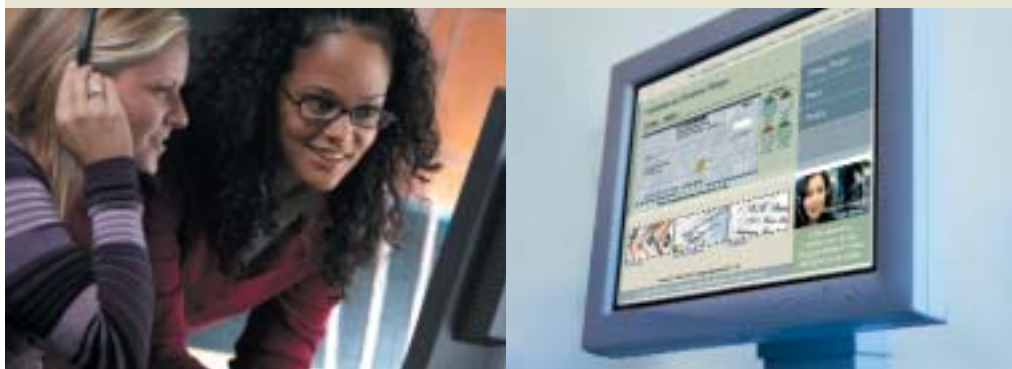


# Evolving Our Programs



## Building Our Future

Q1

QUARTERLY REPORT

*Quarter Ended March 31, 2005*



**Davis + Henderson**

Income Fund

## DAVIS + HENDERSON INCOME FUND

Davis + Henderson Income Fund owns 100% of the Davis + Henderson business.

Davis + Henderson has been serving Canadian financial institutions and their account holders since 1875. Through an integrated service offering, Davis + Henderson is the market leading company in Canada assisting financial institutions with the operation of their cheque supply and related programs.

The Fund intends to provide unitholders with monthly distributions based upon the distributable cash flow of Davis + Henderson. The Fund's units are listed on the Toronto Stock Exchange under the symbol "DHFUN."

## REPORT TO UNITHOLDERS

For our first three years as a public company, Davis + Henderson has reported steady and modestly growing revenues and distributions. For the first quarter of 2005, we experienced a decrease in sales year-over-year of 3.4%. As more fully discussed in the Management's Discussion and Analysis ("MD&A"), this decline was primarily as a result of two fewer business days in the first quarter of 2005 compared to 2004 and lower daily order volumes. These factors were partially offset by the positive impact of continued program expansions in other areas.

Even so, the Fund reported a slight increase in distributable cash as a result of lower cash taxes, funding costs and maintenance capital compared with the same quarter last year. The MD&A contains more detail, but these are the financial highlights of the three months ended March 31, 2005:

- Sales ended at \$66.2 million and operating income was \$19.2 million, representing decreases of 3.4% and 2.8%, respectively, compared to the first quarter of 2004.
- Net income was \$14.6 million, or 12.7% higher compared to the first quarter of 2004.
- Distributable cash was \$0.4109 per unit, a 0.7% increase from the same period in the prior year.
- Declared distributions per unit were \$0.3600 or \$1.44 per unit annualized – a 3.8% increase over last year.

### Operational Highlights

In the first quarter of 2005, we continued to deliver on our strategy of enhancing our cheque supply programs and delivering new valued programs for our customers. *ChequeAdvisor*, *ChequeCentral*, and product repositioning have all contributed positively to performance during the first quarter of this year. Our complementary program, *eSwitch*<sup>™</sup>, is now at various stages of development with each of our large financial institution customers, with full implementations completed at three of these institutions. Our operational plan includes many such initiatives which, when combined, are intended to allow us to meet our objective of growing revenues.

In April, the Fund also announced an additional initiative with the purchase of a partnership interest in a business that provides lenders with search and registration services across Canada. This adds another service that Davis + Henderson can supply to its financial services customers.

### Looking Forward

Davis + Henderson's overall long-term objective is to deliver stable and modestly growing distributions through growing sales in the 3% to 5% range and maintaining margins. In 2004, we exceeded our sales growth target as a result of the implementation of the U.S. cheque supply program, two additional business days, and the benefit of customer promotional campaigns. Based on the sales level in the first quarter in 2005, the Fund expects sales growth to be below the 3% to 5% range; however, the Fund's overall long-term objective remains unchanged.

Yours sincerely,



C. Sanford McFarlane  
Co-Chief Executive Officer  
Davis + Henderson G.P. Inc.



Robert Cronin  
Co-Chief Executive Officer  
Davis + Henderson G.P. Inc.

April 28, 2005

## MANAGEMENT'S DISCUSSION AND ANALYSIS

*Management's Discussion and Analysis ("MD&A") for the first quarter of 2005 should be read in conjunction with MD&A in the Fund's Annual Report for the year ended December 31, 2004, dated February 28, 2005, and the attached interim unaudited consolidated financial statements. External economic and industry factors remain substantially unchanged from the annual MD&A, unless otherwise stated.*

### STRATEGY

Davis + Henderson Income Fund (the "Fund" or the "Business" or "Davis + Henderson") has three key strategies to meet its financial goal of delivering stable and modestly growing cash distributions to unitholders. These are to enhance the value of the cheque supply program, to expand into new programs to serve the chequing account and to pursue additional opportunities to supply program support for other key transaction accounts offered by the Business' financial institution customers.

In growing the cheque supply program, Davis + Henderson is focused on increasing the value of its program through continuously introducing product design alternatives, enhancing security components and combining other logical products into convenient and valuable packages for consumers. Additionally, the Business encourages the financial institutions' customers to reorder directly with Davis + Henderson, thereby improving the efficiency of the order process for the financial institution and improving convenience for the consumer. This direct ordering has allowed the Business to make consumers more aware of their product and service choices, which has resulted in increasing average order value.

On a year-over-year basis, the Business expanded its complementary program, *eSwitch*<sup>TM</sup>, to several additional financial institutions. Currently, all of the Business' large financial institutions are in the process of implementing the *eSwitch*<sup>TM</sup> program, with three now fully implemented.

In April, the Fund announced an additional initiative with the purchase of a partnership interest in a business that provides lenders with search and registration services across Canada. This adds another service that Davis + Henderson can supply to its financial services customers.

## OPERATING RESULTS FOR THE FIRST QUARTER

### Consolidated Statement of Income

| <i>(in thousands of Canadian dollars, except per unit amounts, unaudited)</i> | March 31, 2005 | Three months ended<br>March 31, 2004 |
|---|----------------|--------------------------------------|
| Sales   | \$ 66,234      | \$ 68,589                            |
| Cost of sales   | 39,300         | 41,077                               |
| Gross profit  | 26,934         | 27,512                               |
|   | 40.7%          | 40.1%                                |
| Operating expenses  | 7,694          | 7,709                                |
|   | 11.6%          | 11.2%                                |
| Operating income  | 19,240         | 19,803                               |
|   | 29.0%          | 28.9%                                |
| Interest expense  | 889            | 1,085                                |
| Amortization expense  | 3,796          | 4,134                                |
| Income taxes  | -              | 1,666                                |
| Net income  | \$ 14,555      | \$ 12,918                            |
| Net income per unit, basic and diluted  | \$ 0.3838      | \$ 0.3407                            |

Sales for the first quarter of 2005 decreased by \$2.4 million, or 3.4%, to \$66.2 million when compared to the same quarter in 2004. There were two fewer business days in the first quarter of 2005 versus the first quarter of 2004, accounting for a significant portion of the quarter-over-quarter decrease. Additionally, personal cheque daily order volumes during the first quarter of the year were lower than those in the first quarter of 2004. Specifically, in the first quarter of 2005, volumes were negatively impacted by a reduction in promotional activities by certain customers relating to line of credit and account acquisition activities. As well, in the case of one financial institution, there was a delay in the submission of orders to Davis + Henderson until after April 1, 2005, the scheduled release date of the new Canadian Payments Association compliant cheques. More generally however, volumes were less than those expected based upon average historical trends. Sales were positively affected by the increased value of orders received as a result of program enhancements and the continued migration of orders to the telephone order channel, *ChequeAdvisor*, and to the web-based order channel, *ChequeCentral*. As well, *eSwitch*<sup>TM</sup> volume also contributed to sales growth.

## MANAGEMENT'S DISCUSSION AND ANALYSIS *(continued)*

Management does not believe that there have been material long-term changes in the primary factors affecting cheque orders beyond those historically experienced. Management continues to believe that declining cheque usage has historically contributed to and will continue to contribute to declining cheque orders. Management further believes that other factors, including a significant number of orders received when consumers open new accounts and the migration by consumers towards orders with fewer cheques, will somewhat mitigate the impact related to reduced cheque usage.

Gross profit for the quarter decreased by \$0.6 million, or 2.1%, to \$26.9 million compared with the same period last year primarily as a result of the changes discussed above. Gross margin for the quarter ended March 31, 2005 improved to 40.7% from 40.1% reported during the first quarter of 2004. The increase in gross profit percentage is attributed to higher production efficiencies resulting from continual investments in technology and processes, partially offset by increasing call centre costs.

Operating expenses of \$7.7 million for the first quarter of 2005 were comparable to expenses reported for the first quarter of 2004. Expense reductions related to the elimination of capital taxes with the change in the internal corporate structure in July 2004, reduced marketing costs, lower employee compensation costs and lower professional fees were offset by an increase in technology expenses required to support and upgrade the technology infrastructure.

Operating income decreased by \$0.6 million, or 2.8%, in the first quarter of 2005 over the same quarter in 2004. The changes were a result of the combination of factors referred to above. First quarter operating income as a percentage of sales was essentially unchanged at 29.0% compared to 28.9% for the same quarter last year.

Net interest expense decreased from \$1.1 million for the three months ended March 31, 2004, to \$0.9 million for the three months ended March 31, 2005. Lower interest expenses reflect the lower loan balances outstanding during the first quarter of 2005 versus the same period in 2004.

Amortization expense during the first quarter decreased \$0.3 million, or 8.2%, from the same quarter in the prior year, mainly due to older assets being fully amortized.

After the internal reorganization on July 26, 2004, which converted the Davis + Henderson corporate structure to a trust-on-trust-on-partnership structure, the Fund and its subsidiaries are not subject to any taxes as long as all taxable income generated by the structure is paid to unitholders in the form of distributions. Accordingly,

there was no provision for income taxes recorded for the first quarter of 2005 compared to \$1.7 million recorded during the first quarter of 2004.

Net income of \$14.6 million for the first quarter of 2005 represents an increase of \$1.6 million, or 12.7%, over the same quarter in the previous year, primarily as a result of reduced taxes as discussed above.

### Consolidated Statement of Distributable Cash

| <i>(in thousands of Canadian dollars, except per unit amounts, unaudited)</i> | March 31, 2005 | Three months ended<br>March 31, 2004 |
|---|----------------|--------------------------------------|
| Net income  | \$ 14,555      | \$ 12,918                            |
| Add:  |                |                                      |
| Amortization expense  | 3,796          | 4,134                                |
| Future income taxes   | –              | 1,363                                |
| Cash flow from operations   | 18,351         | 18,415                               |
| Less:   |                |                                      |
| Maintenance capital expenditures  |                |                                      |
| Capital and other assets  | 1,519          | 1,696                                |
| Contract payments   | 1,250          | 1,250                                |
| Distributable cash  | \$ 15,582      | \$ 15,469                            |
| Distributions declared  | \$ 13,651      | \$ 13,151                            |
| Net income per unit   | \$ 0.3838      | \$ 0.3407                            |
| Distributable cash per unit   | \$ 0.4109      | \$ 0.4079                            |
| Distributions per unit  | \$ 0.3600      | \$ 0.3468                            |

Distributable cash is not a defined term under Canadian generally accepted accounting principles but is determined by the Business as net income for the period adjusted to remove specific non-cash items, including amortization and future income taxes, and reduced by maintenance capital expenditures. Non-maintenance capital expenditures are not recorded as a reduction from distributable cash since these expenditures are considered non-recurring and are intended to generate future growth in distributable cash and distributions.

Management believes that distributable cash is a useful supplemental measure of performance as it provides investors with an indication of the amount of cash available for distribution to unitholders. Investors are cautioned, however, that distributable cash should not be construed as an alternative to using net earnings as a measure of profitability or the statement of cash flows. Further, the Fund's method of calculating distributable cash may not be comparable to similarly titled amounts reported by other issuers.

Distributable cash increased by \$0.1 million, or 0.7%, to \$15.6 million for the first quarter of 2005 relative to \$15.5 million recorded in the first quarter of 2004. Net income before amortization and future income taxes was slightly lower in the first quarter of 2005 as compared with the same quarter last year. However, maintenance capital decreased by \$0.2 million in the first quarter of 2005 compared with the same quarter last year, resulting in the quarter-over-quarter increase in distributable cash.

Maintenance capital expenditures will fluctuate based on the timing differences in implementing the Business' capital plan. The Business is continuing its program of investment in the technology area to enable the replacement and enhancement of certain components of the Business' technology infrastructure.

Declared distributions of \$13.7 million for the first quarter of 2005 increased by \$0.5 million, or 3.8%, compared with the first quarter of 2004. The current monthly distribution rate is \$0.1200 per unit, or \$1.44 per unit annualized.

## SUMMARY OF QUARTERLY RESULTS

### Eight Quarter Consolidated Statement of Income – Summary

*(in thousands of Canadian dollars, except per unit amounts, unaudited)*

|                     | 2005      |           | 2004      |           |           |           | 2003      |           |
|---------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|                     | Q1        | Q4        | Q3        | Q2        | Q1        | Q4        | Q3        | Q2        |
| Sales               | \$ 66,234 | \$ 69,068 | \$ 69,065 | \$ 68,864 | \$ 68,589 | \$ 63,636 | \$ 63,404 | \$ 62,676 |
| Operating income    | 19,240    | 19,944    | 19,614    | 19,436    | 19,803    | 18,777    | 18,732    | 18,368    |
| Net income          | 14,555    | 15,098    | 13,707    | 12,545    | 12,918    | 12,305    | 12,289    | 12,035    |
| Net income per unit | \$ 0.3838 | \$ 0.3981 | \$ 0.3615 | \$ 0.3308 | \$ 0.3407 | \$ 0.3245 | \$ 0.3241 | \$ 0.3174 |

Over the last eight quarters, sales have been generally stable and growing with the exception of the first quarter of 2005, when sales were down \$2.8 million compared with the previous quarter. The primary factor that impacted first quarter 2005 sales was lower than expected personal daily order volumes, as previously discussed, and reduced sales from a customer promotional campaign in the fourth quarter of 2004.

Operating income has been steady for the past eight quarters, but was down \$0.7 million as a result of the revenue decline discussed above and an increase in technology expenses, offset partially by reduced expenses in the area of marketing, employee compensation and professional fees.

## Eight Quarter Consolidated Statement of Distributable Cash – Summary

(in thousands of Canadian dollars, except per unit amounts, unaudited)

|                                    | 2005      |           |           |           | 2004      |           | 2003      |           |
|------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|                                    | Q1        | Q4        | Q3        | Q2        | Q1        | Q4        | Q3        | Q2        |
| Distributable cash                 | \$ 15,582 | \$ 15,626 | \$ 16,223 | \$ 16,013 | \$ 15,469 | \$ 15,247 | \$ 15,501 | \$ 15,003 |
| Distributions declared             | 13,651    | 13,530    | 13,287    | 13,287    | 13,151    | 13,083    | 12,889    | 12,888    |
| Distributable cash<br>per unit     | \$ 0.4109 | \$ 0.4121 | \$ 0.4278 | \$ 0.4223 | \$ 0.4079 | \$ 0.4021 | \$ 0.4088 | \$ 0.3956 |
| Distributions declared<br>per unit | \$ 0.3600 | \$ 0.3568 | \$ 0.3504 | \$ 0.3504 | \$ 0.3468 | \$ 0.3450 | \$ 0.3399 | \$ 0.3399 |

Distributable cash for the first quarter of 2005 at \$15.6 million was comparable to the amount reported for the fourth quarter of 2004, in spite of lower operating income reported for the first quarter of 2005. This is a result of lower maintenance capital expenditures, which are deducted to arrive at distributable cash. Maintenance capital expenditures were unusually high in the fourth quarter of 2004.

## CASH FLOW AND LIQUIDITY

### Consolidated Summary of Cash Flow Activities

| (in thousands of Canadian dollars, unaudited)        | March 31, 2005 | Three months ended<br>March 31, 2004 |
|--|----------------|--------------------------------------|
| Cash flows from operating activities                 | \$ 13,406      | \$ 18,497                            |
| Cash flows used for distributions                    | (13,652)       | (13,083)                             |
| Cash flows from (used in) other financing activities | (3,000)        | –                                    |
| Cash flows used for investing activities             | (2,769)        | (3,243)                              |
| Net change in cash                                   | \$ (6,015)     | \$ 2,171                             |

### Cash Flows from Operating Activities

During the quarter ended March 31, 2005, the Business generated \$13.4 million in cash flows from operating activities, including a reduction in cash flows of \$5.0 million as a result of an increase in non-cash working capital balances. The changes in the non-working capital were primarily related to a pay down of current liabilities, including payments related to annual bonuses. The first quarter of 2004 reflected the same general changes in non-working capital balances but benefited from increased payable levels, including those associated with the implementation of the U.S. cheque program.

### **Cash Flows Used for Distributions**

Monthly distributions are declared by the Fund for unitholders of record on the last business day of each month and are paid within 31 days following each month end. Distributions paid during the first quarter include distributions declared for the month of December prior to the start of the quarter, but do not include amounts declared for the last month of the quarter.

During the quarter ended March 31, 2005, the Fund paid distributions of \$13.7 million, compared to \$13.1 million for the same period in the prior year. This increase is consistent with the Fund's financial goal of delivering stable and modestly growing cash distributions to unitholders.

The tax allocation of distributions declared for 2005 is estimated to be 91.6% interest income and 8.4% return of capital. The 2004 tax allocation was 15.0% dividend income, 75.2% interest income, and 9.8% return of capital. The change in tax allocation from 2004 to 2005 is primarily the result of the internal reorganization completed in 2004.

The Fund may issue an unlimited number of trust units. Each trust unit is transferable and represents an equal, undivided beneficial interest in any distribution from the Fund and the net assets of the Fund. All units are of the same class with equal rights and privileges and are not subject to future calls or assessments. Each unit entitles the holder to one vote at all meetings of unitholders.

As at March 31, 2005 and April 28, 2005, 37,920,792 trust units were outstanding. This total number of outstanding units has remained unchanged since April 2, 2002.

### **Cash Flows Used in Other Financing Activities**

Cash flows used in other financing activities in the first quarter of 2005 relate to the reduction of the Business' long-term indebtedness.

## Cash Flows Used in Investing Activities

### Expenditures on Capital and Other Assets

| <i>(in thousands of Canadian dollars, unaudited)</i> | March 31, 2005  | Three months ended<br>March 31, 2004 |
|--|-----------------|--------------------------------------|
| Maintenance capital                                  |                 |                                      |
| Machinery and equipment                              | \$ 88           | \$ 38                                |
| Computer and software                                | 1,386           | 1,193                                |
| Furniture, fixtures and leasehold improvements       | 45              | 465                                  |
| <b>Total maintenance capital</b>                     | <b>1,519</b>    | <b>1,696</b>                         |
| Contract payments, maintenance                       | 1,250           | 1,250                                |
| <b>Total maintenance expenditures</b>                | <b>2,769</b>    | <b>2,946</b>                         |
| Non-maintenance capital                              |                 |                                      |
| Other new services                                   | -               | 97                                   |
| <b>Total non-maintenance capital</b>                 | <b>-</b>        | <b>97</b>                            |
| Contract payments, non-maintenance                   | -               | 200                                  |
| <b>Total non-maintenance expenditures</b>            | <b>-</b>        | <b>297</b>                           |
| <b>Total capital investments</b>                     | <b>\$ 2,769</b> | <b>\$ 3,243</b>                      |

The table above sets out maintenance and non-maintenance expenditures, which include both capital assets and payments under customer contracts. The Fund has various payment obligations under customer contracts. Certain long-term customer contracts provide for fixed contract or program initiation payments to be made and these are treated as non-maintenance capital in that they are not regularly recurring disbursements. Other fixed customer contract payments are made annually over the life of the contract and therefore are treated as recurring maintenance capital. The aggregate of all contract payments, both fixed and variable, recognizes, among other things, the high degree of integration and sharing between Davis + Henderson and the financial institutions of the many activities related to ordering, data handling, customer service and other activities undertaken by financial institutions as part of the operation of the cheque supply and other programs. Previously, total maintenance capital expenditures for the full 2005 fiscal year were anticipated to be equal to or a little more than the \$7.2 million

spent in 2004. As a result of further scoping of information technology maintenance and replacement programs, it is now estimated that certain projects will be implemented over a longer time period than originally anticipated. The planned programs remain unchanged with the exception that the implementation timeframe will extend into 2006. Accordingly, it is anticipated that the maintenance capital expenditures in 2005 will be approximately \$6.0 to \$7.0 million.

The Fund's capital program provides for continued annual maintenance expenditures to be funded by the cash flows from operations. These expenditures are generally directed toward direct ordering technology, the implementation of new programs within the cheque supply business and the maintenance and upgrading of the Business' technology infrastructure. Maintenance capital for the quarter ended March 31, 2005 was consistent with this capital program.

Non-maintenance expenditures support the development of new programs and services, major production efficiency initiatives and certain contract payments. There were no expenditures classified as non-maintenance during the first quarter of 2005.

#### **Cash Balances and Long-term Indebtedness**

At March 31, 2005, cash and cash equivalents totalled \$4.2 million, compared to \$10.3 million at December 31, 2004, which reflects a payment of \$3.0 million against the revolving term debt and the pay down of certain current liabilities.

During the first quarter of 2005, the Business amended the terms of its term credit facilities and extended the maturity dates to January 24, 2009. The facilities now total \$90.0 million and include a \$50.0 million non-revolving term loan and a \$40.0 million revolving term credit facility.

Immediately following the extension and amendment, the Business made a voluntary debt payment of \$3.0 million. As of March 31, 2005, the Business had drawn \$50.0 million under the non-revolving term loan and \$7.0 million under the revolving credit facility. The Business is permitted to draw on the revolving facility's available balance of \$33.0 million to fund capital expenditures or for other general corporate purposes.

The Business has fixed interest rates on \$50.0 million of its outstanding debt at rates of between 5.13% and 6.83% for swap terms ending between March 27, 2006 and January 4, 2009. The average effective interest rate applicable to the Fund's total indebtedness was 5.66% as at March 31, 2005.

Cash flows from operations together with cash balances on hand and unutilized term credit facilities are expected to be sufficient to fund the Business' operating requirements, capital expenditures and anticipated distributions.

## OUTLOOK

Davis + Henderson's overall long-term objective is to deliver stable and modestly growing distributions through growing sales in the 3% to 5% range and maintaining margins. In 2004, with the implementation of the U.S. cheque supply program, extra business days, and the benefit of strong customer promotional campaigns, the Business exceeded this growth target. Based upon the sales level in the first quarter in 2005, the Fund expects sales growth to be below the 3% to 5% range, however, the Fund's overall long-term objective remains unchanged.

As set out in the Fund's statement of strategy, the objective is to grow profits by enhancing the value of our cheque supply program, by expanding into new programs to serve the chequing account and by pursuing additional opportunities related to other key transactional accounts of our financial institution customers.

The Business' operational plans include many initiatives which, when combined, are intended to allow us to meet our objectives. Meeting our growth objective is not dependent on any one of the initiatives as most of the new programs and services are individually not large. Examples of such programs include rolling out *eSwitch*<sup>TM</sup> services to additional national customers and delivering other account opening services and products for chequing and lending accounts. Additionally, the continued increase in the adoption rate of *ChequeCentral* and *ChequeAdvisor* programs is expected to increase average value per order. Growth in the U.S. over the next few years is expected to come solely from the Fund's current base of business.

In April, the Fund announced an additional initiative with the purchase of a partnership interest in a business that provides lenders with search and registration services across Canada. This adds another service that Davis + Henderson can supply to its financial services customers.

Looking forward, operating expenses are expected to show modest growth over 2004 levels and maintenance capital expenditures are expected to show modest declines as previously described.

## MANAGEMENT'S DISCUSSION AND ANALYSIS *(continued)*

Certain information included in this report is forward looking and based upon assumptions and anticipated results that are subject to risks and uncertainties associated with Davis + Henderson's business and the economic environment in which the Business operates. Should one or more of these uncertainties materialize or should the underlying assumptions prove incorrect, actual results may vary significantly from those expected. Risks and uncertainties are discussed above, as well as in greater detail in the Fund's most recently filed Annual Report and Annual Information Form, each of which are available on SEDAR at [www.sedar.com](http://www.sedar.com).

### **ADDITIONAL INFORMATION**

Additional information relating to the Fund, including the Fund's most recently filed Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

April 28, 2005

# CONSOLIDATED BALANCE SHEETS

(in thousands of Canadian dollars, unaudited)

March 31, 2005      December 31, 2004

## ASSETS

### Current Assets:

|                            |            |            |
|----------------------------|------------|------------|
| Cash and cash equivalents  | \$ 4,243   | \$ 10,258  |
| Accounts receivable        | 9,918      | 8,936      |
| Inventory                  | 5,377      | 5,404      |
| Prepaid expenses           | 1,531      | 1,012      |
|                            | <hr/>      | <hr/>      |
|                            | 21,069     | 25,610     |
| Capital assets (note 2)    | 23,747     | 24,333     |
| Other assets (note 3)      | 10,905     | 12,012     |
| Intangible assets (note 4) | 8,671      | 9,255      |
| Goodwill                   | 359,385    | 359,385    |
|                            | <hr/>      | <hr/>      |
|                            | \$ 423,777 | \$ 430,595 |

## LIABILITIES AND UNITHOLDERS' EQUITY

### Current Liabilities:

|   |           |           |
|---|-----------|-----------|
| Accounts payable and accrued liabilities                                      | \$ 22,578 | \$ 26,126 |
| Distributions payable to unitholders  | 4,550     | 4,551     |
| Current portion of disbursement obligations<br>on customer contracts (note 5) | 3,245     | 3,745     |
|   | <hr/>     | <hr/>     |
|   | 30,373    | 34,422    |
| Disbursement obligations on customer contracts (note 5)                       | 4,685     | 5,435     |
| Long-term indebtedness (note 6)   | 57,000    | 60,000    |
| Other long-term liabilities (note 7)  | 2,245     | 2,168     |
|   | <hr/>     | <hr/>     |
|   | 94,303    | 102,025   |

### Unitholders' Equity:

|                      |          |          |
|----------------------|----------|----------|
| Trust units (note 8) | 365,385  | 365,385  |
| Deficit              | (35,911) | (36,815) |
|                      | <hr/>    | <hr/>    |
|                      | 329,474  | 328,570  |

### Commitments (note 9)

|  |            |            |
|--|------------|------------|
|  | <hr/>      | <hr/>      |
|  | \$ 423,777 | \$ 430,595 |

The accompanying notes are an integral part of these consolidated financial statements.



Paul Damp  
Trustee



Gordon J. Feeney  
Trustee



Allan Gotlieb  
Trustee



Brad Nullmeyer  
Trustee



Helen K. Sinclair  
Trustee

## CONSOLIDATED STATEMENTS OF INCOME

(in thousands of Canadian dollars, except per unit amounts, unaudited)

|   | March 31, 2005 | Three months ended<br>March 31, 2004 |
|---|----------------|--------------------------------------|
| Sales                                     | \$ 66,234      | \$ 68,589                            |
| Cost of sales                             | 39,300         | 41,077                               |
|   | 26,934         | 27,512                               |
| Operating expenses                        | 7,694          | 7,709                                |
|   | 19,240         | 19,803                               |
| Interest expense                          | 889            | 1,085                                |
| Amortization expense                      | 3,796          | 4,134                                |
| Income before income taxes                | 14,555         | 14,584                               |
| Income taxes (note 10):                   |                |                                      |
| Current                                   | –              | 303                                  |
| Future                                    | –              | 1,363                                |
|   | –              | 1,666                                |
| Net income                                | \$ 14,555      | \$ 12,918                            |
| Net income per unit,<br>basic and diluted | \$ 0.3838      | \$ 0.3407                            |

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF DEFICIT

(in thousands of Canadian dollars, unaudited)

|                              | March 31, 2005 | Three months ended<br>March 31, 2004 |
|------------------------------|----------------|--------------------------------------|
| Deficit, beginning of period | \$ (36,815)    | \$ (9,657)                           |
| Net income for the period    | 14,555         | 12,918                               |
| Distributions                | (13,651)       | (13,151)                             |
| Deficit, end of period       | \$ (35,911)    | \$ (9,890)                           |

The accompanying notes are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of Canadian dollars, unaudited)

|   | March 31, 2005  | Three months ended<br>March 31, 2004 |
|---|-----------------|--------------------------------------|
| Cash and cash equivalents provided by (used in):                |                 |                                      |
| <b>OPERATING ACTIVITIES</b>                                     |                 |                                      |
| Net income  | \$ 14,555       | \$ 12,918                            |
| Add:  |                 |                                      |
| Amortization expense  | 3,796           | 4,134                                |
| Future income taxes   | –               | 1,363                                |
|   | <u>18,351</u>   | <u>18,415</u>                        |
| Changes in non-cash working capital items                       | (5,022)         | 77                                   |
| Changes in other long-term liabilities                          | 77              | 5                                    |
|   | <u>13,406</u>   | <u>18,497</u>                        |
| <b>FINANCING ACTIVITIES</b>                                     |                 |                                      |
| Repayment of revolving credit facility                          | (3,000)         | –                                    |
| Distributions paid to public unitholders                        | (13,652)        | (13,083)                             |
|   | <u>(16,652)</u> | <u>(13,083)</u>                      |
| <b>INVESTING ACTIVITIES</b>                                     |                 |                                      |
| Expenditures on capital assets                                  | (1,519)         | (1,793)                              |
| Expenditures on other assets                                    | (1,250)         | (1,450)                              |
|   | <u>(2,769)</u>  | <u>(3,243)</u>                       |
| Increase (decrease) in cash and cash equivalents for the period | (6,015)         | 2,171                                |
| Cash and cash equivalents, beginning of period                  | 10,258          | 4,981                                |
| Cash and cash equivalents, end of period                        | <u>\$ 4,243</u> | <u>\$ 7,152</u>                      |
| Supplementary information:                                      |                 |                                      |
| Cash interest paid  | \$ 1,624        | \$ 620                               |
| Cash income taxes paid  | \$ –            | \$ 421                               |

The accompanying notes are an integral part of these consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three months ended March 31, 2005 and 2004

*(in thousands of Canadian dollars, except unit and per unit amounts, unaudited)*

### NATURE OF BUSINESS

Davis + Henderson Income Fund (the “Fund”) is a limited-purpose trust, formed under the laws of the Province of Ontario by a declaration of trust dated November 6, 2001 and as amended and restated on July 23, 2004. The Fund was formed to indirectly acquire the partnership units of Davis + Henderson, Limited Partnership (“Davis + Henderson L.P.”).

Davis + Henderson L.P. is engaged primarily in the business of providing cheque supply program services to Canadian financial institutions. Davis + Henderson L.P. commenced operations on December 20, 2001, when it acquired the Davis + Henderson business. Simultaneously, on December 20, 2001, the Fund completed an initial public offering and acquired a 45.4% interest in Davis + Henderson L.P. On January 10, 2002, under an over-allotment option, the Fund acquired an additional 4.5% interest in Davis + Henderson L.P. On April 2, 2002, the Fund acquired the remaining balance of Davis + Henderson L.P. and now holds 100%.

### 1. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared using the following accounting policies generally accepted in Canada and follow the same accounting policies and their method of application as the Fund’s consolidated financial statements for the year ended December 31, 2004, which are included in the 2004 Annual Report. They do not conform in all respects with disclosures required for annual financial statements and should be read in conjunction with the audited consolidated financial statements of the Fund for the year ended December 31, 2004.

The preparation of financial statements requires that management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and sales and expenses during the reporting period. Actual results could differ from these estimates.

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Fund and its wholly owned subsidiaries, consisting of D + H Holdings Trust, D + H Holdings Corp. (prior to July 26, 2004), Davis + Henderson G.P. Inc., and Davis + Henderson L.P. All inter-company transactions and accounts have been eliminated upon consolidation.

## Financial Instruments

The Fund's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, disbursement obligations on customer contracts, distributions payable to unitholders, interest-rate swaps and long-term indebtedness. The Fund does not enter into financial instruments for trading or speculative purposes.

*Credit Risk* The Fund's financial assets that are exposed to credit risk consist primarily of cash and cash equivalents, accounts receivable and interest-rate swaps. The Fund, in its normal course of business, is exposed to credit risk from its customers. The Fund is exposed to credit loss in the event of non-performance by counterparties to the interest-rate swaps. Risks associated with concentrations of credit risk with respect to accounts receivable and interest-rate swaps are limited due to the credit ratings of the Fund's customers and swap counterparties and the generally short payment terms and frequent settlement of swap differences.

*Fair Value* The fair value of indebtedness that bears interest at fixed rates is based on discounted future cash flows using rates currently available for debt of similar terms and maturities. The carrying value of other financial instruments, being cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and the current portion of the disbursement obligations on customer contracts, approximates fair value due to their short-term maturities.

*Derivative Financial Instruments* Derivative financial instruments are utilized to reduce interest-rate risk on the Fund's debt. The Fund's policy is to formally designate each derivative financial instrument as a hedge of a specifically identified debt instrument. The Fund believes the derivative financial instruments are effective as hedges, both at inception and over the term of the instrument, as the term to maturity, the (notional) principal amount and the interest-rate basis in the instruments all match the terms of the debt instrument being hedged.

Interest-rate swap agreements are used as part of the Fund's program to manage the fixed and floating interest rate mix of the Fund's total debt outstanding and related overall cost of borrowing. The interest-rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based and are recorded as an adjustment of interest expenses on the hedged debt instrument. The related amounts payable to or receivable from swap counterparties are included as adjustments to accrued interest.

In the event of a termination of an interest-rate swap agreement, gains and losses would be deferred under other current, or non-current, assets or liabilities on the balance sheet and amortized as an adjustment to interest expense related to the obligation over the remaining term of the original contract life of the terminated swap agreement. In the event of early extinguishments of the debt obligation, any realized or unrealized gain or loss from the swap is recognized in the consolidated statement of income at the time of extinguishment.

**Cash and Cash Equivalents**

All temporary investments with an original maturity of three months or less when purchased are considered to be cash equivalents.

The Fund and its subsidiaries maintain cash balances in bank deposit accounts or investments in amounts that exceed federally insured limits. The Fund has not experienced any losses in such accounts.

**Inventory**

Inventory of raw materials is stated at the lower of cost and replacement cost. Cost is determined on a first-in, first-out basis.

**Capital Assets**

Capital assets are recorded at cost. Amortization is provided annually at rates calculated to write off the assets over their estimated useful lives as follows:

|                                  |                                      |
|----------------------------------|--------------------------------------|
| Computer, furniture and fixtures | 10% to 30% declining balance         |
| Machinery and equipment          | 10% to 20% declining balance         |
| Leasehold improvements           | straight-line over term of the lease |

**Deferred Charges**

The Fund capitalizes direct costs related to the development of new products and services until the commencement of commercial operation, at which time all related costs are amortized on a straight-line basis over their estimated useful life.

Payments associated with certain major customer contracts are amortized over the term of the related long-term supply contracts.

## **Goodwill**

Goodwill reflects the price paid for the Davis + Henderson business in excess of the fair market value of net tangible assets and identifiable intangible assets acquired. Goodwill is not amortized but is tested for impairment annually.

## **Intangible Assets**

Intangible assets represent the fair market value of rights related to the cheque supply outsourcing contracts obtained by the Fund upon the acquisition of the Davis + Henderson business. Intangible assets are amortized over seven years. The carrying value of the intangible assets is tested for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

## **Revenue Recognition**

The Fund is the principal on all sales transactions and has presented sales based on the gross amount billed to the customers. Revenue for services and product sales is recognized when the services are completed and the products are shipped.

## **Net Income per Unit**

Net income per unit is calculated by dividing net income by the weighted average number of units outstanding during the period.

## **Foreign Currency Translation**

Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date, and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transaction. Foreign exchange gains and losses are included in income.

## **Future Income Taxes**

Future income taxes of the Fund's subsidiary, D + H Holdings Corp., prior to July 26, 2004, are determined using the asset and liability method. Under this method of tax allocation, future tax assets and liabilities are determined on the basis of differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Subsequent to July 26, 2004, the Fund and its subsidiaries are not subject to any income taxes provided all taxable income generated is distributed to unitholders in the form of distributions. Accordingly, subsequent to that date, the Fund no longer records a provision for income taxes.

**Employee Future Benefits**

The Fund provides certain post-retirement benefits for eligible employees, which are not funded. These benefits include health care, life insurance and dental benefits. Obligations under the post-retirement benefit plan are actuarially determined and are accrued by the Fund.

For the Fund's defined contribution pension plan, annual pension expense is based on the Fund's actual contributions to the plan.

**Related Parties**

For the purposes of the financial statements, parties are considered related to the Fund if the Fund has the ability to, directly or indirectly, control the party or exercise significant influence over the party in making financial and operating decisions or vice versa, or where the Fund and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

## 2. CAPITAL ASSETS

|  | March 31, 2005   |                             |                  |
|--|------------------|-----------------------------|------------------|
|  | Cost             | Accumulated<br>amortization | Net              |
| Machinery and equipment                        | \$ 14,042        | \$ 4,502                    | \$ 9,540         |
| Computer equipment and software                | 24,101           | 12,384                      | 11,717           |
| Furniture, fixtures and leasehold improvements | 5,951            | 3,461                       | 2,490            |
|  | <u>\$ 44,094</u> | <u>\$ 20,347</u>            | <u>\$ 23,747</u> |

|  | December 31, 2004 |                             |                  |
|--|-------------------|-----------------------------|------------------|
|  | Cost              | Accumulated<br>amortization | Net              |
| Machinery and equipment                        | \$ 13,954         | \$ 4,172                    | \$ 9,782         |
| Computer equipment and software                | 22,715            | 10,923                      | 11,792           |
| Furniture, fixtures and leasehold improvements | 5,905             | 3,146                       | 2,759            |
|  | <u>\$ 42,574</u>  | <u>\$ 18,241</u>            | <u>\$ 24,333</u> |

Amortization during the quarter ended March 31, 2005 was \$2,105 (Q1 2004 – \$2,166).

## 3. OTHER ASSETS

|                            | March 31, 2005   | December 31, 2004 |
|----------------------------|------------------|-------------------|
| Cost:                      |                  |                   |
| Long-term supply contracts | \$ 17,788        | \$ 17,788         |
| Deferred charges and other | 370              | 370               |
|                            | <u>18,158</u>    | <u>18,158</u>     |
| Accumulated amortization   | (7,253)          | (6,146)           |
|                            | <u>\$ 10,905</u> | <u>\$ 12,012</u>  |

Amortization during the quarter ended March 31, 2005 was \$1,107 (Q1 2004 – \$1,384).

## 4. INTANGIBLE ASSETS

|                          | March 31, 2005  | December 31, 2004 |
|--------------------------|-----------------|-------------------|
| Cost                     | \$ 16,328       | \$ 16,328         |
| Accumulated amortization | (7,657)         | (7,073)           |
|                          | <u>\$ 8,671</u> | <u>\$ 9,255</u>   |

Amortization during the quarter ended March 31, 2005 was \$584 (Q1 2004 – \$584).

**5. DISBURSEMENT OBLIGATIONS ON CUSTOMER CONTRACTS**

|  | March 31, 2005 | December 31, 2004 |
|--|----------------|-------------------|
| Current portion                                      | \$ 3,245       | \$ 3,745          |
| Long-term portion                                    | 4,685          | 5,435             |
| Total disbursement obligations on customer contracts | \$ 7,930       | \$ 9,180          |

The Fund has customer fixed contract disbursement obligations payable as of March 31, 2005 as follows:

|      |          |
|------|----------|
| 2005 | \$ 2,495 |
| 2006 | 2,645    |
| 2007 | 1,395    |
| 2008 | 1,395    |
|      | \$ 7,930 |

**6. LONG-TERM INDEBTEDNESS**

|                           | March 31, 2005 | December 31, 2004 |
|---------------------------|----------------|-------------------|
| Non-revolving term loan   | \$ 50,000      | \$ 60,000         |
| Revolving credit facility | 7,000          | –                 |
|                           | \$ 57,000      | \$ 60,000         |

The Fund has \$90.0 million of term credit facilities due January 24, 2009 (December 31, 2004 – \$98.0 million), consisting of a \$50.0 million non-revolving term loan and a \$40.0 million revolving credit facility. The facilities bear interest at rates that depend on certain financial ratios of the Fund and vary in accordance with borrowing rates in Canada and the United States. The credit facilities, including any hedge contracts with the lenders, are secured in first priority by a pledge of substantially all of the Fund’s assets and by a pledge of the Fund’s indirect ownership interests in Davis + Henderson L.P. The fair value of long-term indebtedness approximates its carrying value.

As of March 31, 2005, the Fund has entered into interest-rate swap hedge contracts with its lenders, such that the borrowing rates on \$50.0 million or 87.7% of its outstanding term indebtedness are effectively fixed at interest rates of between 5.13% and 6.83% per annum for terms ending between March 27, 2006 and January 4, 2009. As of March 31, 2005, the fair value of outstanding interest-rate swaps was approximately \$0.6 million (December 31, 2004 – \$0.9 million), which the Fund would be required to pay if it were to close out the contracts.

## 7. OTHER LONG-TERM LIABILITIES

|                               | March 31, 2005  | December 31, 2004 |
|-------------------------------|-----------------|-------------------|
| Deferred compensation program | \$ 919          | \$ 766            |
| Employee future benefits      | 1,326           | 1,402             |
|                               | <u>\$ 2,245</u> | <u>\$ 2,168</u>   |

The deferred compensation program is a long-term incentive plan for management, subject to certain performance criteria and vesting terms, payable shortly after December 31, 2006. This incentive plan was implemented on January 1, 2004.

Employee future benefits consist of a defined contribution pension plan and a non-pension post-retirement benefit plan. Obligations relating to employee future benefits relate to the non-pension post-retirement benefit plan.

The Fund's principal pension plan is the "Defined Contribution Pension Plan for the Employees of Davis + Henderson," a defined contribution pension plan that provides pensions to substantially all employees with greater than two years of service. Total expense for the Fund's defined contribution pension plan for the quarter ended March 31, 2005 was \$0.3 million (Q1 2004 – \$0.3 million).

The Fund's non-pension post-retirement benefit plan provides certain health care, life insurance and dental benefits to eligible employees. Terms of the plan were amended effective January 1, 2005 resulting in a reduction in obligations of \$1.8 million and actuarial losses of \$1.6 million. Reduction in obligations from the plan amendment will be amortized over three and one-half years and the actuarial losses will be amortized over the next six years starting in 2005. The components of post-retirement benefit costs recognized for the quarter ended March 31, 2005 are as follows:

|  | March 31, 2005 | March 31, 2004 |
|--|----------------|----------------|
| Service cost – benefits earned   | \$ 3           | \$ 12          |
| Interest cost  | 16             | 21             |
| Difference between actuarial loss recognized and actual actuarial loss on accrued benefit obligation for the quarter | 67             | –              |
| Difference between amortization of past service costs and actual plan amendments for the quarter                     | (128)          | –              |
| Net non-pension post-retirement plan (recovery) expense  | <u>\$ (42)</u> | <u>\$ 33</u>   |

**8. TRUST UNITS**

An unlimited number of trust units may be issued by the Fund pursuant to the Fund’s declaration of trust. Each unit is transferable and represents an equal, undivided beneficial interest in any distributions from the Fund and in the net assets of the Fund. All units are of the same class with equal rights and privileges and are not subject to future calls or assessments. Each unit entitles the holder to one vote at all meetings of unitholders. The weighted number of units outstanding during the quarter ended March 31, 2005 was 37,920,792 (Q1 2004 – 37,920,792).

**9. COMMITMENTS**

As of March 31, 2005, the Fund has annual lease obligations with respect to real estate, vehicles and equipment as follows for the years ending:

|            |           |
|------------|-----------|
| 2005       | \$ 2,381  |
| 2006       | 3,091     |
| 2007       | 2,675     |
| 2008       | 2,262     |
| 2009       | 1,845     |
| Thereafter | 2,942     |
|            | \$ 15,196 |

**10. INCOME TAXES**

Income earned by the Fund that is distributed to unitholders in the form of distributions is not subject to taxation in the Fund, but is taxed at the individual unitholder level. A provision for income taxes is recognized for the Fund’s former subsidiary, D + H Holdings Corp., as this subsidiary was subject to tax, including large corporations tax and corporate minimum tax.

In July 2004, unitholders approved an internal reorganization which resulted in the replacement of D + H Holdings Corp. with a trust entity, D + H Holdings Trust. Income of D + H Holdings Trust will not be subject to income taxes as long as all taxable income generated is distributed to the Fund and ultimately to the unitholders in the form of distributions. Accordingly, no provision has been made for income taxes subsequent to July 2004.

## **11. RELATED PARTY TRANSACTIONS**

The Fund has a supplies and equipment maintenance contract with an entity related to an Officer of the Fund. Total amounts paid during the quarter ended March 31, 2005 were \$53 (Q1 2004 – \$60). Based on a review of amounts charged by third parties for similar services, the Fund determined the contract to be at fair market value.

A Trustee of the Fund serves as Chairman of the Board of Canada Post Corporation, one of the Business' major suppliers. Total purchases from this supplier during the quarter ended March 31, 2005 were \$6,286 (Q1 2004 – \$6,355).

## **12. SIGNIFICANT CUSTOMERS**

The Fund operates in one segment, an integrated service offering to Canadian financial institutions and their account holders. For the quarter ended March 31, 2005, the Fund earned 75% (Q1 2004 – 74%) of its revenue from its six largest customers.

## **13. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to conform to the current period's presentation.

## SUPPLEMENTARY FINANCIAL INFORMATION

### Operating Results by Period<sup>1</sup>

| (in thousands of Canadian dollars,<br>except per unit amounts, unaudited) | Three months<br>ended<br>March 31,<br>2005 | Three months<br>ended<br>December 31,<br>2004 | Three months<br>ended<br>September 30,<br>2004 | Three months<br>ended<br>June 30,<br>2004 | Three months<br>ended<br>March 31,<br>2004 |
|---|--|---|--|---|--|
| Sales   | \$ 66,234                                  | \$ 69,068                                     | \$ 69,065                                      | \$ 68,864                                 | \$ 68,589                                  |
| Cost of sales   | 39,300                                     | 40,758  | 41,274   | 40,914                                    | 41,077                                     |
| Operating expenses  | 7,694                                      | 8,366   | 8,177  | 8,514                                     | 7,709                                      |
| Operating income  | 19,240                                     | 19,944  | 19,614   | 19,436                                    | 19,803                                     |
| Interest expense  | 889  | 958   | 1,105  | 1,045                                     | 1,085                                      |
| Amortization and income taxes   | 3,796                                      | 3,888   | 4,802  | 5,846                                     | 5,800                                      |
| Net income  | 14,555                                     | 15,098  | 13,707   | 12,545                                    | 12,918                                     |
| Add:  |  |   |  |   |  |
| Amortization expense  | 3,796                                      | 3,888   | 3,847  | 3,973                                     | 4,134                                      |
| Future income taxes   | –  | –   | 745  | 1,437                                     | 1,363                                      |
| Cash flow from operations   | 18,351                                     | 18,986  | 18,299   | 17,955                                    | 18,415                                     |
| Less: Maintenance capital expenditures:                                   |  |   |  |   |  |
| Capital and other assets  | 1,519                                      | 2,715   | 1,451  | 1,317                                     | 1,696                                      |
| Contract payments   | 1,250                                      | 645   | 625  | 625                                       | 1,250                                      |
| Distributable cash <sup>1</sup>   | \$ 15,582                                  | \$ 15,626                                     | \$ 16,223                                      | \$ 16,013                                 | \$ 15,469                                  |
| Distributions declared  | \$ 13,651                                  | \$ 13,530                                     | \$ 13,287                                      | \$ 13,287                                 | \$ 13,151                                  |
| Net income per unit   | \$ 0.3838                                  | \$ 0.3981                                     | \$ 0.3615                                      | \$ 0.3308                                 | \$ 0.3407                                  |
| Cash flow from operations per unit  | \$ 0.4839                                  | \$ 0.5007                                     | \$ 0.4826                                      | \$ 0.4735                                 | \$ 0.4856                                  |
| Distributable cash per unit   | \$ 0.4109                                  | \$ 0.4121                                     | \$ 0.4278                                      | \$ 0.4223                                 | \$ 0.4079                                  |
| Distributions declared per unit   | \$ 0.3600                                  | \$ 0.3568                                     | \$ 0.3504                                      | \$ 0.3504                                 | \$ 0.3468                                  |

<sup>1</sup> Distributable cash is not a defined term under Canadian generally accepted accounting principles but is determined by the Fund as net income for the period adjusted to remove non-cash expenses, including amortization and future income taxes, and reduced by maintenance capital expenditures. Non-maintenance capital expenditures are not recorded as a reduction from distributable cash as these expenditures are considered non-recurring expenditures which are intended to generate future growth in distributable cash and distributions. Management believes that this earnings measure is a useful supplemental measure of performance as it provides investors with an indication of the amount of cash available for distribution to unitholders. Investors are cautioned, however, that distributable cash should not be construed as an alternative to using net earnings as a measure of profitability or as an alternative to the statement of cash flows. Further, the Fund's method of calculating distributable cash may not be comparable to similarly titled amounts reported by other issuers.

## SUPPLEMENTARY FINANCIAL INFORMATION *(continued)*

### Condensed Balance Sheet<sup>1</sup>

| (in thousands of Canadian dollars, unaudited)       | March 31,<br>2005 | December 31,<br>2004 | September 30,<br>2004 | June 30,<br>2004 | March 31,<br>2004 |
|---|-------------------|----------------------|-----------------------|------------------|-------------------|
| Cash and cash equivalents                           | \$ 4,243          | \$ 10,258            | \$ 11,647             | \$ 7,357         | \$ 7,152          |
| Other current assets                                | 16,826            | 15,352               | 15,744                | 16,672           | 15,898            |
| Future income taxes                                 | –                 | –                    | 28,170                | 28,915           | 30,352            |
| Capital and other assets                            | 34,652            | 36,345               | 36,888                | 32,643           | 34,589            |
| Goodwill and other intangible assets                | 368,056           | 368,640              | 369,223               | 369,806          | 370,389           |
|   | <b>\$423,777</b>  | <b>\$430,595</b>     | <b>\$461,672</b>      | <b>455,393</b>   | <b>\$458,380</b>  |
| Payables and other current liabilities <sup>1</sup> | \$ 30,373         | \$ 34,422            | \$ 35,632             | \$ 33,473        | \$ 31,235         |
| Other long-term liabilities <sup>1</sup>            | 6,930             | 7,603                | 7,867                 | 4,167            | 4,650             |
| Long-term indebtedness                              | 57,000            | 60,000               | 63,000                | 63,000           | 67,000            |
| Unitholders' equity                                 | 329,474           | 328,570              | 355,173               | 354,753          | 355,495           |
|   | <b>\$423,777</b>  | <b>\$430,595</b>     | <b>\$461,672</b>      | <b>\$455,393</b> | <b>\$458,380</b>  |

<sup>1</sup> Certain comparative figures have been reclassified to conform to the current period's presentation.

### Distribution History

| Month                 | 2005             | 2004             | 2003             | Distributions <sup>1</sup> per unit |                  |
|-----------------------|------------------|------------------|------------------|-------------------------------------|------------------|
|                       |                  |                  |                  | 2002                                | 2001             |
| January               | \$ 0.1200        | \$ 0.1150        | \$ 0.1117        | \$ 0.1083                           | \$ –             |
| February              | 0.1200           | 0.1150           | 0.1117           | 0.1083                              | –                |
| March                 | 0.1200           | 0.1168           | 0.1117           | 0.1083                              | –                |
| April                 |                  | 0.1168           | 0.1133           | 0.1083                              | –                |
| May                   |                  | 0.1168           | 0.1133           | 0.1083                              | –                |
| June                  |                  | 0.1168           | 0.1133           | 0.1083                              | –                |
| July                  |                  | 0.1168           | 0.1133           | 0.1117                              | –                |
| August                |                  | 0.1168           | 0.1133           | 0.1117                              | –                |
| September             |                  | 0.1168           | 0.1133           | 0.1117                              | –                |
| October               |                  | 0.1168           | 0.1150           | 0.1117                              | –                |
| November              |                  | 0.1200           | 0.1150           | 0.1117                              | –                |
| December <sup>2</sup> |                  | 0.1200           | 0.1150           | 0.1117                              | 0.0427           |
|                       | <b>\$ 0.3600</b> | <b>\$ 1.4044</b> | <b>\$ 1.3599</b> | <b>\$ 1.3200</b>                    | <b>\$ 0.0427</b> |

<sup>1</sup> Monthly distributions are made to unitholders of record on the last business day of each month and are paid within 31 days following each month end.

<sup>2</sup> Distribution paid in 2001 is in respect of the 12 calendar days from December 20, 2001 to December 31, 2001.

## Tax Allocation of Distributions

|                                    |        |
|------------------------------------|--------|
|                                    | 2005   |
| Interest income                    | 91.6%  |
| Return of capital                  | 8.4%   |
| Total distributions for the period | 100.0% |

The above estimate of tax allocation of distributions is based on total expected distributions for the year ending December 31, 2005.

As a result of the recent reorganization to a trust-on-trust-on-partnership structure, the 2005 distributions do not have a dividend component.

## Other Statistics

| Quarter ended<br>(in thousands, except per unit amounts) | Trading price range of units (TSX: "DHF.UN") |          |          | Average<br>daily<br>volume | Number of<br>units outstanding<br>at period end | Market<br>capitalization<br>at quarter end |
|--|--|----------|----------|----------------------------|---|--|
|  | High   | Low      | Close    |                            |   |  |
| 2005 Q1  | \$ 23.25                                     | \$ 19.65 | \$ 22.00 | 67                         | 37,921  | \$ 834,257                                 |
| 2004 Q4  | 23.25  | 18.80    | 22.70    | 81                         | 37,921  | 860,802                                    |
| Q3   | 19.62  | 16.75    | 19.45    | 58                         | 37,921  | 737,559                                    |
| Q2   | 19.34  | 15.05    | 18.00    | 93                         | 37,921  | 682,574                                    |
| Q1   | 19.40  | 16.71    | 19.40    | 92                         | 37,921  | 735,663                                    |
| 2003 Q4  | 17.50  | 15.10    | 17.45    | 67                         | 37,921  | 661,718                                    |
| Q3   | 15.65  | 14.52    | 15.30    | 99                         | 37,921  | 580,188                                    |
| Q2   | 15.20  | 12.91    | 15.00    | 82                         | 37,921  | 568,812                                    |
| Q1   | 13.69  | 12.48    | 12.94    | 92                         | 37,921  | 490,695                                    |
| 2002 Q4  | 13.25  | 11.22    | 12.86    | 139                        | 37,921  | 487,661                                    |
| Q3   | 12.13  | 10.45    | 12.10    | 165                        | 37,921  | 458,842                                    |
| Q2   | 11.25  | 10.00    | 10.95    | 176                        | 37,921  | 415,233                                    |
| Q1   | 11.20  | 10.11    | 10.51    | 149                        | 18,955  | 199,217                                    |

## COMMITTEES OF THE BOARD

The members of each committee are:

### Audit<sup>1</sup>

Gordon J. Feeney  
(Committee Chair)  
Paul Damp  
Bradley Nullmeyer

<sup>1</sup>Separate audit committees exist for the board of directors of Davis + Henderson G.P. Inc. and for the trustees of Davis + Henderson Income Fund consisting of the same individuals.

### Compensation and Corporate Governance<sup>2</sup>

Helen K. Sinclair  
(Committee Chair)  
Paul Damp  
Allan Gotlieb

<sup>2</sup>A committee of the board of directors of Davis + Henderson G.P. Inc.

## EXECUTIVE TEAM

C. Sanford McFarlane  
*Co-Chief Executive Officer*

Robert J. Cronin  
*Co-Chief Executive Officer*

Chad Alderson  
*Vice President and Chief Technology Officer*

Yves Denommé  
*Vice President, Operations*

Suzanne Mandrozou  
*Vice President, Human Resources*

Catherine Martin  
*Chief Financial Officer*

Serge Rivest  
*Vice President, Sales and Marketing*

Stephen Rotz  
*Vice President, Corporate Development*

Joanne Sisco  
*Vice President, Corporate Data Services*

## CORPORATE INFORMATION

Independent Auditors:  
KPMG LLP

Transfer Agent:  
CIBC Mellon Trust Company

Corporate Counsel:  
Torys LLP

Investor Relations:  
Catherine Martin 416-696-7700  
Email: [investorrelations@dhltd.com](mailto:investorrelations@dhltd.com)

Corporate Office:  
Suite 201,  
939 Eglinton Avenue East,  
Toronto, Ontario M4G 4H7  
Telephone: 416-696-7700  
Facsimile: 416-696-9720  
Website: [www.dhltd.com](http://www.dhltd.com)

Toronto Stock Exchange  
Symbol:  
DHF.UN

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## Submissions of Concerns

Submissions of concerns regarding accounting, internal controls or auditing matters may be made in writing to the Chair of the Audit Committee on a confidential basis: Gordon J. Feeney, Chair of the Audit Committee, Davis + Henderson Income Fund, 270 The Kingsway, P.O. Box 74569, Toronto, Ontario M9A 3T0.

Copies of this quarterly report may be obtained from:

The Secretary,  
Davis + Henderson  
Income Fund,  
Suite 201,  
939 Eglinton Avenue East,  
Toronto, Ontario M4G 4H7.

La version française : Sur simple demande, nous nous ferons un plaisir de vous faire parvenir la version française du présent rapport. Veuillez composer le 416-696-7700 ou nous faire parvenir un courriel [investorrelations@dhltd.com](mailto:investorrelations@dhltd.com).

DAVIS + HENDERSON INCOME FUND  
Suite 201, 939 Eglinton Avenue East,  
Toronto, Ontario M4G 4H7

Toronto Stock Exchange: "DHF.UN"  
Website: [www.dhltd.com](http://www.dhltd.com)



**Davis + Henderson**  
Income Fund