

## Foremost Income Fund Management's Discussion and Analysis

Management's Discussion and Analysis ("MD&A") of Foremost Income Fund, hereinafter referred to as the Fund, for the three and six months ended June 30, 2010, should be read in conjunction with the Fund's Annual Report for the year ended December 31, 2009, as well as the Management's Discussion and Analysis in the Fund's 2009 Annual Report and the Fund's 2009 Annual Information Form ("AIF"). The interim financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with Canadian generally accepted accounting principles. The MD&A has been prepared taking into consideration information to August 11, 2010. Additional information relating to the Fund may be found at [www.sedar.com](http://www.sedar.com).

*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 which are not defined under Canadian generally accepted accounting principles, 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 flows from operating activities or net income or comprehensive income, nor should they be viewed as an alternative to cash flows from operating activities, net income or comprehensive income or other measures of financial performance calculated in accordance with Canadian generally accepted accounting principles. Furthermore, 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** is defined as net income from operations adjusted for items not involving cash and before changes in non-cash working capital. This amount is considered meaningful as it is used to identify the Fund's ability to finance from operations its working capital requirements, planned capital expenditures and trust unit distributions.

**Funds flow per trust unit** is 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.

**Book value per trust unit** is 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 changes in unitholders' equity on a per-unit basis for comparative periods.

### OVERVIEW

The Fund is an unincorporated, open-end unit trust and conducts its business through Foremost Universal LP ("Universal") and Foremost Industries LP ("Foremost"), deriving its net income from both Universal and Foremost.

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

- Universal Industries, a manufacturer of oil treating systems, shop and field storage tanks
- Stettler Universal Limited Partnership ("Stettler"), a gas separator manufacturer
- Corlac Industries ("Corlac"), Peace Land Fabricating and Supply Ltd. ("Peace Land") and De-In Industries Ltd. ("De-In"), all shop tank manufacturers
- Maloney Industries ("Maloney"), a manufacturer of oil and gas process treating equipment
- Force Compression Systems ("Force"), a sales and service provider for natural gas compression equipment.

Subsequent to the end of Q2-2010, the Fund, through Universal, acquired all of the issued and outstanding shares of Brahma Compression Ltd. ("Brahma"). Brahma designs and manufactures sub-200 horsepower compressors. Brahma's head office and 32,000 square foot manufacturing facility are located in Calgary, Alberta. Acquisition costs, to be financed by the Fund's current cash position, will be in the range of approximately \$8.7 million including the retirement of debt and is subject to closing adjustments. There is also contingent consideration based on future earnings. It is expected that Brahma will generate between \$10 million and \$25 million of incremental revenues on an annualized basis as it becomes well integrated into the Fund's existing operations.

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

- Foremost Industries, a manufacturer of custom equipment used for the oil and gas, construction, waterwell and mining industries
- Foremost Drilling Company, Inc., a vendor of Foremost Industries custom equipment to U.S. customers.

Headquartered in Calgary, the Fund's combined businesses, predominantly based in western Canada, currently employ approximately 550 people. Trust units of the Fund trade on the Toronto Stock Exchange under the symbol "**FMO.UN**".

**OVERALL RESULTS**

Q2-2010 operating results reflect stronger than anticipated revenues, lower gross profit margins due to competitive pressures and the fluctuating Canadian dollar and reduced selling, general and administrative expenses. Compared with Q2-2009, revenues for Q2-2010 increased 26.8% and the gross profit percentage declined 3.2%. Selling, general and administrative expenses decreased 19.2% reflecting the ongoing benefits of 2009 cost cutting initiatives. As a result, the Q2-2010 net income was \$5.1 million versus \$3.2 million for Q2-2009.

Q2-2010 consolidated revenues were \$39.3 million compared with \$31.0 million in Q2-2009. Consolidated Q2-2010 gross profit was \$10.4 million (26.4%) versus \$9.2 million (29.6%) for Q2-2009. The Q2-2010 \$5.1 million net income resulted in basic earnings per trust unit of \$0.23 as compared with \$3.2 million and \$0.15 per trust unit for Q2-2009. Funds flow from operations was \$6.1 million for Q2-2010 versus \$4.4 million for Q2-2009 due to the higher net income. Changes in Q2-2010 non-cash working capital items used \$4.4 million of cash versus the generation of \$21.8 million in cash during Q2-2009. Q2-2010 and Q2-2009 capital expenditures to maintain productive capacity were \$0.1 million. Q2-2010 and Q2-2009 trust unit distributions were \$2.1 million or \$0.10 per trust unit. The combination of operating, investing and financing activities resulted in virtually no increase in cash for Q2-2010 versus a \$24.1 million increase in Q2-2009.

YTD-2010 consolidated revenues were \$82.1 million compared with \$70.0 million in YTD-2009. Consolidated YTD-2010 gross profit was \$18.7 million (22.8%) versus \$18.7 million (26.7%) for YTD-2009. The YTD-2010 \$8.2 million net income resulted in basic earnings per trust unit of \$0.38 as compared with \$6.9 million and \$0.32 per trust unit for YTD-2009. Funds flow from operations was \$10.3 million for YTD-2010 versus \$9.2 million for YTD-2009 due to the higher net income. Changes in YTD-2010 non-cash working capital items used \$9.7 million of cash versus the generation of \$27.7 million in cash during YTD-2009. YTD-2010 and YTD-2009 capital expenditures to maintain productive capacity were \$0.2 million. YTD-2010 and YTD-2009 trust unit distributions were \$4.3 million or \$0.20 per trust unit. The combination of operating, investing and financing activities resulted in a YTD-2010 decrease in cash of \$3.2 million versus a \$32.5 million increase in YTD-2009. The Fund had \$33.8 million in cash at June 30, 2010 as compared with \$37.0 million at December 31, 2009 and \$33.3 million at June 30, 2009. The Fund had no short-term borrowings or long-term debt at any of these points in time.

**OUTLOOK FOR 2010**

As discussed in the 2009 annual report, Q2-2010 financial results reflect the Fund's expectations for challenging market conditions and its response to them. The Fund believes these conditions will continue to impact operating margins throughout the remainder of fiscal 2010. Accordingly, the Fund will maintain its focus on cost control, operational efficiency, critical capital expenditures and trust unit distributions to maintain its balance sheet strength and cash position. The Fund continues to closely manage discretionary operating costs and manpower levels. These efforts are necessary to ensure the Fund can respond to any improvement in its core markets and continue the pursuit of additional accretive acquisitions.

Subsequent to the end of Q2-2010, the Fund completed the acquisition of Brahma. The Fund expects a modest increase in revenues and net income from this acquisition for fiscal 2010 as it undertakes to integrate the acquired operations.

**SEASONALITY**

Historically, the Fund's financial results reflect the seasonal operations of the oil and gas markets. Generally, it means that revenues and net earnings reported in the first two quarters are lower than the third and fourth quarters. However, this trend can be offset by significant shifts in economic activity in the global energy and mining industries or by the impact of business acquisitions or divestitures. Based on the current outlook, this pattern may not occur in fiscal 2010.

**RESULTS OF OPERATIONS****Universal**

Universal's Q2-2010 revenues were \$28.4 million compared with \$17.9 million in Q2-2009. Q2-2010 net income was \$3.2 million compared with \$1.0 million in Q2-2009. Q2-2010 gross profit was \$6.9 million (24.3% of revenues) versus \$5.0 million (28.1% of revenues) in Q2-2009. Q2-2010 selling, general and administrative expenses were \$2.9 million (10.4 % of revenues) as compared with \$3.3 million (18.4% of revenues) in Q2-2009. The Q2-2010 revenue and gross profit dollar increase arose principally from higher vessel, field tank and shop tank revenues. The lower gross profit percentage reflects the impact of highly competitive market conditions. The decrease in selling, general and administrative expenses reflects benefits from fiscal 2009 cost cutting initiatives.

Universal's YTD-2010 revenues were \$62.9 million compared with \$44.3 million in YTD-2009. YTD-2010 net income was \$5.6 million compared with \$2.3 million for YTD-2009. YTD-2010 gross profit was \$12.9 million (20.6% of revenues) versus \$10.4 million (23.5% of revenues) in YTD-2009. YTD-2010 selling, general and administrative expenses were \$5.8 million as compared with \$6.6 million for YTD-2009. The YTD-2010 revenue and gross profit dollar increase arose principally from higher vessel, field tank and shop tank revenues. The lower gross profit percentage reflects the impact of highly competitive market conditions. The decrease in selling, general and administrative expenses reflects ongoing benefits from fiscal 2009 cost cutting initiatives.

**Foremost**

The Foremost group Q2-2010 revenues were \$10.9 million as compared with \$13.2 million for Q2-2009. Q2-2010 net income was \$1.9 million versus \$2.2 million for Q2-2009. Q2-2010 gross profit was \$3.5 million (31.9% of revenues) versus \$4.2 million (31.6% of revenues) for Q2-2009. Q2-2010 selling, general and administrative expenses were \$1.5 million (13.6% of revenues) versus \$2.2 million (16.7% of revenues) for Q2-2009. The revenue decrease reflects is principally due to lower vehicle sales. The Q2-2010 marginal increase in gross profit percentage is principally due to select higher margin sales. The decrease in selling, general and administrative expenses reflects the ongoing benefits of 2009 cost reduction initiatives.

The Foremost group YTD-2010 revenues were \$19.2 million as compared with \$25.7 million for YTD-2009. YTD-2010 net income was \$2.6 million versus \$4.7 million for YTD-2009. YTD-2010 gross profit was \$5.8 million (30.2% of revenues) versus \$8.3 million (32.2% of revenues) for YTD-2009. YTD-2010 selling, general and administrative expenses were \$2.7 million (13.4% of revenues) versus \$3.5 million (13.7% of revenues) for YTD-2009. The revenue decrease reflects lower vehicle sales and the impact of the fluctuating Canadian dollar to U.S. dollar

exchange rate on U.S. dollar denominated revenues. The YTD-2010 decrease in gross profit percentage is due to the combination of lower margin product revenues and the impact of fluctuating Canadian to U.S. dollar exchange rates. The decrease in selling, general and administrative expenses reflects the ongoing benefits of 2009 cost reduction initiatives.

#### **SELLING, GENERAL AND ADMINISTRATIVE**

The Funds consolidated Q2-2010 selling, general and administrative expenses amounted to \$4.4 million (11.3% of revenues) compared with \$5.5 million (17.7% of revenues) for Q2-2009. The Funds consolidated YTD-2010 selling, general and administrative expenses amounted to \$8.5 million (10.4% of revenues) compared with \$10.1 million (14.4% of revenues) for YTD-2009. The Q2-2010 \$1.1 million decrease in relation to Q2-2009 and YTD-2010 \$1.5 million decrease relative to YTD-2009 primarily reflects ongoing benefits from fiscal 2009 cost cutting initiatives in all functional areas. The Fund expects Q3-2010 selling, general and administrative expenses to increase over Q2-2010 as a result of the acquisition of Brahma during Q3-2010.

#### **INTEREST**

Q2-2010 net interest income was \$25,000 (Q2-2009 - \$nil). YTD-2010 net interest income was \$45,000 versus interest expense of \$5,000 for YTD-2009. The Fund continued to earn interest income on its cash balances and did not incur interest expense as it did not utilize its operating loan during Q2-2010 or YTD-2010. At June 30, 2010, the Fund has no interest rate swap contracts or similar instruments to manage interest rate risk. The Fund expects to report lower net interest income for Q3-2010 due to the utilization of cash in the acquisition of Brahma during Q3-2010.

#### **AMORTIZATION**

Q2-2010 amortization was \$1.0 million and \$1.2 million for Q2-2009. YTD-2010 amortization amounted to \$2.1 million as compared with \$2.3 million for YTD-2009. Q3-2010 amortization is expected to increase relative to Q2-2010 due to the acquisition of Brahma in Q3-2010.

#### **FOREIGN EXCHANGE**

The Fund reported a Q2-2010 foreign exchange gain of \$0.1 million versus a Q2-2009 loss of \$0.2 million. YTD-2010 resulted in virtually no gain or loss as compared with \$0.2 million loss for YTD-2009. At any time, the Fund generally holds a net U.S. dollar working capital position. The Q2-2010 exchange gain 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 June 30, 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 June 2009. This foreign exchange forward contract was accounted for on a marked to market basis with gains or losses arising from the comparison of the contract rate with the foreign exchange rate at December 31, 2008 and March 31, 2009 and closing date being recorded. As at June 30, 2009, there was a Q2-2009 gain of \$0.8 million and YTD-2009 gain of \$0.6 million gain recognized on this contract. YTD-2010 and between June 30, 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 income tax liability for the Fund.

On June 22, 2007, the Canadian government substantially enacted legislation which imposes a tax on certain distributions from publicly traded specified income flow-through trusts ("SIFT") entities effective January 1, 2011 or earlier if the Fund exceeds certain permitted growth guidelines established by the Canadian Department of Finance. The Fund remains subject to these tax measures. These measures result in the recognition of the estimated future income tax assets or liabilities based on the estimated timing differences (differences between the accounting basis and the tax basis of the respective assets and liabilities) at December 31, 2010. These differences are measured using the substantively enacted rates and laws expected to be applicable at that date. These differences are measured on a quarterly basis with any changes charged to the income statement when determined. The current future income tax asset and liabilities have been determined using tax rates ranging from 25% to 26.5%. The estimated \$19.5 million future income tax asset at June 30, 2010 remains unchanged from December 31, 2009.

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, operating results, changes to tax deduction pool balances and trust unit distributions. The future income asset will be recalculated quarterly and differences in the actual realization of this future income tax asset may be material.

The Canadian government amended the Income Tax Act (Canada) to permit the "conversion" of income trusts into corporations. The Fund is continuing to assess the impact of these proposed amendments.

#### **CASH LIQUIDITY AND KEY FINANCIAL RATIOS**

Q2-2010 funds flow from operations amounted to \$6.1 million versus \$4.4 million for Q2-2009. The increase is primarily a result of the higher level of income from operations. Changes in non-cash working capital, comprised of changes in accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities and deferred revenue balances relative to March 31, 2010, resulted in the use of \$4.4 million of cash as compared with the generation of \$21.8 million of cash during Q2-2009. These changes reflect the impact of increased business activity during Q2-2010. As a result, cash flows provided by operations amounted to \$1.7 million for Q2-2010 versus the \$26.2 million generated in Q2-2009.

YTD-2010 funds flow from operations amounted to \$10.3 million versus \$9.2 million for Q2-2009. The increase is primarily a result of the higher level of income from operations. Changes in non-cash working capital, comprised of changes in accounts receivable, inventories,

prepaid expenses, accounts payable and accrued liabilities and deferred revenue balances relative to December 31, 2009, resulted in the use of \$9.7 million of cash for YTD-2010 as compared with the generation of \$27.7 million of cash YTD-2009. These changes reflect the impact of increased business activity during YTD-2010. As a result, cash flows provided by operations amounted to \$0.7 million for YTD-2010 versus the generation of \$36.9 million for YTD-2009.

Q2-2010 and Q2-2009 investing activities resulted in capital expenditures of approximately \$0.1 million. YTD-2010 and YTD-2009 capital expenditures were each approximately \$0.2 million. The Q2-2010 capital expenditures were to maintain productive capacity necessary for current revenue requirements. The Fund's fiscal 2010 capital expenditure program remains centered on maintaining anticipated productive capacity is expected to not exceed the original estimate of \$0.8 million.

Q2-2010 financing activities were comprised of a \$2.1 million trust unit distribution (\$0.10 per trust unit) and the issuance of \$0.1 million of trust units pursuant to the exercise of unit options. Q2-2009 financing activities consisted of the \$2.1 million trust unit distribution (\$0.10 per trust unit). YTD-2010 financing activities reflect the Q2-2010 issuance of the \$0.1 million of trust units and cumulative trust unit distributions of \$4.3 million. YTD-2009 financing activities were comprised of a \$0.3 million repayment of bank indebtedness and \$4.3 million of trust unit distributions.

The Q2-2010 trust unit distribution was partially funded from cash flows from operating activities with the remainder paid from the cash balances held by the Fund whereas in Q2-2009, cash flows from continuing operations were used to fund Q2-2009 trust unit distributions. YTD-2010 trust unit distributions have been primarily funded by existing cash balances whereas YTD-2009 trust unit distributions were funded from cash flows from operating activities.

Net working capital at June 30, 2010 was \$77.4 million compared to \$71.1 million at December 31, 2009 and \$70.4 million at June 30, 2009. The Fund's June 30, 2010 working capital ratio increased and debt-to-equity ratio improved slightly in relation to December 31, 2009. Relative to June 30, 2009, the working capital ratio improved significantly while the debt-to-equity ratio increased slightly. The June 30, 2010 working capital ratio was 4.57:1 versus 4.49:1 at December 31, 2009 and 4.27:1 at June 30, 2009. The debt-to-equity ratio was 0.15:1 at June 30, 2010 compared with 0.14:1 at December 31, 2009, and 0.14:1 at June 30, 2009.

Book value per trust unit was \$6.79 at June 30, 2010, \$6.61 at December 31, 2009 and \$7.31 at June 30, 2009. The decline relative to June 30, 2009 is due to the Q4-2009 recognition of the \$13.5 million (\$0.63 per trust unit) goodwill impairment.

The Fund has no short-term or long-term debt and continues to use cash flow from operating activities, current cash balances and if necessary its operating facility to support non-cash working capital, investing and financing requirements. The Fund expects Q3-2010 cash flows from operations and its cash balances will fund anticipated Q3-2010 working capital needs (including the impact of the acquisition of Brahma), planned capital expenditures and forecast trust unit distributions. The Fund does not expect to use its operating facility to fund any of its operational requirements for the remainder of fiscal 2010.

The Fund has not utilized its \$20.0 million credit facility during YTD-2010. The Fund's bank credit facility contains certain debt covenants. The Fund is well within these covenants at June 30, 2010 and expects to remain well within these covenants throughout the rest of fiscal 2010.

Subsequent to the end of Q2-2010, the Fund renewed its uncommitted \$20.0 million credit facility. The renewal is under the same terms and conditions except for the rate of interest which is reduced, subject to a specific debt covenant, to bank prime +.25% or bank prime +.5%.

#### **TRUST UNIT DISTRIBUTIONS**

The Fund declares trust unit distributions to unitholders on a quarterly basis. The amount of trust unit distributions is generally determined by taking cash flows from operating activities and adjusting for the costs of property, plant and equipment upgrades and expansion, business acquisitions and the effect of changes in general business conditions on working capital. Taking into consideration the Fund's current market conditions, forecast earnings and related cash flows, the Q2-2010 trust unit distribution remained at \$0.10 per trust unit. This resulted in total cash payments of \$2.1 million for Q2-2010 and Q2-2009. YTD-2010 and YTD-2009 trust unit distributions each cumulatively total \$4.3 million or \$0.20 per trust unit. In order to manage the impact of the expected continuation of uncertain business conditions and the potential impact on cash flows from operating activities, the Fund will continue to review its trust unit distributions on a quarter by quarter basis. Consequently, the amount of quarterly trust unit distributions may vary significantly from quarter to quarter during fiscal 2010. The amount of trust unit distributions are also expected to continue to vary over time depending on anticipated working capital requirements, property, plant and equipment expenditures, acquisition opportunities and changing business conditions. Using the current 21,426,036 trust units outstanding and the Q2-2010 \$0.10 per trust unit distribution rate, the Fund would require approximately \$2.1 million in cash for future quarterly trust unit distributions.

Cash flows from operating activities and cash balances are used to fund the cash portion of trust unit distributions with any shortfall financed with short-term bank indebtedness. A shortfall generally results from timing differences arising from the Fund's investment in non-cash working capital. Subsequent period cash flows generated from continuing operating activities are expected to repay this bank indebtedness.

#### **UNITHOLDERS' CAPITAL**

Unitholders' capital at June 30, 2010 was \$62.2 million, up \$0.1 million over December 31, 2009 and June 30, 2009. Fifteen thousand trust unit options were issued during Q2-2010 as a result of the exercise of 15,000 unit options at \$4.12 per unit and total proceeds of \$61,800. During Q2-2010, 5,000 unit options with an exercise price of \$13.00 per trust unit and 7,500 unit options with an exercise price of \$8.75 per trust unit were forfeited. As at June 30, 2010 there were 21,426,036 issued and outstanding trust units and 573,500 unit options outstanding. As of the date of this MD&A there were 21,426,036 trust units issued and outstanding and 573,500 unit options outstanding.

**UNITHOLDERS' EQUITY**

Unitholders' equity, comprised of unitholders' capital, contributed surplus and accumulated earnings was \$145.5 million at June 30, 2010 versus \$141.5 million at December 31, 2009 and \$156.5 million at June 30, 2009. The increase from December 31, 2009 is comprised of the YTD-2010 net income of \$8.2 million less \$4.3 million of trust unit distributions and the issuance of \$0.1 million of trust units.

**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 six months ended June 30, 2010, the total amount invoiced for consulting services was \$242,000 (2009 - \$333,000). No amounts for due diligence or business acquisition services were incurred during YTD-2010 or YTD-2009. For the six months ended June 30, 2010, total payments for amounts invoiced during YTD-2010 and balances owing at the beginning of fiscal 2010 totaled \$180,000 (2009 - \$919,000). There was \$61,400 due and payable at June 30, 2010 (2009 - \$28,500). These amounts are included in accounts payable.

**OBLIGATIONS AND COMMITMENTS**

At June 30, 2010, the Fund had no material outstanding obligations and commitments for capital expenditures. At June 30, 2010, the Fund had no outstanding letters of guarantee related to performance of specific customer contracts or contract bids. The Fund has operating lease commitments for office space and service equipment, none of which individually, or in aggregate, are material.

**FINANCIAL INSTRUMENTS**

Except for foreign exchange forward contracts, the Fund's financial assets and liabilities at June 30, 2010 continue to be accounted for at their historical value which approximates fair value due to the relative short-term to maturity. Foreign exchange forward contracts are accounted for at their fair value. Transaction costs related to these financial instruments are expensed in the period incurred. There were no foreign exchange forward contracts or interest rate swap agreements outstanding at June 30, 2010.

**RISKS AND UNCERTAINTIES**

The Fund's risks and uncertainties are described in detail in the December 31, 2009 MD&A. These risks include fluctuating revenues associated with the shifting levels of economic activity in the energy and mining industries, foreign currency risk, credit and interest rate risk, new product risk, skilled labour shortages, financing risk, the impact of the enactment of the proposed legislation to tax income distributions and risks associated with the ability to maintain current trust unit distributions. At June 30, 2010, the Fund's risks and uncertainties have not materially changed from those described in the December 31, 2009 Audited Consolidated Financial Statements.

**DISCLOSURE CONTROLS AND PROCEDURES**

The Fund's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") are responsible for ensuring management establishes and maintains the Fund's disclosure controls and procedures to provide reasonable assurance that material information related to the Fund is made known to them and that information required to be disclosed by the Fund is reported within the time periods prescribed by the applicable securities legislation. The Fund's CEO and CFO conducted a review and evaluation of the effectiveness of the Fund's disclosure controls and procedures and concluded that as at June 30, 2010 the Fund's disclosure controls and procedures are adequate to provide reasonable assurance that material information related to the Fund is made known by others within the Fund and are adequate 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 CONTROLS AND PROCEDURES**

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 of the Fund's internal control over financial reporting as at June 30, 2010, and based on that assessment determined that the Fund's internal control over financial reporting provides 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 three months ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

**CRITICAL ACCOUNTING POLICIES**

The Fund's significant accounting policies are described in detail in the December 31, 2009 Audited Consolidated Financial Statements. The critical policies deal with revenue recognition, inventories, foreign currency translation, income taxes and financial instruments. At June 30, 2010, the Fund's critical accounting policies have not changed from those described in the December 31, 2009 Audited Consolidated Financial Statements.

**RECENT ACCOUNTING PRONOUNCEMENTS**

i) In January 2009, the CICA issued Handbook Section 1582, Business Combinations that replaces the previous business combinations standard. Under the new standard, the purchase price used in a business combination is based on the fair values of shares exchanged at the marked price at acquisition date. Under the current standard, the purchase price used is based on the market price of shares for a reasonable

period before and after the date the acquisition is agreed upon and announced. In addition, the new standard generally requires all acquisition costs to be expensed. Current standards allow for the capitalization of these costs as part of the purchase price. This new standard also addresses contingent liabilities, which will be required to be recognized at fair value on acquisition, and subsequently remeasured at each reporting period until settled. Current standards require only contingent liabilities that are due to be recognized. The new standard requires any negative goodwill to be recognized as a bargain purchase gain in earnings rather than the current standard which reduces the fair value of non-current assets in the purchase price allocation. The new standard applies prospectively to business combinations on or after January 1, 2011 with earlier application permitted. The Fund is considering early adoption of the new standard as a result of the Q3-2010 Brahma acquisition and is in the process of evaluating the requirements of this new standard with respect to the Brahma acquisition.

ii) In January 2009, the CICA issued Handbook Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling interests. Section 1601 and 1602 together replace Section 1600, Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is the equivalent to the corresponding provisions of IFRS IAS 27 - Consolidated and Separate Financial Statements and applies to the interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Fund is considering early adoption of these new standards as a result of the Q3-2010 Brahma acquisition and is in the process of evaluating the requirements of these new standards with respect to the Brahma acquisition.

iii) 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. Accordingly, the Fund will report under IFRS commencing with the March 31, 2011 first quarter interim financial statements. The Fund will convert to these new standards according to the timetable set within these new rules and provided a comprehensive update as to the status of the Fund's progress regarding the implementation of IFRS in the December 31, 2009 MD&A. As at June 30, 2010, the Fund has progressed further towards the final selection of applicable IFRS 1 policy selections and the quantification of IFRS disclosures for 2010. The Q2-2010 focus has been completing the documentation to support the opening balance sheet as at January 1, 2010 under IFRS. During Q2-2010 and throughout Q3-2010, efforts will be devoted to the development of a full set of pro-forma financial statements using Q1-2010 financial information to reflect the expected revised financial statements format and anticipated changes in note disclosure. Completion of this effort is expected to be during Q4-2010. Staff training will continue throughout the remainder of 2010. System changes to support IFRS requirements are currently being evaluated, but are not expected to be significant at this time. As of the date of this MD&A, there have been no material changes to the internal control or disclosure control environments identified and the Audit Committee will continue to receive quarterly updates on the status of this project from management. The nature and extent of this project may be affected by changes in the strategic direction of the Fund or changes in IFRS. As the IASB has projects underway which could result in new pronouncements, today's IFRS may differ from that applied at the transition date.

#### **CRITICAL ACCOUNTING ESTIMATES**

The Fund's significant accounting estimates are described in detail in the December 31, 2009 Audited Consolidated Financial Statements. These estimates include the review of property, plant and equipment for potential impairment, the review of goodwill and intangibles for potential impairment, determination of net realizable values of inventory, estimation of warranty provisions, estimation of allowances for doubtful accounts and estimation of timing differences for future income taxes. Critical accounting estimates require management's judgment about future events. Management is required to make estimates and judgments that affect reported amounts within the consolidated financial statements and the related disclosure of contingencies. These estimates and judgments are based on historical experience and other assumptions believed to be reasonable in the circumstances. These estimates are evaluated regularly and revised as updated information becomes available. However, actual results may differ from these estimates under different assumptions or conditions. At June 30, 2010, the Fund's critical accounting estimates have not changed from those described in the December 31, 2009, Audited Consolidated Financial Statements.

**SUMMARY OF QUARTERLY RESULTS** (Unaudited)

(000's, except per trust unit amounts)

	2010			2009			2008		
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue	\$ 39,258	\$42,884	\$ 34,944	\$24,082	\$31,038	\$38,922	\$57,161	\$57,270	\$52,991
Net income (loss)	\$ 5,070	\$ 3,121	\$ (12,424)	\$ 1,622	\$ 3,227	\$ 3,702	\$ 8,576	\$ 8,421	\$ 7,579
Net income:									
Per trust unit, basic	\$ 0.23	\$ 0.15	\$ (0.58)	\$ 0.08	\$ 0.15	\$ 0.17	\$ 0.40	\$ 0.39	\$ 0.36
Per trust unit, diluted	\$ 0.24	\$ 0.15	\$ (0.58)	\$ 0.08	\$ 0.15	\$ 0.17	\$ 0.40	\$ 0.39	\$ 0.35

Q4-2009 net loss reflects a goodwill impairment charge of \$13,540 (\$0.63 per trust unit) recorded on December 31, 2009.

**PERFORMANCE SUMMARY**

(000's, except per trust unit amounts)

For the	SIX months ended	Year ended	SIX months ended
	June 30, 2010	December 31, 2009	June 30, 2009
Revenue	\$ 82,142	\$ 128,986	\$ 69,960
Net income (loss)	\$ 8,191	\$ (3,873)	\$ 6,929
Funds flow from continuing operations	\$ 10,344	\$ 14,382	\$ 9,218
Earnings (loss) per trust unit, basic	\$ 0.38	\$ (0.18)	\$ 0.15
Funds flow from operations, per trust unit	\$ 0.48	\$ 0.67	\$ 0.43
Number of trust units, end of period	21,426,036	21,411,036	21,411,036

**CASH LIQUIDITY AND KEY FINANCIAL RATIOS**

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

As at:	June 30, 2010	December 31, 2009	June 30, 2009
<b>Working capital ratio</b>			
Current assets	\$ 99,099	\$ 91,395	\$ 91,939
Current liabilities	21,667	20,338	21,526
Working capital	\$ 77,432	\$ 71,057	\$ 70,413
Ratio	4.57:1	4.49:1	4.27:1
<b>Debt-to-equity ratio</b>			
Total debt	\$ 21,667	\$ 20,338	\$ 21,526
Unitholders' equity	\$ 145,569	\$ 141,528	\$ 156,469
Ratio	0.15:1	0.14:1	0.14:1
<b>Book value per trust unit</b>			
Unitholders' equity	\$ 145,569	\$ 141,528	\$ 156,469
Trust units outstanding	21,426,036	21,411,036	21,411,036
Book value per trust unit	\$ 6.79	\$ 6.61	\$ 7.31

**FOREMOST INCOME FUND**  
**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**CONSOLIDATED BALANCE SHEETS**

(000's) (Unaudited)

As at:	June 30, 2010	December 31, 2009	June 30, 2009
<b>Assets</b>			
Current assets			
Cash (note 4)	\$ 33,759	\$ 37,035	\$ 33,323
Accounts receivable	22,907	19,444	17,498
Inventories (note 2)	41,847	34,563	40,467
Prepaid expenses	586	353	651
	<b>99,099</b>	<b>91,395</b>	<b>91,939</b>
Property, plant and equipment	47,323	49,555	51,497
Future income taxes	19,485	19,485	19,485
Goodwill and intangibles	1,329	1,431	15,074
	<b>\$ 167,236</b>	<b>\$ 161,866</b>	<b>\$ 177,995</b>
<b>Liabilities and Unitholders' Equity</b>			
Current liabilities			
Accounts payable and accrued liabilities	\$ 15,921	\$ 13,871	\$ 14,208
Deferred revenue	5,746	6,467	7,318
	<b>21,667</b>	<b>20,338</b>	<b>21,526</b>
Unitholders' equity (note 3)			
Unitholders' capital	62,195	62,115	62,115
Contributed surplus	1,482	1,428	1,285
Accumulated earnings	81,892	77,985	93,069
	<b>145,569</b>	<b>141,528</b>	<b>156,469</b>
	<b>\$ 167,236</b>	<b>\$ 161,866</b>	<b>\$ 177,995</b>

Commitments and contingencies (note 11)

Subsequent event (note 12)

**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
AND ACCUMULATED EARNINGS**

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

	for the <b>THREE</b> months ended June 30,		for the <b>SIX</b> months ended June 30,	
	2010	2009	2010	2009
Revenue	\$ 39,258	\$ 31,038	\$ 82,142	\$ 69,960
Cost of sales	28,903	21,849	63,403	51,266
	<b>10,355</b>	<b>9,189</b>	<b>18,739</b>	<b>18,694</b>
Selling, general and administrative	4,427	5,483	8,503	10,089
Interest expense (income)	(25)	-	(45)	5
Amortization	1,041	1,152	2,092	2,277
Foreign exchange loss (gain)	(148)	234	9	154
Realized gain on forward exchange contracts	-	(818)	-	(614)
Gain on disposal of property, plant and equipment	(10)	(89)	(11)	(146)
	<b>5,285</b>	<b>5,962</b>	<b>10,548</b>	<b>11,765</b>
Net income and comprehensive income	5,070	3,227	8,191	6,929
Accumulated earnings, beginning of period	78,965	91,983	77,985	90,422
Distributions to unitholders	(2,143)	(2,141)	(4,284)	(4,282)
Accumulated earnings, end of period	<b>\$ 81,892</b>	<b>\$ 93,069</b>	<b>\$ 81,892</b>	<b>\$ 93,069</b>
Earnings per trust unit (note 10)				
Basic	\$ 0.23	\$ 0.15	\$ 0.38	\$ 0.32
Diluted	\$ 0.24	\$ 0.15	\$ 0.38	\$ 0.32

See accompanying notes to interim consolidated financial statements

**FOREMOST INCOME FUND**  
**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(000's) (Unaudited)

For the **THREE** months  
ended June 30,

For the **SIX** months  
ended June 30,

**2010**      2009      **2010**      2009

**Cash flows provided by (used in):**

**Operating:**

Income from operations	\$ 5,070	\$ 3,227	\$ 8,191	\$ 6,929
Items not involving cash:				
Amortization	1,041	1,152	2,092	2,277
Gain on disposal of property, plant and equipment	(10)	(89)	(11)	(146)
Trust units based compensation	36	79	72	158
	<b>6,137</b>	<b>4,369</b>	<b>10,344</b>	<b>9,218</b>

**Change in non-cash working capital:**

Accounts receivable	(1,965)	13,240	(3,463)	24,620
Inventories	(2,366)	11,417	(7,284)	15,981
Prepaid expenses	74	584	(233)	535
Accounts payable and accrued liabilities	(111)	(654)	2,050	(8,276)
Deferred revenue	(35)	(2,752)	(721)	(5,131)
	<b>(4,403)</b>	<b>21,835</b>	<b>(9,651)</b>	<b>27,729</b>
	<b>1,734</b>	<b>26,204</b>	<b>693</b>	<b>36,947</b>

**Investing:**

Purchase of property, plant and equipment	(103)	(69)	(199)	(157)
Proceeds from sale of property, plant and equipment	451	131	452	318
	<b>348</b>	<b>62</b>	<b>253</b>	<b>161</b>

**Financing:**

Bank indebtedness repayments	-	-	-	(343)
Issuance of trust units	62	-	62	-
Distributions to unitholders	(2,143)	(2,141)	(4,284)	(4,282)
	<b>(2,081)</b>	<b>(2,141)</b>	<b>(4,222)</b>	<b>(4,625)</b>

Net change in cash during the year	1	24,125	(3,276)	32,483
Cash, beginning of year	33,758	9,198	37,035	840
<b>Cash, end of year</b>	<b>\$ 33,759</b>	<b>\$ 33,323</b>	<b>\$ 33,759</b>	<b>\$ 33,323</b>

Supplemental disclosure of cash flow information

Interest received (paid)	\$ 25	\$ -	\$ 45	\$ 5
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See accompanying notes to interim consolidated financial statements

**FOREMOST INCOME FUND**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
*(Unaudited)*

**1. Accounting Policies**

a. Basis of consolidation

Foremost Income Fund (the "Fund") prepares its financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). These interim consolidated financial statements follow the same accounting policies and methods of computation as the most recently audited December 31, 2009 consolidated financial statements. As these interim unaudited financial statements do not include all of the disclosure requirements of GAAP for annual financial statements, they should be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2009.

b. Recent pronouncements

The Fund is continually assessing new and revised accounting pronouncements that have been issued but are not yet effective. Based on these assessments, the following pronouncements may have a significant impact on the Fund:

i) In January 2009, the CICA issued Handbook Section 1582, Business Combinations that replaces the previous business combinations standard. Under the new standard, the purchase price used in a business combination is based on the fair values of shares exchanged at the market price at acquisition date. Under the current standard, the purchase price used is based on the market price of shares for a reasonable period before and after the date the acquisition is agreed upon and announced. In addition, the new standard generally requires all acquisition costs to be expensed. Current standards allow for the capitalization of these costs as part of the purchase price. This new standard also addresses contingent liabilities, which will be required to be recognized at fair value on acquisition, and subsequently remeasured at each reporting period until settled. Current standards require only contingent liabilities that are due to be recognized. The new standard requires any negative goodwill to be recognized as a charge to earnings rather than the current standard which reduces the fair value of non-current assets in the purchase price allocation. The new standard applies prospectively to business combinations on or after January 1, 2011 with earlier application permitted. The Fund is considering early adoption of the new standard as a result of the Q3-2010 Brahma acquisition and is in the process of evaluating the requirements of this new standard with respect to the Brahma acquisition.

ii) In January 2009, the CICA issued Handbook Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling interests. Section 1601 and 1602 together replace Section 1600, Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is the equivalent to the corresponding provisions of IFRS IAS 27 - Consolidated and Separate Financial Statements and applies to the interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Fund is considering early adoption of these new standards as a result of the Q3-2010 Brahma acquisition and is in the process of evaluating the requirements of these new standards with respect to the Brahma acquisition.

iii) In February 2008, Canada's Accounting Standards Board ("AcSB") confirmed that Canadian generally accepted accounting principles, as used by publicly accountable enterprises, will be fully converged 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. Accordingly, the Fund will report under IFRS commencing with the March 31, 2011 first quarter interim financial statements. The Fund will convert to these new standards according to the timetable set within these new rules. The Fund continues to evaluate and adapt to the impact of this change on its financial statements, business processes, internal controls and information systems and is not yet able to determine the total impact. Furthermore, the nature and extent of this project may be affected by changes in the strategic direction of the Fund or changes in IFRS. As the IASB has projects underway which could result in new pronouncements, today's IFRS may differ from that applied at the transition date.

**2. 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 accrued 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.

At June 30, 2010, raw materials amounted to \$17.8 million of which approximately \$1.4 million was valued at estimated net realizable value, \$17.0 million at December 31, 2009 of which approximately \$1.6 million was valued at estimated net realizable value and \$20.1 million at June 30, 2009 of which approximately \$1.5 million was valued at estimated net realizable value. Work in progress amounted to \$21.9 million at June 30, 2010, \$13.6 million at December 31, 2009 and \$15.2 million at June 30, 2009. Finished goods amounted to \$2.1 million at June 30, 2010 of which approximately \$2.1 million was valued at estimated net realizable value, \$3.9 million at

**FOREMOST INCOME FUND**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
*(Unaudited)*

December 31, 2009 of which \$3.0 million was valued at estimated net realizable value and \$5.2 million at June 30, 2009 of which \$0.4 million was valued at estimated net realizable value.

The amount of inventories charged to cost of sales for the three months ended June 30, 2010 was \$27.2 million (June 30, 2009 – \$19.0 million). The amount of inventories charged to cost of sales for the six months ended June 30, 2010 was \$60.8 million (2009 - \$46.4 million).

An additional write-down of inventory of \$0.3 million was charged to cost of sales for the three months ended June 30, 2010 as compared with \$0.2 million for the same period in 2009. An additional write-down of inventory of \$0.4 million was charged to cost of sales for the six months ended June 30, 2010 and \$0.3 million for the six months ended June 30, 2009.

**3. Unitholders' Equity**

*(000's for stated values, except trust units outstanding)*

a. Unitholders' capital

Authorized:

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

Issued:

	THREE months ended June 30, 2010		TWELVE months ended December 31, 2009		THREE months ended June 30, 2009	
	Number	Stated Value	Number	Stated Value	Number	Stated Value
Unitholders' capital, beginning of period	21,411,036	\$ 62,115	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 period	21,426,036	\$ 62,195	21,411,036	\$ 62,115	21,411,036	\$ 62,115

	SIX months ended June 30, 2010		TWELVE months ended December 31, 2009		SIX months ended June 30, 2009	
	Number	Stated Value	Number	Stated Value	Number	Stated Value
Unitholders' capital, beginning of period	21,411,036	\$ 62,115	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 period	21,426,036	\$ 62,195	21,411,036	\$ 62,115	21,411,036	\$ 62,115

b. Contributed surplus

	THREE months ended June 30, 2010	TWELVE months ended December 31, 2009	THREE months ended June 30, 2009
Contributed surplus, beginning of period	\$ 1,464	\$ 1,127	\$ 1,206
Options exercised	(18)	-	-
Trust unit based compensation expense	36	301	79
Contributed surplus, end of period	\$ 1,482	\$ 1,428	\$ 1,285

	SIX months ended June 30, 2010	TWELVE months ended December 31, 2009	SIX months ended June 30, 2009
Contributed surplus, beginning of period	\$ 1,428	\$ 1,127	\$ 1,127
Options exercised	(18)	-	-
Trust unit based compensation expense	72	301	158
Contributed surplus, end of period	\$ 1,482	\$ 1,428	\$ 1,285

c. Trust units based compensation plan

No unit options have been granted during the six months ended June 30, 2010. During the three months ended June 30, 2010, 5,000 unit options with an exercise price of \$13.00 and 7,500 unit options with an exercise price of \$8.75 were forfeited and 15,000 unit options were exercised at \$4.12 per trust unit for total proceeds of \$61,800. There were 573,500 unit options outstanding at June 30, 2010.

**FOREMOST INCOME FUND**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
*(Unaudited)*

d. Trust unit distributions

The June 30, 2010 and June 30, 2009 trust unit distributions were paid in cash and amounted to \$2.1 million (\$0.10 per trust unit) respectively. Total trust unit distributions, all paid in cash, were \$4.3 million for the six months ended June 30, 2010 and June 30, 2009.

**4. Credit Facility and Cash**

The Fund's credit facility, a \$20.0 million uncommitted operating facility has not been utilized during the year. The \$20.0 million credit facility was renewed subsequent to the end of Q2-2010 on the same terms and conditions.

**5. Financial Instruments**

a. Fair values

The Fund's financial assets and liabilities are accounted for at their historical cost which approximates fair value. For accounts receivable, accounts payable and accrued liabilities the carrying amounts at June 30, 2010, December 31, 2009 and June 30, 2009 approximate fair value due to the near term maturity of these financial instruments. Derivative instruments such as foreign exchange future contracts are recorded in the balance sheet at fair value. Transaction costs associated with financial instruments are charged to net income in the period incurred.

b. Credit risk

The Fund's principal assets subject to credit risk are cash and accounts receivable and their respective carrying amounts are considered the Fund's maximum credit exposure. The Fund continues to manage the credit risk associated with cash by holding these assets with reputable financial institutions and therefore considers the risk of loss to be low. The principal source of credit risk remains accounts receivable balances with oil and gas industry customers. Risk management for accounts receivable includes the use of letters of credit, up front cash deposits and progress payments and export insurance for capital equipment sales contracts. For parts, service or other open credit sales, the Fund utilizes export insurance and routinely reviews customer credit limits, collections patterns and its aged accounts receivable listing. In assessing the current level of credit risk associated with accounts receivable, the Fund initially takes into consideration balances which are reported as 60 days or more past due. As at June 30, 2010, accounts receivable in excess of 60 days amounted to 19% of accounts receivable as compared with 15% at December 31, 2009 and 26% at June 30, 2009. The Fund then reviews each of these accounts to understand why the amount is past due and if subsequent payments have been received. This analysis also generates an allowance for doubtful accounts which represents the Funds estimate of accounts receivable credit risk at that point in time. The estimated allowance for doubtful accounts at June 30, 2010 is \$0.6 million (2009 - \$0.8 million) and is down \$0.1 million from December 31, 2009. There was no bad debt expense for the three months ended June 30, 2010 (2009 - \$0.1 million) and a bad debt recovery of \$0.1 million for the six months ended June 30, 2010 versus an expense of \$0.2 million for the same period last year.

c. Foreign currency risk

A significant portion of the Fund's revenues, expenses, accounts receivable and accounts payable are denominated U.S. dollars, and consequently the Fund is subject to the risk of fluctuating exchange rates. The Fund estimates that based on current U.S. dollar based revenues, a 1% increase or decrease in the Canadian dollar to U.S. dollar relationship would impact earnings by approximately \$0.2 million. At June 30, 2010, the Fund had no foreign exchange forward contracts in place to manage this risk.

d. 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 borrowings 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.

e. 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 manages its liquidity risk by continually monitoring forecast and actual cash requirements for operations, capital expenditures and trust unit distributions. The Fund principally uses its cash flow from operations, operating loan and revolving 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 June 30, 2010 and current cash forecasts, liquidity risk is considered low. The balance of accounts payable and accrued liabilities are all due within one year. Any outstanding bank indebtedness is considered repayable within one year of the date of most recent renewal of the credit facility.

**6. 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 six months ended June 30, 2010, the total amount invoiced for consulting services was \$242,000 (2009 - \$333,000). No amounts for due diligence or business acquisition services were incurred during YTD-2010 or YTD-2009. For the six months ended June 30, 2010, total payments for amounts invoiced during YTD-2010 and balances owing at the

**FOREMOST INCOME FUND**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
*(Unaudited)*

beginning of fiscal 2010 totaled \$180,000 (2009 - \$919,000). There was \$61,400 due and payable at June 30, 2010 (2009 - \$28,500). These amounts are included in accounts payable.

**7. Business Segments - (\$000's)**

For the <b>THREE</b> months ended June 30,	Universal		Foremost		Total	
	2010	2009	2010	2009	2010	2009
Revenue	28,416	17,858	10,842	13,180	39,258	31,038
Interest expense (income)	(16)	-	(9)	-	(25)	-
Amortization	762	839	279	313	1,041	1,152
Income before income taxes	3,156	1,010	1,914	2,217	5,070	3,227
Net income	3,156	1,010	1,914	2,217	5,070	3,227
Property, plant and equipment expenditures	57	36	46	33	103	69

For the <b>SIX</b> months ended June 30,	Universal		Foremost		Total	
	2010	2009	2010	2009	2010	2009
Revenue	62,972	44,261	19,170	25,699	82,142	69,960
Interest expense (income)	(29)	3	(16)	2	(45)	5
Amortization	1,590	1,731	502	546	2,092	2,277
Income before income taxes	5,550	2,263	2,641	4,666	8,191	6,929
Net income	5,550	2,263	2,641	4,666	8,191	6,929
Property, plant and equipment expenditures	134	84	65	73	199	157

	Universal			Foremost			Total		
	June 30	Dec. 31	June 30	June 30	Dec. 31	June 30	June 30	Dec. 31	June 30
	2010	2009	2009	2010	2009	2009	2010	2009	2009
Property, plant and equipment	37,201	38,996	40,399	10,122	10,559	11,098	47,323	49,555	51,497
Goodwill and intangibles	1,329	1,431	15,074	-	-	-	1,329	1,431	15,074
Total assets	108,599	103,320	132,313	58,637	58,546	45,682	167,236	161,866	177,995

**8. Geographic Segments - (000's)**

	For the <b>THREE</b> months ended June 30,		For the <b>SIX</b> months ended June 30,	
	2010	2009	2010	2009
Revenue				
Canada	\$ 30,972	\$ 22,313	\$ 67,787	\$ 52,121
United States	3,392	1,998	5,277	2,901
International	4,894	6,727	9,078	14,938
	\$ 39,258	\$ 31,038	\$ 82,142	\$ 69,960

	June 30	December 31	June 30
	2010	2009	2009
Property, plant and equipment, goodwill and intangibles			
Canada	\$ 48,176	\$ 50,508	\$ 66,088
United States	476	476	476
International	-	2	7
	\$ 48,652	\$ 50,986	\$ 66,571

The Fund recorded a goodwill impairment of \$13.5 million on December 31, 2009 and therefore only intangibles of \$1.3 million were reported at June 30, 2010 and \$1.4 million at December 31, 2009. All intangibles are located in Canada.

**9. 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 necessary to pursue 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.

**FOREMOST INCOME FUND**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
*(Unaudited)*

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, refinance 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:

	June 30 2010	December 31 2009	June 30 2009
Working capital ratio	4.57:1	4.49:1	4.27:1
Debt-to-equity ratio	0.15:1	0.14:1	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 June 30, 2010.

The Fund will become subject to Canadian income taxes beginning in 2011. This may result in changes to the capital structure of the Fund or the nature of the Fund itself. The Fund continues to assess its options with no specific changes to the capital structure of the Fund or the nature of the Fund itself having yet been determined.

#### 10. 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:

	For the <b>THREE</b> months ended June 30,		For the <b>SIX</b> months ended June 30,	
	2010	2009	2010	2009
Basic weighted average trust units	21,421,585	21,411,036	21,416,340	21,411,036
Effect of dilutive trust unit options	1,535	2,773	3,252	2,773
Diluted weighted average trust units	21,423,120	21,413,809	21,419,592	21,413,809

#### 11. Commitments and Contingent Liabilities

As at June 30, 2010, there were no material commitments for capital expenditures or outstanding letters of guarantee.

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.

#### 12. Subsequent Event

Subsequent to the end of Q2-2010, on July 8, 2010 the Fund, through Universal, acquired all of the issued and outstanding shares of Brahma Compression Ltd. ("Brahma"). Brahma designs and manufactures sub-200 horsepower compressors. Brahma's head office and 32,000 square foot manufacturing facility are located in Calgary, Alberta. Acquisition costs, to be financed by the Fund's current cash position, will be in the range of approximately \$8.7 million including the assumption of debt and is subject to closing adjustments. There is also contingent consideration based on future earnings.