Understanding Income Trusts









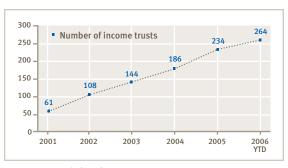
Income trusts have evolved into a significant segment of the Canadian equity market that now represents approximately 10% of the S&P/TSX Index.

The proliferation of the income trust market in recent years and the wide variation in the types of businesses represented makes it important for investors to understand what makes these investments unique. Not all income trusts are created equal. Experienced professional management can help you navigate through this complex and evolving segment of the Canadian market.

BENEFITS OF INVESTING IN INCOME TRUSTS

- Investors can achieve a relatively high level of regular, tax-efficient cash flow along with the potential for modest capital appreciation.
- > Income trusts offer investors access to a wide range of relatively mature and stable businesses.
- > Investing in income trust securities offers the potential for portfolio diversification.

INCOME TRUSTS - A FAST GROWING SEGMENT



Source: RBC Capital Markets

WHAT ARE INCOME TRUSTS

- An income trust is simply a legal structure built around an underlying business. This specific structure is designed so that the underlying business can distribute out most of its pre-tax income to its investors, or unitholders.
- You Typically, stable income-generating businesses in more mature industries represent good candidates for the income trust structure.
- > Today, many different types of businesses are structured as income trusts. Natural resource, power, pipeline and real estate companies are the most common.
- > Income trusts closely resemble equities in terms of the investment risks involved. Similar to equities, income trusts trade on a stock exchange and just like any company, their value will rise and fall depending on future prospects for the business.
- Distributions are generally a combination of interest income, dividend income, return of capital and capital gains.

HOW INCOME TRUSTS WORK

Underlying Business

Operates to generate profits.

Almost all profits, generally at least 80%, flow through to the income trust on a pre-tax basis.

Business retains a small portion of the profits, generally less than 20%, to pay for capital expenditures and other operating costs.



Income Trust

Income trust is the legal structure that owns the underlying business.

Receives pre-tax cash flow from the business and distributes to the unitholders, usually on a monthly or quarterly basis.



Unitholders

Investors who buy units in the income trust.

Unitholders receive cash distributions and pay tax at their own personal tax rate.



DIFFERENT TYPES OF INCOME TRUSTS

Income trusts represent approximately 10%* of the S&P/TSX Index, and can be broken down into the following four categories:

S&P/TSX Index Income Trusts (10% of overall S&P/TSX Index)			
9%	12%	34%	45%
Power/Pipeline trusts	Real estate income trusts (REITs)	Business trusts	Resource trusts
Represent investments in privately owned oil and gas oipeline systems and power-generating facilities. Distributions tend to be very stable due to predictable ong-term sales contracts. Highly sensitive to interest rate changes as they often carry significant amounts of debt.	Own and operate income- producing real estate properties (apartments, hotels, shopping centres, offices, etc.). Predictable income stream from long-term leases. Generally offer lower distribution rates, but tend to be more stable.	General and diverse category that is growing rapidly. Includes companies in the areas of fast food, sardine packing, retirement homes, pet food, mattresses, long-distance trucking and waste management. Risks and sensitivities vary according to type of business.	Collections of producing oil and gas wells. Usually offer higher yields but are also the most volatile. Distributions can fluctuate with movements in energy prices.



Similar to stocks, not all income trusts offer the same opportunities or have the same risks. Key investment considerations include:

- > Income sustainability. Prices and distributions of an income trust are directly affected by the profitability of the business. As such, neither the unit price nor the distributions from income trusts are guaranteed. Additionally, if a trust cuts its distribution, the value of its units will generally drop, sometimes substantially, resulting in a decline in the value of an investor's holdings.
- Rising interest rates. Higher interest rates mean higher borrowing costs and lower net incomes for many underlying businesses, leaving less cash for distribution to investors.
- > Quality and transparency. Over the past 5 years, there has been rapid growth in both the number and type of businesses operating as income trusts. There are varying levels of transparency and reporting. As with any investment, the future prospects of the business and the quality of the management team are critical.

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INCOME TRUST DISTRIBUTIONS: RETURN OF CAPITAL

Any portion of the distribution classified as return of capital is not taxable in the year of receipt. Taxation of this portion of the distribution is deferred until the units are ultimately sold.

For more information about income trusts, contact your advisor.

* Data from the TSX as of June 30, 2006.

This piece is provided for general information on income trusts and is not intended to provide specific financial investment, tax, legal, accounting or other advice. To determine suitability, please consult your advisor.