

**General Donlee Income Fund**  
Second Quarter 2005 Results Conference Call  
August 16, 2005

(Note: slight modifications have been made to this transcript to clarify meaning and improve understanding)

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## **Presentation**

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### ***Operator***

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Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the General Donlee Income Fund Second Quarter Results Conference Call. [Operator Instructions] I will now turn the conference call over to Mr. Ralph Barnes, Director of Investor Relations. Please go ahead.

### ***Mr. Ralph Barnes, Director of Investor Relations***

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Thank you, operator, and good morning, ladies and gentlemen. I would like to welcome you to our Second Quarter 2005 Conference Call. Today you will hear comments from Gerry Thain, Chief Financial Officer. Unfortunately Thomas Faucette, CEO of the Fund, has been delayed and may be able to join us later. Before we begin, I would like to remind all participants and others listening to this conference call that certain information provided may be forward looking and based on assumptions and anticipated results that are subject to uncertainties including the general economy and our ability to obtain and complete orders. Should one or more of these uncertainties materialize or should the underlying assumptions prove incorrect, actual results may vary significantly from those expected.

Also please note that items such as distributable cash are not GAAP measures and may vary from those used by other issuers. A description and reconciliation of distributable cash is included in Management's Discussion and Analysis which is available with our second quarter press release on our website at [www.generaldonlee.com](http://www.generaldonlee.com). Please be aware that this conference call is being webcast live over the Internet and is also being recorded for those not able to participate during the live event.

Today we will elaborate on the second quarter 2005 consolidated financial results released yesterday for the General Donlee Income Fund. I will now turn the call over to Gerry Thain, CFO of the General Donlee Income Fund.

## ***Gerald Thain, Chief Financial Officer***

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Good morning, ladies and gentlemen. Thank you for joining us. Since we reported to you in May 2005, we have continued to experience somewhat soft results in most of our markets. However, commercial aerospace has experienced some pickup. Consolidated sales in the second quarter of 2005 were \$8.8 million, \$1.8 million higher than in the second quarter of 2004 and \$0.7 million higher than the first quarter of 2005. In the Aerospace and Power Generation Products division, we achieved second quarter sales of \$4.5 million, an increase over last year of \$1.0 million due principally to increased shipments in the commercial aerospace segment. There were no shipments of the catapult and barrel assemblies in the second quarter 2005; however, much processing work was expended on the units in the quarter, which has temporarily increased our work-in-process inventories. We are now targeting the start of these shipments in the third quarter.

In the Industrial Products division, second quarter sales were \$4.3 million, up from \$3.5 million in the second quarter last year, principally due to completion of the shipment of delayed orders from 2004.

The Fund generated net earnings of \$0.9 million for the quarter, which compares to break even in the second quarter 2004, before a goodwill write-off of \$13.5 million. After the goodwill impairment charge, net loss in the quarter in 2004 was \$13.5 million. Improved margins in the Industrial Products division and higher shipments and other factors impacted the bottom line this quarter.

In second quarter 2005, distributable cash amounted to \$1.6 million. Distributable cash in the second quarter last year totaled \$0.4 million. In this quarter distributable cash was favorably impacted by improved business conditions and increased sales and gross margins in both the Aerospace and Power Generation division and in the Industrial Products division. In the second quarter of 2005, monthly distributions were made at an annual rate of 10 cents per unit. Yesterday the trustees announced the July 2005 distribution at the same level, payable on August 31st to those unit holders of record on August 26, 2005.

Before beginning the second quarter 2005 discussion, let me remind you that the second quarter 2005 consolidated financial statements and notes are currently available on the Financial Reports page of our website, [www.generaldonlee.com](http://www.generaldonlee.com), and they have been filed at SEDAR.

Consolidated sales for the second quarter ended June 30, 2005 were \$8.8 million, an increase of \$1.8 million compared to the second quarter last year. In our Aerospace and Power Generation Products division, second quarter sales of shafts and other precision cylindrical products were \$4.5 million, up \$1.0 million compared to the second quarter experienced in 2004. On a year-over-year basis, the net increase in the second quarter of 2005 can be attributed as follows. Military Aerospace sales were down \$0.1 million, Commercial Aerospace sales were up \$1.3 million, Industrial was flat, and Power Generation was down \$0.2 million. In the second quarter, the increase was primarily due to increased shipments in the Commercial Aerospace segment. Sales for the quarter in the total division did not meet management's expectations, however, due to engineering challenges related to the catapult barrel assemblies project.

On a year-to-date basis, the Aerospace and Power Generation division sales of \$8.6 million in 2005 were \$0.2 million lower than the same period in 2004 due to Military Aerospace being \$1.1 million lower, Commercial Aerospace was higher by \$2.1 million, Industrial was higher by \$0.2 million, and Power Generation was below last year by \$1.4 million.

In the Industrial Products division, second quarter sales of gears, splines, and assemblies were \$4.3 million, an increase of \$0.8 million compared to the similar quarter last year. The improved shipment level in the division is primarily the result of completing and shipping delayed orders from 2004.

During the quarter in the six months to June 30, 2005 the Canadian dollar versus the U.S. dollar was 8% higher on average. The stronger Canadian dollar in 2005 had an adverse impact on the U.S. dollar revenues of approximately \$0.3 million in the second quarter and \$0.6 million for the first six months, excluding the effect of any foreign exchange forward contracts.

In the second quarter of 2005, the Military Aerospace segment accounted for only 7% of sales, down from 10% in the second quarter of 2004, while Commercial and General Aerospace accounted for 38% of sales, up significantly from 29% in 2004. Industrial Product sales in the quarter decreased slightly from 56% to 53%, while Power Generation dropped from 6% last year to 2% this year.

The declines in the Military and Power Generation segments primarily reflect the two major contracts that ended in the first quarter of 2004. The very encouraging part of the current sales pattern was the sizeable pick-up in the Commercial and General Aviation segment, which we hope will continue through 2005.

On a geographic basis, for the second quarter of 2005, the same basic factors just outlined caused sales in Canada to account for 51% of total sales, while sales to the U.S. customers accounted for 44% of the total, and sales in Europe accounted for 5%.

Sales order backlog at June 30, 2005 totaled \$43.4 million, down from the year-end 2004 level of \$47.7 million, due to shipments exceeding new orders during the six months. The Aerospace and Power Generation division accounts for 94% of the total backlog, and the Industrial Products division, which has a shorter product cycle, accounts for the balance. The impact of the Canadian dollar versus the U.S. dollar was not material in valuing the backlog.

Gross profit for the second quarter in 2005 was \$2.0 million or 22.7%, more in line with our normal level and up significantly from the \$1.4 million and 16.8% of sales recorded in the first quarter of 2005. The improvement over the first quarter reflected increased operating efficiencies, as some of the operational issues have been resolved in the industrial products division. In addition, higher sales volumes and improved sales mix in the Aerospace and Power Generation division contributed to the improved gross margin level.

In the first six months of 2005 the gross margin was somewhat lower compared to the first six months of 2004. This was due to the product mix, reduced margins in the Industrial Products

division, due to rising steel prices and operational difficulties, a higher Canadian dollar, and underutilization of certain machine centers in the Industrial Products division.

Selling, general and administrative expenses for the second quarter of 2005 were \$0.9 million, or 9.7% of sales, which compares to the second quarter of 2004 of \$0.8 million, or 11.4% of sales. In the current 2005 quarter fund costs were \$0.3 million, which compares to \$0.2 million in the second quarter of 2004.

The net impact of marking-to-market the company's foreign exchange forward contracts at June 30, 2005 produced a foreign exchange gain of \$0.1 million in the second quarter. In 2004 the foreign exchange loss in the comparable quarter was \$0.1 million.

Total amortization charges for the quarter ended June 30, 2005 were \$0.7 million including \$0.5 million for the amortization of property, plant, and equipment, and \$0.2 million for the amortization of other assets. In the second quarter of 2005, \$0.5 million is included in the cost of sales. Total amortization charges for the second quarter in 2004 were \$1.1 million including \$0.5 million for property, plant, and equipment, and \$0.6 million for other assets. The amortization of other assets reflects the amortization of the value of contracted sales agreements at the time of the IPO in 2002. This item is now fully amortized and reduced the second quarter cost by \$0.4 million. Although not having an impact on future cash flows, lower amortization costs will increase net earnings in the second half by \$1.2 million.

Net earnings generated by the fund in the second quarter of 2005 were \$0.9 million. This compares to a net loss in the second quarter of 2004 of \$13.5 million after absorbing a goodwill impairment charge of \$13.5 million.

The company has entered into foreign exchange forward contracts seeking to help minimize exposure to foreign currency rate fluctuation. At June 30, 2005, the company had foreign currency forward exchange contracts outstanding to sell U.S. \$9.4 million at an average rate of Canadian 1.2471 per U.S. dollar, or 80.19 cents U.S. cents versus yesterday's rate of 1.19, or 83.38 U.S. cents, maturing from July 2005 to December 2006.

Consolidated working capital at June 30, 2005, was \$11.9 million. At December 31, 2004, working capital totaled \$10.2 million. The current ratio at June 30, 2005 was 3.2-to-1.0, which compares to the 3.1-to-1.0 at December 31, 2004. The consolidated net debt-to-equity ratio was 0.31-to-1.0 at June 30, 2005. Net debt is defined as total debt less cash. This is down slightly from the December 31, 2004 level of 0.35-to-1.0. This decrease reflects the repayment of \$0.3 million of the previous term loan.

During the quarter ended June 30, 2005, cash provided from operating activities was \$0.7 million. This was comprised of cash flows from operations of \$1.7 million while non-cash working capital items used \$1.0 million principally to fund-increased inventories partially offset by higher accounts payable. In the same quarter in 2004, cash flows from operating activities totaled \$1.5 million including \$1.2 million cash from operations, while non-cash working capital items contributed a further \$0.3 million.

For the quarter ended June 30, 2005, distributable cash was \$1.6 million, or 17.9 cents per unit. In the same quarter in 2004 distributable cash was \$0.4 million, or 4 cents per unit. The increase in 2005 reflects higher cash flows from operations and no fixed asset purchases. Cash distributions paid in the second quarter, June 30, 2005, were \$0.2 million, or 2.5 cents per unit, which included distributions for the months of March, April, and May 2005. The June 2005 distribution was not included in the payment indicated above, but was paid on July 29, 2005. The Fund's distributions during the same quarter in 2004 were \$1.2 million or 13.7 cents per unit.

In March 2005, the company negotiated a renewed credit facility totaling \$16.8 million with its banker. The facility includes a \$9.7 million non-amortizing term loan; a \$3 million operating facility; a \$4 million operating lease facility; and a corporate credit card facility of \$0.1 million. The term loan expires April 30, 2008. The operating loan is renewable annually, and the operating lease will be amortized over 5 years. The financial covenants have been revised to correspond with the increased facility.

Additions to property, plant and equipment for the current quarter were nil. Management has reviewed the capital requirements of the operations and at this time has planned only minimum capital expenditures during 2005. Management is currently evaluating the acquisition of a large capacity, multi-functional machining centre, which would be funded by the \$4 million operating lease facility just mentioned. The purchase of this equipment is contingent on formalizing a three-year contract with an existing aerospace customer. If this project were to proceed, management believes the expenditure of funds would be primarily in the year 2006.

Tom Faucette has now joined us so I will now turn the call over to him for further comments.

***Thomas Faucette, President and Chief Executive Officer***

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Thanks, Gerry. As we reported to you in the first quarter, a change in leadership was made in the Industrial Products division and Barry Fletcher, the former General Manager, agreed to return on an interim basis. The search for a permanent general manager for the Industrial Products division is continuing.

Regarding new business for General Donlee, we continue development efforts with our existing customers and some potential new customers in both the Aerospace and Industrial Products areas. In Aerospace we're making progress as some Military and Commercial Aerospace orders have been obtained; none large enough to merit a press release at this point. We expect that the catapult barrel assemblies for the U.S. Navy will start shipping before the end of the third quarter. Our quoting activity has been steady, and we hope that additional sales will result.

As Gerry indicated, we're in discussions with one of our Aerospace customers regarding a three-year contract for shafts. However, the terms and conditions of the agreement are not tied down at this time. When we obtain a contract or when we discontinue discussions we will communicate with you at that time. Earlier identified bids for additional nuclear work have not resulted in additional orders and could take some time to be decided.

In the Industrial Products division quoting activity is also steady. Efforts are being made on both the cost and pricing sides to restore future margins. This is a priority for the division in 2005. A strong effort is also being made to improve or re-establish relationships with our customers.

In general, management is cautiously optimistic that the improved tone in the Aerospace segment is likely to continue for the near to medium term. We have started to see higher volumes in our Commercial Aerospace segments.

In Industrial Products division, under Mr. Fletcher's leadership, we are focusing on operational improvements to restore margins in the division. However, capital equipment markets are still relatively flat with no perceived pick-up in business levels. Sales order backlog remains strong at June 30th, and we hope that new orders in the second half will improve the current level of backlog.

Management expects that the Fund should be in a position to continue to distribute the current annual level of 10 cents per unit (or higher amounts) for the foreseeable future.

This concludes the prepared portion of the conference call. At this point, before we start the question-and-answer session, we remind all participants that we're not in a position to discuss materially undisclosed information on this call. Operator, we'd now like to open the call to any questions participants might have.

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## Question and Answer Session

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Operator: Your first question comes from Walter Spracklin from RBC Capital Markets. Please go ahead with your question.

***Walter Spracklin: Capital spending and distributions***

Walter Spracklin: Thanks very much; good morning, guys.

Thomas Faucette: Good morning.

Walter Spracklin: Just on the capital spending program, you mentioned that you saw that there was zero spent in the quarter, quite minimal during the year. Is there any concern here on the maintenance side regarding the asset base? And looking into 2006, do you have any sort of view on where maintenance CapEx might come in, in 2006?

Thomas Faucette: In terms of general maintenance of existing machinery that's an ongoing process. It's not reflected in the capital expenditure levels. But in terms of replacement of existing facilities

or additions, there will be potentially some additions made in the next year to supplement obsolete or difficult-to-maintain equipment.

Walter Spracklin: So, you are expensing a lot of the maintenance expenses that you do?

Thomas Faucette: Maintenance, yes. Always.

Gerald Thain: Yes, it's always expensed on an ongoing basis.

Walter Spracklin: And then, you just capitalize anything that replaces any old assets or something? Okay. Debt repayment, I know that you mentioned that your term debt is done in '08, but do you have any views on debt repayment between now and 2008? Or, are you happy to just keep that debt level as it is right now?

Gerald Thain: I think that's something that will be reviewed as time goes on depending on cash flows.

Walter Spracklin: Would an increase in distributions come before or after bringing down your debt?

Gerald Thain: I think that's a decision that the trustees will make when the time is appropriate.

Walter Spracklin: Okay. SG&A year-to-date is up 20%. Any comments on the increase?

Gerald Thain: We had that first quarter charge for employment related costs.

Walter Spracklin: Okay. I mean, it's up in the second quarter as well.

Gerald Thain: I think it is just probably timing of expenses more than anything else. We are definitely controlling expenses.

Walter Spracklin: Okay. Shipments, it sounds like you said there was a delay in shipments in '04 and that came in the quarter for your Industrial Products division. Can you quantify how much that impacted? I know you said \$0.8 million higher and then said this was due to delayed shipments. Does that imply that is was about an impact of \$0.8 million?

Gerald Thain: That would pretty much cover it, yes.

Walter Spracklin: Okay. The last question is just on the new equipment purchase that you mentioned. Can you give us a sense of what kind of cost that would be for that new equipment purchase? Just a range.

Thomas Faucette: I don't think we've finalized any kind of numbers on that.

Gerald Thain: No, we really haven't got it finalized. It will be leased equipment.

Walter Spracklin: Okay.

Gerald Thain: And it would be spread over probably a five-year lease.

Walter Spracklin: I see, okay. And you mentioned a three-year contract for shafts and then mentioned that there was this equipment purchase would be contingent on a winning of a project. Is that the one you are talking about?

Gerald Thain: Yes, that is correct.

Walter Spracklin: Okay, perfect. All right, that's all my questions, thank you very much.

Gerald Thain: Thank you.

Operator: The next question comes from Cameron Doerksen of Versant Partners. Please go ahead with your question.

***Cameron Doerksen: Raw materials costs***

Cameron Doerksen: Good morning gentlemen.

Thomas Faucette, Gerald Thain: Good morning.

Cameron Doerksen: I have a question on raw materials. A number of other aerospace suppliers have indicated they've been struggling a little bit with getting raw materials and then obviously costs have come up on those as well. Can you comment on how that is affecting your business and if that is leading to any delivery delays at all for you?

Thomas Faucette: In most of the areas where we would have long-term raw material requirements, we are placing new orders well in advance although there are, as you just indicated, a lot of manufacturers are having problems because the mills are extending the deliveries. So, we do get caught with the same situation sometimes where we are expecting the stuff to come in and it might be a month or two months later, so it is kind of a catch-up game. In many cases, we are able to pass the pricing on to our customers.

Cameron Doerksen: Do customers in some cases also source the raw materials for you or is that something you typically do on your own?

Thomas Faucette: In some cases, they do that. There are a couple of our larger customers where in fact, we buy them the material but they negotiate the pricing so it is fixed for a year out for instance, and if it changes the following year, then we are able to pass on the negotiated difference. In other cases, some of our customers supply the forgings or raw materials to us and in a lot of cases we buy it ourselves.

Cameron Doerksen: Okay. That's all I had, thank you.

Gerald Thain: Thank you.

Operator: Mr. Barnes, there are no further questions at this time. Please continue.

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## **Closing Remarks**

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### ***Mr. Ralph Barnes, Director of Investor Relations***

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Ladies and gentlemen, thank you for joining us today. This concludes General Donlee Income Fund's Second Quarter Conference Call for 2005. To listen to a replay by telephone, in Toronto call (416) 640-1917 or toll free 1 (877) 289-8525 and give the access pass code of 21132926#. The archived webcast will be available on the Presentations page of our Investor Relations website at [www.generaldonlee.com](http://www.generaldonlee.com). We will also post a transcript of the call on our website by August 18th. We look forward to talking with you again in mid-November to review our third quarter 2005 results. Thanks again for joining us today.