes liquidity risk to be extremely low.

The Fund has no long-term debt and continues to rely on cash flow from operations to support its non-cash working capital, investing and financing requirements. For 2011 the Fund expects that cash flows generated from operations will be sufficient to support anticipated working capital requirements, planned capital expenditures and cash requirements for trust unit distributions.

Consistent with the financing strategy for previous acquisitions, plans to finance any future acquisitions would first consider operating cash flows then debt issuance and finally, the issuance of trust units. This sequence of financing is intended to maintain the objective of minimizing dilution to existing unitholders.

The Fund was in compliance with all debt covenants throughout 2010 and, based on current 2011 forecasts, expects to remain fully compliant throughout 2011.

CASH LIQUIDITY AND KEY FINANCIAL RATIOS

(000's, except for per trust unit amounts)

As at December 31,	2010	2009	2008
Working capital ratio			
Current assets	\$ 101,476	\$ 91,395	\$ 100,249
Current liabilities	\$ 27,142	\$ 20,338	\$ 34,933
Working capital	\$ 74,334	\$ 71,057	\$ 65,316
Ratio	3.74:1	4.49:1	2.87:1
Debt to-equity-ratio			
Total debt	\$ 27,142	\$ 20,338	\$ 34,934
Unitholders' equity	\$ 127,679	\$ 141,528	\$ 153,663
Ratio	0.21:1	0.14:1	0.23:1
Book value per trust unit			
Unitholders' equity	\$ 127,679	\$ 141,528	\$ 153,663
Trust units outstanding, end of year	21,426,036	21,411,036	21,411,036
Book value per trust unit	\$ 5.96	\$ 6.61	\$ 7.18
Selected Annual Information			
Revenue	\$ 171,323	\$ 128,986	\$ 217,279
Income before other expenses (income)	\$ 12,728	\$ 9,053	\$ 30,134
Net income (loss) before income tax	\$ 12,728	\$ (3,873)	\$ 30,398
Net Income (loss) and comprehensive income (loss)	\$ 13,094	\$ (3,873)	\$ 32,840
Funds flow per trust unit from operations	\$ 0.64	\$ 0.67	\$ 1.54
Earnings (loss) per trust unit, basic	\$ 0.61	\$ (0.18)	\$ 1.54
Earnings (loss) per trust unit, diluted	\$ 0.61	\$ (0.18)	\$ 1.53
Total assets	\$ 154,821	\$ 161,866	\$ 188,597
Total liabilities	\$ 27,142	\$ 20,338	\$ 34,933
Cashes flows from operating activities	\$ 1,002	\$ 45,179	\$ 33,134
Less: capital expenditures	\$ (1,024)	\$ (469)	\$ (2,716)
Standardized distributable cash	\$ (22)	\$ 44,710	\$ 30,418
Trust unit distributions paid	\$ 8,569	\$ 8,564	\$ 21,300
Basic and diluted standardized distributable cash per unit	\$ (0.00)	\$ 2.09	\$ 1.42
Trust unit distributions paid per trust unit	\$ 0.40	\$ 0.40	\$ 1.00
Trust unit distributions per trust unit	\$ 0.77	\$ 0.40	\$ 1.00

ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 2010 were \$37.7 million versus \$19.4 million in 2009. The increase is a direct result of higher revenues. Universal accounts receivable amounted to \$32.1 million for 2010 as compared with \$17.3 million in 2009. Foremost accounts receivable at December 31, 2010 amounted to \$5.6 million as compared with \$2.1 million for 2009. The accounts receivable turnover ratio for 2010, calculated as net sales divided by the average accounts receivable for the year, was 4.5 times as compared with 4.2 for 2009. The Universal accounts receivable turnover was 4.1 times versus 3.2 in 2009. Foremosts' account receivable turnover ratio was 7.2 in 2010 versus 12.6 for 2009. The improvement in turnover ratio for Universal is due to improved collections and payment terms. The decline in Foremosts' turnover is due to higher fourth quarter revenues.

Current business conditions still indicate the risk of slower customer payment patterns and bad debts. In response, the Fund has continued with increased frequency of account review from the time of order to receipt of final payment. Large contracts continue to utilize letters of credit, initial deposits and progress payments to minimize risk. As well, these products are generally not shipped until final payments have been received. Export insurance is also used for accounts receivable related to international parts sales and service. Finally, where the options above don't apply, the Fund will attempt to obtain information as to the ongoing credit worthiness of that particular customer from a variety of sources such as credit references, credit bureaus and bank references. Based on historical collection patterns for domestic and international accounts, the Fund believes a reasonable indicator of accounts receivable collection risk is represented by balances which are more than 60 days past due. At December 31, 2010 15.4% of accounts receivable were more than 60 days past due as compared with 15.0% as at December 31, 2009. After review of outstanding accounts receivable on an account by account basis, the Fund has established an allowance for doubtful accounts of \$0.4 million versus \$0.7 million last year.

INVENTORY

Inventory at the end of 2010 was \$41.3 million compared with \$34.6 million in 2009. Universal inventory at December 31, 2010 amounted to \$28.9 million (2009 - \$24.0 million). Universal's inventory is composed of \$11.6 million in raw materials (2009 - \$10.0 million), \$14.4 million in work in progress (2009 - \$10.7 million) and finished goods of \$2.9 million (2009 - \$3.3 million).

Each category of Universal's inventory reflects the current increase in customer orders and long lead items considered essential for future customer orders.

Foremosts' inventory at December 31, 2010 was \$12.4 million as compared with \$10.6 million for 2009. Foremosts' inventory is composed of \$6.8 million in raw materials (2009 - \$7.1 million), \$4.4 million in work in progress (2009 - \$2.9 million) and finished goods of \$2.9 million (2009 - \$0.6 million). The decrease in raw materials is the result of improvements in purchasing. The increase in work in progress is a result of increased fourth quarter orders and the increase in finished goods inventory reflects the completion of two stock units late in December.

Based on current 2011 revenue forecasts, total inventory on hand is expected to be similar to the end of 2010.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of land, buildings, equipment and rental assets. The \$1.0 million investment in property, plant and equipment for 2010 was to replace and upgrade equipment necessary to maintain current levels of productive capacity. Based on current year results and management's outlook and forecast for 2010, management determined there are no indications of impairment.

Capital expenditures for 2011 to maintain required operational capacity are not expected to exceed \$1.0 million and should be funded from operating cash flows. Amortization expense for fiscal 2011 is forecast at approximately \$4.0 million.

GOODWILL

The Fund's 2010 addition to goodwill arose from the purchase of Brahma. Goodwill is not amortized over an estimated life but is reviewed at least annually for potential impairment. The determination of impairment is by reporting unit (Universal and Foremost). The process involves analysis of current reporting unit earnings, future reporting unit earnings, valuation multiples and techniques. Impairment is considered to exist at a point in time when it is determined that the fair value of the reporting unit is less than the carrying value of the reporting unit (including goodwill) and the shortfall is not considered to be temporary. In accordance with its accounting policy, the Fund conducted a goodwill impairment test at December 31, 2010 there was no indication of impairment.

The Fund conducted a goodwill impairment test at December 31, 2009. The goodwill impairment test involved a two step process. In the first step, the Fund compared the estimated fair value of Universal to its respective carrying value. The Fund estimated fair value using market information and discounted cash flow estimates. As this step indicated carrying value was greater than estimated fair value, step two was completed. In step two, the amount of impairment is calculated by comparing the implied fair value of Universal's goodwill to the carrying value of its goodwill. The implied fair value of the goodwill is calculated as if Universal was acquired in a business combination. At that point, if the implied fair value is less than the carrying value, an impairment charge is recorded for the difference. The charge is recorded by reducing the carrying value of goodwill on the balance sheet and recognizing a non-cash impairment charge to income. The Fund believes that the methodology used to test impairment of goodwill, which involves a significant number of judgments and estimates, provides a reasonable basis for determining any impairment. Many of the factors used in determining whether or not goodwill is impaired are outside of management's control and involve inherent uncertainty. At December 31, 2009, the Fund conducted its goodwill impairment test and determined that Universal's carrying value of goodwill was greater than its estimated fair value. Therefore, goodwill was considered impaired and a goodwill impairment charge for the entire balance of goodwill of \$13.5 million was recorded at that date. The main contributing factor to the impairment was the decline in Universal revenues and earnings which led to a reduction in the estimated fair value of the reporting unit. The decline in revenue and earnings was the result of continued weak business conditions within its core markets. The net effect to the Fund of this non-cash write-down is a reduction in total assets and a corresponding reduction in unitholders' equity.

INTANGIBLES

The Funds intangibles consist of patent rights for an inclined separator technology and a non-compete agreement. These assets are being amortized on a straight-line basis over their estimated useful lives resulting in approximately \$0.2 million of annual amortization. Assessing fiscal 2010 operating results, management's forecast 2011 operating results and management's long-term outlook, no impairment adjustment was considered necessary.

LONGTERM INVESTMENTS

The Fund's long-term investments consist of its investment in Air and Gas LP. Air and Gas GP Ltd., a wholly owned subsidiary of Universal is the general partner of Air and Gas LP. The value of the investment (\$0.4 million) represents a 4% interest in Air and Gas LP and is recorded at cost.

DEFERRED REVENUE

Deferred revenue was \$10.7 million at December 31, 2010 as compared with \$6.5 million in 2009; the increase in customer progress payments at Universal and Foremost accounts for the majority of the increase. Deferred revenue represents the excess of progress billings to customers and contract payments received from customers over the related accrued revenue for capital equipment currently being manufactured. Although these amounts are directly associated to the Fund's inventory levels, they are reflected as current liabilities within the financial statements.

FUTURE INCOME TAXES

Under the Income Tax Act (Canada) the Fund and its flow-through subsidiary entities are taxable only on income that is not distributed or distributable to the Unitholders. As the Fund and its flow-through subsidiaries distribute all of their taxable income to the Unitholders, neither the Fund nor its flow-through subsidiaries are currently subject to income tax. In 2007 the Canadian government enacted legislation to apply a tax to distributions from Canadian publicly traded income trusts; however with the voluntary delisting by the Fund effective December 15, 2010, the Fund is no longer a publicly traded trust and as a result is no longer subject to a distribution tax beginning in 2011. Therefore, as long as the Fund maintains its current structure and the Fund and its flow-through subsidiaries continue to distribute all of their taxable income, the Fund and its flow-through subsidiaries will not be subject to tax. This results in an effective tax rate of zero for the Funds flow through entities which led to the reversal of the future income tax asset that was booked upon the enactment of the SIFT rates in 2007. Accordingly, a reversal of \$18.5 million has been recorded through accumulated earnings during 2010 as it arose from a change in shareholder status.

The Fund's foreign and Canadian corporate subsidiaries are subject to corporate income taxes based on their taxable incomes determined using each entity's applicable income tax rules and regulations. The future tax asset or liability associated with these assets recorded on the balance sheet at December 31, 2010 utilizes their respective corporate income tax rates. Repatriation of Fund's from foreign subsidiaries is also subject to applicable income tax rules and regulations. To estimate temporary differences at December 31, 2010, the Fund used assumptions that included no changes to the Fund's organizational structure, no changes to existing tax deduction pool balances, use of current trust unit distributions and estimates of operating results and substantially

enacted income tax rates for the years ended 2010 and onward.

The Fund's actual realization of this estimated future income tax asset will vary based on actual results, including but not limited to, changes in organizational structure, changes to tax deduction pool balances, variations in trust unit distributions, variances in operating results and changes to income tax rates. This future income tax asset will be recalculated for each subsequent reporting period with any changes in amounts recorded in the income statement. Differences in the actual realization of this future income tax asset may be material.

TRUST UNIT DISTRIBUTIONS

References to "Standardized Distributable Cash" refer to cash from operating activities less capital expenditures, both measures recognized under GAAP. Standardized Distributable Cash is a financial measure that indicates the Fund's ability to make distributions. It is a measure that has been recommended by the CICA's Canadian Performance Reporting Board for use by income Funds in Canada as an indicator of financial performance. As one of the factors that may be considered relevant by investors is the cash available to be distributed by the Fund relative to the price of the trust units, the Fund believes that Standardized Distributable Cash is a useful supplemental measure that may assist investors to assess an investment in the trust units.

The Standardized Distributable Cash of the Fund is substantially comprised of distributions from the Fund which are impacted by the operating results of Foremost and Universal. The preceding table sets out the Standardized Distributable Cash calculation for the years ended December 31, 2010, 2009 and 2008 respectively.

The Fund declares trust unit distributions to unitholders on a quarterly basis. The amount of the trust unit distributions is generally determined by taking Funds flow from operations and adjusting for anticipated working capital requirements, costs of property, plant and equipment expenditures, business acquisitions and the effect of changes in general business conditions. The Fund's DRIP program remains suspended. Consequently, current and future trust unit distributions are all paid using cash. The amount of trust unit distributions are expected to vary over time depending on anticipated working capital requirements, property, plant and equipment expenditures, acquisition opportunities, reinstatement of the DRIP, decision to pay distributions using trust units and changing business or other conditions.

Subsequent to the year end, the Fund has reviewed expectations for 2011 Funds flow from operations, capital expenditures, working capital requirements and various economic factors. This review resulted in the March 31, 2011 trust unit distribution being maintained at the 2010 level of \$0.10 per unit. Subsequent to year end and as of the date of this report 432,682 trust units were tendered for redemption by the Fund, resulting in payments of \$2.8 million. Based on the 20,993,354 trust units currently outstanding, cash requirements for this distribution will be about \$2.1 million. The Fund determines trust unit distributions on a quarter by quarter basis and will continue to adjust the distribution amount to reflect business performance and current economic conditions.

UNITHOLDERS' CAPITAL

Unitholders' capital was \$62.2 million at December 31, 2010 and \$62.1 million in 2009. Trust units issued and outstanding were 21,426,036 at December 31, 2010 and 21,411,036 at December 31, 2009. During the year 15,000 trust unit options were exercised resulting in an increase to unitholders capital of \$0.1 million.

The Fund is authorized to issue an unlimited number of trust units. These units entitle the unitholder to one vote per trust unit, pro-rata interest in the net assets of the Fund and pro-rata participation in all trust unit distributions. Upon special trustee resolution, the Fund may issue special voting units. These units entitle the unitholder to such number of votes as prescribed by the resolution but do not entitle the unitholder to participate in any distributions from the Fund or any beneficial interest in any assets of the Fund. No special voting units were issued as at December 31, 2010 or for the period up to the date of this MD&A.

Trust units are redeemable in whole or in part at any time on demand by the unitholder. Upon receipt of an executed redemption notice and related trust unit certificate the unitholder ceases to have any rights with respect to those trust units. On November 26, 2010 the Fund amended its Deed of Trust. The amendment made changes to the value at which the unitholder is entitled to receive at time of redemption. The unitholder, for each unit tendered for redemption, will receive equal to plus or minus 10% of the tangible book value of the Fund. The stated redemption price will be reviewed by the Board of Trustees on a quarterly basis; the stated redemption price for purposes of redemption was \$6.40 at December 31, 2010. The November 26, 2010 amendment also increased redemptions limits to \$1,500,000 per month and can be paid in cash or in certain circumstances by the issuance of an unsecured promissory note. There were no trust units redeemed during the year.

The amendment also limited the unitholders ability to sell, transfer, consign, mortgage, pledge, or dispose of any Trust Units in any manner whatsoever, other than a transfer to a similar beneficiary, without the prior written consent of the Board of Trustee's. Consent from the Board of Trustees will be evidenced by a resolution, and any attempt to do so shall be void without such approval.

UNITHOLDERS' EQUITY

Unitholders' equity is comprised of unitholders' capital, accumulated earnings and contributed surplus. Unitholders' equity at December 31, 2010 was \$127.7 million compared with \$141.5 million for 2009. The \$13.8 million decrease reflects the net effects of net income of \$13.1 million less trust unit distributions of \$8.6 million, the adjustment to future income taxes of \$18.5 million, the addition of unit capital of \$0.1 million and the increase in contributed surplus of \$0.1 million. The December 31, 2010 unitholders' equity expressed as a percentage of total assets was 82.5%, a decrease over the 87.4% for 2009. The debt-to-equity ratio is 0.21:1 as compared with 0.14:1 in the previous year.

CREDIT FACILITIES

The Fund maintains a credit facility with a chartered bank. In July 2009, based on anticipated borrowing requirements and associated costs, the Fund entered into a one year agreement for a \$20 million uncommitted operating credit facility with the same major Canadian chartered bank. This uncommitted operating credit facility bears interest at prime plus 0.25% or prime plus 0.5% depending on a specific covenant ratio and is subject to certain financial covenants, including margin ratios for acceptable accounts receivable and inventory, debt-service ratio limits and current ratio limits. This facility is secured by a general security agreement and floating charge debenture in the amount of \$75 million covering all assets of the Fund. Under the terms of this facility, the Fund is permitted to make use of bankers' acceptances to borrow at effective interest rates, which are usually lower than those charged under the bank's lines of credit and use certain financial instruments to manage interest and exchange risk.

At the end of 2010, the Fund had not utilized this operating facility and based on current cash flow forecasts does not anticipate using it in 2011.

The Fund had consolidated cash at December 31, 2010 of \$21.8 million versus \$37.0 million for 2009. The Fund's operating groups use various operating bank accounts, both Canadian and U.S. dollar, to transact business. The Fund utilizes its banking facilities to consolidate certain of its Canadian dollar operating accounts for purposes of interest calculations. The Canadian and U.S. dollar balances not included in this consolidation amounted to \$0.1 million at December 31, 2010 versus \$0.7 million in 2009.

At December 31, 2010 the Fund had no outstanding letters of guarantee (2009 - \$0.1 million) related to the performance of specific contracts. The Fund's credit facility is renewed annually. The next renewal date is mid 2011 and currently the Fund has no reason to believe the facility will not be renewed at that time.

CRITICAL ACCOUNTING POLICIES

The Fund's significant accounting policies and estimates are as follows:

Revenue recognition

The Fund uses the percentage-of-completion method in determining revenue recognition for capital equipment fabrication. At each month end, the Fund systematically reviews every job in progress and determines the appropriate revenue and related costs to be reflected in the statement of income using, among other measurement criteria, cost information to date, anticipated margins, progress status estimates and estimated costs to complete. These estimates are constantly evaluated to ensure their application properly reflects the month end revenue and cost valuations. At the completion of each project, a post mortem review is conducted to identify reasons for actual costs being different from original contract estimates, the results of which are used to provide better information in evaluating ongoing projects.

Foreign currency translation

Foreign currency translation gains or losses are recognized when they occur. The majority of foreign exchange translation is with the U.S. dollar and operating results are prone to be influenced by rapid changes in these exchange rates within a given year. In the normal course of business, the Fund does not trade or speculate on future foreign currency exchange rates. It may use forward exchange contracts to manage exchange risk related to specific sale agreements when the Fund believes business conditions warrant it. When forward exchange contracts are used, the subsequent gains or losses are charged to net income with a corresponding adjustment to the related account receivable or payable.

Income taxes

Under the Income Tax Act (Canada) the Fund and its flow-through subsidiary entities are taxable only on income that is not distributed or distributable to the Unitholders. As the Fund and its flow-through subsidiaries distribute all of their taxable income to the Unitholders, neither the Fund nor its flow-through subsidiaries are currently subject to income tax. In 2007 the Canadian government enacted legislation to apply a tax to distributions from Canadian publicly traded income trusts; however with the voluntary delisting by the Fund effective December 15, 2010, the Fund is no longer a publicly traded trust and as a result is no longer subject to a distribution tax beginning in 2011. Therefore, as long as the Fund maintains its current structure and the Fund and its flow-through subsidiaries continue to distribute all of their taxable income, the Fund and its flow-through subsidiaries will not be subject to tax.

The Fund's foreign and Canadian corporate subsidiaries are subject to corporate income taxes based on their taxable incomes determined using each entity's applicable income tax rules and regulations. The future tax asset or liability associated with these assets recorded on the balance sheet at December 31, 2010 utilizes their respective corporate income tax rates. Repatriation of Fund's from foreign subsidiaries is also subject to applicable income tax rules and regulations.

The Fund's corporate subsidiaries follow the asset and liability method of accounting for income taxes. Under this method, the change in future income tax assets or liabilities is charged to income. Future income tax assets and liabilities are recognized for temporary differences between the accounting and tax basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. These future income tax assets or liabilities are measured using the currently enacted, or substantively enacted, tax rates and laws expected for when these differences reverse. The effect of a change in these income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

Financial instruments

CICA Section 3855 prescribes when a financial instrument is to be recognized on the balance sheet and at what amount. It also prescribes the recognition of financial gains and losses. All financial instruments are classified into one of the following five categories; held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. Subsequent measurement and recognition of changes in the carrying amount of financial instruments depends on their initial classification:

- a) Held-to-maturity investments, loans and receivables and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost using the effective interest rate method.
- b) Available-for-sale financial assets are measured at fair value. Unrealized gains and losses are included in other comprehensive income until the asset is removed from the balance sheet at which time the gains or losses are then realized and included in net income.
- c) Held-for-trading financial instruments are measured at fair value. Realized and unrealized gains and losses are included in net income in the period incurred. All derivative financial instruments are classified as held-for-trading financial instruments and are measured at fair value, even when they are part of a hedging relationship.

Transaction costs are incremental costs directly related to the acquisition of a financial asset or the issuance of a financial liability. The Fund incurs transaction costs primarily through the annual renewal and issuance of bank indebtedness and charges these costs to net income in the period incurred.

Derivative instruments are recorded in the balance sheet at fair value with subsequent gains or losses charged to net income in the period.

Critical Accounting Estimates

The critical accounting estimates shown below require management's judgment as to the effect of future events that are inherently uncertain. Management is required to make estimates and judgments that affect reported amounts within the consolidated financial statements and the related disclosure of commitments and contingencies. These estimates and judgments are based upon historical experience and various other assumptions that are believed to be reasonable in these circumstances. These estimates are evaluated on a regular basis and revised as updated information becomes available. It should be noted that actual results may differ from these estimates under different assumptions or conditions. Management believes that the fol-

lowing accounting estimates, which impact all reported business segments, are significant and require additional disclosure.

Property, plant and equipment

The Fund regularly reviews its property, plant and equipment for potential impairment. The determination of impairment in value is calculated by taking the difference of the lower fair market value and the higher book carrying amount, which is then charged to current earnings. The Fund cannot predict when such events will occur, nor can it estimate the effect on the carrying value of these assets. Rather, the Fund conducts reviews of these assets quarterly or when economic or environmental changes occur that may affect the valuation of the assets.

Goodwill

The Fund reviews its goodwill for potential impairment. The impairment test is based on management's best estimate of the fair value of the related segments compared with the carrying amounts of these segments. The fair value of the related segments is determined according to an estimate of future discounted cash flows. Impairment in the value of goodwill arises when the carrying amount is greater than the fair value of the related segment and is charged to current earnings.

Intangible assets

Other intangible assets consist of certain patent rights, licensing agreements and non-compete payments. The Fund regularly reviews other intangible assets for potential impairment. The determination of impairment in value is calculated by taking the difference of the lower fair market value and the higher book carrying amount, which is then charged to current earnings. The Fund cannot predict when such events will occur, nor can it estimate the effect on the carrying value of these assets. Rather, the Fund conducts reviews of these assets quarterly or when economic or environmental changes occur that may affect the valuation of the assets.

Net realizable value of inventory

The net realizable value of inventory is estimated on a product-by-product basis. The determination of this value uses a combination of historical analysis of each product's usage and management's judgment as to the probability of future use of the product. Based on this assessment, management then estimates the net realizable value for those products not expected to be used in the foreseeable future. Net realizable value is the estimated selling price of that product in the ordinary course of business less any estimated costs of completion and estimated selling costs.

Warranty provisions

Warranty provisions are based upon a standard allocation for each capital equipment unit produced. These estimates are based upon historical data for similar types of capital equipment. In the case of capital equipment products that have not been previously manufactured, management estimates and extrapolates warranty liabilities based upon the closest historical models and will use its judgment to consider additional factors.

Allowance for doubtful accounts

Given the cyclical nature of the energy and mining sectors and the rapid manner in which these changes can occur, management continually monitors the collectability of outstanding accounts receivable. Management conducts an account by account review to determine those accounts that may not be collected. Based on this review, the allowance for doubtful accounts is estimated and adjusted on a quarterly basis.

Future income taxes

The Fund recognizes, on a prospective basis, future income tax assets or liabilities based on the estimated temporary differences (differences between the accounting basis and the tax basis of the assets and liabilities) at December 31, 2010. To estimate these temporary differences at December 31, 2011, the Fund used assumptions that included no changes to the Fund's organizational structure, no changes to existing tax deduction pool balances, use of current trust unit distributions and estimates of operating results and substantially enacted income tax rates for the years ended 2011 onward.

The Fund's actual realization of this estimated future income tax asset will vary based on actual results including, but not limited to, changes in organizational structure, changes to tax deduction pool balances, variations in trust unit distributions, variances in operating results and changes to enacted income tax rates. The current future income tax asset will be recalculated for each subsequent reporting period with any changes in amounts recorded in the income statement. Differences in the actual realization of this future income tax asset may be material.

Business combinations

Effective January 1, 2010, the Fund early adopted CICA Handbook Section 1582, "Business Combinations". Section 1582, which is substantially converged with IFRS 3, "Business Combinations," establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date and that non-controlling interests would be measured at fair value at the date of acquisition. This standard is applied prospectively to business combinations with acquisition dates on or after January 1, 2010. This new standard was applied to the acquisition of Brahma Compression Ltd. ("Brahma").

Consolidated financial statements

Effective January 1, 2010, the Fund early adopted CICA Handbook Section 1601, "Consolidated Financial Statements", as a result of adopting Section 1582. This section partly replaces the existing Section 1600. Section 1601 carries forward existing Canadian guidance for preparing consolidated financial statements other than non-controlling interests. The adoption of this standard did not have a significant impact on the Fund's consolidated financial statements.

Non-controlling interests

Effective January 1, 2010, the Fund early adopted CICA Handbook Section 1602, "Non-controlling Interest", as a result of adopting Section 1582. This section partly replaces the existing Section 1600. Section 1602 establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. The adoption of this standard did not have any impact on the Fund's consolidated financial statements.

RELATED PARTY TRANSACTIONS

The Fund utilizes the consulting services of a company owned and managed by a trustee of the Fund in normal course operations. The consulting services consist of legal and professional advice and investor relations. As necessary, the Fund utilizes due diligence and business acquisition services from the same company. The consulting, due diligence and business acquisition services are measured at fair value with these amounts agreed to by all parties. For the year ended December 31, 2010 the total amount invoiced for consulting services was \$915,775 (2009 - \$643,000). \$420,000 of the amounts paid during the year were for due diligence or business acquisition services (2009 - \$0). There were no unpaid balances at December 31, 2010 or 2009.

OBLIGATIONS, COMMITMENTS AND CONTINGENCIES

Other than as noted throughout this analysis, there are no other material obligations, commitments or contingencies that are required to be acted upon by the Fund. The Fund has operating lease commitments for certain office and service equipment, none of which, individually or in aggregate, are material.

SEASONALITY

Historically, the Fund's financial results normally reflect the seasonal operations of the oil and gas markets using its products and services whereby revenues and net earnings reported in the first two quarters are lower than the third and fourth quarters. The 2010 results do not reflect this seasonal pattern as they have been impacted by the increase in economic activity during the latter half of 2010.

DISCLOSURE CONTROLS AND PROCEDURES

Management has established and maintained disclosure controls and procedures for the Fund in order to provide reasonable assurance that material information relating to the Fund is made known to management in a timely manner and that information required to be disclosed by the Fund is reported within the time periods prescribed by applicable securities legislation. Management has designed and evaluated the effectiveness of the Fund's disclosure controls and procedures, as at December 31, 2010. Based on their review of the design and evaluation, the CEO and CFO have concluded that the Fund's disclosure controls and procedures as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim filings, are effective to ensure the information required to be disclosed in reports that are filed or submitted under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in those rules and forms.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Management, including the CEO and CFO, assessed the design and effectiveness of the Fund's

internal control over financial reporting as at December 31, 2010 and, based on that assessment, determined that the Fund's internal control over financial reporting are effective and provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

There have been no changes in the internal controls over financial reporting during the year or for the three months ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

INTERNATIONAL FINANCIAL REPORTING STANDARDS UPDATE

In February 2008, Canada's Accounting Standards board confirmed January 1, 2011 as the official changeover date for publicly listed Canadian companies to start reporting under International Financial Reporting Standards ("IFRS"). IFRS uses a conceptual framework that is similar to Canadian GAAP, but there are differences in recognition, measurement and disclosure. The International Accounting Standards Board also currently has projects underway that should result in new pronouncements and the Canadian convergence initiative is ongoing as of the date of these statements.

The Fund has a project plan to complete the transition to IFRS by January 1, 2011, including the preparation of required comparative information.

The project plan involved an initial assessment of the effects of adopting this standard, a more detailed assessment of the impact and required steps to adopt these standards and finally implementation of the standards. Progress to date in this area includes:

- a) completion of the initial assessment including:
 - i) identification of potential accounting issues
 - ii) identification of potential disclosure issues
 - iii) identification of potential information system changes
 - iv) identification of potential for third party assistance
 - v) identification of issues encountered with the adoption of Section 3031 - Inventories

- b) detailed assessment of the following critical areas:
 - i) assessment of current significant components of property, plant and equipment for compliance with IFRS
 - ii) analyzed accounting policy alternatives and implementation options including the first time adoption exemptions detailed in IFRS 1 (see below)
 - iii) reviewed impact of impairment testing and the impact of cash generating units
 - iv) analyzed the potential reclassification of the Fund's issued and outstanding trust units from equity to long-term debt
 - v) analyzed the impact of the December 31, 2005 reorganization as a controlling interest transaction
 - vi) drafting of the opening balance sheet required under IFRS

The Fund has substantially completed the detailed assessment and design phase of the project during 2010. The Fund has accomplished the necessary steps and is progressing on the subsequent steps of its plan. The Fund expects to adopt IFRS effective January 1, 2010 and will report March 31, 2011 interim financials accordingly.

Accounting policies

The Fund has determined the accounting policy choices available under IFRS 1 First Time Adoption of IFRS as follows:

Business Combinations

The classification of the Fund's former business combinations under Canadian GAAP will be maintained and remeasurement of the fair values determined at the time of the business combination will not be required.

Property, plant and equipment

The Fund will not restate each item of property, plant and equipment at its fair value and use that fair value as its new deemed historical cost going forward from January 1, 2010. The Fund will measure its property, plant and equipment at historical cost.

Share-based payment transactions

The Fund will use the exception under IFRS 1 and will apply IFRS 2 retrospectively for any unit options that have not vested at January 1, 2010.

Borrowing costs

The Fund will not retrospectively capitalize any borrowing costs that meet the definition of capital under IFRS. The Fund is in the process of making all other accounting policies IFRS compliant.

Information technology and data management systems

The Fund has been continually assessing the demands on its information technology and data management systems ("IT systems") with respect to IFRS conversion. Based on this assessment, the Fund currently believes that all existing IT systems are capable of handling the current conversion requirements.

Internal controls

The conversion to IFRS is not expected to have a significant impact on the current control environment. During the implementation phase, the Fund will make any required changes to its business processes, financial systems, accounting policies and internal controls over financial reporting.

Disclosure controls

The Fund is in the process of completing a first draft of full IFRS financial statements. The additional information required for disclosure under IFRS will be readily available. The Fund will complete the necessary steps to ensure the opening balance sheet is IFRS compliant.

Sufficiency of financial reporting expertise

The Fund's corporate reporting team is believed to have adequate knowledge of IFRS including the transition from generally accepted accounting principles to IFRS. The Fund is also employing the assistance of a third party consultant with experience in the transition to IFRS.

SUMMARY OF QUARTERLY INFORMATION (unaudited)

(000's, except per trust unit amounts)

2010	Q1	Q2	Q3	Q4	Total
Revenue	\$ 42,884	\$ 39,258	\$ 42,242	\$ 46,939	\$ 171,323
Income before other expenses (income)	\$ 3,120	\$ 5,070	\$ 3,945	\$ 593	\$ 12,728
Net income	\$ 3,120	\$ 5,070	\$ 3,945	\$ 959	\$ 13,094
Net income					
Per trust unit, basic	\$ 0.15	\$ 0.24	\$ 0.18	\$ 0.04	\$ 0.61
Per trust unit, diluted	\$ 0.15	\$ 0.24	\$ 0.18	\$ 0.04	\$ 0.61

2009	Q1	Q2	Q3	Q4	Total
Revenue	\$ 38,922	\$ 31,038	\$ 24,082	\$ 34,944	\$ 128,986
Income before other expenses (income)	\$ 3,906	\$ 2,409	\$ 1,622	\$ 1,116	\$ 9,053
Net income (loss)	\$ 3,702	\$ 3,227	\$ 1,622	\$ (12,424)	\$ (3,873)
Net income (loss)					
Per trust unit, basic	\$ 0.17	\$ 0.15	\$ 0.08	\$ (0.58)	\$ (0.18)
Per trust unit, diluted	\$ 0.17	\$ 0.15	\$ 0.08	\$ (0.58)	\$ (0.18)

FOURTH QUARTER RESULTS (unaudited)

(000's, except per trust unit and trust unit amounts)

	2010	2009
Revenue	\$ 46,939	\$ 34,944
Cost of sales	41,390	28,573
	5,549	6,371
Selling, general and administrative	3,705	3,756
Interest expense (income)	74	(16)
Amortization	908	1,130
Foreign exchange loss	289	385
Gain on disposal of property, plant and equipment	(20)	-
	4,956	5,255
Income before other expenses	593	1,116
Other expenses (income)		
Goodwill impairment	-	13,540
Net income (loss) before income tax	593	(12,424)
Future income tax recovery	(366)	-
Net income (loss) and comprehensive income (loss)	\$ 959	\$ (12,424)
Earnings (loss) per trust unit, basic	\$ 0.04	\$ (0.58)
Earnings (loss), per trust unit, diluted	\$ 0.04	\$ (0.58)
Weighted average trust units, basic	21,426,036	21,411,036
Weighted average trust units, diluted	21,426,036	21,411,036

DISCUSSION OF FOURTH QUARTER RESULTS

OVERALL RESULTS

Fourth quarter 2010 results reflect the strengthening of business conditions relative to 2009 and continued efforts to control costs. Fourth quarter revenue was \$46.9 million versus \$35.0 million last year. Gross profit declined to \$5.5 million (11.8% of revenue) from \$6.4 million (18.2% of revenue) for 2009. Selling, general and administrative expenses in 2010 were equivalent to 2009. Income before other expenses was \$0.6 million as compared with \$1.1 million last year. Net income before tax was \$0.6 million compared to a loss of \$12.4 million in 2009. The loss in 2009 is a result of the non-cash goodwill impairment recorded in the fourth quarter. The 2010 fourth quarter net income was \$1.0 million (\$0.04 per trust unit) versus a net loss of \$12.4 million for 2009. Fourth quarter property, plant and equipment expenditures were \$0.7 million as compared with \$0.2 million last year. Fourth quarter trust unit distributions paid amounted to \$0.10 per trust unit and totaled \$2.1 million in both 2010 and 2009. A special non-cash distribution of \$0.37 per unit was recorded at yearend; the special distribution allocates the balance of taxable income from the Fund to the unitholders.

UNIVERSAL

Fourth quarter 2010 revenue amounted to \$34.6 million versus \$24.7 million for the fourth quarter 2009.

Universal's gross profit for the fourth quarter decreased to \$2.3 million compared with \$4.1 million last year. The gross profit percentage of the current year's fourth quarter was 6.6% compared with 16.5% in 2009. This significant decrease in gross profit dollars and percentage is caused by competitive pressures and cost overruns on certain projects.

Universal's overhead, comprised of selling, general and administration costs, amounted to \$2.5 million for the quarter compared with \$2.7 for fourth quarter 2009. Overhead, as a percentage of revenue, was 7.2% for the quarter as compared with 10.8% last year. The \$0.2 million decrease reflects the continued efforts to control costs.

The 2010 fourth quarter was a net loss of \$1.0 million versus a fourth quarter net loss of \$13.0 million in 2009. The 2009 results include a \$13.5 million non-cash goodwill impairment charge.

FOREMOST

Revenue for fourth quarter 2010 was \$12.3 million compared with \$10.2 million for the same period in 2009.

The gross profit for the fourth quarter was \$3.3 million compared with \$2.2 million last year. The fourth quarter gross profit percentage was 26.8% of revenue as compared with 21.5% last year. The higher gross profit reflects the impact of higher revenues and changes in product mix.

Overhead expenses were \$1.0 million for the quarter as compared with \$1.1 million from the same period last year and reflect continued cost control efforts.

Foremost generated fourth quarter net income of \$1.7 million versus \$0.5 million last year.

RISKS AND UNCERTAINTIES

The Fund's products are primarily used in the global energy and mining sectors, which have historically experienced rapid and severe shifts in economic activity. These shifts can arise from factors such as significant changes in global market conditions, acceleration or delays in the timing of customer expenditures and changes in government regulations. As the majority of the Fund's revenues are derived from these sectors, its overall results will continue to be impacted by these large economic fluctuations. Two specific areas that could be impacted are total revenues and related gross profits and bad debts associated with customer accounts receivable.

A portion of the Fund's operational business is conducted in foreign markets with the currency typically expressed in U.S. dollars. This includes not only product sales, but also the purchase of a substantial portion of the components required to manufacture those products sold. This dependence on U.S. currency for both sales and purchasing exposes the Fund to risks related to significant fluctuations in currency exchange rates. Gross profit is influenced by fluctuations in exchange rates. A permanent strengthening of the Canadian dollar versus U.S. currency would result in a decline in the margins enjoyed on U.S. dollar denominated sales and could negatively impact future revenues. The value of net monetary assets, consisting of cash, receivables and payables, will also fluctuate significantly based on rapid or large changes in currency exchange rates. Based on current business levels, a 1% change in the Canadian to U.S. dollar currency exchange rate would impact reported earnings by \$0.2 million.

A portion of revenue is earned from foreign customers susceptible to political and economic risks. These risks are mitigated for larger contracts with contractual credit terms that require a considerable cash deposit and/or letter of credit to guarantee payment of contract amounts. Additionally, in some cases, the Export Development Corporation ("EDC") is utilized to insure foreign contracts and receivables. However, if a situation requires reliance on EDC coverage, collection can be postponed significantly and may be less than the total contract price.

Modifications to existing products, product customization and new product development have inherent risks that include:

1. Technical risk that either the product does not perform as desired or that there are unacceptable reliability issues that may render the new product un-merchantable.
2. Competitive risk that the Fund's competitors develop and produce an alternative product that may render the related product obsolete.
3. Supplier risk that components, engines, and other modules procured from third-party vendors, which are used in the assembly of products, do not perform in an acceptable manner thereby increasing product liability.
4. Commercial risk that product development cost over-runs result in a significant financial drain. The Fund maintains a process requiring the review of proposed product initiatives to ensure approval of those projects where the risk/reward trade-off is acceptable.
5. Environmental risk is regularly assessed to ensure that environmental issues do not materially affect the Fund's financial condition or its performance.

The amount of trust unit distributions to unitholders is affected by events which directly impact the net income, generation of cash flows from operating activities and cash flows used by investing activities of the Fund. Accordingly, a decline in revenue or gross profits arising from changing economic cycles, a material bad-debt loss, contract cancellation or product failure or a significant acquisition or investment in property, plant and equipment could impact the timing and amount of trust unit distributions to unitholders.

The Fund may find it necessary to obtain additional debt or equity financing to support ongoing operations, undertake capital expenditures or to complete business acquisitions. There can be no assurance that additional financing will be available to the Fund when needed or on terms acceptable to the Fund. The Fund's inability to raise the necessary financing could limit the Fund's growth and may have an adverse effect on the Fund. Currently the Fund is not and does not expect to use its credit facility. Should the Fund utilize its credit facility, net borrowings of \$3.0 million would impact annual earnings by \$0.1 million. If the entire \$20.0 million credit facility was utilized, a 1% change in interest rates would impact annual earnings by approximately \$0.2 million.

The Fund's business is primarily conducted in western Canada, which continues to experience a shortage of skilled labour and other qualified personnel. The Fund's ability to attract and retain the necessary skilled labour to meet its requirements will continue to be a challenge in the foreseeable future. Accordingly, the Fund's ability to grow, as well as the Fund's overall performance, could be adversely affected if it is unable to attract the necessary skilled labour and other qualified personnel.

The Fund is also impacted by changing government regulation, particularly in the areas of safety. The Fund has established programs to ensure compliance with current safety and regulatory standards. However, the Fund's operations are subject to risks inherent in the manufacturing industry. These risks could expose the Fund to substantial liability for personal injury, loss of life, business interruption, property damage or destruction, pollution and other environmental damages. Although the Fund has obtained insurance against certain of the risks to which it is exposed, such insurance is subject to coverage limits and no assurance can be given that such insurance will be adequate to cover the Fund's liabilities or will be generally available in the future or, if available, that premiums will be commercially justifiable. If a substantial liability were to arise which was not covered by insurance or was in excess of policy limits then the Fund's financial condition or operations could be materially affected.

The Fund's overall financial results may continue to be affected by government initiated changes and subsequent customer reactions to new environmental legislation. These reactions include possible cancellation, delay, revision or relocation of projects, which in turn impact opportunities for Fund revenue generation.

MANAGEMENT'S REPORT

To the Unitholders of Foremost Income Fund

The consolidated financial statements of Foremost Income Fund and all other financial information included in this annual report have been prepared by management. It is management's responsibility to ensure that sound judgment, appropriate accounting principles and methods and reasonable estimates have been used in the preparation of this information. They also ensure that all information presented is consistent.

Management is also responsible for developing and maintaining a system of internal controls over the financial reporting process. Such systems are designed to provide reasonable assurance, on a cost effective basis, that the financial information is relevant and reliable and that the Fund's assets are appropriately accounted for and adequately safeguarded. Management believes the system of internal controls, review procedures and established policies currently in place provide reasonable assurance the financial information is relevant and reliable and that the Fund's assets are appropriately accounted for and safeguarded. Management also believes that the Fund's operations are conducted in conformity with the law and with a high standard of business conduct.

The Board of Trustees is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Committee, which consists of non-management trustees, reviews the financial statements and all other information within the annual report, and recommends them to the Board for approval. The Committee meets with management and external auditors to discuss internal controls, auditing matters and financial reporting issues. External auditors have full and unrestricted access to the Audit Committee. The Committee also recommends a firm of external auditors for appointment by unitholders.

The December 31, 2010 and 2009 consolidated financial statements have been audited in accordance with Canadian generally accepted auditing standards by KPMG, the appointed external auditors.



Pat W. Breen, President
Foremost Income Fund

March 29, 2010
Calgary, Alberta



Douglas J. Rae, Chief Financial Officer
Foremost Income Fund

March 29, 2010
Calgary, Alberta



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INDEPENDENT AUDITORS' REPORT

To the Unitholders of Foremost Income Fund

We have audited the accompanying consolidated financial statements of Foremost Income Fund, which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of income (loss) and comprehensive income (loss) and accumulated earnings, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Foremost Income Fund as at December 31, 2010 and 2009, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
March 29, 2011

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. KPMG Canada provides services to KPMG LLP.

FOREMOST INCOME FUND

CONSOLIDATED BALANCE SHEETS

(000's)

As at December 31,	Notes	2010	2009
Assets			
Current assets			
Cash		\$ 21,766	\$ 37,035
Accounts receivable		37,686	19,444
Inventories	3	41,275	34,563
Prepaid expenses		749	353
		101,476	91,395
Property, plant and equipment	4	46,863	49,555
Future income taxes	10	1,700	19,485
Goodwill	5	3,154	-
Intangibles and other assets	6	1,628	1,431
		\$ 154,821	\$ 161,866
Liabilities and Unitholders' Equity			
Current liabilities			
Accounts payable and accrued liabilities		\$ 16,395	\$ 13,871
Deferred revenue		10,747	6,467
		27,142	20,338
Unitholders' equity			
Unitholders' capital	8		
	8(a)	62,195	62,115
Contributed surplus	8(e)	1,492	1,428
Accumulated earnings		63,992	77,985
		127,679	141,528
		\$ 154,821	\$ 161,866

Commitments and contingent liabilities (Note 16)

Subsequent event (Note 17)

See accompanying notes to consolidated financial statements.

Approved by the Trustees



James T. Grenon
Trustee



Gord M. Wiebe
Trustee

FOREMOST INCOME FUND

CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) AND ACCUMULATED EARNINGS

(000's, except for per trust unit amounts)

Years ended December 31,	Notes	2010	2009
Revenue		\$ 171,323	\$ 128,986
Cost of sales		137,494	97,187
		33,829	31,799
Selling, general and administrative		16,752	17,508
Amortization		4,000	4,559
Interest expense (income)		16	(18)
Foreign exchange loss		363	842
Gain on disposal of property, plant and equipment		(30)	(145)
		21,101	22,746
Income before other expenses (income)		12,728	9,053
Other expenses (income)			
Realized gain on forward exchange contracts		-	(614)
Goodwill impairment	5	-	13,540
		-	12,926
Net income (loss) before income tax		12,728	(3,873)
Future income tax recovery	10	(366)	-
Net income (loss) and comprehensive income (loss)		13,094	(3,873)
Accumulated earnings, beginning of year		77,985	90,422
Future income tax adjustment	10	(18,518)	-
Distributions to unitholders	8	(8,569)	(8,564)
Accumulated earnings, end of year		\$ 63,992	\$ 77,985
Earnings (loss) per trust unit	9		
Basic		\$ 0.61	\$ (0.18)
Diluted		\$ 0.61	\$ -

See accompanying notes to consolidated financial statements.

FOREMOST INCOME FUND

CONSOLIDATED STATEMENTS OF CASH FLOWS

(000's)

Years ended December 31,	Notes	2010	2009
Cash flows provided by (used in):			
Operations:			
Net income (loss) and comprehensive income (loss)		\$ 13,094	\$ (3,873)
Items not involving cash:			
Amortization		4,000	4,559
Gain on disposal of property, plant and equipment		(30)	(145)
Goodwill impairment	5	-	13,540
Future income tax recovery	10	(366)	-
Trust units based compensation	8(d)	82	301
		16,780	14,382
Change in non-cash working capital:			
Accounts receivable		(16,255)	22,674
Inventories		(2,920)	21,885
Prepaid expenses		(380)	833
Accounts payable and accrued liabilities		(503)	(8,613)
Deferred revenue		4,280	(5,982)
		(15,778)	30,797
		1,002	45,179
Investments:			
Purchase of property, plant and equipment		(1,024)	(469)
Business acquisition (net of cash)	5	(3,250)	-
Proceeds from sale of property, plant and equipment		578	392
		(3,696)	(77)
Financing:			
Bank indebtedness repayments	5	(4,068)	(343)
Issuance of trust units	8(a)	62	-
Distributions to unitholders	8(f)	(8,569)	(8,564)
		(12,575)	(8,907)
Net change in cash during the year		(15,269)	36,195
Cash, beginning of year		37,035	840
Cash, end of year		\$ 21,766	\$ 37,035
Supplemental disclosure of cash flow information			
Interest paid (received)		\$ 16	\$ (18)

See accompanying notes to consolidated financial statements.

FOREMOST INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

NOTE 1. DESCRIPTION OF THE FUND

Foremost Income Fund (the "Fund") is an unincorporated, open-ended unit trust established by a Deed of Trust under the laws of the Province of Alberta dated November 12, 2005 and as amended and restated November 26, 2010.

The Fund intends, as described within the Deed of Trust, to distribute all of its taxable income and realized capital gains to the common trust unitholders ("unitholders"). As distributions are paid quarterly, any remaining undistributed taxable income and realized capital gains will be distributed to the unitholders of record as at the fourth quarter distribution record date in December of each fiscal year. Distribution of this taxable income can be in the form of cash or additional common trust units ("trust units"). Under the terms of the Deed of Trust, if taxable income is distributed in the form of additional trust units, there will be an immediate reconsolidation of the number of trust units outstanding. After the consolidation, each unitholder will hold the same number of trust units as held before the distribution of additional trust units.

The Fund's business operations are conducted through two subsidiary limited partnerships: Foremost Universal LP ("Universal") and Foremost Industries LP ("Foremost"). Universal designs, manufactures, sells and services oil treating systems, pressure vessels, fluid storage tanks, gas separators, steam generators and compression equipment. Foremost designs, manufactures, sells and services drilling equipment, heavy all-terrain vehicles, parts and tooling.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) with the following significant accounting policies:

(a) Basis of consolidation

The consolidated financial statements include the accounts of the Fund and all wholly-owned subsidiary entities including the partnerships and their wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated on consolidation. Certain comparative figures have been reclassified in order to conform to current year's presentation.

(b) Use of estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingent assets and liabilities at the dates of the financial statements and the revenues and expenses for the reporting year. Actual results could materially differ from those estimates. Significant areas requiring the use of management estimates include revenue recognition, provisions for doubtful accounts receivable, estimates of net realizable value for inventories, warranty provisions, useful lives of long-lived assets, impairment assessments of long-lived assets and goodwill and future income tax assets and liabilities.

(c) Inventories

Raw materials for manufacturing purposes and repair parts are valued at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis. Net realizable value is the estimated selling price in the ordinary course of business less any estimated costs necessary to make the sale.

Work in progress related to capital equipment contract sales is determined using the percentage-of-completion method and includes material, labour and manufacturing overhead, and is recorded net of related deferred revenue on a contract by contract basis.

Other work in progress and finished goods are valued at the lower of cost and net realizable value. The cost of other work in progress includes raw materials and related portions of labour and manufacturing overhead. Net realizable value is the estimated selling price in the ordinary course of business less any costs of completion and estimated costs necessary to make the sale.

(d) Property, plant and equipment

Property, plant and equipment are recorded at cost. Amortization of buildings, equipment and rental assets is determined using cost less estimated residual value, the estimated useful life of the asset and application of the following methods and rates:

Buildings	–	straight-line	–	25 years
Equipment	–	straight-line	–	3 to 25 years
Rental assets	–	straight-line	–	3 to 7 years

Amortization commences when the asset is entered into commercial use.

Improvements that extend the life of an asset are capitalized; other repairs and maintenance are expensed. When assets are retired or otherwise disposed of, their carrying values and accumulated amortization are removed from the accounts.

(e) Impairment of long-lived assets

The Fund's long-lived assets consist of property, plant, equipment and intangible assets. These assets are reviewed whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is assessed by comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of by sale are reported at the lower of carrying amount or fair value less costs to sell.

(f) Goodwill and intangibles

Goodwill represents the excess of the purchase price over the fair market value of the net identifiable assets acquired. The goodwill balance is not amortized but is assessed for impairment whenever events or changes in circumstances indicate possible impairment. The impairment test is based on management's best estimate of the fair value of the related segments compared to the carrying amounts of those segments. The fair value of the related segments is determined according to an estimate of future discounted cash flows. Impairment in the value of goodwill arises when the carrying amount is greater than the fair value of the related segment. Once determined, the impairment is charged against income in that period.

Intangible assets, consisting of patent rights, licensing and non-compete agreements, are recorded at cost and are amortized over their estimated useful lives, ranging from 5 to 15 years on a straight-line basis. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is assessed by comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets.

(g) Warranty provision

The Fund provides for future warranty costs on a product by product basis at the time the products are sold. These amounts are included in accounts payable and accrued liabilities.

(h) Foreign currency translation

The Fund's foreign currency transactions principally involve the translation of U.S. dollar currency amounts to Canadian dollar currency amounts using the transaction date exchange rate. The Fund's foreign subsidiaries are accounted for as integrated operations. Monetary items have been adjusted to reflect the year end rate of exchange while non-monetary items are translated at historical rates. Gains and losses arising on foreign currency transactions are charged to income.

(i) Financial instruments

A financial instrument, defined as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity, including derivatives, is initially recognized on the balance sheet at fair value and classified into one of the categories below. This classification determines the subsequent basis of measurement and recognition of changes in the carrying amounts for that financial instrument:

- a) Held-to-maturity investments, loans and receivables and other financial liabilities are initially measured at fair

value and subsequently measured at amortized cost using the effective interest rate method. The Fund's accounts receivable have been classified as loans and receivables. The Fund's bank indebtedness and accounts payable and accrued liabilities have been classified as other financial liabilities.

b) Available-for-sale financial assets are measured at fair value. Unrealized gains and losses are included in other comprehensive income until the asset is removed from the balance sheet at which time the gains or losses are then realized and included in net income. The Fund has no available-for-sale assets.

c) Held-for trading financial instruments are measured at fair value. Realized and unrealized gains and losses are included in net income in the period incurred. All derivative financial instruments are classified as held-for-trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. The Fund has classified cash and foreign exchange forward contracts as held-for-trading.

Transaction costs are incremental costs directly related to the acquisition of a financial asset or the issuance of a financial liability. The Fund incurs transaction costs primarily through the annual renewal and issuance of bank indebtedness and charges these costs to net income in the period incurred.

In the normal course of operations, the Fund may utilize derivative financial instruments to manage its foreign exchange risk. The Fund will purchase foreign exchange forward sales contracts to reduce its exposure to certain foreign currency denominated revenues and related accounts receivable balances. The Fund does not utilize derivative financial instruments for trading or speculative purposes and has not designated its financial derivative contracts as effective accounting hedges. Settlement gains or losses on financial derivative contracts are recognized in net earnings at the contract settlement date.

Financial instruments measured at fair value on the balance sheet require classification into one of the following levels of the fair value hierarchy:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs that are observable for the asset or liability, either directly or indirectly other than quoted prices included in Level 1.

Level 3 - Inputs for the asset or liability that are not based on observable market data.

The fair value hierarchy level at which a fair value measurement is categorized is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The Fund has classified its cash as level 1 and any financial derivative contracts as level 2.

(j) Revenue recognition

The Fund uses the percentage-of-completion method in recognizing revenue for capital equipment contract sales currently being manufactured and which are at various stages of completion. Using this method, revenues and related cost of sales are recognized at the end of each period, based on the costs incurred to period end as a percentage of total expected costs.

Revenues from parts sales, tooling and pipe and the sale of other finished goods are recognized on a point of sale basis and when title passes to the customer.

Revenues from the rental of equipment or facilities are recognized in accordance with the terms of the rental agreement on a monthly basis over the contracts specified timeframe.

(k) Trust units based compensation plan

The Fund accounts for the compensation expense for unit options granted to employees, directors and trustees using the fair value method. Under this method, fair value is determined using the Black-Scholes option pricing model which takes in to account, as of the grant date, the exercise price, the expected life of the options, the current price of the underlying trust unit and its expected volatility, expected trust unit distributions and the risk-free interest rate over the expected life of the unit option. The fair value is amortized on a straight line basis over the vesting pe-

riod with a corresponding increase to contributed surplus. Any consideration paid for trust units on exercise of unit options is credited to unitholders' capital, along with the amount previously recognized in contributed surplus.

(l) Income taxes

Under the Income Tax Act (Canada) the Fund and its flow-through subsidiary entities are taxable only on income that is not distributed or distributable to the Unitholders. As the Fund and its flow-through subsidiaries distribute all of their taxable income to the Unitholders, neither the fund nor its flow-through subsidiaries are currently subject to income tax. In 2007 the Canadian government enacted legislation to apply a tax to distributions from Canadian publicly traded income trusts; however with the voluntary delisting by the Fund effective December 15, 2010, the Fund is no longer a publicly traded trust and as a result is no longer subject to a distribution tax beginning in 2011. Therefore, as long as the Fund maintains its current structure and the Fund and its flow-through subsidiaries continue to distribute all of their taxable income, the Fund and its flow-through subsidiaries will not be subject to tax.

The Fund's foreign and Canadian corporate subsidiaries are subject to corporate income taxes based on their taxable incomes determined using each entity's applicable income tax rules and regulations. The future tax asset or liability associated with these assets recorded on the balance sheet at December 31, 2010 utilizes their respective corporate income tax rates. Repatriation of funds from foreign subsidiaries is also subject to applicable income tax rules and regulations.

The Fund's corporate subsidiaries follow the asset and liability method of accounting for income taxes. Under this method, the change in future income tax assets or liabilities is charged to income. Future income tax assets and liabilities are recognized for temporary differences between the accounting and tax basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. These future income tax assets or liabilities are measured using the currently enacted, or substantively enacted, tax rates and laws expected for when these differences reverse. The effect of a change in these income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

(m) Comprehensive income

The Fund is required to report comprehensive income and its components in the financial statements. As the Fund does not have self-sustaining foreign operations, available-for-sale investments or derivatives designated as cash flow hedges, the application of this revised standard results in comprehensive earnings being the same as net income for the period presented. Should the Fund have any other comprehensive income in the future, the cumulative changes in other comprehensive income would be recognized in accumulated other comprehensive income which would be presented in a new category within the unitholders' equity section on the balance sheet.

(n) Per trust unit amounts

Basic earnings per trust unit is calculated using the weighted average number of trust units outstanding during the year. Diluted earnings per trust unit is calculated using the treasury stock method.

(o) Business combinations

Effective January 1, 2010, the Fund early adopted CICA Handbook Section 1582, "Business Combinations". Section 1582, which is substantially converged with IFRS 3, "Business Combinations," establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date and that non-controlling interests would be measured at fair value at the date of acquisition. This standard is applied prospectively to business combinations with acquisition dates on or after January 1, 2010. This new standard was applied to the acquisition of Brahma Compression Ltd. ("Brahma").

(p) Consolidated financial statements

Effective January 1, 2010, the Fund early adopted CICA Handbook Section 1601, "Consolidated Financial Statements", as a result of adopting Section 1582. This section partly replaces the existing Section 1600. Section 1601 carries forward existing Canadian guidance for preparing consolidated financial statements other than non-controlling interests. The adoption of this standard did not have a significant impact on the Fund's consolidated financial statements.

(q) Non-controlling interest

Effective January 1, 2010, the Fund early adopted CICA Handbook Section 1602, "Non-controlling Interest", as a re-

sult of adopting Section 1582. This section partly replaces the existing Section 1600. Section 1602 establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. The adoption of this standard did not have any impact on the Fund's consolidated financial statements.

(r) International financial reporting standards

In February 2008, Canada's Accounting Standards Board ("AcSB") confirmed that Canadian generally accepted accounting principles, as used by publicly accountable enterprises, will converge into International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB") for reporting periods commencing on or after January 1, 2011.

NOTE 3. INVENTORIES

(000's)	2010	2009
Raw materials and parts	\$ 18,494	\$ 17,019
Work in progress	18,773	13,597
Finished goods	4,008	3,947
	\$ 41,275	\$ 34,563

At December 31, 2010, raw materials included approximately \$3.4 million valued at net realizable value (2009 - \$1.6 million) and finished goods included approximately \$2.5 million valued at estimated net realizable value (2009- \$3.0 million).

The amount of inventories charged to cost of sales for the year ended December 31, 2010 was \$127.7 million (2009 - \$89.6 million).

An additional write-down of inventory of \$0.4 million was charged to cost of sales for the year ended December 31, 2010 (2009 - \$0.4 million).

NOTE 4. PROPERTY, PLANT AND EQUIPMENT

(000's)	2010			2009		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Land	\$ 8,786	\$ -	\$ 8,786	\$ 8,786	\$ -	\$ 8,786
Buildings	40,994	9,956	31,038	41,432	8,664	32,968
Equipment	28,703	22,121	6,582	26,534	19,479	7,055
Rental assets	2,409	1,952	457	2,595	1,849	746
	\$ 80,892	\$ 34,029	\$ 46,863	\$ 79,347	\$ 29,992	\$ 49,555

NOTE 5. BUSINESS COMBINATION AND GOODWILL

Effective July 1, 2010, the Fund acquired all of the issued and outstanding shares of Brahma Compression Ltd. ("Brahma") for cash consideration and contingent consideration based upon earnings results for a five year period. Brahma manufactures sub-200 horsepower gas compressors at its location in Calgary, Alberta.

Total purchase price of Brahma was \$3.25 million, and the assumption of \$4.0 million of bank indebtedness which was subsequently repaid by the fund. In addition to the assumption of debt, the Fund acquired current assets, property, plant and equipment, other assets, goodwill, future income tax assets and Brahma's current liabilities. The contingent consideration has not been recorded in the consolidated financial statements as managements' estimate of future cash flows does not indicate a foreseeable recognizable event. The goodwill recorded relates to the expertise and experience of Brahma's workforce, its current product line of sub-200 horsepower compressors, and is not deductible for income tax purposes. Costs incurred for this acquisition are \$0.4 million, which relate mainly to legal fees and due diligence costs paid to a related party. These costs have been included in general and administrative expenses in the consolidated statement of earnings and comprehensive income.

The aggregate consideration given and established fair values of net assets acquired in the acquisition of Brahma described above are as follows:

(000's)	
Current Assets	\$ 5,426
Plant and equipment	732
Long term investments	402
Future income tax assets	367
Goodwill	3,154
Current liabilities	(2,763)
Bank indebtedness assumed	(4,068)
Total	\$ 3,250

For the six months ended December 31, 2010, Brahma has contributed revenue of \$4.4 million and a net loss of \$1.1 million to the consolidated statement of income and comprehensive income. If the acquisition had occurred on January 1, 2010, management estimates that consolidated revenue would have been \$11.0 million, and a consolidated net loss would have been \$0.7 million for the twelve months ended December 31, 2010. These estimates are based on the assumption that the fair value adjustments that arose on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2010.

At December 31, 2010, the Fund conducted its goodwill impairment test and determined that the estimated fair value of goodwill was greater than its carrying value, and that goodwill is fairly stated. At December 31, 2009, the Fund conducted its goodwill impairment test and determined that the carrying value of goodwill was greater than its estimated fair value. Therefore, goodwill was considered impaired and a goodwill impairment charge of \$13,540 was recorded at that date.

NOTE 6. INTANGIBLES AND OTHER ASSETS

(000's)	2010			2009		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Long term investments	\$ 402	\$ -	\$ 402	\$ -	\$ -	\$ -
Patent rights and licenses	1,980	904	1,076	1,980	740	1,240
Non-compete agreements	423	273	150	423	232	191
	\$ 2,805	\$ 1,177	\$ 1,628	\$ 2,403	\$ 972	\$ 1,431

Amortization of patents rights and licenses and the non-compete agreement for the year amounted to \$205,000 (2009 - \$205,000). The Fund determined there was no impairment of intangibles.

NOTE 7. BANK INDEBTEDNESS

The Fund has extended its agreement for a \$20 million uncommitted operating credit facility (2009 - \$20 million committed facility) with a major Canadian chartered bank. This uncommitted operating credit facility bears interest at prime plus 1% or prime plus 0.5% depending on a specific covenant ratio. This facility is secured by a general security agreement and floating charge debenture in the amount of \$75 million covering all assets of the Fund. Under the terms of this facility, the Fund is permitted to make use of bankers' acceptances to borrow at effective interest rates, which are usually lower than those charged under the bank's lines of credit.

At December 31, 2010, the Fund had no outstanding letters of guarantee (2009 - \$0.1 million) related to the performance of specific contracts. These letters of guarantee reduce the amount of operating facility available for use.

NOTE 8. UNITHOLDERS' EQUITY

(a) Unitholders' capital

Authorized:

The Fund is authorized to issue an unlimited number of trust units and an unlimited number of special voting units.

Special voting units may be issued upon Trustee resolution. These special voting units entitle the holders thereof to such number of votes as prescribed by the resolution. These special voting units do not entitle the holder to participate in any distributions from the Fund or beneficial interest in any assets of the Fund.

Issued:

<i>(000's except for trust unit amounts)</i>	2010		2009	
	Number	Stated Value	Number	Stated Value
Unitholders' capital, beginning of year	21,411,036	\$ 62,115	21,411,036	\$ 62,115
Trust units issued on exercise of options	15,000	62	-	-
Contributed surplus on options exercised	-	18	-	-
Unitholders' capital, end of year	21,426,036	\$ 62,195	21,411,036	\$ 62,115

The November 26, 2010 Amended and Restated Deed of Trust limits the unitholders ability to sell, transfer, consign, mortgage, pledge, or dispose of any Trust Units in any manner whatsoever, other than a transfer to a similar beneficiary, without the prior written consent of the Board of Trustee's. Consent from the Board of Trustees will be evidenced by a resolution, and any attempt to do so shall be void without such approval.

(b) Redemption of trust units

Trust units are redeemable in whole or in part at any time on demand by the unitholder. Upon receipt of an executed redemption notice and related trust unit certificate, the unitholder ceases to have any rights with respect to those trust units. The unitholder is entitled to receive a cash redemption price equal to the tangible book value, plus or minus 10%. The cash redemption price is set at the discretion of the Board of Trustees. As a result of the voluntarily delisting, the Fund has increased the monthly Redemption limit to \$1.5 million per month and can be paid in cash or, in certain circumstances, by the issuance of an unsecured promissory note.

The amendment also limited the unitholders ability to sell, transfer, consign, mortgage, pledge, or dispose of any Trust Units in any manner whatsoever, other than a transfer to a similar beneficiary, without the prior written consent of the Board of Trustee's. Consent from the Board of Trustees will be evidenced by a resolution, and any attempt to do so shall be void without such approval.

(c) Trust units based compensation plan

In June, 2008, the unitholders approved an amended and restated unit option plan. The Fund received regulatory approval to reserve 2,123,013 unit options under the amended and restated unit option plan resulting in 1,637,013 unit options available to grant. In August, 2008, 407,500 unit options with an exercise price of \$8.75 were granted leaving 1,229,513 unit options available. For the year ended December 31, 2010, 15,000 unit options were exercised and 182,500 options with an average exercise price of \$11.54 were forfeited leaving 1,524,513 unit options available to grant in the future and 403,500 unit options outstanding at December 31, 2010 (2009 - 601,000).

The exercise price of each option equals the unit price at the date of grant. Options vest at a rate of 20%, on each of the five anniversaries of the date of grant, and expire one year after the fifth anniversary.

A summary of changes in the plan during the years then ended is presented below:

Unit Option Plan	2010		2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Unit options, beginning of year	601,000	\$ 10.44	688,500	\$ 10.29
Granted	-	-	-	-
Exercised	(15,000)	4.12	-	-
Forfeited	(182,500)	11.54	(87,500)	9.19
Unit options, end of year	403,500	10.18	601,000	10.44
Unit options exercisable, end of year	243,000	\$ 11.13	280,000	\$ 9.69

The following table summarizes information about the unit options outstanding:

Year	Exercise Price	Number of options	Options Outstanding		Options Exercisable	
			Remaining contractual life	Exercise price	Number of options	Exercise price
2005	\$ 13.00	136,000	0.9	\$ 13.00	136,000	\$ 13.00
2008	\$ 8.75	267,500	3.6	\$ 8.75	107,000	\$ 8.75
		403,500	2.7	\$ 10.18	243,000	\$ 11.13

(d) Trust units based compensation expense

The 407,500 unit options granted in August 12, 2008 vest over a five year period and expire six years from the date of grant. They are exercisable on a one to one basis at the exercise price of \$8.75 per unit option. The fair value of these unit options was estimated to be \$524,000. For the year ended December 31, 2010, \$28,275 was recorded as compensation expense with an equal amount credited to contributed surplus. The weighted average fair value per option of \$1.29 was calculated using the Black-Scholes model with the assumptions being a risk free rate of 3.5%, an expected option life of six years, a volatility of 61% and a quarterly dividend rate of 2.9%.

The Fund did not grant any options during 2007 and 2006.

During 2005, the Fund granted a total of 300,000 unit options at a weighted average exercise price of \$12.63 per option to employees, officers, directors and trustees. These unit options vest over a five year period and are exercisable on a one to one basis into trust units. The fair value of the unit options granted in 2005 was estimated to be \$1.8 million of which \$52,675 was recorded as part of the compensation expense during 2010 (2009- \$0.3 million) with an equal amount credited to contributed surplus. The weighted average fair value per unit option of \$5.86 was calculated using the Black-Scholes model with the assumptions being a risk free rate of 3.5%, an expected option life of five years, a volatility of 74% and a quarterly dividend rate of 4.5%.

(e) Contributed surplus

Charges and credits to contributed surplus are related to unit options and are as follows:

(000's)	2010	2009
Contributed surplus, beginning of year	\$ 1,428	\$ 1,127
Compensation expense	82	301
Unit options exercised	(18)	-
Contributed surplus, end of year	\$ 1,492	\$ 1,428

(f) Trust unit distributions

The Fund's amended Deed of Trust provides for the payment of quarterly trust unit distributions on the last day of each quarter. A summary of the trust unit distributions is provided below:

(000's, except for per trust unit amounts and units issued)

Record Date	Total per unit	Total amount	Paid in cash
March 17, 2010	\$ 0.10	\$ 2,141	\$ 2,141
June 16, 2010	0.10	2,142	2,142
September 15, 2010	0.10	2,143	2,143
December 15, 2010	0.10	2,143	2,143
December 31, 2010	0.37	7,928	-
	\$ 0.77	\$ 16,497	\$ 8,569
March 14, 2009	\$ 0.10	\$ 2,141	\$ 2,141
June 15, 2009	0.10	2,141	2,141
September 16, 2009	0.10	2,141	2,141
December 16, 2009	0.10	2,141	2,141
	\$ 0.40	\$ 8,564	\$ 8,564

Subsequent to the year end, the Fund declared a March 31, 2011 trust unit distribution of \$0.10 per unit.

(g) Distribution reinvestment plan

Effective March 31, 2008, the Fund's Distribution Reinvestment Plan ("DRIP") was suspended indefinitely. At December 31, 2010, the DRIP remains suspended with 1,099,829 units still reserved for future distribution under the DRIP.

NOTE 9. EARNINGS PER TRUST UNIT

Earnings per trust unit is calculated using the weighted-average number of trust units outstanding. The reconciliation of the denominators used to determine the basic earnings per trust unit and diluted earnings per trust unit is below:

Earnings Per Trust Unit

	2010	2009
Basic weighted-average trust units	21,421,228	21,411,036
Effect of dilutive trust unit options	-	-
Diluted weighted-average trust units	21,421,228	21,411,036

NOTE 10. INCOME TAXES

The Fund is an open-ended unit trust and is subject to tax on any Canadian taxable income not distributed to unitholders. Under terms of the Deed of Trust, all Canadian taxable income of the Fund is to be allocated to unitholders and accordingly, except for taxes of the underlying corporate subsidiaries, the Fund has no Canadian tax expense.

As a result of the voluntary delisting by the Fund effective December 15, 2010, the Fund is no longer a SIFT Trust and is therefore no longer subject to the SIFT tax legislation that passed in Bill C-52 in June 2007. The SIFT legislation otherwise provided that the Fund would be subject to a tax on distributions. Under the new status for the non-listed Fund, distributions remain deductible and the SIFT distribution tax does not apply. Management intends that the Fund will distribute taxable income to the unitholders to eliminate any taxable income in the Fund. This results in an effective tax rate of zero for the Fund's flow through entities. Accordingly the Fund has reversed the future income tax asset that was booked upon the enactment of the SIFT rates in 2007. For the change in shareholder status, this reversal of \$18.5 million has been recorded through accumulated earnings during 2010.

Future income tax assets and liabilities carried by taxable subsidiaries remain recognized using enacted rates of 25% - 28%. The components of the net future income tax asset (liability) at December 31 are:

(000's)	2010	2009
Future income tax assets:		
Property, plant and equipment	\$ 750	\$ 3,945
Goodwill and intangibles	19	22,708
Loss carryforwards	2,831	2,264
Valuation allowance	(1,819)	(9,325)
Future income tax liability		
Property, plant and equipment	(81)	(107)
	\$ 1,700	\$ 19,485

The following is a reconciliation of income taxes, calculated at the combined federal and provincial income tax rate, to the income tax provision included in the consolidated statements of income and comprehensive income.

(000's)	2010	2009
(Loss)/ income from continuing operations before taxes	\$ 12,728	\$ (3,873)
Statutory rate	28.0%	29.0%
Expected income tax (recovery) provision	\$ 3,564	\$ (1,123)
Add (deduct):		
Income distributed to unitholders	(4,617)	(2,484)
Differences in effective tax rates applied to timing differences of partnerships	1,267	(1,252)
Under (over) provided in prior years	(261)	-
Adjustment to timing differences	(37)	-
Change in valuation allowance	-	4,848
Non-deductible portion of gains	-	(11)
Expenses not deductible for tax and other adjustments	(282)	22
Future income taxes expense (reduction)	\$ (366)	\$ -

Universal, through its corporate subsidiaries, has non-capital loss carry forwards of \$3.6 million (2009 - \$1.8 million). These loss carry-forwards are available to reduce taxable income in future years and expire in years ranging from 2014 to 2030.

Foremost, through one of its U.S. subsidiaries, has significant U.S. non-capital loss carry-forwards. During 2010, one of its subsidiaries has taxable income of \$0.3 million as compared with taxable loss of \$0.1 million in 2009. The U.S. subsidiary has approximately \$5.9 million (2009 - \$6.2 million) of non-capital loss carry-forwards that may be applied against future taxable income. The Fund has provided a full valuation allowance against the value of the U.S. subsidiaries losses. These losses expire in varying amounts from 2016 to 2030.

NOTE 11. FINANCIAL INSTRUMENTS

(a) Fair values

The following summarizes the significant methods and assumptions used in estimating fair values of financial instruments. For accounts receivable, accounts payable and accrued liabilities, the carrying amounts at December 31, 2010 and December 31, 2009 approximate fair value due to the near term maturity of these financial instruments. Cash and derivative instruments are recorded in the balance sheet at fair value.

(b) Risk management activities

The Fund is exposed to a number of financial risks in the normal course of operations. The Fund's major financial risks consist of credit risk associated with significant levels of revenues attributable to a limited number of customers and collection of accounts receivable balances, market risks due to fluctuations in interest rates and foreign currency exchange rates, and liquidity risk from material changes in the timing of operating, investing and financing cash flows. The nature of the financial risks and the Fund's strategy for managing these risks is outlined below and has not materially changed from the prior year.

(c) Credit risk

Credit risk is defined as the potential for financial loss by the Fund if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Fund's principal assets subject to credit risk are cash and accounts receivable. The Fund manages the credit risk associated with its cash by holding these assets with reputable financial institutions. The Fund has determined the maximum potential loss for cash equals the amount of cash reported on the balance sheet at December 31, 2010 and that the risk of loss is low. The two principal factors associated with accounts receivable credit risk and the Fund's related risk management practices are outlined below:

- a) Within any financial period, the Fund can have significant exposure to an individual customer because of a large capital equipment sales contract. For the year ended December 31, 2010, the Fund in aggregate had two customers who accounted for 21.7% of consolidated revenues compared with one customer who accounted for 15.3% of 2009. Within the Universal segment, two customers each accounted for more than 28.3% of 2010 segment revenues whereas two customers accounted for 10.0% of 2009 segment revenues. Within the Foremost segment, no customer accounted for more than 10% of segment revenues in either of 2010 or 2009. The Fund manages this risk primarily through the diversity of products and services sold and by maintaining a

large active international and reputable customer base.

b) Credit risk also arises from the sale of products to customers, primarily in the oil and gas industry, with relatively long manufacturing times or with payment terms which result in accounts receivable. The Fund uses a variety of steps to manage this exposure. Up front cash payments and confirmed letters of credit are principal methods of payment for material international projects. Capital equipment sales contracts normally require initial cash deposits and subsequent progress payments with final payment received prior to delivery. For parts, service or other open credit sales, the Fund utilizes export insurance and routinely reviews third party credit information, customer credit limits, collections patterns and historical allowances for doubtful accounts.

The Fund believes the maximum potential loss for accounts receivable equals the amount reported on the December 31, 2010 balance sheet. The Company mitigates its credit risk by entering into contracts with established counterparties that have strong credit ratings and reviewing its exposure to individual counterparties on a regular basis. The Fund has determined the current level of credit risk associated with accounts receivable is represented by its allowance for doubtful accounts at December 31, 2010. The estimated allowance for doubtful accounts at December 31, 2010 was \$0.4 million (2009 - \$0.7 million). At December 31, 2010 \$5.8 million of accounts receivable were more than 60 days past due as compared with \$2.9 million as at December 31, 2009. Bad debt recovery for the year ended December 31, 2010 amounted to \$0.2 million (2009 - \$0.2 million bad debt expense).

(d) Foreign currency risk

A significant portion of the Fund's revenues, expenses, accounts receivable and accounts payable are denominated in U.S. dollars, and consequently the Fund is subject to the risk of fluctuating exchange rates. Using 2010 U.S. dollar based revenues and taking into account its current U.S. dollar net asset position, a 1% increase or decrease in the Canadian dollar to U.S. dollar relationship would impact earnings by \$0.2 million

(e) Interest rate risk

The Fund's short-term bank borrowings are subject to floating interest rates. This floating rate debt is subject to interest rate risk, as the required cash flow to service the debt will fluctuate as a result of changes in market rates. The Fund has not used any interest rate swap contracts to manage this risk. Currently the Fund has no short-term bank borrowing and is therefore not subject to significant interest rate risk. If the Fund were to borrow the maximum amount of its current operating facility of \$20.0 million, each 1% increase or decrease in interest rates would increase or decrease interest expense by approximately \$0.2 million.

(f) Liquidity risk

Liquidity risk is the risk that the Fund will not be able to meet its financial obligations as they become due. The Fund's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring acceptable losses or risking damage to the Fund's name. The Fund manages its liquidity risk by continually monitoring forecast and actual cash requirements for operations, capital expenditures and trust unit distributions. The Fund normally uses its cash flow from operating activities and drawings on its short-term bank credit facility to fund current financial obligations. Requirements for major capital expenditures or business acquisitions may result in the use of some combination of additional long-term debt and equity. Based on the debt- to- equity ratio as at December 31, 2010 and current cash forecasts, liquidity risk is considered low. The balance of accounts payable and accrued liabilities are all due within one year. Subject to the annual renewal of the credit facility, bank indebtedness is considered repayable within one year.

NOTE 12. RELATED PARTY TRANSACTIONS

The Fund utilizes the consulting services of a company owned and managed by a trustee of the Fund in normal course operations. The consulting services consist of legal and professional advice and investor relations. As necessary, the Fund utilizes due diligence and business acquisition services from the same company. The consulting, due diligence and business acquisition services are measured at the exchange amount, being the amounts agreed to by all parties. For the year ended December 31, 2010 the total amount invoiced for consulting services was \$915,775 (2009 - \$643,000). Included in the total amount for 2010 is \$420,000 relating to due diligence or business acquisition services for the Brahma acquisition (note 5) compared to none in 2009. There were no unpaid balances at December 31, 2010 or December 31, 2009.

NOTE 13. BUSINESS SEGMENTS

(000's)	Universal		Foremost		Total	
	2010	2009	2010	2009	2010	2009
Revenue	130,990	88,783	40,333	40,203	171,323	128,986
Interest expense (income)	9	(10)	7	(8)	16	(18)
Amortization	3,137	3,463	863	1,096	4,000	4,559
Income before other expenses (income)	7,237	4,029	5,491	5,024	12,728	9,053
Net income (loss) before income tax	7,237	(9,143)	5,491	5,270	12,728	(3,873)
Net income (loss) and comprehensive income (loss)	7,690	(9,143)	5,404	5,270	13,094	(3,873)
Property, plant and equipment	37,195	38,996	9,668	10,559	46,863	49,555
Goodwill, intangibles and other assets	4,782	1,431	-	-	4,782	1,431
Total assets	111,057	103,320	43,764	58,546	154,821	161,866
Property, plant and equipment expenditures	908	384	116	85	1,024	469

The Fund has two reportable segments, Universal and Foremost. Universal designs, manufactures, sells and services oil treating systems, pressure vessels, fluid storage tanks, gas separators, steam generators and compression equipment. Foremost designs, manufactures, sells and services: drilling equipment, heavy all-terrain vehicles and related parts and tooling.

Universal's results are shown net of inter-segment sales (2010 - \$5.5 million, 2009 - \$4.9 million).

NOTE 14. GEOGRAPHIC SEGMENTS

(000's)	2010		2009	
Canada	\$ 141,311	\$ 100,077	\$ 51,126	\$ 50,508
United States	12,504	7,980	476	476
International	17,508	20,929	9	2
Total	\$ 171,323	\$ 128,986	\$ 51,611	\$ 50,986

Revenue by geographic segment is based upon the location of the customer's permanent establishment. Property, plant and equipment, goodwill and intangibles are allocated to the respective geographic segments using the geographic location of each operating business. All goodwill and intangibles are located in Canada.

NOTE 15. MANAGEMENT OF CAPITAL

The Fund's objectives when managing capital are to safeguard the Fund's ability to continue as a going concern in order to provide returns to unitholders' and benefits for other stakeholders, maintain financial liquidity and flexibility in order to fulfill existing financial obligations, support capital requirements of current operations, pay trust unit distributions in cash and provide capital for accretive acquisitions.

In the definition of capital, the Fund includes unitholders' capital, contributed surplus, accumulated earnings, long-term debt (including any current portion), bank indebtedness, cash and cash equivalents and undrawn credit facilities.

The Fund's financial strategy is designed to maintain a flexible capital structure consistent with the objectives stated above and to respond to growth opportunities or changes in economic conditions. In order to maintain or adjust its capital structure, the Fund may issue new trust units, redeem trust units, repay outstanding debt, issue new debt, re-finance existing debt, acquire or dispose of assets, adjust trust unit distribution amounts or the form of payment, or adjust the amount of cash and short-term investment balances.

The Fund monitors its capital using the following financial metrics calculated on a quarterly basis:

	2010	2009
Working capital ratio	3.74:1	4.49:1
Debt-to-equity ratio	0.21:1	0.14:1

The Fund calculates its working capital ratio by dividing the total of all current assets by the total of all current liabilities. The Fund calculates its debt-to-equity ratio by dividing total liabilities (current and long-term) by total unitholders' equity.

The Fund is not subject to any externally imposed capital requirements. The Fund is subject to certain covenants under its credit facility and is compliant at December 31, 2010.

NOTE 16. COMMITMENTS AND CONTINGENT LIABILITIES

At December 31, 2010, the Fund had no outstanding letters of guarantee supporting specific performance obligations and contract bids (\$0.1 million - 2009) and no commitments for capital expenditures.

The Fund has operating lease commitments for office space and service equipment, none of which, individually or in aggregate, are material.

The Fund is involved in various legal claims arising in the ordinary course of business. It is management's opinion that these claims, once settled or otherwise determined, are not expected to materially affect the Fund's financial position. Any costs to the Fund arising from these claims will be charged to income in the year in which they occur.

NOTE 17. SUBSEQUENT EVENT

Subsequent to year end 432,682 trust units were tendered for redemption by the Fund. The redemption of the trust units resulted in cash payments of \$2.8 million.