STRATEGIC ANALYSIS OF A SERVICE COMPANY IN THE FILM AND TELEVISION INDUSTRY IN CANADA

by

Cheryl Nex
Certified General Accountant,
Certified General Accountants Association of British Columbia, 1998

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APPROVAL

Name: **Cheryl Nex**

Degree: **Master of Business Administration**

Title of Project: **Strategic Analysis of a Service Company in the Film and Television Industry in Canada**

Supervisory Committee:

____

Edward Bukszar, Ph.D.
Senior Supervisor
Associate Professor of Strategy

____

Neil Abramson, Ph.D.
Second Reader
Associate Professor of Strategy

Date Approved: August 11, 2006

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ABSTRACT

EP Canada Limited Partnership, a wholly owned subsidiary of Rainmaker Income Fund, is the leading 'full service' provider of payroll and employer-of-record services to the film and television industry in Canada. The size of the payroll volume outsourced in the film and television industry in Canada is directly correlated to the level of production activity in Canada.

After several consecutive years of growth, the production of feature films and television programs, in Canada, is in decline. The strength of the Canadian dollar, in comparison with the US dollar, and tax credit competition from filming locations worldwide is contributing to the decline.

The purpose of this paper is to analyze the current competitive advantage and business operations and make recommendations to help EP Canada Limited Partnership diversify its business in accordance with parent company objectives and better manage employee turnover.

DEDICATION

I dedicate this paper to my husband Michael, whose love and support enabled me to complete the Executive MBA Program; to my family, friends and colleagues, whose support and encouragement got me through the late nights and early mornings; and to my team mates (Joe, Jonathan, Saf and Peter), whose patience, confidence and understanding made this a experience I will cherish forever.

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GLOSSARY

Above the Line	A term used while budgeting for a motion picture and television project to describe an expenditure that is negotiated or spent before filming begins.
Axium	Axium Entertainment Canada
Below the Line	A term used to refer to the salaries of the non-starring cast members and the technical crew, film studio, technical equipment, travel, location, and catering costs.
BESI	Bulloch Entertainment Services Inc.
C&C	Cast and Crew Canada
COL	Cheques On Location®
CR	Client representative
CSC	Client Service Coordinator
Employer of Record	A term used to describe a unique employee-employer relationship between film and television production companies and Film Industry payroll companies.
EPC	EP Canada Limited Partnership
EP-USA	Entertainment Partners, USA
EPOL	EP On Location®
Film Industry	Canadian film and television production industry
FTC	Canadian Film or Video Production Tax Credit
Loan-out corporation	A term used to identify legal entities incorporated in Canada
Payee	Employees, sub-contractors, and corporations
Producer	Independent filmmaker and financier
Production	A generic term collectively used to include a theatrical film, television show, special, or series, and/or DVD release
PSTC	Film or Video Production Services Tax Credit
The Fund	Rainmaker Income Fund
REG	Rainmaker Entertainment Group Ltd.
RNK Capital LP	RNK Capital Limited Partnership
TVD	TVD Televector Enterprises Inc.

1 INTRODUCTION

1.1 Company History

EP Canada Limited Partnership ("EPC") offers payroll and 'employer-of-record' services to the Canadian film and television production industry ("Film Industry"). With a staff of 91 employees and offices in Toronto, Ontario and North Vancouver, British Columbia, EPC processes payroll in excess of one billion dollars Canadian, generates close to 500,000 paycheques and issues more than 40,000 Canada Revenue Agency tax slips per annum while administering all trade union and statutory deductions, remittances and reporting from coast to coast.

EP Canada Inc. was created on January 1, 2002 as a result of a merger on October 31st, 2001 between Bulloch Entertainment Services Inc. ("BESI") and TVD Televector Enterprises Inc. ("TVD"). BESI offered payroll and employer-of-record services to the Film Industry from Ontario to the East Coast of Canada. TVD offered payroll and employer-of-record services to the Film Industry from Manitoba to the West Coast of Canada. EP Canada Inc. continued to offer payroll and employer-of-record services to the Film Industry, from coast to coast, until August 4th of 2005, when the Rainmaker Income Fund (the "Fund") acquired the assets of EP Canada Inc. through a Class A limited-partnership units offering in RNK Capital Limited Partnership; EPC was formed to carry on providing payroll services to the Film Industry.

1.2 Description of Parent Company - Rainmaker Income Fund

The Fund is an unincorporated, open-ended, limited-purpose trust established under the laws of the Province of British Columbia by a declaration of trust on April 22, 2002, as amended

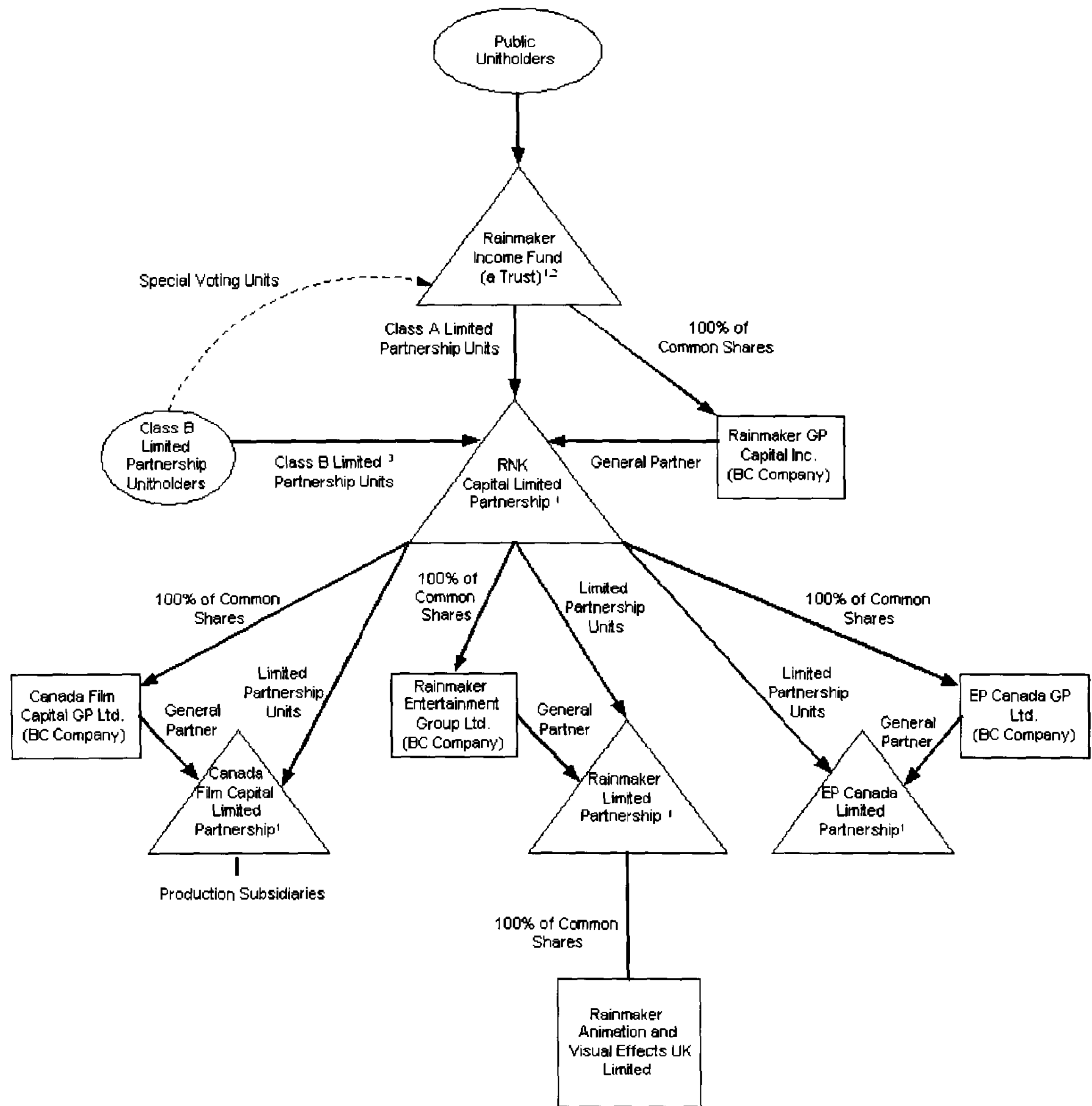
April 30, 2003 and amended and restated May 10, 2004. The Fund, initially created to invest in the securities of Rainmaker Entertainment Group Ltd. ("REG"), trades on the Toronto Stock Exchange under the instrument symbol RNK.un. The Fund's head office is in Vancouver, British Columbia and the registered office is located at Fasken Martineau DuMoulin LLP, Suite 2100, 1075 Georgia Street West, Vancouver, British Columbia, V6E 3G2.

On May 31st, 2002, REG and the Fund completed an arrangement under section 252 of the Company Act (British Columbia), by which the Fund indirectly acquired all of the issued and outstanding shares of REG. When the fund was converted to a trust structure, RNK Capital Limited Partnership ("RNK Capital LP") was created to hold all of the shares of REG. Shareholders of REG exchanged, through a series of transactions, their common shares of REG for either: (i) units of the Fund; or (ii) non-voting Class-B limited partnership units of RNK Capital LP and special-voting units of the Fund.

On August 4th, 2005, the Fund, through RNK Capital LP, completed the acquisition of 100 percent of EP Canada Inc. Upon completion of the arrangement, the Fund had issued and outstanding 16,889,439 Class A limited-partnership units and 340,736 Class B limited-partnership special-voting units, each of which is convertible into a unit on a one-for-one basis for no additional consideration.

Figure 1 below sets out the organizational structure of the Fund as at March 30th, 2006 including each material subsidiary and majority-owned partnership of the Fund.

Figure 1 - Organizational Structure of the Rainmaker Income Fund as at March 28th, 2006



Source: Rainmaker Income Fund. (2005). Annual Report to Unitholders.

1.3 Services

EPC is a 'full service' provider of payroll and employer-of-record services to the Film Industry. EPC's services are contracted during the pre-production, production and post-

production phases of feature film and television production. Depending on the type of production, these phases can range from two weeks to nine months in duration. Types of productions include feature films and television pilots, movies of the week, series, and mini-series. During these phases, employees, sub-contractors, and corporations ("Payees") are hired to provide services for the making of a "Production" (theatrical film, television show, special, or series, and/or DVD release).

Payees include both Canadian-resident and non-resident cast and crew personnel, including producers, directors, writers, actors, background performers, production management, office staff, carpenters, lighting technicians, hair stylists, make-up artists, camera operators, technicians, editors, and auto and truck drivers. Engagements range from one day to several consecutive weeks or months. Payees contracted to provide services are represented by multiple trade unions, and are paid weekly as employees (individuals), subcontractors, or loan-out corporations.

Payroll services are contracted to manage and administer the payroll function for all Payees hired to perform services in the making of a Production. Payroll services include:

- Calculating from work hours to gross pay based on union contract agreements;
- Issuing cheques to all cast and crew Payees;
- Providing the client with a reconciliation of all calculations (union and statutory additions and deductions);
- Assisting clients with explanations of union contract administration and taxation;
- Issuing Records of Employment, as required by Human Resources and Social Development Canada;
- Issuing Canada Revenue Agency tax slips (where necessary);
- Providing, in a timely manner, all union remittance statements and funds in accordance with union contract agreements;
- Providing, in a timely manner, all statutory deductions to Canada Revenue Agency;
- Deducting and remitting on third-party demands;

- Maintaining the necessary documentation for union and Canada Revenue Agency audit and inspection; and
- Providing various statements of earning to Payees.

All Payees complete timecards, a detailed record of start and stop times (hours worked) and break times taken. Timecards are approved by department heads, forwarded to accounting and used to calculate gross pay. From gross pay, statutory additions and deductions are made.

In the Film Industry, Payees are grouped into three generic categories: above-the-line cast and crew, below-the-line cast and crew, and background performers. These categories are relevant for billing purposes. Above-the-line Payees include producers, directors, writers, and actors playing leading roles. Background performers are those performers with non-speaking roles, known as 'extras'. Below-the-line Payees are everyone else: production management, office staff, carpenters, lighting technicians, hair stylists, make-up artists, camera operators, technicians, editors, and auto and truck drivers, photo doubles and stunt performers. Payroll services for above-the-line cast and crew are charged based on a flat per cheque charge and payroll services for below-the-line cast and crew and background performers are charged based on a percentage of gross payroll labour plus fringes.

EPC offers clients a choice of three different payroll services at three different price points. The three different services are called EP Plus, EP Payroll and EP On Location®. Each service involves calculating 'hours-to-gross' and 'gross-to-net'. Hours-to-gross is calculated from a detailed record of a Payee's daily start and stop times, known as a 'timecard'. Gross pay is calculated after applying negotiated union contract terms and conditions regarding straight time, over time, penalties and premiums, to the hours worked. From gross pay, union and statutory deductions are deducted along with third-party demands and voluntary garnishees resulting in net pay.

When clients choose EP Plus, EPC's premium payroll service, they are charged 1 percent of gross payroll labour plus fringes for below-the-line cast and crew, 5 percent of payroll labour plus fringes for background performers and $10 per cheque for above-the-line cast and crew. For a 20 percent premium, in comparison to other services offered by EPC, clients forward uncalculated timecards to EPC for processing. EPC takes the timecards from Production and calculates hours-to-gross-to-net pay using a proprietary, in-house, server-based system called 'NPS'. NPS incorporates rules and tables to handle the payments, journal interfaces, remittances to government and unions, as well as tracking expenditures that may be eligible for government incentive programs. This program is continually updated and enhanced to provide the highest level of service and accuracy in the Film Industry. No other competitor in the payroll industry offers this type of service. EP Plus payroll service is used by about 30 percent of EPC's clients.

When clients use EP Payroll, they are charged .85 percent of gross payroll labour plus fringes for below-the-line cast and crew, 3 percent of payroll labour plus fringes for background performers and $8 per cheque for above-the-line cast and crew. Using EP Payroll, clients forward pre-calculated timecards to EPC for further processing. Members of the production company accounting department calculate manually, hours-to-gross. The timecards, which indicate gross-pay, are forwarded to EPC and EPC, relying on the client's calculations, manually inputs gross-pay into NPS to further calculate gross-to-net pay. With EP Payroll, EPC is not held responsible for the accuracy of the gross pay calculation. This service is used by just 10 percent of EPC's clients and is inherently flawed because it is difficult to catch mistakes as there is no intervention to double check calculations for accuracy.

EP On Location® ("EPOL") is a Windows®-based Production-office-accounting tool developed by EPC's internal information technology department, and is used by clients to calculate hours-to-gross. Clients are charged .80 percent of gross payroll labour plus fringes for below-the-line cast and crew, 3 percent of payroll labour plus fringes for background performers

and $8 per cheque for above-the-line cast and crew. Using EPOL and pre-established pay rules, clients enter hours from timecards into EPOL and a data file is transferred to EPC. EPC takes the data from the client and calculates gross-to-net using NPS. EPOL is unmatched worldwide in its ability to accommodate intense complexity and variability of the Production environment. No other competitor in the Industry offers this type of software application. EPOL is used by about 60 percent of EPC's clients.

Regardless of the type of service used by clients, EPC acts as the employer-of-record, a term used to describe an employee-employer relationship unique to the Film Industry. All Payees' cheques are cleared through EPC bank accounts, and all Records of Employment and Canada Revenue Agency forms are issued in the name of EPC. As the employer-of-record, EPC assumes responsibility for making contributions to the necessary authorities for employee deductions and employer contributions withheld from Payees. Clients have unrestricted access to experienced staff that can source and/or answer almost any question relating to Canada Revenue Agency and Workers Compensation Board rules and regulations, and payroll payment terms and conditions of union agreements, used in the Film Industry, in Canada.

In addition to offering payroll services, EPC provides each production company with a cost accounting system. The cost accounting system, called VISTA®, is a Film Industry specific system used to report Production costs to project decision makers. EPC provides an interface diskette of payroll costs that is up-loaded into VISTA® to prevent hours of manual entry because payroll labour costs represent a significant portion of a Production budget.

EPC offers, free of charge, budgeting guides for all Canadian provinces and unions. These guides are available on-line and are updated continually as trade unions provide EPC with updated rates and fringes. EPC is a reseller of Entertainment Partners' ("EP-USA") production management software tools: EP Budgeting and EP Scheduling. EP Budgeting is a budgeting

program capable of tracking foreign currency budget items and multiple filming locations. EP Scheduling is a Film Industry specific scheduling tools used to coordinate filming elements and shooting scenarios. EPC earns less than 1 percent of its annual revenue from software sales.

Lastly, EPC offers a referral service to companies looking for accountants and assistant accountants in the Film Industry. This referral service works to connect studio contacts and accounting department contacts to EPC. Even though EPC refers accountants with no strings attached, there is an unspoken reciprocal referral arrangement between accountants who have been referred and EPC.

1.4 Key Strategic Relationship

EPC has an exclusive arrangement with EP-USA, to provide US-based clients with Canadian employer-of-record and payroll services and access to VISTA®. EPC pays EP-USA a license fee for the privilege of this exclusive arrangement.

EP-USA, with offices in Los Angeles, New York, and Florida, has been in business for more than 25 years and offers a range of integrated products and services designed to increase productivity for Production accounting departments. EP-USA products and services include payroll services, Production budgeting and scheduling programs, and Production document management tools.

EP-USA services US-based clients by processing payments for any US resident working on any Production anywhere in the world and/or for anyone working in the United States of America ("US"). EPC services Canadian clients by processing payments for any Canadian resident working on a Production anywhere in the world and/or for anyone working in Canada. As a result, the relationship, between EPC and EP-USA, is complementary. VISTA® is

maintained and enhanced by EP-USA; EPC provides technical support but does not have access to the program source code to make system changes.

1.5 Discussion of the Competitors

Three companies, in Canada, offer payroll and employer-of-record services to the Film Industry: 1) EPC, 2) Cast & Crew Canada ("C&C"), and 3) Axium Entertainment Services ("Axium"). Each offers payroll and related consulting services along with cost accounting software under different corporate and fee structures.

In addition to the three companies servicing the Film Industry, there are two large 'conventional' payroll companies who offer payroll and human resource services to the payroll industry: Ceridian Canada ("Ceridian") and ADP Canada ("ADP"). However, neither Ceridian nor ADP provides service to this niche sector of the Film Industry.

EPC has offices in Vancouver and Toronto, and offers employer-of-record and payroll services along with technical support services for VISTA®. EPC has, on average, a 70 percent market share in Canada.

"C&C" is a branch office of a US company, Cast & Crew Entertainment Services, Inc., with head offices in Los Angeles, California. C&C manually calculates hours-to-gross and services clients from offices in Vancouver and Toronto. C&C uses a proprietary payroll system, built in the US and adapted for use in Canada to calculate gross-to-net. C&C offers, exclusively, cost accounting software called PSL, and has, on average, a 20 percent market share in Canada.

Axium is also a branch office of a US company: Axium International Inc., with head offices in Los Angeles, California. They also manually calculate hours-to-gross, service clients from offices in Vancouver and Toronto, and use a proprietary payroll system, built in the US and

adapted for use in Canada to calculate gross-to-net. Axium offers, exclusively, cost accounting software called Visual Max, and has, on average, a 10 percent market share in Canada.

EP-USA is not considered a competitor in this niche market for several reasons. First, US-based clients prefer to deal with a payroll company local to the Production office. Second, US producers prefer a separation from the Internal Revenue Service and the shield that EPC, as employer-of-record, provides between themselves and the Canadian authorities. Third, Producers prefer to have the Records of Employment and Canada Revenue Agency forms issued in EPC's name, and not the name of the production company. Fourth, they prefer to know that a local payroll company is handling all inquiries, reporting and remittances, and lastly, they prefer to know that the records are kept locally and are available for audit and inspection.

Neither Ceridian nor ADP acts as the employer-of-record. Ceridian and ADP will issue paycheques, but all Canada Revenue Agency remittances, Records of Employment, and tax slips are prepared in the name of the company. It would therefore be the responsibility of the company to make the records available for audit and inspection. In addition, Ceridian and ADP do not process union payroll, a requirement of the Film Industry.

Ceridian and ADP focus on providing human resources ("HR") solutions. HR solutions include Payroll, HR Information Systems, Recruiting, Employee Assistance Programs and Benefits, Learning & Development, Employee Effectiveness, Organizational Effectiveness and Post-Employment services. Companies in the Film Industry do not require the HR-focused services offered by Ceridian and ADP; these services are provided to Payees by their respective trade union. Instead companies in the Film Industry require a payroll service company that can facilitate timely remittances to multiple trade unions.

Payment for services rendered by cast and crew personnel require rapid response time. Cast and crew personnel are paid on a weekly basis; the union agreements require that cast and

crew be paid on the fourth working day following the last day of work. Typically, film crews work Monday to Friday. Therefore, it is necessary for cast and crew to be paid on Thursdays. Cast and crew complete timecards, which are calculated and routed through to the payroll company, processed and turned around in four days. It is common for cast and crew to turn in timecards late and still expect payment on Thursday. The tight deadlines require immediate action; Ceridian and ADP require extra processing time, time that is not available in the Film Industry.

Ceridian and ADP have a complex billing structure based on the numbers of payments processed, the number of management reports provided, the number of adjustments made, the number of Records of Employment and Canada Revenue Agency tax slips prepared. The uncertainty of these 'per click' charges makes the budgeting of service fees far more difficult than the simple percentage of labour and fringes/benefits or flat per-cheque-per-week calculation used in the Film Industry.

This niche market emerged as a result of the Film Industry's unique and focused needs: tight timelines, intense client demands, unique employer-of-record status, upfront cost estimate, complex union calculations, and detailed reporting packages.

1.6 Discussion of the Clients

The clients are a narrowly defined group of Canadian and foreign independent filmmaker and financiers ("Producers") of feature film and television Productions. Canadian television and feature film Producers include the French-language market and together are referred to as 'domestic' Producers. They represent the largest single segment of the Film Industry and are located in all provinces across Canada. Domestic Producers include Alliance Atlantis, Brightlight Pictures, Coast Mountain Films, Corus Entertainment, Dufferin Gate Productions, Keystone Pictures, and Muse Entertainment Enterprises, to name a few.

The data contained below in Table 1.1 is based on the Government of Canada fiscal year of April to March and indicates the total volume attributable to Canadian television Production, Canadian feature film Production, foreign location Production and Canadian broadcasters, in Canada from fiscal 1996/97 to fiscal 2004/05.

Table 1.1 - Total Volume of Film and Television Production in Canada (1996 – 2005)

Total Volume of Film and Television Production in Canada									
(In millions)	96/97	97/98	98/99	99/2000	00/01	01/02	02/03	03/04	04/05
Canadian Television	1,217	1,134	1,832	1,875	1,803	1,754	1,793	1,636	1,685
Canadian Feature Film	251	341	293	377	301	284	371	369	253
Foreign Location	768	819	1,096	1,506	1,762	1,760	1,914	1,904	1,463
Broadcaster/In-house	790	743	760	850	885	962	996	1,042	1,091
Total Volume	$3,026	$3,037	$3,981	$4,608	$4,751	$4,760	$5,074	$4,951	$4,492
Some totals may not add due to rounding									

Adapted from Canadian Film and Television Producers Association. (2006). Profile 2006 – An economic report on the Canadian film and television production industry.

Foreign location film and television Producers include US major motion picture studios, such as The Walt Disney Company, NBC/Universal, Warner Brothers, and SONY, independent feature films Producers, such as Phoenix Pictures, Spyglass Entertainment, Revolution Pictures, and the Weinstein Company, and companies specializing in television series, television movies, and television mini-series, such as FOX, ABC, SONY TV, and Warner Brothers Television.

Most Producers, foreign and domestic, award their business annually and often use the same payroll service provider year after year.

1.7 Focus of this Strategic Analysis

For several years, EPC has operated comfortably in a profitable niche industry, an industry that, until recently, has seen steady growth. The focus of this analysis is to assess the existing resources of the company, and suggest strategic adjustment to help guide the efforts of

the company and improve overall performance through related diversification opportunities and improved employee retention strategies.

An overall industry analysis is outlined in Chapter 2 including a description of the film and television industry, the payroll industry and key success factors. An internal analysis of EPC follows in Chapter 3, which includes a description of current strategy along with a firm-level value chain in order to determine current competitive advantage.

Issues affecting the company are described and developed in Chapter 4, and in Chapter 5 strategic adjustments are recommended specific to the relevant issues.

2 EXTERNAL ANALYSIS (INDUSTRY ANALYSIS)

2.1 Industry Overview

2.1.1 Description of the Film Industry

Canada's history of film making dates back to the creation of the National Film Board of Canada in 1939. In 1967, during Canada's centennial year, the government saw the value of supporting the development of independent Canadian feature films to help foster and celebrate the culture of a nation (Department of Canadian Heritage, 1998).

Over the past few decades, rapid growth of the Film Industry has been achieved through a combination of factors: affordable Production costs, favourable currency exchange rates, federal and provincial tax incentives, geographic proximity to Los Angeles, availability and access to diverse locations, proximity to a major metropolitan service centre, a growing infrastructure of quality facilities and specialty equipment, along with skilled technical and creative workers.

The Film Industry in Canada includes the making of movies and television programs. Movies are first made for theatrical release. After the films first exploitation, in movie theatres, it is often broadcast on television and made available for purchase or rental at video stores. Film is considered by many to be an important art form; films entertain, educate, enlighten and inspire audiences. Any film can become a worldwide attraction, by translating the dialogue into subtitles.

Television programs are made by Producers for original run, also known as first run. The Producer creates a program of one or multiple episodes which is shown by a station or network

that has either paid for the Production to be made or to which the Producers have granted a broadcast licence.

2.1.2 Description of the Payroll Industry

The payroll industry in Canada has emerged as a result of a shift, or transfer of work, to outside third-parties. The shift has come as a result of an increasing need for business to recognize operational efficiencies. As of March 2006, "One estimate puts the current value of outsourced goods and services around the world at a whopping $6 trillion US a year" (Canadian Broadcasting Corporation, 2006, para. 1).

The payroll industry, in general, is known for its scale and low margins, and is viewed by many as a commodity. Payroll services in the Film Industry are significantly different from conventional payroll services; conventional payroll services are defined as services offered by banks (Ceridian and ADP). Payroll services in the Film Industry are characterized by tight deadlines, rapid response times, multiple trade union governance, a high level of personal customer service, and above average profit margins.

Personnel in the Film Industry work Monday to Friday, and union contracts require that cast and crew personnel get paid, by 4:00pm, on the fourth working day following their last day of work; in most cases that is the following Thursday. Often, timecards are turned in late with no extension to provide payment. Cast and crew personnel have been known to stop working as a result of not receiving a pay cheque.

Cast personnel are represented by Canadian labour organizations that represent self-employed artists and subcontractors working on feature films, television, radio, digital media, corporate videos and commercials as dramatic actors, comedians, dancers, background performers, voice-over specialists, singers, puppeteers, and stunt performers.

Crew personnel are represented by multiple trade unions:

- Canadian branches of International Alliance of Theatrical Stage Employees, representing technical employees and camera operators;
- The Directors Guild of Canada, representing the creative and logistical personnel; and
- Canadian branches of The International Brotherhood of Teamsters, in Alberta and British Columbia.

Servicing the needs of the Film Industry is costly. Employees must remain flexible and ready to stay late into the evening at a moments notice to manage the client account. Employees must manage multiple tasks and deadlines and be familiar with numerous special employment conditions, conditions that can be different from show to show and day to day.

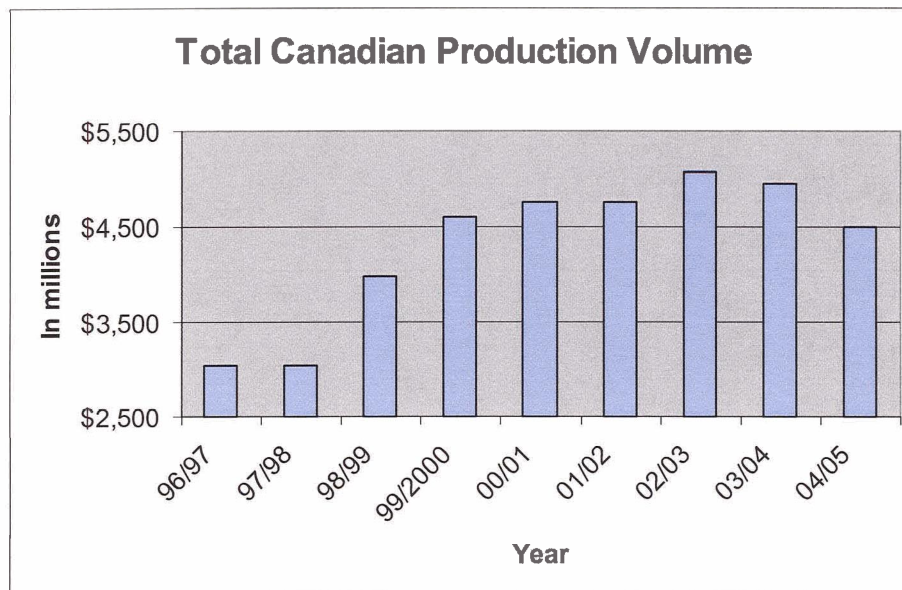
2.1.3 The Size of the Industry

The size of the payroll volume outsourced in the Film Industry is directly correlated to the level of Production in Canada. It is estimated that labour costs account for approximately 50 percent of Production spending (British Columbia Ministry of Economic Development, 2005).

After more than seven straight years of increases, and a slight decrease in fiscal 2003/04 (government fiscal year April 2003 – March 2004), the total Production volume of film and television in Canada experienced a significant decrease in fiscal 2004/05 to $4.492 billion dollars. All amounts are in Canadian dollars and refer to the Canadian government fiscal year April – March, see Figure 2 below.

In 2003/04 the Canadian Production industry reached nearly $5 billion in total volume of Production; a 2.1 percent decrease from 2002/03 when total Production volume in Canada peaked at just over $5 billion ($5.074). In 2004/05, production dropped an additional 9 percent, down to $4.495 billion. There are more than 135,000 Canadians employed, directly or indirectly, in the Film Industry (Department of Canadian Heritage, 2006).

Figure 2 - Total Canadian Production Volume (1996/97 – 2004/05)



Adapted from Canadian Film and Television Producers Association. (2006). Profile 2006 – An economic report on the Canadian film and television production industry.

About 60 percent of Canadian television Production use outsourced payroll services; 100 percent of Canadian feature film and foreign location Production is outsourced. However, not all Producers in the Film Industry outsource to payroll service companies. Broadcasters, for example Canadian Broadcasting Corporation (CBC), BBC Canada, and Discovery Channel, have an established corporate infrastructure with fully staffed corporate accounting departments who perform the payroll function internally (in-house).

Of the total Production volume approximately $1.364 billion in payroll, approximately 50 percent of total Production budgets, was outsourced in 2004/05, $1.627 billion in 2003/04, and $1,680 in 2002/03, see Table 2.1 below.

The other 50 percent of Production budgets is spent on other services, such as sound stage rentals, accommodations, meals and food service, auto rentals, building suppliers, and camera and lighting equipment.

Table 2.1 - Size of Outsourced Film and Television Payroll Industry in Canada

Size of Film and Television Payroll Industry in Canada									
(In thousands)	96/97	97/98	98/99	99/2000	00/01	01/02	02/03	03/04	04/05
Canadian Television (60%)	730	680	1,099	1,125	1,082	1,052	1,076	982	1,011
Canadian Feature Film	251	341	293	377	301	284	371	369	253
Foreign Location	768	819	1,096	1,506	1,762	1,760	1,914	1,904	1,463
Total Volume	$1,749	$1,840	$2,488	$3,008	$3,145	$3,096	$3,361	$3,255	$2,727
50% of total volume is labour costs processed through payroll companies									
Size of Payroll Industry	$875	$920	$1,244	$1,504	$1,572	$1,548	$1,680	$1,627	$1,364

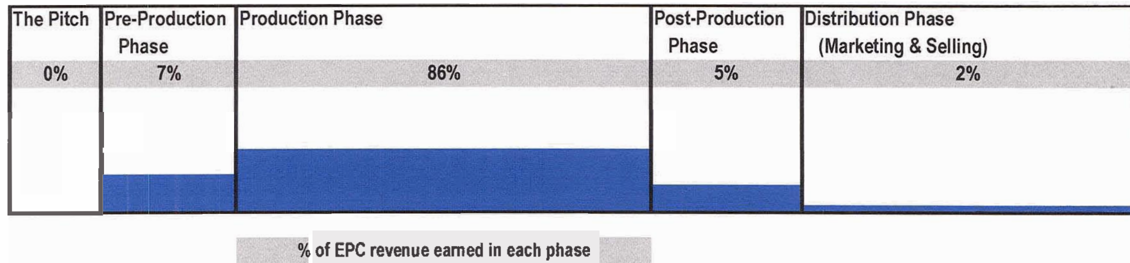
Adapted from Canadian Film and Television Producers Association. (2006). Profile 2006 – An economic report on the Canadian film and television production industry.

2.2 Film Industry Value Chain

The Film Industry value chain can be broken down into five phases; the pitch phase, the pre-production phase, the production phase, the post-production phase and the distribution (marketing and selling) phase. These phases can range in length from several years to just a couple of weeks.

Below is the Film Industry value chain, see Figure 3. It illustrates the phases of Production and the percentage of EPC's revenue associated with each phase.

Figure 3 - Industry Value Chain for Film and Television Production



By the author.

The activities within the Film Industry value chain, for the most part, are performed by a series of service providers; from labour to consumables, equipment that is rented, sound stage facilities and various location fees, catered meals and food service delivery, and professional services. The sequence of activities encompasses a series of service providers creating value by collaborating to turn a story into a feature film or television program and ultimately creating shareholder value. Following this, the end user consumes entertainment when he or she watches movies and television or rents from video stores.

The first phase in the Film Industry value chain is known as the pitch phase. In this phase the writer takes an idea and turns it into a story by writing a script. With this script in hand, the writer, and/or agent, approaches a studio executive or Producer to pitch the story. In general, if the Producer likes the story, the project is made, if not, the project is shelved, or the writer takes another pass at improving and/or changing the story. If the pitch is successful, the writer and the Producer negotiate terms where, typically, the writer sells the rights to the film maker to make the project for broadcast on television or for theatrical release in movie theatres. The Producer arranges financing, the total budget value is 'locked', and the project receives a 'green-light' to proceed. Outsourced payroll services are not required during this phase; cheques are issued from the studio for the few payments that are made during this phase.

The pre-production phase is the planning phase. The writer continues to hone the story, producers, directors, and leading actors and actresses are hired, a filming location (country) is selected, and a detailed budget is created, often using EP Budgeting. Sets and custom assets are designed and a detailed shooting schedule is prepared, using EP Scheduling.

During the pre-production phase, EPC assists Producers and production managers by providing budget guides outlining the hourly rates and fringe benefits payable, to cast and crew personnel, under the collective agreements. The payroll contract is awarded and payments are made to Production personnel. EPC generates approximately 7 percent of its revenue from this phase of production.

The need for EPC's payroll services increase slowly during pre-production. The Producer incorporates a new company and finances that company which is responsible for completing the project. A new production company is incorporated for each new Production to provide limited-liability protection for the Producers. This protection is important for copyright and ownership issues and the temporary nature of employment in the Film Industry.

The actual making of the film is done by hundreds of companies, small businesses, and union personnel hired by the production company as needed. In the last week or two of pre-production, producers and production managers schedule travel, auditions, and rehearsals. They also engage supporting actors, background performers, directors, union trades people (carpenters, painters, electricians, labourers, set decorators, costume designers, and makeup and hairstyling artists), and camera operators, and they rent facilities and equipment for the duration of the project.

Immediately following the pre-production phase is the production phase, also referred to as 'principal photography', during which EPC generates about 86 percent of its revenue. The

EPC works with the accounting departments to facilitate the on-going payment of all personnel and weekly reporting and remittances to unions, agents and government authorities.

After production is complete, post-production activities shape the film into its final form. Post-production activities include picture editing, sound editing and recording, and the addition of visual and special effects. During post-production the need for payroll services drops off significantly and EPC generates just 5 percent of its revenue from this phase of production. EPC continues to finalize all payments, tidy up reporting, chase down lost payments and support VISTA®. Editing, visual effect, and sound services are contracted to third-party companies. These companies typically charge an all-inclusive contract price, which includes labour, expendables and an amount to cover overheads. VISTA® is used in pre-production through completion of the post-production phase to track and report production costs and overruns to the Producer.

The final, or distribution, phase includes marketing and selling activities. Certain marketing activities begin before the film or television show starts production. Marketing personnel develop the marketing strategy for the release. They estimate the demand for the film or show and the audience to which it will appeal, develop an advertising and promotion plan, and decide where and when to release the project. Studio executives have staff that distribute, lease, and sell their films and made-for-television programs to theatre owners and television networks. Upon completion of the project, publicists set up interviews and television appearances for the stars or director to promote a film or television project.

The selling phase for feature films includes the project exploitation; box office receipts, videocassette and DVD sales and rentals, foreign picture release, pay per view movie release, and lastly broadcast on television. The distribution phase for television movies and series includes broadcast on television and videocassette and DVD boxed set sales and rentals.

EPC generates just 2 percent of its revenue from the distribution phase. During this phase, studios periodically contract EPC to make 'use payments'. Use payments are called 'additional buyout payments' for Canadian performers and 'residual payments' for US performers. Additional buyout payments and residual payments are payments for the continued, or additional, use of a performer's performance. Producers make these additional buyout payments so that they may continue to exploit the use of the asset as the film or program navigates its way through the box office, DVD and VHS sales, video store rental, television broadcast, and re-runs. A majority of Canadian additional buyout payments are processed through the performers' trade union. US performer residuals payments are processed through EP-USA.

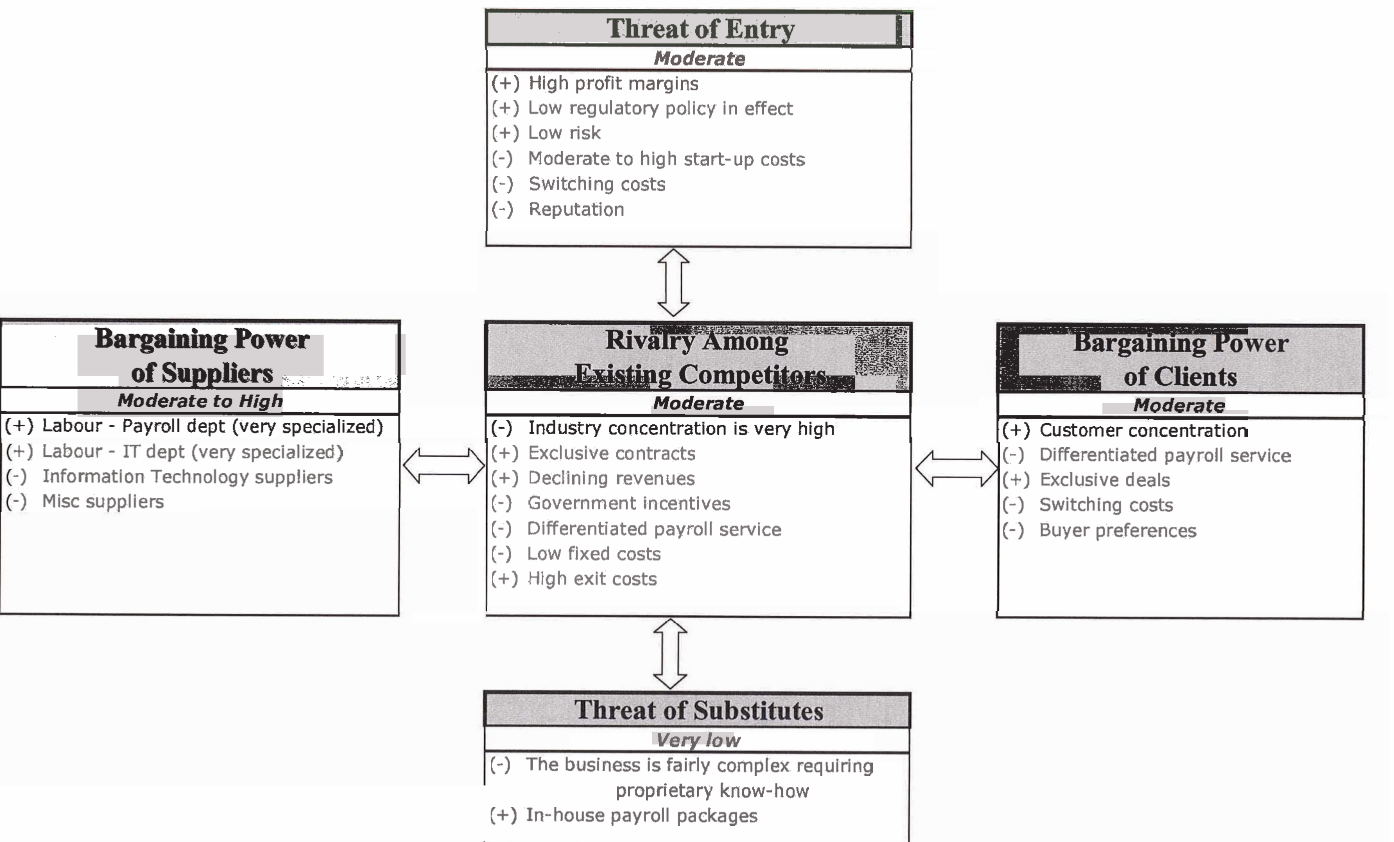
2.3 Payroll Service Industry Analysis

An industry analysis of Payroll Services in the Film Industry follows, using Michael Porter's five forces framework; see Figure 4 below.

2.3.1 Degree of Rivalry

Rivalry among existing competitors is moderate. There are just three companies offering payroll services to the Film Industry. High industry concentration decreases rivalry among companies, as choice is limited. The entrance of Ceridian and ADP would significantly increase the degree of rivalry among competitors. However, to date, they have been uninterested in offering a service to meet the needs of this niche market.

Figure 4 - Five Forces Analysis of Payroll Services in the Canadian Film and Television Industry



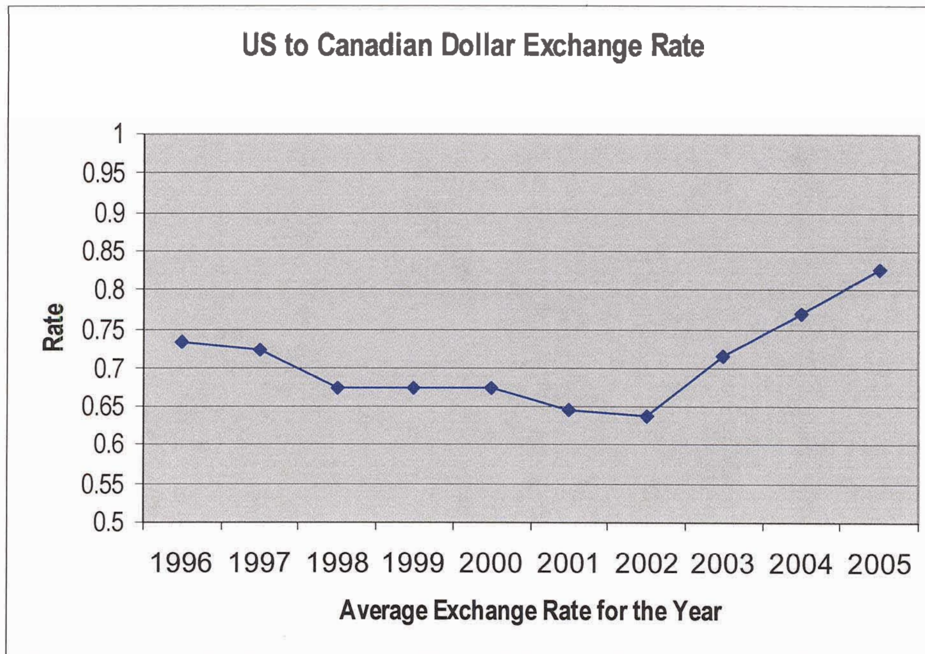
Adapted from Ed Bukszar. (2006). BUS607: Business Strategy class notes.

Increasing the degree of rivalry in the payroll industry is the existence of exclusive agreements. EPC, C&C, and Axium each have a client base that is considered 'exclusive'. Exclusive arrangements lead to repeat business and often involve corporate volume-rebate discounts. However, clients regularly seek price quotes from all three companies, creating a competitive environment where companies are kept in check. This practice temporarily intensifies rivalry, however, the cheaper quotes are often used by decision makers to negotiate an even better deal from their exclusive provider; Producers do not often leave an exclusive arrangement as it would jeopardize their annual volume rebate.

Film Industry growth has become flat and is now in decline; see Figure 2 on page 17. Up to and including fiscal year end 2002/03, the entire Film Industry saw steady increases. Several factors have contributed to the decline in Production in Canada. First, according to the Canadian Film and Television Production Association and l'Association des Producteurs de Film et de Television du Quebec, in conjunction with the Department of Canadian Heritage, the international marketplace for Canadian television programs remains weak. The export value of Canadian television in fiscal 2004/05 dropped for the fifth straight year in a row (Canadian Film and Television Producers Association, 2006, p.10). For clarification, export value refers to the value of international financial participation in the Film Industry recognizing that film and television Productions are intangible products that can be exported to foreign countries (Canadian Film and Television Producers Association, 2006).

Second, the strengthening of the Canadian dollar relative to the US dollar has contributed to the decline in Production in Canada. Based on the average Bank of Canada annual exchange rate, the Canadian dollar has experienced considerable volatility, see Figure 5 below.

Figure 5 - Average Annual US to Canadian Dollar Exchange Rate (1996 – 2005)

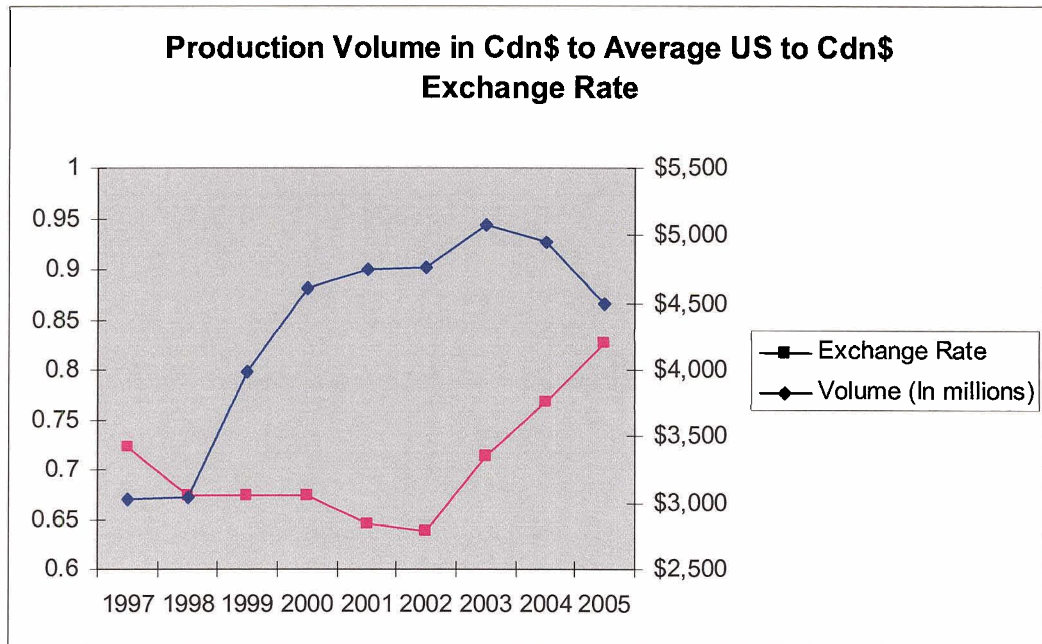


Adapted from Bank of Canada. (n.d.). Monthly average rates: 10-year lookup.

In response to the upward movement in the Canadian dollar, and declining total Production volume in Canada, see Figure 6 below, Federal and Provincial government tax credit incentives were introduced. There are two types of incentive programs: one for domestic Producers and one for foreign Producers, and under each program there is a Federal incentive and a Provincial incentive.

Under the Canadian Film or Video Production Tax Credit ("FTC") Program, the Federal government provides incentives to domestic corporations for the Production of Canadian film or video productions. The FTC is provided to production companies at a rate of 25 percent of Canadian labour expenditures. The Provincial governments offer additional tax credit incentives, based on the same eligibility requirements as the federal incentive.

Figure 6 - Production Volume in Cdn $ and Bank of Canada Average Monthly US to Cdn $ Exchange Rate (1997 – 2005)



By the author.

Under the Film or Video Production Services Tax Credit ("PSTC") Program, the Federal government provides incentives to foreign-based film Producers to stimulate job growth by encouraging foreign-based film Producers to employ the services of Canadians. The PSTC is provided to production companies at the rate of 16 percent of Canadian labour expenditures for services rendered in Canada by Canadian residents. The Provincial governments offer additional tax credit incentives ranging from 18 percent to 55 percent, based on the same eligibility requirements as the federal incentive. See Appendix 1 for a complete listing of all Federal and Provincial Canadian tax credit incentives available to domestic and foreign film Producers.

On May 10th, 2006 at 10:18 EST, the Canadian dollar traded at 90.87 US cents. The Canadian dollar had reached 91.10 US cents the day before, the highest since January of 1978 (Anwar, 2006, para. 5).

According to David Watt, Senior Economist for BMO Nesbitt Burns there is little to stand in the way of further strengthening of the Canadian dollar, factors such as "... rising commodity prices, particularly prices for energy and metals, have continued to support the Canadian dollar over the period, largely offsetting the impact of negative Canada – U.S. interest rate differentials" (Watt, 2006, para. 6). According to Marc Levesque, Chief Strategist, North America FX and Fixed Income Research for TD Securities,

> The US dollar is poised to weaken further, and the combination of elevated commodity process and a change in the Bank of Canada's tone is clearly Canadian-dollar supportive. We now see the Canadian dollar climbing to 93 cents over the near term, before softening up on the back of lower commodity prices later this year" (Levesque, 2006, para. 9).

It is common knowledge that it is costly and at times difficult to film in the US. With favourable labour rates, close proximity to the US, reasonable location rentals fees, efficient city-permitting processes and talented cast and crew personnel, Canada is known as a favourable foreign filming location. Despite these favourable factors, supporting Canada as a preferred filming location, these more recent increases in the value of the Canadian dollar will have further negative impacts on the level of Production in Canada.

A third factor contributing to the decline in Production in Canada is growing competition from other filming locations in the US; see Appendix 2, and internationally, such as Australia, New Zealand, and the United Kingdom; see Appendix 3. These other locations have witnessed the success of the Film Industry and have recently adopted similar incentive models. Overall, declining revenues will increase rivalry, as growth is possible only at the expense of competitors.

Federal and provincial tax credit incentives are intended to attract more Production to Canada, thereby making more projects available for companies to service. With more projects there is less need to compete for the contracts; the incentives decrease rivalry among competitors.

Payroll services are differentiated. EPC offers a differentiated product from C&C and Axium and as a result rivalry is decreased. If a client prefers a premium type payroll service, like EP Plus, where hours and calculations are verified, they have just one provider to choose.

Fixed costs are reasonably low compared to large brick and mortar enterprises. Such low fixed costs decrease the degree of rivalry among competitors. However, increasing the degree of rivalry are high exit costs. As each company acts as the employer-of-record for Canada Revenue Agency, Workers' Compensation Boards across Canada, and various unions, they are required by statute to keep the books and records, for the required statutory period, and make them available, for audit and examination, if and when necessary. Further adding to the cost to exit the industry is the financial obligations that follow the company until the statutory timeframes for reassessment expire.

2.3.2 Threat of Substitutes

The threat of substitutes in the Film Industry is very low. The operations side of the business is fairly complex requiring a considerable amount of proprietary know-how. The workforce in the Film Industry is unionized and each Production can have as many as five to seven union agreements, both Canadian and foreign, in use at any one time. This requires the proficient handling of salaries and benefits to avoid late penalties being charged and grievances being filed on behalf of employees. In addition, expert knowledge of Canadian and non-resident taxation, provincial labour standards legislation, privacy policies, and prevailing tax treaties is required.

A possible substitute is a client choosing to use its internal accounting department to process payroll manually (do-it-yourself) using an 'off-the-shelf' accounting package. However, this is very unlikely to happen as the complexities of the services required go beyond the capabilities of off-the-shelf programs.

2.3.3 Bargaining Power of Clients

In the Film Industry the bargaining power of clients is moderate. High payroll industry concentration (only three payroll companies) means that clients have limited choices. With limited choice the client's power to impose or demand certain pricing is restricted.

Also decreasing the bargaining power of clients is the differentiated nature of payroll services. Differentiated payroll services are not easily replaced and therefore lock-in clients to one service over another.

Conversely, exclusive agreements, or large volume deals increase the bargaining power of clients. It is very common for a Producer to negotiate an exclusive arrangement with one payroll company that will service all the Producer's projects. This exclusive arrangement often results in providing the client with an annual volume discount on total service fees.

Low switching costs, for a single project, increase the bargaining power of the clients. A client that engages a payroll service company for a single project finds that the costs of switching from one company to another are low. However, switching costs are high for Producers who have negotiated an annual volume discount. An exclusivity clause requires that the Producer use that one payroll company for all its business and if the Producer does not remain exclusive, the Producer forfeits the rebate.

A factor that further decreases the bargaining power of the clients is user preferences for one cost accounting software. Studios that implement large enterprise systems, such as SAP and Oracle, around an accounting package are then locked into using that software on each Production. A switch to new cost accounting software would result in expensive training costs and possible reporting delays. However, Producers can appreciably increase their bargaining power by threatening to change their exclusive arrangements. These exclusive arrangements are coveted by payroll service companies.

2.3.4 Bargaining Power of Suppliers

The bargaining power of suppliers in the Film Industry is moderate to high. Labour in this sector represents an integral component and is quite specialized. Payroll department staff is trained on the intricacies that exist in the various collective agreements governing the Film Industry. On average, it takes in excess of six months to complete the training necessary for a payroll department staff member to accurately advise clients. Incorrect advice can be very costly to both the production company and/or the payroll company.

Given the considerable knowledge requirements of payroll department personnel servicing the Film Industry, some may believe that there is not much of a market for these skills outside of the payroll company, when in fact a natural place for payroll department personnel is in the accounting departments on each Production. These alternative employment opportunities increase the bargaining power of these suppliers, and causes payroll companies to remain very competitive by offering better than market employment conditions.

Each payroll company has a proprietary payroll system that it uses to generate and balance pay cheques, union information and remittances and government remittances and reporting. Frequent maintenance of these systems is crucial to keeping them operable. As a result, each company has a complement of internal information technology staff that is familiar with these proprietary systems. Losing one or more of these important resources could significantly impair a company's ability to operate.

Suppliers of specialized information technology labour possess a moderate to high amount of power and can use it to exert some pressure over an employer resulting in higher wages and better overall employee benefits. The bargaining power of these personnel is somewhat mitigated by the fact that their skills are not broadly in demand.

Suppliers of computer hardware have insignificant supplier power. Although the business is systems intensive, the systems run on hardware that may be provided by many equipment providers. Connectivity providers and hardware providers of servers, computers, switches, and hubs can be replaced with relative ease. Suppliers of stationery and general office supplies have no power because supplies are readily and easily available.

2.3.5 Threat of Entry

The threat of entry into the Film Industry niche of the payroll niche is moderate. The payroll industry in general is characterized by very low margins. However, payroll in the Film Industry is quite the opposite. Companies like Ceridian and ADP earn, on average, about $2.50 for each paycheque processed. Companies like EPC earn as much as $20 per paycheque issued. This healthy margin increases the threat of entry and market participants should expect others to enter and try to take advantage of existing profits.

Increasing the threat of entry is the fact that there are no regulatory limitations to starting a payroll company. Furthermore, and increasing the threat of entry, the risk associated with this business is low because payment terms, with clients, are collect on deliver, and there is no obligation for the payroll companies to remit to Canada Revenue Agency, various Workers' Compensation Boards and provincial authorities money they have not collected.

Decreasing the threat of entry are considerable start-up costs for computer hardware and software, infrastructure, personnel, and marketing. An entrant would have to make extensive modifications to off-the-shelf payroll packages, or contract out the development of a computerized payroll system to handle the rigorous reporting requirements of the various unions and government agencies. In addition, location set-up costs, personnel and marketing costs would require a significant investment before the operation started returning revenues.

Difficult access to clients further reduces the threat of entry. The Film Industry is very relationship and reputation-intensive, making it difficult to 'cold-call' clients. For example, at inception, EPC relied heavily on the already established relationships enjoyed with US clients by EP-USA. C&C and Axium also used their US parent companies' reputations to establish themselves in Canada. It is very common for clients to refuse meetings with sales representative from one of the other payroll companies.

2.4 Industry Attractiveness

This Film Industry payroll niche in Canada is a moderately attractive industry. The Film Industry has been ignored by the larger conventional payroll companies and, as a result, the film and television specific payroll service providers have deployed systems and technology and acquired the expertise required to entrench themselves in this market. Just three companies compete for over a billion dollars in Film Industry payroll volume in Canada.

However, revenues in the Film Industry in Canada are in decline due in part to the overall strength of the Canadian dollar against the US dollar, and tax credit competition from other filming locations.

2.5 Key Success Factors

There are two key success factors for a company that is competing for payroll services in the Film Industry: an excellent reputation, and attracting and retaining key personnel.

A reputation for a high-level of performance, accuracy, timely delivery, and reliability is imperative to develop and maintain strong client relationships which offer the best opportunity for repeat business. A reputation as a reliable provider of up-to-date union rates and fringe benefits lead to requests for budgeting assistance in the pre-production phase. Being contacted

early in the pre-production phase offers the opportunity to build relationships and rapport with clients and provides a pre-emptive opportunity to secure a payroll service agreement.

A significant part of developing and maintaining an excellent reputation is dependence on computer systems because accuracy, timely delivery and reliability are required by clients who outsource their payroll services. A major mistake or late delivery of paycheques could cause irreparable damage to a Producer's reputation in a relatively small community of film makers.

Attracting and retaining key personnel is critical to a company's ability to deliver the level and continuity of service expected by its clients. The company must lock in key personnel who possess high levels of expertise to create a sense of familiarity and trust with clients. Without these key personnel companies cannot compete successfully. Extensive and on-going training programs are required so that the clients' diverse needs can be met. In addition, the ability to quickly adapt systems and processes to changing pay rules and taxation issues is critical to on-going success.

3 INTERNAL ANALYSIS AND CAPABILITIES

3.1 Current Strategy

The goal of EPC is to be the industry leader in payroll services and software solutions to the Film Industry. EPC has differentiated its services from C&C and Axium by offering a service where payroll calculations are double checked for accuracy (EP Plus) and by offering EPOL, a front-end payroll calculation engine used to calculate payroll costs. Neither C&C nor Axium offer these types of services and that is reflected in the market share proportions which are approximately 70 percent EPC, 20 percent C&C, and 10 percent Axium.

EPC's competitive advantage is innovative products and processes coupled with experienced staff that have working knowledge of escrow agreements, child trust requirements and remittances, resident and non-resident taxation issues and union contract administration and wages and benefits calculations.

To understand how EPC's activities align to the corporate strategy, a strategic fit analysis was performed. A strategic fit chart, shown below in Figure 7, indicates a predominantly differentiation-based organization.

Figure 7 - EPC Strategy Diagram

Strategic Fit Chart for EP Canada Limited Partnership													
	Cost-Based	1	2	3	4	5	6	7	8	9	10	Differentiation
Product Strategy	Rapid Follower								8			Innovative
R&D Expense	Low R&D								8	⇨		High R&D
Structure	Centralized								8			Decentralized
Decision Making	Less Autonomy									9		Autonomy
Production	Economies of Scale							7				Economies of Scope/Flexibility
Labour	Mass Production								8			Highly Skilled /Flexibility
Marketing	Comparative/Push									9		High Cost/Pioneering/Pull
Risk Profile	Low Risk					5						High Risk
Capital Structure	Leveraged										10	Conservative

Adapted from Ed Bukszar. (2006). BUS607: Business Strategy class notes.

3.1.1 Product Strategy – Innovative (8)

EPC is an industry leader in product and process innovation within the Film Industry. EPC provides clients with a computerized 'hours-to-gross' payroll entry program, EPOL. EPOL is a desktop computer software application used to calculate payroll costs, straight time, overtime penalties, and premiums. This innovative product is provided exclusively by EPC to its clients; neither C&C nor Axium have a product like EPOL.

EPC is also known for process innovation within the industry. The functionality and flexibility of EPC's payroll systems are unmatched by competitors in the Film Industry. NPS can be quickly adapted to handle new union or government additions or deductions. EPC continues to make enhancements to NPS to improve reporting to various agencies and unions.

EPC was the first to offer Cheques On Location® ("COL"). COL is an internally developed software application used by clients, through server access, to print payroll cheques in the clients' offices, anywhere in the world. EPC was the first payroll service company in Canada to offer the reporting and transmission of Human Resources Development Canada Records of

Employment via the World Wide Web. EPC was the first to send electronic remittances to the Workers' Compensation Boards within Canada. EPC was also the first to provide the various unions in the Film Industry with an electronic data interface of their members' wages and benefits. While these initiatives may seem inconsequential in today's changing climate, they are quite significant for an industry that prefers to handle paper and personally deliver paycheques.

EPC has demonstrated a willingness to pursue innovative technology. EPC continues to innovate, providing clients with customized tax credit reports and detailed pay stubs. EPC's product and process innovation has been accomplished through employee resources, not acquisition.

3.1.2 Research & Development Expense – High (8)

In 2006, EPC is budgeted to spend about 4 percent of sales on research and development ("R&D"). A comparable organization, Ceridian Corporation (trading on the New York Stock Exchange), spends on average about 1.86 percent of sales on R&D per annum (Ceridian Corporation, 2004, p.8).

Given EPC's desire to incorporate changing technology in order to improve client service, investment in R&D is necessary. The value added is in the ability to proactively advise and recommend innovative technology solutions and products to streamline the payroll process. Developers and Systems Engineers are some of the highest paid employees at EPC.

In the strategic fit chart, shown in Figure 7 on page 35, an arrow indicates movement towards higher R&D expense. To maintain its large market share, EPC must continue to invest in R&D to reinforce its position as a provider of technology solutions and process innovation to the Film Industry.

3.1.3 Structure – Decentralized (8)

EPC's management style is decentralized. Management's role is that of a leader; by their actions and words management shows the way for employees. Management coaches and engages employees by communicating the purpose and direction of the organization.

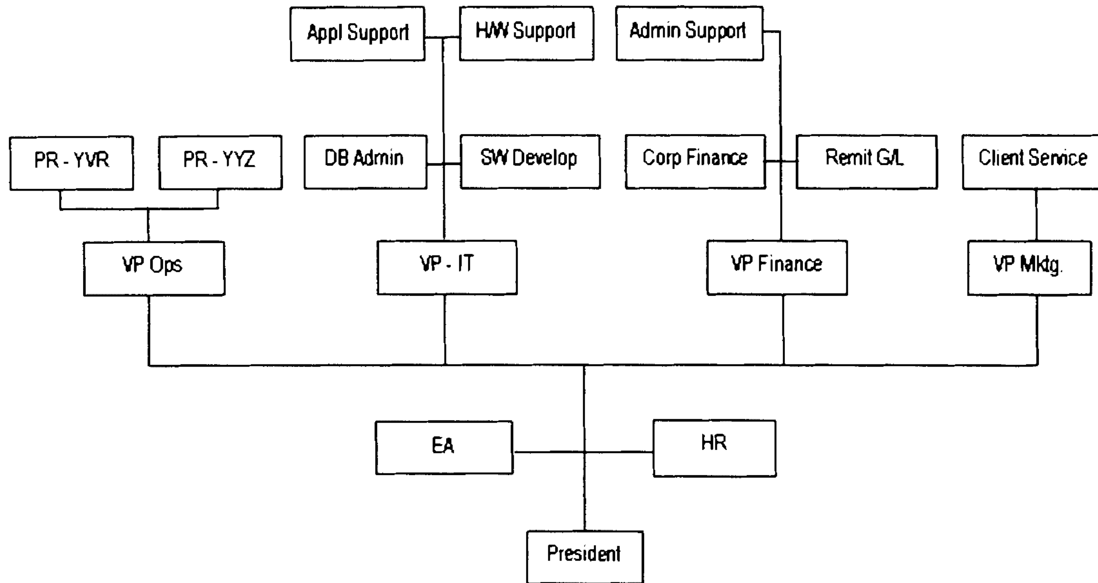
Senior management, managers and supervisors use discussing and delegating management styles. Managers discuss relevant business issues; they present ideas, ask questions, listen, provide feedback, challenge assumptions, and coach as needed. Managers often perform the role of facilitator, making sure the discussion stays on track and everyone has a chance to contribute.

Managers, using a delegating management style, explain or seek agreement on what has to be accomplished and when it must be completed. The how-to-do-it part is left up to the employee. Responsibility and authority are given to employees to get the job done, and the executive, managers and supervisors are there to help when called on.

EPC's corporate structure is fairly hierarchical, as shown in Figure 8 below. All staff report to a supervisor, supervisors report to a manager, managers report to a Vice President, Vice Presidents report to the President and the President reports to the Chief Executive Officer for the Fund. EPC has four Vice Presidents, one responsible for operations, one for marketing, one for finance and administration, and one for information technology. Along with the President, the Vice Presidents make up the executive team.

The structure facilitates effective communication within the company and individual departments. Given weekly timelines, there is little time to spare waiting for information to make its way through the departments. It is no mistake that the organizational chart is upside down. Information is pushed down to Senior Management and up to staff at weekly department meetings to ensure an informed workforce.

Figure 8 - EPC Organizational Chart



By the author.

3.1.4 Decision Making – Autonomous (9)

Decision making at EPC can be described as very autonomous. Managers, supervisors and employees are encouraged to make decisions, and to share and learn from the experiences of others. Decisions as to how tasks will be accomplished are left to the employees, and only when the employees need assistance are decisions made collaboratively. Employees have the power to take appropriate actions to achieve desired goals. Managers are cautious to avoid reverse delegation when employees try to give back decisions that they should be making.

Management believes in open and frequent communication, and that information is best put in the hands of those who can use it to better service and assist clients' on-going needs. This open management style has evolved over time, and it generally facilitates quicker response times and a more engaged workforce.

3.1.5 Production – Economies of Scope (7)

Labour economies of scope are achieved by using highly skilled employees, with common knowledge, to provide multiple services to clients. This is achieved by extensive internal training programs. The company has great flexibility in assigning employees, once they are trained, to perform multiple tasks for multiple clients. The company assigns several clients to each highly-skilled Client Representative ("CR"), where each CR can perform any one of the three services offered by EPC. Using the expertise and knowledge gained through offering a similar service offering, from the same output system, a learning effect is created, allowing the company to take on new customers quickly.

3.1.6 Labour – Highly Skilled (8)

EPC is known as a reliable source of information in the industry having familiarity and expertise in foreign and local escrow agreements, foreign and local child trust regulations, reporting and remittance requirements, resident and non-resident taxation, detailed union contract administration, and wages and benefits calculations. The payroll department is also known to exceed client expectations while remaining flexible to change schedules and adaptable to differing needs.

In the payroll department, it is very common for employees to start in an entry level position, such as a data entry clerk, and advance through the company to the position of CR. In recent months there has been some turnover in data entry clerk and CR positions. This is concerning to EPC, given the excessive training costs and on-going client service expectations.

In the IT department, hardware and software support staff are moderately skilled. Programmers that are responsible for EPC's proprietary products (EPOL, NPS, and COL) are highly skilled and specialized. Their quick and accurate response is required to meet the changing needs of clients, unions, and government. In addition, the IT department must keep

current on the programming languages and changing technology in the market, so that systems are kept up to date, flexible, and adaptable to change. There is very little employee turnover in the IT department.

In the finance department, employees are expected to have accounting experience, but for the most part are fairly easily replaceable. There has been an inordinate amount of turnover in the finance department, and while this is not an area of core competence for EPC, it is an important function and necessary to deliver the required reporting to the Chief Financial Officer of the Fund.

To measure employee turnover at EPC, an annualized turnover rate is calculated. Annualized turnaround provides a consistent basis for comparison and is calculated as follows; turnover equals (number of employees exiting the job / average actual number of employees during the year). The average number of employees on staff during the year is calculated by taking the average count of trained staff at the beginning and end of the year.

Turnaround is further analyzed for voluntary and involuntary turnover. Voluntary turnover occurs when employees decide to leave, while involuntary turnover occurs when management makes the decision to end employment. In recent years, EPC has experienced total turnover ranging from as low as 8 percent in 2002 to as high as 19 percent in 2003. Upon close consideration of the annualized turnover rates, in individual departments, there is some cause for concern. Figure 9, below, details EPC's voluntary and involuntary turnover rates for 2001 – 2003.

Figure 9 – Employee Turnover – voluntary versus involuntary, 2001 - 2003

	2001			2002			2003		
	Voluntary Turnover	Involuntary Turnover	Total Turnover	Voluntary Turnover	Involuntary Turnover	Total Turnover	Voluntary Turnover	Involuntary Turnover	Total Turnover
Payroll	13%	0%	13%	5%	0%	5%	14%	18%	32%
IT	0%	0%	0%	7%	0%	7%	0%	8%	8%
Finance	0%	0%	0%	8%	0%	8%	8%	24%	32%
Total EP East	*5%*	*0%*	*5%*	*7%*	*0%*	*7%*	*9%*	*17%*	*26%*
Payroll	8%	0%	8%	0%	0%	0%	5%	10%	15%
IT	0%	10%	10%	0%	0%	0%	0%	0%	0%
Finance	25%	17%	42%	5%	21%	26%	10%	5%	15%
Total EP West	*14%*	*9%*	*22%*	*2%*	*8%*	*10%*	*6%*	*6%*	*13%*
Total company turnover	**10%**	**5%**	**15%**	***4%***	***4%***	***8%***	***7%***	***12%***	***19%***

By the author.

In 2001, employee turnover in the Vancouver office (Total EP West) was 22 percent. A merger between BESI and TVD, on October 31, 2001 and on-going performance problems in the Vancouver finance department caused high turnover during this period. The 2001 merger brought together two fully staffed and functioning payroll companies, resulting in redundant positions in the Vancouver IT and finance departments. Layoffs of these redundant positions account for the involuntary turnover in the IT department and most of the involuntary turnover in the finance department.

Further contributing to the 42 percent turnover in the finance department, in 2001, were significant performance problems. Prior to 2001, TVD implemented a new accounting general ledger called EPICOR. EPICOR required a new workflow and the implementation of a new set of policies and procedures. The management of the finance department, at the time, proved incapable of managing the department through completion of the implementation. A new Vice President of Finance was hired to oversee a complete restructuring of the finance department and completion of the implementation of EPICOR. Additional lay-offs occurred in 2001, accounting for the rest of the involuntary turnover in the finance department. This Vice President of Finance remained at EPC through completion of the BESI and TVD merger. Overall turnover in the Toronto office in 2001 was just 5 percent.

After the merger between BESI and TVD (October 31st, 2001), EPC owned two payroll systems and two accounting general ledger programs. EPC decided to standardize nationally on the systems used by the Vancouver office, specifically NPS and EPICOR.

In 2002, total employee turnover was quite low; just 8 percent for the entire company. Involuntary turnover in the Vancouver finance department amounted to 21 percent, as management continued to work through the restructuring plan, terminating several additional finance department employees, while the Toronto and Vancouver payroll and IT departments engaged in detailed discussions about transitioning the company to one payroll system, which would be effective from January 1st, 2003.

In 2003, overall employee turnover, in the Toronto office was high; 32 percent in the payroll department, 8 percent in the IT department, and 32 percent in the finance department. The combined total was 26 percent. Turnover in the Toronto payroll and finance departments occurred as a result of the implementation of NPS and EPICOR. These computer programs required a different skills set and aptitude for the adoption of different policies and procedures.

Employees in the payroll department who were unwilling to adapt to the new systems were terminated while others decided on their own that the new systems and proficiencies were not a fit, resulting in 18 percent involuntary turnover and 14 percent voluntary turnover. EPICOR, and its integration with NPS, was more complicated than the previous accounting general ledger used by BESI. Involuntary turnover in the Toronto finance department was 24 percent because EPC terminated several employees and hired more experienced staff.

In 2004 through 2006, overall employee turnover at EPC has been in decline, see Figure 10 below.

Figure 10 - Employee Turnover – voluntary versus involuntary, 2004 – 2006

	2004			2005			2006*		
	Voluntary Turnover	Involuntary Turnover	Total Turnover	Voluntary Turnover	Involuntary Turnover	Total Turnover	Voluntary Turnover	Involuntary Turnover	Total Turnover
Payroll	17%	23%	40%	29%	0%	29%	0%	7%	7%
IT	10%	0%	10%	24%	12%	35%	0%	0%	0%
Finance	0%	0%	0%	8%	0%	8%	16%	24%	40%
Total EP East	*10%*	*10%*	*20%*	*20%*	*3%*	*23%*	*6%*	*11%*	*17%*
Payroll	11%	6%	17%	12%	0%	12%	6%	0%	6%
IT	21%	11%	32%	11%	0%	11%	0%	0%	0%
Finance	5%	5%	10%	6%	0%	6%	12%	0%	12%
Total EP West	*11%*	*6%*	*17%*	*9%*	*0%*	*9%*	*7%*	*0%*	*7%*
Total company turnover	**10%**	**8%**	**18%**	**14%**	**1%**	**15%**	**6%**	**5%**	**12%**

By the author.

In 2004, total employee turnover was 18 percent. Turnover was highest, at 40 percent, in the Toronto payroll department, followed, at 32 percent, by the Vancouver IT department. A majority of the turnover in the Toronto payroll department in 2004 was involuntary. Management made the decision to end the employment of several members of the payroll department who continued to struggle with the new policies and procedures implemented in 2003, and/or proved unwilling to change behaviors around client service. In the IT department, internal technical and hardware support experienced voluntary turnover. The position changed over twice during the year and was left unfilled over year-end. The involuntary turnover in the Vancouver IT department was a lay-off from the VISTA® technical support department, due to a slower-than-expected year. The position has not subsequently been filled.

In 2005, voluntary turnover in the Toronto payroll department remained high, at 29 percent. Most of this turnover was in lower-paying entry-level positions. Turnover at this level occurs for a couple of reasons. First, the work is not very challenging leading some to experience boredom and second, employees at this level are impatient. It takes six to nine months to complete the training process and impart the knowledge required to service clients at the level to which they are accustomed. Entry level employees get impatient waiting. Turnover at this level tends to cost the company less per replacement employee, than do higher-paying job roles.

However, EPC incurs the cost more often. Turnover in the Toronto IT department, 35 percent, consisted of two voluntary departures and one involuntary departure, none of which have been replaced.

In the first six months of 2006, the finance department continued to experience staggering rates of turnover: 40 percent in Toronto and 12 percent in Vancouver. On August 4th, 2005, EPC became part of the Fund. The change from a private company to an operating entity within an income fund changed the working climate significantly in the finance department. Specifically, employees who were comfortable with regular nine-to-five work hours were expected to work overtime. Monthly financial statement delivery deadlines to the Chief Financial Officer; quarterly audits; and stricter overall compliance requirements led to the overtime. Several finance department members had previously moved to the finance department, from the payroll department, to get away from working overtime. This change has unfortunately caused employees to choose to work elsewhere. "Mergers, acquisitions, divestitures, and corporate reorganizations have been major factors in increased employee turnover during the past two decades" (Goolsby, 2005, para. 3).

It is common for employees to start their career in one department and move throughout the company. Transfers into other departments are encouraged and the result is employees with a broader understanding of the business and company procedures. Transferees offer new ideas, approaches, abilities, and attitudes that help keep the organization from becoming stagnant. Even though some departments are experiencing higher-than-normal turnover, currently 34 employees out of 91 (37 percent of the current workforce) spread throughout each of the Toronto and Vancouver offices, have more than eight years' of company experience.

3.1.7 Marketing – High Cost / Pull (9)

EPC uses a 'pull' promotional strategy but with a soft low-key approach. This approach is quite costly because EPC's sales force makes regular visits to Los Angeles and New York creating interest (demand) for its services. EPC operates in a niche market built on personal relationships and trust.

EPC's marketing effort is concentrated on personal sales calls and one-on-one discussions. EPC's marketing department spends considerable time tracking Production leads and making direct phone calls to decision makers. EPC does not spend its resources on expensive advertising campaigns; its greatest asset is its 20-year reputation as the largest provider of payroll services to the Film Industry.

It is difficult to stimulate growth in this niche market, because payroll business in the Film Industry is directly correlated to Production volumes. Decision makers do not make a decision on a film location based on a payroll service. However, once the production decision is made, EPC is quick to make a personal call to inform the Producer of its service offerings and reputation.

3.1.8 Risk Profile – Moderate Risk (5)

EPC's risk profile is moderate. Based on its strategy of differentiation, EPC charges a premium for its services. These higher fees facilitate EPC's continual advancement of systems and services in order to better service clients. Nonetheless, increasing EPC's risk profile is the fact that EPC is running out of room to innovate and there will come a time when EPC can do little more to advance innovation.

There is a point at which Producers achieve little advantage from incremental innovation of payroll services and systems. To date, EPC has found and maintained a balance between: (i)

innovating enough to stay ahead and justify higher fees, and (ii) innovating too much and driving clients towards a simpler solution.

However, competitors have proven that it is possible to operate in this niche market with less innovative products and services. C&C and Axium have done little to match or copy EPC's products and services. Their apparent unwillingness to match the level of technological and process innovation lowers the overall risk profile of EPC.

Furthermore, the Film Industry is exposed to considerable systemic risk due to fluctuations in currency exchange rates. A weak Canadian dollar has the effect of increasing foreign demand in Canada, as seen in the Production volume in the Film Industry in 2000 to 2002, see Figure 6, page 26; whereas a strong dollar has the opposite effect. Currency fluctuations increase the level of risk to operations for EPC because EPC cannot predict the exchange rate or have an effect on its movement one way or another.

3.1.9 Capital Structure – Conservative (10)

EPC is a wholly owned subsidiary of the Rainmaker Income Fund, an unincorporated open-ended limited-purpose trust. As of November 14th, 2005, there were about 16.8 million units of RNK.un outstanding (Rainmaker Income Fund, 2005, p. 2). The main attraction of income trusts, in addition to tax advantages, is their ability to generate constant cash flows for investors (unitholders). The unitholders are the beneficiaries of the trust, and their units represent their right to participate in the income and capital of the trust. Typically, a substantial portion of the earnings are paid out monthly to the unitholders.

Under this corporate structure, little cash is left in the business to reinvest in the business. This would not normally be an ideal structure for a company using a differentiation strategy.

However, in EPC's case, with strong profit margins (around 35 percent) the company has been successful in acquiring sufficient finances to fund on-going R&D and marketing.

EPC does not rely on creditors to finance operations. As at December 31st, 2005 EPC had $430,000 in current operating liabilities on the books, with $9.5 million in unitholder equity. EPC is solid financially, with no bank loan or long term liabilities of any kind.

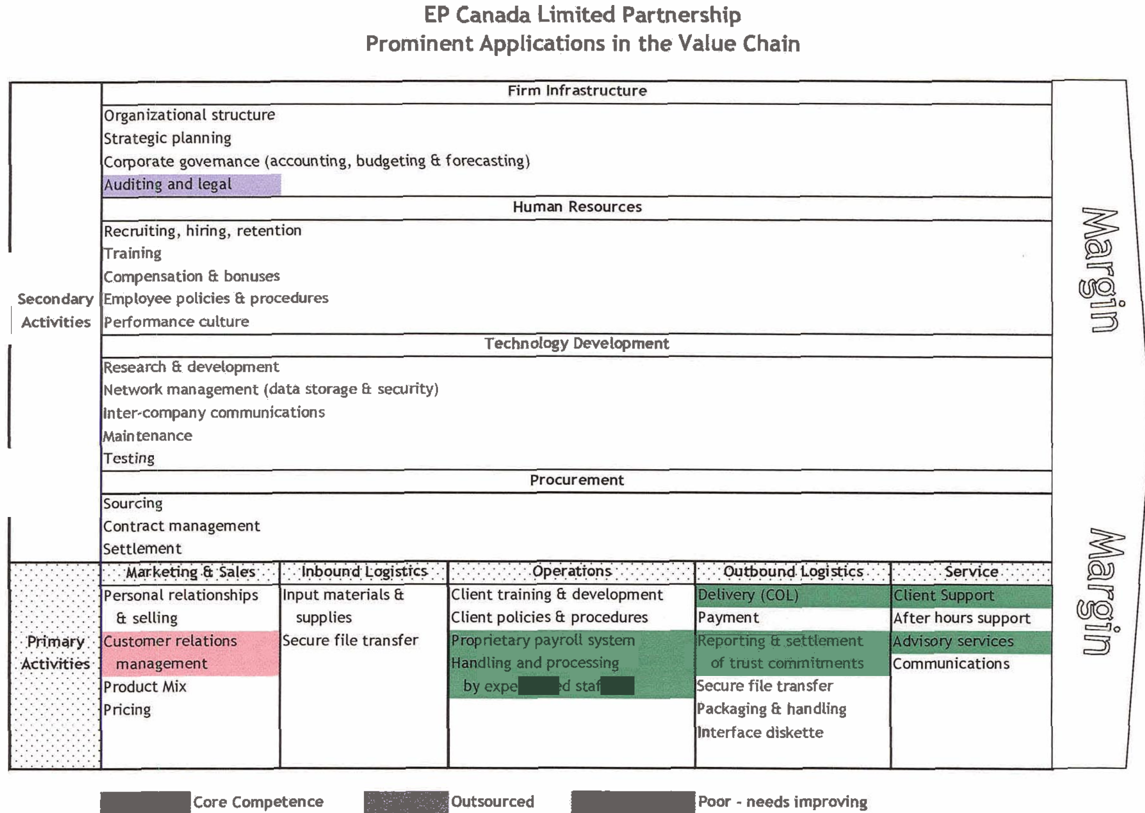
3.2 Firm Level Value Chain

To better understand the activities through which a company or firm develops a competitive advantage and creates unitholder value, it is useful to separate the business system into a series of value-generating activities referred to as the firm level value chain.

In a firm level value chain analysis, Michael Porter distinguishes between primary activities and support activities. Primary activities are directly concerned with the creation or delivery of a product or service. Each of these primary activities is linked to support activities which help to improve their effectiveness or efficiency. The margins imply that organizations realize a profit margin which depends on their ability to manage the linkages between all activities in the value chain. In other words, the firm's margin or profit then depends on its effectiveness in performing these activities efficiently.

A firm level value chain, the series of activities that create and build value, for EPC appears in Figure 11 below. EPC, as the employer-of-record, assumes the Payee function and administers all union and statutory deductions, remittances and reporting. EPC processes more than 500,000 cheques in a calendar year totalling close to one billion dollars Canadian. EPC is one of Canada's largest issuers of Records of Employment and prints 25,000 Canada Revenue Agency tax slips per year.

Figure 11 - EPC Firm Level Value Chain



Adapted from Ed Bukszar. (2006). BUS607: Business Strategy class notes.

3.2.1 Primary Activities

EPC's primary value chain activities include marketing and sales, inbound logistics, operations, outbound logistics, and follow-up. These primary activities are directly involved with the physical delivery of payroll services. Support activities are not directly involved but have the potential to increase effectiveness and efficiency.

3.2.1.1 Marketing and Sales

The first primary activity in the chain is marketing and sales. EPC's marketing and sales efforts include personal relationships and selling, but not a lot of print advertising. As a service provider, EPC's reputation and results have a far greater impact than print ads. Personal relationships and selling include personal visits to clients' offices and studios. EPC marketing

representatives travel to Los Angeles three to four times per year, to New York two to three times per year, and across Canada once a year, making personal one-on-one visits to Producers in order to discuss EPC's services.

Currently, clients are tracked by the marketing department in weekly leads meetings. A Client Service Coordinator ("CSC") in Vancouver tracks shows west of Manitoba and a CSC in Toronto tracks shows east of Manitoba. The Vice President of Marketing and the CSC share the responsibility for pursuing new projects. Most Producers are repeat clients; EPC relies heavily on word of mouth advertising. In a very low pressure manner, the CSC describes in detail the service available to the client. The client chooses one of EP Plus, EPOL, or EP Payroll for cast and one of EP Plus, EPOL or EP Payroll for crew, or additional follow-up is done. Additional follow-up includes phone calls and/or a letter from the Vice President of Marketing outlining EPC's track record for delivery of quality and professional service and support.

At this stage EPC continues to provide consulting support on:

- paying non-resident Payees for services rendered in Canada;
- answering questions on facilitating payments to US affiliate unions;
- assignment agreements to assign services to the local one-off production company;
- budgeting local Payee hourly rates and fringes; and
- providing names and phone numbers for available accounting department staff.

Once the client has made a decision, the CSC is responsible for acquiring the show set-up details. Show set-up involves taking, over the phone, production company name, address, phone, fax and e-mail contact details, province and union specific details and account configuration for VISTA® accounting system set-up. The CSC immediately forwards to Production a 'Start Pack' (a package of information, paperwork, and forms).

The CSC posts to a private public folder in Outlook, the details he or she has received and the show is set-up for processing in NPS by the payroll department supervisors. The accounting system is ordered and the client begins to transfer information necessary for the processing of payroll for the show to EPC. The accounting system is forwarded to the client once it is received from EP-USA, which is typically within five business days. The finance department activates the necessary accounts in the general ledger, and opens a Workers' Compensation account in the name of the production company.

With the set-up complete, a cast CR and a crew CR are assigned to the project. With the exception of issues that require escalation above the assigned CR, the CR takes over as the single point of contact for each client until completion of the project. The designated CR becomes familiar with client preferences and details specific to the project and is responsible for all client contact, advisory services, guidance and assistance. All matters enter and leave EPC's offices from the desk of the CR.

The CSC remains available to provide assistance when necessary and follow up bi-weekly with clients to ensure services are being delivered as expected. The CSC shares the feedback received from clients with the Vice President of Marketing, Vice President of Operations and the Payroll Department Managers. Based on this feedback, additional personal attention is provided until all unsatisfactory issues are resolved.

Because personal relationships and selling are the most important means of marketing EPC's services and building EPC's client base, a more comprehensive and robust customer relations management software would be beneficial. At present, a combination of Outlook Contacts and private public folders is used to post information for sharing about each individual project. It is adequate, but by no means sufficient given the high importance of this activity.

EPC is currently in the process of building a software requirement specification for customer-relations-management software.

3.2.1.2 Inbound logistics

The second primary activity in the chain is inbound logistics. When a Payee is engaged, new hire 'start-up' forms are completed. For crew personnel start-up forms include a 'start slip' (completed by employees and corporations), and/or a TD1 – Federal and Provincial (completed by employees only) or a 'corporate waiver' (completed by corporations only). For cast personnel, who are paid as sub-contractors, start-up forms include a 'contract for engagement'.

The start slip is a one-page document outlining the Payee's name, employee number, address, category, rate of pay, and other special employment conditions. The TD1's provide details on personal exceptions for taxation purposes, and the corporate waiver is an acknowledgement by corporations that the corporation will make income tax payments, and Canada Pension Plan and Employment Insurance contributions. The cast contract includes the Payee's name, employee number, address, category, rate of pay, buy-out rate, and other special employment conditions. Start-up forms for cast and crew personnel are sent to EPC in batches prior to the first payment being processed.

Every week, Payees (both cast and crew) complete a detailed record of their working hours, known as a 'timecard'. The timecard is turned in to accounting and routed through an approval process in the Production office.

Once the timecard is approved, depending on the service chosen, clients either relay the paperwork to EPC, or use the timecard for input into EPOL, in which a data file is later forwarded to EPC for further processing. For EP Plus and EP Payroll service, the hard copies of the paperwork are delivered to EPC by one of the Production office employees. The package is received by reception, date and time stamped and forwarded to the CR. For EPOL payroll

service, the data file is transmitted via EPC's FTP site. The CR is alerted electronically once the file has arrived.

3.2.1.3 Operations

The third primary activity in the chain is operations, where EPC issues paycheques and a package of back-up documents for clients, using a combination of highly skilled employees and integrated computer systems. For EP Plus payroll service, start slips and timecards are submitted to EPC's offices by Tuesday morning, before noon. The CR sorts the start-up paperwork and the timecards into alphabetical order. Payees in NPS are cross referenced to the new start-up paperwork, and the new paperwork is interfiled alphabetically with the other starts. The CR inputs the timecards into NPS and within 48 hours, paycheques are returned to the Production office for distribution.

For EPOL payroll service, data files are received at varying times throughout the day on Monday through Wednesday. The CR alphabetically sorts the start-up paperwork and refers to it as the data file is run through a nine-step computer process. Within 24 hours of receiving the file, paycheques are returned to the Production office for distribution.

For EP Payroll service, start slips and timecards are submitted to EPC's offices by Wednesday morning, before noon. The CR sorts the start-up paperwork and the timecards into alphabetical order. Payees in NPS are cross referenced to the new start-up paperwork, and the new paperwork is interfiled alphabetically with the other starts. The CR inputs the pre-calculated gross pay figures into NPS, and within 24 hours, paycheques are returned to the Production office for distribution.

All employees are trained to calculate payroll based on the clauses and provision of the collective agreements negotiated by Producers. Clients and EPC employees engage weekly in a process of sharing information relating to hours worked, benefits and entitlements. From

Production report information, sick days are monitored, special temporary daily (even hourly) upgrades are discussed, along with meal penalty and turnaround provisions.

Through extensive training and established internal polices and procedures the CR processes payroll data, making the necessary union additions and deductions based on the collective agreements and any special terms that are negotiated by the production company. EPC responds to third-party demands (garnishees) and facilitates all statutory deductions and reporting to Canada Revenue Agency and provincial Workers' Compensation Boards.

All payroll operations are performed on NPS, regardless of the type of service a client is using. The system is designed, built, and maintained by a team of in-house programmers. It is flexible to change and responsive to user preferences and demands and is used extensively in the delivery of payroll services. Ongoing maintenance and testing of this system are performed by in-house payroll department and information technology staff. This proprietary payroll system is the foundation upon which EPC has built its reputation as the best in the business.

EPC's services include client support (including after-hours support) and advisory services. Regardless of which service a client is using, EPC client support and advisory services are broad and diverse and are integral to EPC's success. Clients contact staff at EPC to ask questions about escrow agreements, child trust requirements and remittances, resident and non-resident taxation issues, union contract interpretation, union contract administration and wages and benefits calculations. Accurate and timely communication of facts and figures is important to maintaining and fostering a reputation of trust and confidence. The company considers this relationship an integral part of delivering value-added service to clients on a weekly basis.

Equally important to EPC's success is employee commitment. It is very common for employees to stay late into the evening and change whatever personal plans they may have had. Executives also assist clients during the evenings and on weekends. EPC's personnel are unique;

they are extremely responsible with an unmatched customer-service ethic. Without this commitment, deadlines would not be met, which would in turn result in EPC paying a 1 percent of gross-pay-per-day penalty to each Payee (dictated by union contract). Such penalties, if invoked, would result in EPC forfeiting its entire service fee revenue, and more, for the week.

With most Productions working Monday to Friday, there is little opportunity to smooth client-delivery expectations. As a result of overlapping client demands, and an inflexible Thursday pay day, CRs are often required to work excessive amounts of overtime. In addition, throughout the production phase, EPC continues to provide clients with software support for the VISTA® program, making support staff available sixteen hours a day, seven days a week.

3.2.1.4 Outbound logistics

The fourth primary activity in the chain is outbound logistics; where in all cases NPS produces various reports, journals, copies of relevant source documents, and most importantly, paycheques for all cast and crew Payees. Delivery of paycheques to clients happens in one of two ways: via hand delivery to the Production office's accounting department, or via COL. Each Thursday morning, those payrolls being hand delivered are packaged for delivery. Each parcel is personally addressed to the accounting department representative and delivered, that day, before noon by EPC staff. In exchange for a package of information containing billing details on settlement of trust commitments and an interface file of payroll costs, the client provides a cheque to settle the amount of disbursements including EPC's payroll fees for providing services.

The interface file of payroll costs into VISTA® is enormously valuable to clients. The interface file provides, in detail, a break down of all payroll costs coded into the different general ledger accounts that correspond to the locked budget. The interface file is uploaded to VISTA® saving hours of manual entry.

For those clients whose offices are outside of Vancouver and Toronto, payroll is shipped along with the interface diskette, via expedited courier to arrive on Thursday morning before noon. Alternatively, clients can choose to use COL. Using COL, clients can dial into EPC's Virtual Private Network and gain access to the payroll package, including cast and crew personnel paycheques that would have otherwise been shipped to them via courier. To print cheques, clients download a file and print to a local printer equipped with a magnetic ink cartridge. All other reports are downloaded and printed for filing. The interface diskette is copied to a local drive and loaded into VISTA®. COL, and the administrative process facilitating the remote delivery of payroll cheques, is of significant value to clients.

3.2.1.5 Follow-up

The fifth primary activity in the chain is follow up. Client representatives, supervisors and management, regularly follow up with union agents to ensure deductions have been made correctly and remitted. A finance department representative follows up with regulatory agencies to ensure that accounts are kept up to date and that the necessary filings are done on time. In addition, a finance department representative follows up with various banking institutions to ensure correct and legitimate clearing of pay cheques.

EPC's payroll services are differentiated in terms of service, price, performance, and delivery. The entire payroll outsourcing experience described above provides value because it relieves a significant burden for the production company, and by extension the Producer. EPC's computerized systems provide wide-ranging value to assist in administering the union benefits and contributions (additions and deductions), electronic exchange of data and remittances to unions and government. In order to further relieve the burden for Producers, EPC accepts responsibility for making the records available for audit to Canada Revenue Agency for the statutory period of seven years.

Producers can film a movie in Canada, outsource their payroll services, complete the production phase, and continue into post-production knowing and trusting that their entire payroll function will be carried out. Employees will be paid, they will have access to the necessary paperwork and documentation, and they will have a central and local company to contact for duplicate copies of forms and tax slips.

3.2.2 Support Activities

To execute on a differentiation strategy there are support activities that are critical to efficient and effective operations. EPC has an established and effective infrastructure in place to govern and guide its operations. The organizational structure is hierarchical; all employees report through a supervisor to a manager, managers report to a Vice President, Vice Presidents report to the President and the President reports to the Chief Executive Officer of the parent Company, Rainmaker Income Fund. This structure is effective for EPC as it ensures communication throughout the organization.

The executive team engages in planning meetings twice a year for two days at a time; one day is dedicated to tactical planning and one day is devoted to strategic planning (new products and target markets). Corporate goals and objectives are determined during these sessions and the executive team is expected to execute on those goals and objectives throughout the year.

As a public entity (Rainmaker Income Trust, TSX:RNK.un), corporate governance is a prominent part of the infrastructure. The audit committee is responsible to review the financial statements (including budget and forecasts), accounting policies, and reporting procedures of the Fund. Consistent with this function, the executive team encourages continuous improvement of, and fosters adherence to, the Fund's policies, procedures and practices at all levels. The audit function is outsourced to Deloitte & Touche. Legal services are provided by Fasken Martineau DuMoulin LLP.

EPC's HR functions play a key role in supporting EPC's business activities. EPC performs the HR function in-house and has a full-time HR Manager who is responsible to oversee the entire function. Recruiting and retention of a talented workforce is critical for continuity of service. As a matter of practice, all postings (whether a replacement or a new position) are posted internally. Applicants from within the company are given first opportunity to advance within the organization. This 'promote-from-within' strategy has resulted in longer tenure employees. It has also resulted in knowledge sharing within each and across each department, which is an added value, and a catalyst for helping transfers of technical employee policies and procedures in order to ensure delivery of client expectations.

Competitive compensation and bonus incentives should ensure that employees are rewarded fairly and favourably. At EPC, base salary compensation is intended to compensate employees for performing their day-to-day job responsibilities. In addition, and dependant upon the company's ability to pay, an annual bonus of approximately 8 percent of salary is paid to employees. The annual bonus is intended to reward employees for their contribution to EPC's overall success but fails to reward employees for individual performance and longevity of employment (loyalty).

Employee performance reviews are performed annually on each employee's anniversary date. EPC's HR department is responsible for reminding department managers to complete these annual reviews. On each review form, employees are asked to indicate personal goals and complete a section called 'wish list'. Employees are prompted with a broad request for suggestions or improvements to the ways things are done. Copies of wish list requests are forwarded to the President, and followed up by department managers and supervisors.

Upon voluntary departure from EPC, employees are requested to complete an exit interview form and they are invited to discuss their comments and feedback with the HR department. The employee can choose to have the exit interview feedback reviewed by:

1. President only;
2. President and Senior Management only;
3. President, Senior Management and department manager only; or
4. President, Senior Management, department manager, and supervisor.

Most employees choose option 4, enabling management and HR to review and actively discuss options for improvement. Exit interview feedback, performance review feedback, salary guidelines, and employee morale are discussed monthly at HR meetings held between the President, the HR Manager, and the Vice President of Finance.

Technology activities and the information technology department are critical resources for EPC. R&D is performed in-house. However, the rate upon which the payroll industry innovates is slowing. More recently, R&D has consisted of process innovations. These process innovations include improved reporting to various guilds, unions, and government agencies.

NPS, EPOL, and COL were all developed in-house and all contribute to EPC's competitive advantage. Each of these systems are developed and supported by employees and each contributes to EPC's execution of its highly specialized services. On-going enhancements and testing helps EPC deliver its service promises.

EPOL is maintained, supported and enhanced by a Senior Consultant and a Software Developer located in Toronto. NPS and COL are maintained, supported and enhanced by a team of four full-time Systems Analysts located in Vancouver. All programmers, analysts, and software developers ("IT Staff") have superior knowledge of database and object oriented development, along with the Rapid Application Development tool Delphi, and Microsoft's

Enterprise Database System SQL 7.0. IT Staff skills are kept current through continuing-education programs.

IT Staff are directly involved with support and code revisions enabling EPC to respond quickly to changing needs and facilitating direct communication between the payroll departments and IT Staff. Code revisions are managed through a 'change log' process, by which all systems revisions are prioritized and IT Staff resources assigned accordingly. Code revisions are grouped into two categories: bug fixes and systems enhancements.

Resources are immediately assigned to bug fixes. Immediate action is taken by one or more IT Staff to resolve the problem and bug fix programming is released immediately into the system. A group of employees, comprised of at least one representative from each department, meets bi-weekly to discuss system enhancements. The group meets to discuss and assign priorities at which time a 'champion' is assigned to each system enhancement. The champion is responsible for providing IT Staff with a description of the necessary changes, for working with IT Staff to determine look, feel, and functionality, for testing and for final sign-off. Completed systems enhancements are released weekly, on Sunday evening followed by an e-mail from IT Staff describing the new functionality.

Network management, including secure data storage and security, is performed by an in-house Network Administrator. This same administrator is responsible for the e-mail system, a tool methodically used by EPC as an inter-company communication tool. With employees working varying hours, efficient communication of clients' needs is an important part of EPC's ability to provide an advanced level of service.

EPC's procurement activities are performed by in-house purchasing agents, one in each office (Vancouver and Toronto). These agents are experienced in negotiating contracts and pricing and follow a corporate purchasing policy. The policy includes guidelines on sourcing,

contract (vendor) management, and settlement. The purchasing policy provides procedures which specify the number of competitive quotes that must be acquired before a purchase is made, provides details on preferred vendors and guidelines for sign-off and final settlement. The purchasing process is centralized so that others are not unnecessarily taken away from revenue-generating activities.

3.3 Competitive Advantage

EPC's competitive advantage is the ability to deliver to Producers benefits that exceed those offered by competitors. EPC's greatest competitive advantage is its ability to deliver flexible technology solutions and reliable service to clients. Accomplishing this is highly dependant on employee commitment, information systems, and working relationships with clients.

EPC delivers flexible technology solutions through its three different service types. A Producer can mix and match EP Plus, EP Payroll and EPOL depending on the experience of the payroll person at the Production office. EPC services are reliable, as evidenced by its 70 percent market share. EPC is known as a reliable source of information; competitors have even referred clients when unable to answer their own clients' questions. EPC happily assists such clients creating the possibility that a new lasting relationship may form.

EPC's competitive advantage permits it to earn excess return for its unitholders.

3.4 Corporate Culture

The company culture at EPC is adaptive and client focused. Employees possess a high degree of adaptability, high accountability standards, and a commitment to individual initiative. The company culture has evolved over time, and will continue to evolve as each new employee

brings his or her own values and practices to the group and as the environment in which the company operates, such as the laws, regulations, and business climate changes.

The organizational footprint within the Wexler Wheel (Wexler, 2005), prior to becoming part of the Fund ("Pre 2005"), was approximately 40 percent Communitarian worldview, 25 percent Regulatory worldview, 10 percent Entrepreneurial worldview and 25 percent Network worldview (Wexler, 2005).

According to Wexler, the Communitarian worldview is regarded as participative with empowered employees, trusting relationships and a strong sense of community where 'we' is often used, not 'I'. EPC's culture greatly supports this worldview. Employees are seen as members of the organization. Annual celebrations, such as EPC's annual Kick-off Party (a celebration held in January each year to kick-off the coming year), are attended by over 95 percent of employees.

The Regulatory worldview (Wexler 2005) is regarded as bureaucratic and rules based. Pre 2005, EPC's foot print within this worldview was approximately 25 percent and while the words 'bureaucracy' and 'rules' seem to be a complete contradiction to a participative culture, certain procedural rules and guidelines must be in place and followed to ensure the correct processing, remitting and reporting of hundreds of thousands of dollars, on a weekly basis.

Pre-2005, EPC's footprint within the Entrepreneurial worldview (Wexler 2005) was approximately 10 percent. In the Entrepreneurial worldview, there are winners and losers; winners battle to create wealth at the expense of losers. EPC has proven to be a winner, with a strong market share and healthy historical earnings.

In the Network worldview (Wexler 2005), where technology defines success, companies are regarded as visionary and innovative. With a Pre-2005 footprint in this worldview, EPC has

proven its ability to advance useful knowledge through its investment in technological and process innovation.

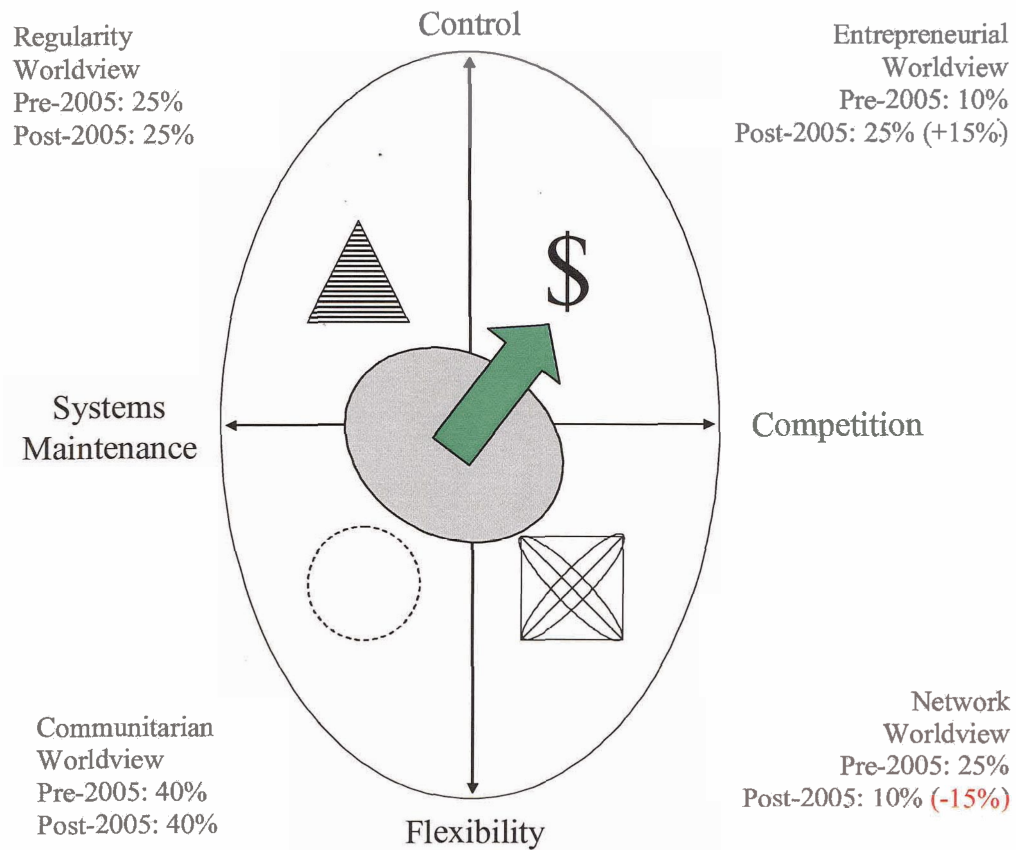
After becoming part of the Fund ("Post-2005"), EPC has maintained its Communitarian (40 percent) and Regulatory worldview (25 percent) footprints, which are extremely important. The Communitarian lean is critical to maintaining engaged and valued employees, who can make decisions and who are trusted to follow through. The Regulatory lean is critical to conveying competence and confidence. There must be some consistent policies and procedures.

However, EPC's footprint within the Entrepreneurial worldview and Network worldview has changed, see Figure 12 below. At the expense of technological innovation, and a 15 percent decrease in the Network worldview, the company's footprint in the Entrepreneurial worldview has increased by 15 percent, signalling a move towards greater emphasis on wealth creation for unitholders.

Wealth creation for unitholders is consistent with income trusts and represents a shift in culture for EPC. A shift that, if not managed effectively, can lead to a push-back from employees and resistance to further change. This can ultimately lead to even greater employee turnover.

As indicated in section 3.1.6 above, the company has already experienced periods of high employee turnover which is often a consequence of significant shifts in corporate structure and continuous change. However EPC has, to date, managed continuous change though the use of change management plans that, consistent with EPC's discussing and delegating management styles, incorporate employee input and focus on small improvement, not large-scale transformations. To more effectively manage employee turnover, improvements are required at EPC.

Figure 12 - Organizational Footprint



Adapted from Mark Wexler. (2005). Leadership in context - the four faces of capitalism.

Continuous change in organizations is not uncommon and can lead to 'change fatigue' which in turn perpetuates resistance to change. However, change fatigue can be avoided by supporting employees through the process of change and transition by assisting employees in coping both emotionally and professionally. To address this specific issue, EPC introduced an Employee and Family Assistance Program ("EFAP") in the spring of 2006. The EFAP provides confidential and professional counselling services to employees and their immediate family members.

There should be no doubt that the culture at EPC has changed and if EPC is to maintain its strong market position and reduce employee turnover, management will have to continue to

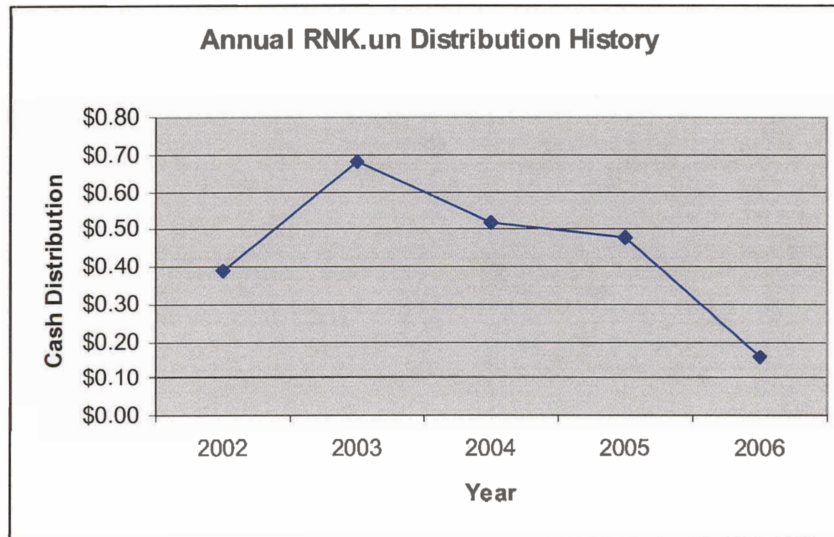
support an environment where an enormous amount of discretion and support is given the employees to get things done.

3.5 Financial Analysis

The financial performance of EPC is monitored by its Vice President of Finance, who works very closely with the Chief Financial Officer of the Fund. EPC is one of three operating entities held under the Fund. In addition to EPC, the Fund includes Rainmaker LP, a post-production, visual effects and animation company, and Canada Film Capital LP ("CFC"), a tax credit administration and financing service company. Both Rainmaker LP and CFC operate in the Film Industry.

The Fund, since its creation in 2002, has paid cash distributions, see Figure 13 below. The 2002 declaration includes declarations for June to December 2002, and the 2006 cash distribution below includes year-to-date declarations for January to April 30th, 2006. Payment of cash distributions to Fund unitholders is expected to continue.

Figure 13 - Annual Rainmaker Income Fund Cash Distributions History (2002 – 2006)



By the author.

3.5.1 Revenue (EPC)

Revenues for EPC are generated primarily from offering employer-of-record and payroll services in the Film Industry. More than 85 percent of EPC's fees are generated from Productions filming in Ontario and British Columbia. Less than 1 percent of EPC revenue is generated from reselling EP-USA's production management tools, EP Budgeting and EP Scheduling programs. EPC's remaining fees are generated from Productions in Alberta, Saskatchewan, Manitoba, Quebec, and Atlantic Canada.

EPC relies on sales to a limited number of clients, impacting the ability to accurately forecast the timing and amount of future revenue. Over the longer term, revenues will be affected by the total Production volume in Canada and EPC's market share of that volume. Total Production volume will be driven by the Canadian dollar, favourable labour rates, and government incentives. EPC's market share will be driven by its ability to maintain a high level of quality and customer service.

3.5.2 Costs (EPC)

Direct costs are related to salaries and benefits and license fees to EP-USA. More than 65 percent of EPC's totals operating costs relate to these two line items. This intuitively makes sense given that people resources are so integral to EPC's success, and the key strategic relationship between EPC and EP-USA. Salaries and benefits include base compensation, annual bonuses, all employer statutory fringe contributions, and EPC's share of the group insurance premiums. The EP-USA license fee is a flat percentage of revenue generated from payroll operations. Other costs include rent and occupancy costs, computer supplies and service costs, travel and promotion costs, and legal and accounting costs.

In the short term, as the dollar continues to hover around 90 cents, EPC would manage a downturn by laying off clerical staff, eliminating overtime, and requesting employees take 'voluntary days off' (days off without pay). There are several operating expenses that are directly related to payroll volume: postage, courier, office supplies, long distance charges, bank service charges, cheque stock, certain computer supplies and toner cartridges. In addition, EPC would significantly reduce or eliminate non-critical capital expenditures, travel expenses, donations, sponsorships, and client perks and parties.

3.5.3 Rainmaker Income Fund (2005)

The first half of 2005 produced disappointing overall results for the Fund, but significant improvement was recognized in the second half of the year. The information in Figure 14, below, is derived from the consolidated financial statements, which were prepared in accordance with Canadian generally accepted accounting principles. A copy of the Fund's 2005 Audited Financial Statements are in Appendix 4.

Prior to the acquisition of EPC and CFC, on August 4th, 2005, the only operating entity in the Fund was Rainmaker LP, a post-production and visual effects company. The Fund's total

revenue decreased to \$28.291 million in 2005 from \$28.761 million in 2004. The decrease was as a result of a decrease in the revenue from Rainmaker LP of \$8.53 million. This 30 percent decrease was offset by an increase in revenue of \$8.06 million following the acquisitions of EPC and CFC. EPC reported revenue of \$6.287 million from the date of acquisition, August 4th, 2005, to December 31st, 2005, which was well in excess of expectations and represented one of the strongest operating periods in the history of EPC. CFC reported revenues of \$1.773 million from the date of acquisition, August 4th, 2005, to December 31st, 2005.

Total Fund operating, general and administration expenses increased to \$21.527 million in 2005, from \$19.565 million in 2004. EPC and CFC's combined operating costs accounted for \$4.470 million of the Fund's total expenses in 2005. Rainmaker LP had a decrease in operating expenses of \$2.5 million to \$16.1 million in 2005 from \$18.6 million in 2004. With revenues down by 30 percent, cost cutting measures were taken by Rainmaker LP. EPC and CFC's cost were lower than normal.

Earnings before income taxes and non-controlling interest decreased to \$2.377 million in 2005 from \$8.541 million (includes the proceeds of life insurance of \$3.0 million) in 2004. If the proceeds of the life insurance are excluded from 2004, earnings before income taxes and non-controlling interest decreased \$3.164 million in 2005. For Rainmaker LP, earnings before income taxes and non-controlling interest, excluding the impact of the life insurance proceeds, decreased by \$5.9 million in 2005. The decrease was solely attributable to the decline in revenue in Rainmaker LP, which mostly occurred in the first six months of 2005. The acquisitions of EPC and CFC together resulted in earnings before income taxes and non-controlling interest of \$2.8 million for 2005.

Figure 14 - Rainmaker Income Fund Financial Summary

All amounts are in 000's of dollars, except per unit figures

	Years ended December 31,		
	2005 (Note 1)	**2004**	**2003**
Revenue			
Rainmaker LP			
Video Post	10,269	11,480	12,554
Visual Effects	6,964	13,216	11,999
Film Lab	1,761	2,957	3,983
Other	1,237	1,108	1,045
	20,231	28,761	29,581
EP Canada LP	6,287	-	-
Canada Film Capital LP	1,773	-	-
	28,291	28,761	29,581
Expenses			
Operating	20,214	18,622	17,515
General and administration	1,313	943	926
	21,527	19,565	18,441
Earnings before undernoted items	6,764	9,196	11,140
Depreciation and amortization	4,360	3,133	3,338
Life insurance proceeds	-	(3,000)	-
Other	27	522	547
Earnings before income tax	2,377	8,541	7,255
Income tax expense (recovery)	(205)	105	114
Earnings before non-controlling interest	2,582	8,436	7,141
Non-controlling interest	(1)	(465)	(486)
Net earnings for the period	2,581	7,971	6,655
Net earnings per unit - basic	0.19	0.74	0.62
Net earnings per unit - diluted	0.19	0.73	0.62
Distributions declared	0.48	0.52	0.68

Note 1 2005 financial information includes the results of operations for EP Canada LP and Canada Film Capital LP from August 4th, 2005, the date of acquisition.

Source: Rainmaker Income Fund. (2005). Annual Report to Unitholders.

It is the Fund's goal to make monthly cash distributions on or about the 15th of each month to unitholders of record as of the last day of the preceding month. Distributions are not

guaranteed and depend upon the amount of cash earned, which is ultimately determined by the results of operations and availability of cash from other sources.

Total distributions for 2005 were $6.6 million or $0.48 per unit as compared with $5.9 million in 2004 or $0.52 per unit. Distributable cash for 2005 was $4.7 million or $0.34 per unit. The distributions declared, and paid in excess of distributable cash earned, have been paid out of cash balances, principally the life insurance proceeds.

Distributable cash is not a term defined under Canadian generally accepted accounting principles. For The Fund, it is defined as cash flow from operations before the change in non-cash-operating working-capital items adjusted for certain investing activities, including purchases and proceeds on sale of property, plant and equipment and for certain financing activities including repayment of and proceeds from capital leases.

In 2005, on revenue of $8.06 million, EPC and CFC combined generated $2.8 million in earnings before income taxes and non-controlling interest. Assuming that EPC and CFC contributed equally to these earning, EPC's profit margin can be calculated to be 35 percent.

4 ISSUES

The Film Industry, and by extension EPC, faces considerable uncertainty due to the current Canadian to US dollar exchange rates. "Filming in Canada by U.S. production companies, known as 'runaway productions' to Hollywood executives, saves about 10 percent versus the cost of filming in the U.S. But with the rising dollar, those savings will disappear" (Dolgin, 2006, para. 4). As shown in Figure 6, on page 26, there is a direct correlation between the exchange rate and overall Production volume in Canada; as the value of the Canadian dollar increases, the volume of Production decreases.

Times have been good for EPC. With steady historical earnings, even in years where financial top line results were not fantastic, bottom line results were healthy. As a result, EPC has not felt the need to diversify its operations. However, this lack of diversification is proving to now be an issue. In addition, the company is experiencing periods of excessive employee turnover. This is a concern given the fact that a highly skilled work force is critical to EPC's success in the Film Industry.

4.1 Lack of Diversification

Even though EPC has maintained if 70 percent market share, EPC is facing a shrinking total Production market in Canada. In May of 2006, the Canadian dollar reached a 28-year high and traded at 90.87 US cents (Anwar, 2006, para. 5). It is believed that the industry, seen as a manufacturing process, cannot sustain, in the long-run, a 90 cent dollar. "The manufacturing industry will see 100,000 jobs lost this year if the loonie stays on its perch, according to the Canadian Manufacturers and Exporters" (Green, 2006, para. 16).

EPC continues to exclusively provide payroll services to the Film Industry; it has not diversified its operations. Therefore, with such a sustained focus on a small sector of the overall payroll industry, EPC is unprotected from the effects of a significant downturn in the Film Industry.

To protect itself and its 91 employees EPC can consider two types of diversification, related diversification and unrelated diversification. "Related diversification provides the potential to attain synergies by sharing assets or competencies across businesses" (Aaker, 2001, p.232). Related diversification, for EPC, could include expansion into industries where hourly versus salary paid employees are prevalent. EPC's established reputation in the Film Industry will provide a solid foundation to pursue companies in the construction, mining, gaming, and special events industries.

"Unrelated diversification lacks enough commonality in markets, distribution channels, production technology, or R&D thrust to provide the opportunities for synergy through the exchange or sharing of assets or competencies" (Aaker, 2001, p. 239). The objectives of unrelated diversification are financial; "... to generate profit streams that are either larger, less uncertain, or more stable than they would otherwise be" (Aaker, 2001, p. 239).

4.1.1 Related Diversification

Related diversification would permit EPC to focus on its core strength and allow the transfer of core competencies from one part of the business to another. In addition, economies of scope could be achieved by operating two or more businesses under the same corporate umbrella, because it is less costly for two or more businesses to operate under centralized management than to function independently. EPC's chances of successful related diversification are good. Related diversification would smooth risk events in a portfolio so that the positive performance of some investments would neutralize the negative performance of others.

Related diversification can be achieved through:

- shared technology;
- shared office facilities;
- common labour skills;
- common suppliers;
- ability to share common sales force;
- similar operating methods; and
- similar kinds of managerial know-how.

However, to successfully accomplish this related diversification, significant modifications to EPC's overall service offering will be required. A greater focus must be placed on HR-related functions: management of employee salaries and pay grades, tracking employee benefits, performance, and attendance, recruiting, and succession plans.

EPC could not compete with Ceridian and/or ADP's low cost structure. EPC would have to target a sector, similar to the Film Industry, with above-average needs to justify higher fees. EPC should target other niche segments characterized by large numbers of unionized personnel, high turnover and portability of employees from job-to-job, employees who are dispatched to multiple locations and employers who require custom reporting and remitting needs.

Diversification possibilities include the construction industry, the mining sector, companies that provide security guards, live-entertainment employees, and casino employees. There are three related diversification strategies that EPC could consider. They include:

1. acquisition;
2. internal market development; and
3. partnership or joint venture.

4.1.1.1 Acquisition

An acquisition strategy has significant advantages. The acquisition of a small-to-medium-sized conventional payroll service company would increase market share and economies

of scope for EPC and eliminate a competitor. The acquisition candidate should have a strong product along with technical and management capabilities that can be integrated into EPC's existing business model.

The Fund is entirely dependent on the operations and assets of the operating entities. Assuming that a small-to-medium-sized conventional payroll service company had fairly low fixed costs, low capital expenses, and created value for the unitholders, the Board of Trustees would support this strategy. The Board of Trustees would raise the capital by offering for sale additional units of the Fund.

4.1.1.2 Internal Market Development

Entry through internal market development involves the creation of a new business unit in the payroll industry. This strategy has complex challenges for EPC including structural entry barriers and the risk of retaliation by incumbent firms. Structural barriers to entry include upfront investment and start-up losses, brand identification and proprietary software development costs. The risk of retaliation by incumbents is seen as an additional cost of entry. Incumbent firms might escalate marketing efforts, offer special promotions and lower prices. In addition, incumbent firms offering conventional payroll services, who have traditionally avoided the Film Industry, might consider expansion of their service offering.

Under this option, EPC would incur additional software, marketing, and training costs. EPC would have to build or buy a new software application capable of the incremental HR functions associated with providing services in this market. In addition, EPC would have to hire a new sales force, and train employees to provide services to this clientele.

4.1.1.3 Partnership or Joint Venture

A partnership or joint venture strategy raises essentially the same issues as the section above and presents the additional challenges of division of efforts among partners and control.

4.1.2 Unrelated Diversification

As part of the Rainmaker Income Fund, it is unlikely that EPC will engage in unrelated diversification. To date, the Fund has focused on businesses within the Film Industry to balance cash flows, instead of independent business units in other industries.

4.2 Employee Retention

The second key issue for EPC is employee retention. Employee turnover is a costly problem and negatively impacts the bottom line. In addition, there are both direct and indirect hidden costs associated with employee turnover. Annual employee turnover costs amount to thousands of dollars and potentially prevent EPC from pursuing opportunities and acquiring new business.

Direct costs associated with employee turnover include outplacement fees for the outgoing employee, newspaper classified ads, search fees, fees necessary to screen the applicants, training costs, lost productivity costs, decreased accuracy and quality of work among the employees left behind, costs associated with using expensive contract and temporary employees to do the work until a permanent employee is hired, and expenses associated with replacing lost business. Indirect costs include new employee mistakes, reduced employee morale, and lost customers due to higher rates of error. Turnover costs can "add up to anywhere from 30 to 200 percent of a single employee's annual wages or salary, depending on the industry and the job role being filled" (Conjecture Corporation, n.d., para. 2).

According to Steve Brearton, of the Globe and Mail, the turnover rates for the twenty best companies to work for in Canada range from 1 percent to 17 percent, see Figure 15 below. This data was compiled from responses from 79 organizations across Canada. The study was started in the summer of 2005 by the Queen's School of Business and Hewitt Associates.

Figure 15 - Turnover rates for the 20 best small companies to work for in Canada

	Company Name	Location	Industry	Number of Employee's	Total Turnover
1)	**SportsDirect**	Halifax, NS	Media	104	10%
2)	**High Road Communications**	Toronto, ON	Public Relations	63	4%
3)	**Sapient Canada**	Toronto, ON	IT Service	101	17%
4)	**CNC Global**	Toronto, ON	IT Service	247	15%
5)	**Cariboo Friendship Society**	Williams Lake, BC	Not-for-profit	56	9%
6)	**Mary Kay Cosmetics**	Mississauga, ON	Consumer products	99	5%
7)	**Dempsey Corp.**	Toronto, ON	Distributors	50	11%
8)	**Innovation Place**	Saskatoon, SK	Real estate development	79	6%
9)	**Lutherwood**	Waterloo, ON	Not-for-profit	211	14%
10)	**iTrans Consulting**	Richmond Hill, ON	Engineering	58	n/a
11)	**Windsor Family Credit Union**	Windsor, ON	Financial Services	104	2%
12)	**Laurentide Controls**	Kirkland, QC	Engineering	114	8%
13)	**The Orthotic Group**	Markham, ON	Consumer Products	112	3%
14)	**Lakeside Process Controls**	Mississauga, ON	Engineering	100	1%
15)	**4Refuel Canada**	Langley, BC	Oil & Gas Services	51	8%
16)	**Algorithme Pharma**	Montreal, QC	Pharmaceutical Research	302	n/a
17)	**Eagle Professional Resources**	Ottawa, ON	HR Consulting	91	10%
18)	**CAN Canada**	Toronto, ON	Insurance	120	6%
19)	**Spectra Credit Union**	Estevan, SK	Financial Services	132	3%
20)	**Mega Group**	Saskatoon, SK	Consumer products	75	12%

Adapted from Steve Brearton. (2006). The 20 best small companies to work for in Canada.

Compared to companies in the 2005 Queen's School of Business study, total turnover rates, for EPC seems high. An acceptable annual turnover rate for EPC would be seven to nine employees per year, or 8 to 10 percent given client expectations, timelines and deadlines, and the diverse and specialized knowledge base of employees. Total turnover greater than 8 to 10 percent will jeopardize EPC's ability to meet clients' demands.

However, turnover can yield benefits; for example, if employees transfer to other departments within the organization, the company gains experienced advocates in other departments. Turnover can also reduce structural costs; assuming new employees are brought in at lower pay scales. In addition, turnover creates the opportunity to bring in new employees with needed skills and fresh insights.

Employees will always be attracted to higher salaries and better benefits. "The best strategy for reducing employee turnover is increasing employee loyalty" (Goolsby, 2005. para. 6). According to a Deloitte Research Study, published in 2004, employers must concentrate on the things that employees care about most, "… developing in ways that stretch their capabilities, deploying onto work that engages their heads and hearts, and connecting to the people who will help them achieve their objective" (Deloitte & Touche LLP, 2005, p. 6). This Develop-Deploy-Connect model (Deloitte & Touche LLP, 2005, p. 6) can be accomplished by investing in employees. Investment in employees can be accomplished by establishing training programs that provide employees with career development opportunities, by offering promotions from within, by encouraging employees to make suggestions, by acting on those suggestions, and by rewarding employees for contributions that help the business grow.

According to an on-line HR poll, conducted in March of 2006, the number-one reason why employees stick with their employer is good coaching and interaction with their boss, followed by a good compensation and benefits package and opportunities to learn new skills (Heathfield, 2006), see poll results in Figure 16 below.

Figure 16 - Poll Results: Why Do You Stick With Your Employer?

Ranking	Respondent's Comment	Number of Responses	%
1)	Good coaching from and interaction with my boss	438	30%
2)	Good compensation and benefits package	365	25%
3)	Opportunity to learn new skills	130	9%
4)	Like my co-workers	125	9%
5)	Respectful treatment	85	6%
6)	Recognition of a job well done	82	6%
7)	Just can't seem to get motivated enough to leave	81	6%
8)	Challenging, rewarding, interesting work	62	4%
9)	Mission of the company	54	4%
10)	Talent and vision of company management team	48	3%
	Total Number of responses	1470	

Adapted from Susan Heathfield. March 21, 2006. Poll: Why do you stick with your employer?

By focusing on developing employees' capabilities, deploying their heads and hearts, and connecting them to people who will help them achieve their objective "... organizations can generate capability, commitment, and alignment in key workforce segments, which in turn improve business performance" (Deloitte & Touche LLP, 2005, p. 6).

5 RECOMMENDATIONS

5.1 Strategic Adjustments

EPC has limited growth possibilities in its current niche. At the same time, EPC faces cost pressures from both internal and external forces. The convergence of limited growth opportunities, slowing innovation within the payroll industry, cost pressures, and a differentiation strategy creates a challenging business climate for EPC.

This section provides two recommendations which address important issues for EPC: one specific to related diversification of the current business unit and one specific to the retention of employees.

5.1.1 Related Diversification

The objective of this adjustment is to increase EPC's customer base by providing payroll services to industries and markets that have remained untouched by EPC. Adoption of this alternative involves leveraging EPC's technical and service-oriented strengths while offering payroll services outside of the Film Industry niche.

To accomplish this, EPC should begin to pursue the acquisition of a small-to-medium-sized conventional payroll service company with some years of experience. An ideal acquisition target would be a boutique-style company operating in a niche, whose customers are prepared to compensate for a differentiated service offering.

Once the acquisition is complete new business prospects should be targeted. The construction sector is a natural fit for EPC's business model and area of competence for EPC; with many unionized employees who are dispatched for days, weeks, or months at a time to

varying locations. The mining sector is also a good fit for EPC; these unionized employees are transported to distant locations and require a higher degree of accuracy and attention to detail to ensure correct payment of wages. In addition, EPC should target companies coast-to-coast that provide security guards, live-entertainment employees, and casino employees. These businesses are often characterized by large numbers of unionized employees who frequently move from job-to-job. While the Fund pursues this acquisition, management should begin formulating a marketing strategy for approaching these sectors; a marketing strategy that emphasizes EPC's service and customer-oriented approach.

A vital factor in this acquisition will be managing the operational risks – defined here as the risk of monetary losses resulting from inadequate or failed internal processes, employees and systems. A key issue in managing the operational risks will be the retention of key employees and managers of the incumbent to ensure a seamless transition and to ensure continuity with current clients and computer systems knowledge. Key employees and managers of the incumbent will have important HR competencies that are lacking in EPC's current operation.

The transition plan should incorporate team-building efforts and a reasonably paced transfer of operations to work in tandem with EPC's Film Industry payroll operation. It is imperative that the transition plan balance anticipated economies of scale with continued success of the acquisition target and EPC.

5.1.2 Employee Retention

EPC has experienced periods of excessive turnover. Given EPC's reliance on a highly skilled and committed workforce, this is a concern. Even though most of the turnover has occurred around identifiable company events such as mergers, acquisitions and new system implementations, EPC must work towards some stability and an overall downward trend in

voluntary turnover. This can be accomplished with the adoption of an effective 'talent strategy' for all employees. Involuntary turnover will be dictated by performance.

EPC's talent strategy should incorporate and join the Develop-Deploy-Connect model (Deloitte & Touche LLP, 2005) with compensation and benefits. As seen above, in Figure 16 on page 77, good coaching and interaction with bosses ranked first, good compensation and benefits racked second and opportunity to learn new skills ranked third in importance to employees. To successfully reduce employee turnover, EPC's talent strategy, to start, should incorporate these factors.

A talent strategy can develop employees by offering an allowance to all employees for continuing education and professional development. If employees are performing well, EPC should be willing to help them grow and develop so they might stay with the organization longer and continue to contribute. Employees who see their positions as evolving are more likely to remain committed.

A training and professional development allowance should be based on length of service to EPC and relate to each employee's area of employment and personal interest:

- 3 months of employment to the end of year 2 – 100% of all course costs up to $500 per year, plus 50% of any amount in excess of $500, to an annual maximum of $1,500;
- years 3 and 4 - 100% of all course costs up to $1,000 per year, plus 50% of any amount in excess of $1,000, to an annual maximum of $1,500; and
- years 5 and over - 100% of all course costs up to $1,500 per year, plus 50% of any amount in excess of $1,500, to an annual maximum of $2,000.

An employee should be required to remain employed for six months after completion of training and professional development courses. If an employee leaves within six months of receiving reimbursement they should be required to reimburse EPC two-twelfths of the course costs for each month.

These training and professional development programs will cost the company more than the current budget for training and development, depending upon the number of employees who choose to participate. However, inviting employees to learn new things and explore options is not as costly as paying them when they are disengaged, or losing them all together.

In addition to formal training programs and courses, employee development can be achieved through 'action learning' (Deloitte & Touche LLP, 2005, p. 7). Action learning is defined as "… the collaborative resolution of real-life issues" (Deloitte & Touche LLP, 2005) and is achieved through regular interaction with co-workers and working through assignments that stretch employees beyond their comfort zone. An employee learns, not by contemplating a hypothetical situation, but by tackling the real issue head-on. Active learning should be incorporated into EPC internal training programs by offering a schedule of lunch and learn programs and promoting a 'buddy system' where employees are encouraged to mentor each other.

Deployment is about matching employees to the correct job or project and ensuring that their skills, interests, and capabilities continue to evolve in-line with strategic objectives. This includes continuing to offer lateral and horizontal redeployment opportunities within EPC and not holding employees to the confines of their resume.

EPC's talent strategy should connect employees by creating an environment where they feel welcome and wanted; an environment where they are given their best chance of success. Management can stay connected by conducting salary surveys to ensure salaries are kept equitable and competitive with the market. EPC should conduct regular employee satisfaction surveys, and continue to analyze and act on exit interview and performance review comments.

A key component to EPC's overall talent strategy will be the inclusion of an effective compensation strategy. At EPC, employees generate greater-than-average value for unitholders.

In return, the company should reward employees with a total compensation package that is better than average. "By offering employees benefits such as reasonable flexibility with work and family balance, performance reviews, and performance based incentives, along with traditional benefits such as paid holidays or sick days, companies are better able to manage their employee turnover rates" (Conjecture Corporation, n.d., para. 4).

Presently, more can be done to ensure salaries are kept competitive with comparable positions in the market. To remain competitive and get all employees to pull in the same direction, EPC should redraft its compensation strategy to better align employee benefits with company objectives. A competitive compensation package should offer starting base salaries (job rate) that are consistent with the 80th - 90th percentile in the market for equivalent position, with the opportunity to earn compensation that is above the median for exceptional company and individual performance. Pay for exceptional performance should progress above the job rate to a range maximum of 115 to 120 percent of market.

In addition, annual incentive pay should be restructured. With a bonus program at just 8 percent of an employee's salary, with no component for loyalty or individual performance, EPC's current bonus plan is inadequate in its strength to retain key employees. Annual incentive pay should reward employees for their contribution to the company's overall success, along with a component awarded for individual performance achievements and loyalty.

Management should establish a pool of funds of which 30 percent is awarded based on the company's overall success. The 30 percent should be allocated on a pro-rata basis based on each employee's salary as a percentage of total salaries. Another 40 percent should be awarded based on the employee's performance rating determined during their annual review, by applying a multiplier to the pro-rata payment. Multipliers should range from .75 (partially met expectations) to 1.5 (exceeded expectations). The last 30 percent should be awarded based on loyalty –

longevity of employment – "a good incentive plan should include a factor for employee loyalty" (Normand, 2006, para. 8).

The pool of funds allocated to incentive pay should be 10 percent of profits. EPC should avoid a plan that compensates based on a percentage of salary. Such plans are often used, but they are difficult to relate to the three criteria discussed above, namely overall company success, individual performance and loyalty. "To create a real incentive, the recipient must perceive the potential reward as a significant addition to income. Otherwise, the incentive is looked upon as deserved supplemental income or even as a *benefit*" (Normand, 2006, para. 3). Incentives should be paid as frequently as possible but not less than quarterly, otherwise "the incentive is not kept in front of the employees as the incentive weakens" (Normand, 2006, para. 15).

> Incentive pay shows appreciation and creates a sense of participation in the company's well-being that straight salary dollars, no matter how large, don't convey. A well-designed incentive-pay plan can also help pull people together, help point them in the direction you want them to go, and give that extra push that every company needs in today's competitive environment. (BusinessTown.com, LLC., n.d., para. 3)

EPC currently offers adequate vacation pay and sick day benefits. Employees start with two weeks vacation and increase one day per year to a maximum of four weeks. Managers and executive start with three weeks vacation and increase one day per year to a maximum of five weeks. All employees are entitled to six sick pay days per year. These days, if not used, are forfeited at the end of the year. It is recommended that sick days be renamed 'discretionary days' and that the number of discretionary days increases, based on length of service:

- 3 months of employment to the end of year 2 – six discretionary days per calendar year;
- years 3 and 4 – seven discretionary days per calendar year; and
- years 5 and over – eight discretionary days per calendar year.

A reclassification of these days would enable employees to take time to tend to family matters and personal issues. To further enhance and support work-life balance EPC should

permit salary-paid employees to extend their workday by forty-five minutes a day in lieu of taking every other Friday off with pay, during the spring and summer months.

Overall, the vacation, sick pay, and workday extension recommendations will not cost EPC more in salaries and benefits. They will simply be a reclassification of resources from work time to an investment in employee work-life balance, which will help create an environment where productivity can flourish.

A new business venture will offer new opportunities for employees and create greater value for the Rainmaker Income Fund unitholders. Employee turnover recommendations should be adopted by EPC's executive team and incorporated in its talent strategy for all employees. This implementation should be seamless for EPC given senior management's open and relaxed management style and level of autonomy and trust for employees. The result will be an engaged and committed work environment where employees are connected and willing to teach each other and work together to drive company performance and business results.

6 APPENDICES

6.1 Appendix 1 – Canadian Domestic and Foreign Production Incentives

6.1.1 Canada and Alberta

Jurisdiction	Canada		Alberta
Program	Film or Video Prod. Services Tax Credit	Canadian Film or Video Production Tax Credit	Alberta Film Development Program
Delivery Agency	Canadian Audio Visual Certification Office (CAVCO) Phone: (888) 433-2200		Alberta Economic Development (AED), Industry and Regional Development Division phone (780) 427-6601
Tax Credit Rates	16% of the Canadian labour expenditures.	25% of eligible labour, to a maximum of 60% of total production costs	14%-21% of production expenses (not just labour) made in Alberta, dependant upon level of Albertan ownership and employment of Albertan key creative
Bonus Features	None	None	Up to an additional 2% of production expenses per funding stream for employment of additional Albertan key creative personnel
Eligible Companies or Individuals	Canadian permanent establishments whose primary business is the production of film and videos in Canada. NOT available if production has received Cdn. Film or Video Production Tax Credit. Private broadcasting/cable subsidiaries are eligible.	Canadian owned & controlled companies, which are taxable in Canada and whose primary business is the production of Canadian films or videos. Private broadcasting/cable subsidiaries are eligible.	All projects must be supported with a broadcast license or a distribution agreement (in the case of theatrical releases) of fair market value. Applicant must be incorporated in Alberta (higher funding for equal/minority and majority Albertan ownership).
Project Criteria	Costs for a film production must exceed $1 million. For a series consisting of 2 or more episodes or for a pilot, costs must exceed $100,000 if episode less than 30 minutes; or exceed $200,000 if episode more than 30 minutes	Minimum 75% of production costs paid to Canadian individuals or companies. Minimum 75% of post- production done in Canada. Production company must own copyright for 25 years from completion. Must be exhibited or broadcast in Canada within 2 years of completion	The amount spent in Alberta must be greater than $25,000 (before GST). Applicants must provide written evidence of 65% confirmed financing at time of submission. Except with prior approval of AED, principal photography must not have commenced prior to AFDP submission.
Points for Certification	No CAVCO points required	Must meet at least 6 of 10 CAVCO Canadian content points	No CAVCO points or provincial points required.
Deductions from Total Eligible Expenses	Eligible labour reduced by the amount of any other funding being received that is tied to labour, for example provincial tax credits	Total production costs reduced by government and private assistance, except for the Canadian Television Fund License Fee Program costs also reduced by equity not owned by the production entity(s).	All production expenses consistent with the standards established by Telefilm Canada are eligible, as long as these were expended in Alberta.
Program Cap	None	None	None.
Project Cap	None	None	Maximum funding available to any project is $1.5M.
Corporate Cap	None	None	None.
User Fees	$5000 flat fee with a rebate allowable for Prods. whose aggregate tax credit is less than $25,000	Part A, Accreditation: $200 Part B, Completion: 0.12 % of eligible production costs (maximum 48% of costs)	None.

Adapted from Canada Film Capital Limited Partnership. (2006).

6.1.2 British Columbia, Manitoba and Newfoundland

British Columbia		Manitoba	Newfoundland
Production Services Tax Credit	Film Incentive BC	Manitoba Film & Video Prod. Tax Credit	Film & Video Tax Credit
British Columbia Film phone: (604) 736-7997		Manitoba Film & Sound phone: (204) 947-2040	Newfoundland and Labrador Film Development Corporation
18% of qualified BC labour expenditures	Basic incentive: 30% of BC labour expenditures, to a maximum of 48% of total eligible production costs	45% of approved Manitoba labour expenditures, with no maximum.	Lesser of 40% of eligible Newfoundland and Labrador labour
Regional tax credit of 6% of accredited qualified labour (pro rated by no. of days regional/total BC days), when more than 50% of BC principal photography outside Vancouver area (must be at least 5 days). 15% of Digital Animation or Visual Effects labour for projects beginning after March 31, 2003.	Regional incentive of 12.5% of qualified labour (pro rated by no of days regional/total BC days), when more than 50% of BC principal photography outside Vancouver area (must be at least 5 days) Training tax credit totaling the lesser of 30% of trainee salaries or 3% of total eligible labour. 15% of Digital Animation or Visual Effects labour for projects beginning after March 31, 2003.	Additional 5% regional incentive if at least 50% of Manitoba production days are shot at least 35 km from Winnipeg city center. Additional 5% bonus on third film shot within 2 year period. Incentive 45% tax credit for salaries paid to non-residents who work in a designated department where at least 1 Manitoba resident is training. Non-resident does not have to deliver the training. Maximum credit is 10% of total eligible labour if 1 trainee, 20% if 2 trainees.	40% training incentive. Residency requirement waived for workers who train at least one resident, and wages of both will qualify for enhanced credit
Company with a permanent establishment in BC, that primarily produces or provides production services in film or video. (Either the copyright owner or has contracted directly with the copyright owner). Broadcasting/cable subsidiaries are eligible.	For basic tax credit, company must be Cdn.-owned & BC controlled with primary business in film/TV production and contro of copyright. For Regional, Training and DAVE, must be eligible for Basic. **Broadcasting/cable subsidiaries are eligible.**	Corporation must be taxable with a permanent establishment in Manitoba, and must be primarily carrying on a business that is a film or video production business. At least 25% of salaries and wages paid by the corporation must be paid to eligible Manitoba employess for work performed in Manitoba. Broadcasting/cable subsidiaries are eligible.	Must be incorporated federally or provincially. Must have permanent establishment in Newfoundland or Labrador. Must have total assets less than $25 million. Broadcasting/cable subsidiaries are not eligible.
$1 million minimum budget for feature film. For a series with 2 or more episodes or for a pilot, costs must exceed $100,000, if episode less than 30 minutes (exception: productions that consist of all or substantially all digital animation or visual effects); or exceed $200,000 if episode more than 30 minutes	Minimum 75% of total production (exemption for documentaries) and 75% of post-production costs paid in BC to BC residents. Minimum 75% of shooting days in BC (exemption for documentaries, treaty co-productions and interprovincial co-productions). Canadian distribution or broadcast must be by a Canadian corporation within 2 years of completion	Must be producing an eligible film.	At least 25% of total salaries and wages must be paid in Newfoundland and Labrador to eligible employees. Currently developing criteria to include personal service corporations and local vendor labour
No CAVCO or provincial points required	Must meet at least 6 of 10 CAVCO Canadian content points	No CAVCO or provincial points required	No CAVCO or provincial points required
Labour reduced by other assistance to extent that the assistance is received in respect of eligible labour	Total production costs reduced by deferrals and government and private assistance (other than federal tax credit and BC tax credit)	Total Eligible Manitoba Labour costs reduced by government assistance (except for federal tax credits or Manitoba tax credits, equity funding from Telefilm or Canada TV Fund, or Manitoba or Canada TV Fund license fees)	Total production costs reduced by government assistance (other than Federal and Newfoundland tax credits, receivables under Canada TV & Cable Fund, and recoupable government equity investments)
None	None	None	None
None	None	None	$1 million / 12 month period
None	None	None	$2 million / 12 month period
$5000 + GST with a rebate allowable for Prods. whose aggregate tax credit is less than $25,000	For eligibility: $200 + GST For completion: 0.05% of final production costs, minimum $200 + GST	None	None

Adapted from Canada Film Capital Limited Partnership. (2006).

6.1.3 New Brunswick, Nova Scotia, and Ontario

New Brunswick	Nova Scotia	Ontario	
Labour Incentive Tax Credit	Nova Scotia Film Industry Tax Credit	Ontario Production Services Tax Credit (OPSTC)	Film & Television Tax Credit
New Brunswick Film phone: (506) 869-6868	Nova Scotia Film Development Corporation	Ontario Media Development Corporation (OMDC) phone: (416) 314-6858	
40% of eligible labour expenses. Eligible labor can be no more than 50% of production costs.	Lesser of 35% of eligible labour expenditures and 17.5% of total production costs, with no maximum	18% of eligible Ontario labour expenditures incurred after December 31, 2004 and before April 1, 2006	30% of eligible labour expenditures incurred after December 31, 2004 and before January 1, 2010. No maximum.
Upon application, province may waive residency requirement for jobs where qualified NB residents cannot be found	Regional incentive, outside metro Halifax: Lesser of 40% of eligible labour costs and 20% of total production costs. Additional 5% bonus on third film shot within 2 year period.	Additional 20% of resident salaries (or 10% of payments to self-employed), who work in computer animation and special effects.	40% credit for first time productions on the first $240,000 of eligible labour costs. Additional 20% refundable tax credit for computer animation and special effects. Additional 10% credit for eligible Ontario labour when 85% of production occurs outside Greater Toronto Area (minimum 5 location days in Ontario). Pre-production costs are allowed depending on the Production Commencement Time (PCT)
Permanent establishment in NB, but no requirement for NB headquarters, ownership or control. Companies incorporated in the Province are considered to have a permanent establishment in New Brunswick. Broadcasting/cable subsidiaries are not eligible.	Production companies must have a permanent NS establishment. Co-productions are eligible. Broadcasting/cable subsidiaries are not eligible.	Companies with a permanent establishment in Ontario whose primary business is the production of film and videos in Ontario. Broadcasting/cable subsidiaries are eligible.	Ontario-based, Canadian-controlled companies whose primary business is the production of Canadian film and videos. Broadcasting/cable subsidiaries are eligible but may not be initial broadcaster of the program.
Minimum 25% of labour costs paid to NB residents	Minimum 25% of labour costs paid to NS residents (including personal service corporations and other labour expenditures). Also qualifying are wages and salaries paid to Nova Scotians for work outside the province.	$1 million minimum budget for feature film. For a series with 2 or more episodes or for a pilot, costs must exceed $100,000 if episode less than 30 minutes or $200,000 if episode more than 30 minutes	Minimum 75% of costs must be Ontario costs. Producer must be an Ontario resident. Must be shown in Ontario within 2 years by an Ontario-based film distributor or Canadian broadcaster in Prime Time. Company must own copyright for 25 years from completion
No CAVCO or provincial points required	No CAVCO or provincial points required	No CAVCO or provincial points required	Must meet at least 6 of 10 CAVCO Canadian content points
Eligible total production costs reduced by assistance from NB provincial government agencies (not federal or other provincial)	Total production costs reduced by government assistance. Not reduced by any other tax credits, federal or provincial, or government equity investments.	Labour base reduced by other assistance	Total production costs reduced by deferrals and government or private assistance (other than federal tax credit, Ontario tax credit, and Canada TV Fund)
None	None	None	None
None	None	None	None
None	None	None	None
None	0.2% of eligible NS labour; minimum fee of $200, maximum fee of $2000	0.14% of total estimated labour, minimum $100 to a maximum of $5,000. Interim letter additional $100	0.06% of total production costs, minimum $100 and maximum $5,000. Interim letter additional $100

Adapted from Canada Film Capital Limited Partnership. (2006).

6.1.4 Prince Edward Island, Quebec and Saskatchewan

PEI	Quebec		Saskatchewan
PEI Film and Television Labour Rebate Program	Quebec Refundable Tax Credit for Film or TV Prod Services	Refundable Tax Credit for Quebec Film & TV Productions	Tax Credit Saskatchewan Film Employment Tax Credit
Tech PEI phone: (902) 569-7770	Société de développement des Enterprise Culturelles (SODEC) phone: (514) 841-2200		SaskFilm and Video Development Corporation phone: (306) 798-3456
30% of eligible labour expenditures to a maximum of 15% of total eligible	20% of eligible Quebec labour expenditures	29.1667% of eligible labour costs, to a maximum of 50% of total eligible production costs	45% of eligible labour expenditures to a maximum of 50% of total eligible production costs
30% tax credit for salaries paid to non-residents who must supervise training of at least 1 PEI resident when there is no PEI resident qualified/available.	Additional 20% credit for wages of Québec residents doing computer animation and special effects work	Bonus for French-language films with higher Québec content: 39.375% of eligible labour to maximum of 50% of production costs. Bonus of up to 10.2083% for eligible computer animation and special effects. Bonus of up to 19.3958% to films produced outside Montréal region.	Additional 5% of total Sask. expenditures if at least 50% of the principal photography of production located at least 40 km outside Regina or Saskatoon (all expenses, labour and non-labour, from pre-production to post-production). Additional 35% of wages of any non-resident who trains a Sask. resident (all job categories, above- and below-the-line). Additional 5% "Key Position" bonus eligible on projects that attain 6 out of 10 points on positions ranging from director to production coordinator.
Canadian (provincially or federally) incorporated company with permanent establishment in PEI and whose primary business is film, video or television production. Broadcasting/cable subsidiaries are not eligible.	Company must have permanent establishment in Québec, with principal business of film and TV production or production services. Not Eligible: The holder of a broadcasting licence issued by the Canadian Radio-Television and Telecommunications Commission (CRTC) or if it is not at arm's length, in the year or the 24 months preceding said year, to a corporation which holds such a licence.	Independent, Québec-based film or TV production companies. Must be directly controlled by Qué. residents for at least 2 yrs. prior to principal photography. NOT ELIGIBLE: A corporation holding a broadcast license issued by the Canadian Radio-television and Telecommunications Commission ("Broadcaster"), or a corporation that, at any time during a taxation year or the preceding 24 months, is not at arm's length with a Broadcaster or is controlled directly or indirectly, in any way whatsoever, by a	Company must have a permanent establishment in Saskatchewan. Broadcasting/cable subsidiaries are not eligible.
Minimum 25% of salaries and wages paid to PEI residents for work done at least partially on PEI.	Production cost for films for the 24-month period after principal photography has begun must exceed $1 million. For a series with 2 or more episodes or for a pilot, costs must exceed $100,000 if episode less than 30 minutes or $200,000 if episode more than 30 minutes	Min 75% of post-prod costs in Que. Min 75% of total prod costs paid to Que. Residents (aside from key Que.-content staff, Que. Post-prod and financing costs). Exempton from 75% req. for 15/70 format films, for expenses relating to prod. And post prod. srvc not available in Quebec	Minimum 25% of salaries and wages paid to Saskatchewan residents
No CAVCO or provincial points required.	No CAVCO or provincial points required	If production exceeds 75 minutes, must have min. 6 of 10 Quebec content points	No CAVCO or provincial points required
Tax credits reduced by government assistance other than federal or provincial film industry tax credits.	Labour reduced by other assistance to extent that the assistance is received in respect of eligible labour. Credit is not available where the production has received a tax credit for Québec film and television productions.	Eligible production costs reduced by gov't & private assistance and deferrals (other than assistance from prescribed sources, incl. Telefilm, NFB, CTF and others	Eligible production costs reduced by government assistance (but not if Telefilm and Canada TV Fund, National Film Board, CBC funding, or federal or provincial tax credits)
None	None	None	None
None	None	$2,187,500	None
None	None	None	None
None	$3 per each $1,000 of eligible labour up to $1.5 million. $1.75 per $1,000 over $1.5 million. Minimum fee of $350, maximum $25K.	$1.75 for every $1,000 of production costs. Minimum fee $100, maximum fee $25K.	None

Adapted from Canada Film Capital Limited Partnership. (2006).

6.2 Appendix 2 – US Production Incentives

SUMMARY OF *CURRENT* US MOTION PICTURE PRODUCTION INCENTIVES		
STATE	**INCENTIVE**	**DESCRIPTION**
GEORGIA	INCOME TAX	• **9%** Transferable income tax credits on all costs spent in Georgia, plus: • **3%** credit on wages paid to Georgia residents, plus: • **2%** credit for TV productions that spend more than $20 million annually.
ILLINOIS	WAGE TAX CREDIT	• **25%** credit on first $25,000 of wages paid to Illinois residents.
LOUISIANA	INVESTOR TAX CREDIT EMPLOYMENT/LABOR TAX CREDIT SALES & USE TAX EXCLUSION	• **15%** transferable credit of entire spend including post production costs not done in Louisiana (if spending exceeds $8 million, otherwise 10% credit), plus: • 20% credit on total aggregate payroll of Louisiana residents (10% if payroll is between $300,000 and $1 million) plus: • **4%** sales and use tax exclusion.
MARYLAND	FILM PRODUCTION ACTIVITY	• **50%** rebate on wages (up to $25,000 per employee) with proposed funding at $4 million per year.
NEW MEXICO	PRODUCTION TAX CREDIT INTEREST-FREE LOAN	• **15%** Refundable tax credit for eligible production costs (additional **5%** credit for targeted TV series productions) with 80% of refund given in advance of spending, plus: • Interest free loan up to $15 million. • Job training funds.
NEW YORK	FILM PRODUCTION TAX CREDIT	• **10%** tax credit of qualified expenditures, capped at $100 million over 4 years. • City of New York offers same incentive with a refundable tax credit equal to **5%** of qualified expenditures.
PENNSYLVANIA	INCOME TAX CREDIT	• **20%** transferable tax credit of qualified Pennsylvania costs when production spends 60% of production costs in state (cap of $10 million/year).
PUERTO RICO	PRODUCTION PROJECT TAX CREDIT	• **40%** transferable labour tax credit (paid to Puerto Rican residents). At least 50% of the shooting must take place in Puerto Rico.

SUMMARY OF *PENDING* US PRODUCTION INCENTIVES		
STATE	**INCENTIVE**	**DESCRIPTION**
ARIZONA	INCOME TAX CREDITS	• **20%** transferable income tax credit on production expenditures or sales tax exemption on purchases. • To qualify, a production must hire a minimum of AZ residents.
FLORIDA	FILM INDUSTRY REBATE PROGRAM	• **15%** reimbursement of qualified expenditures. • Increases funding from $2.45 million to $10 million per year.
HAWAII	FILM AND DIGITAL MEDIA PRODUCTION	• Increases existing refundable motion picture production income tax credit from 4% to **15%** plus: • Additional **5%** for production work on neighbouring islands.
ILLINOIS	PRODUCTION TAX CREDIT EXTENDER	• Extends **25%** wage credit by 10 years.
KANSAS	KANSAS FILM PRODUCTION	• **15%** Refundable tax credit for expenditures paid to Kansas based vendors and employees.
RHODE ISLAND	MOTION PICTURE INCENTIVES	• **15%** investment tax credit for qualified productions, plus: • **10%** employment tax credit.
SOUTH CAROLINA	TRANSFERABLE TAX REBATES	• Increases the existing incentive rebate from 5% to **15%** of the total aggregate payroll for employees who are subject to South Carolina withholding, if in-state spending is at least $1 million, plus: • Existing **7%** rebate for purchases/rentals of in-state goods and services • Capped at $10 million annually.
TEXAS	WAGE-BASED PRODUCTION REBATE	• Grants equal to **20%** of wages to Texans up to $750,000 per production.

Adapted from What is the Cost of Run-Away Production? Jobs, Wages, Economic Output and State Tax Revenue at Risk When Motion Picture Productions Leave California. (2005).

6.3 Appendix 3 – International Production Incentives

STATE	INCENTIVE	DESCRIPTION
AUSTRALIA	REFUNDABLE TAX OFFSET	• **12.5%** rebate for qualifying Australian production expenditures on films and TV series that spend a minimum of A$15 million.
FIJI	TAX CREDITS	• **15%** refundable tax offset for productions that spend a minimum of F$50,000.
IRELAND	PRODUCTION TAX RELIEF	• **12%** of Irish production expenditures capped at $2.9 million per project.
NEW ZEALAND	FILM GRANTS	• **12.5%** large budget film grant on films that spend a minimum of NZ$15 million.
SOUTH AFRICA	SOUTH AFRICAN PRODUCTION EXPENDITURE	• **15%** of the gross amount spent in South Africa for foreign production. At least 50% of the production must be shot in South Africa with a minimum budget of $3,800,000.
UNITED KINGDOM	TAX DEDUCTION	• A production company can enter into a "sale and lease back" of its film with a UK investor and receive approximately **15%** of its negative cost.

Adapted from What is the Cost of Run-Away Production? Jobs, Wages, Economic Output and State Tax Revenue at Risk When Motion Picture Productions Leave California. (2005).

6.4 Appendix 4 – Rainmaker Income Fund Financial Statements

6.4.1 Rainmaker Income Fund Balance Sheet

RAINMAKER INCOME FUND
Consolidated Balance Sheets
As at December 31,
Expressed in thousands of dollars

Assets	2005	2004
Current		
Cash	$ 14,976	$ 5,425
Accounts receivable	7,760	3,233
Loans due from production subsidiaries (Note 21(a)(iii))	17,167	-
Property, plant and equipment held for resale (Note 5 and 22(b))	2,034	-
Other (Note 7)	770	432
	42,707	9,090
Property, plant and equipment (Note 5)	14,633	13,260
Intangible assets (Note 6(a))	7,061	-
Other (Note 7)	384	220
Goodwill (Note 6(b))	1,954	-
	$ 66,739	$ 22,570
Liabilities		
Current		
Accounts payable and accrued liabilities	$ 5,341	$ 2,035
Liability for payroll disbursements (Note 8)	7,940	-
Deferred revenue	1,776	201
Distributions payable	689	907
Bank loan (Note 9)	16,519	-
Current portion of capital lease obligations payable (Note 11)	1,133	982
	33,398	4,125
Capital lease obligations payable (Note 11)	1,497	1,510
Other (Note 10)	719	877
Non-controlling interest (Note 14)	496	1,142
	36,110	7,654
Unitholders' Equity		
Unitholders' capital (Note 12)	33,971	14,408
Accumulated earnings	19,452	16,871
Accumulated distributions	(23,425)	(17,037)
Contributed surplus	631	674
	30,629	14,916
	$ 66,739	$ 22,570

Source: Rainmaker Income Fund. (2005). Annual Report to Unitholders.

6.4.2 Rainmaker Income Fund Statement of Operations

RAINMAKER INCOME FUND

Consolidated Statements of Operations
For the years ended December 31,
Expressed in thousands of dollars, except unit and per unit amounts

	2005	2004
Revenue	$ 28,291	$ 28,761
Expenses		
Operating	20,214	18,622
General and administration	1,313	943
	21,527	19,565
Earnings before under noted items	6,764	9,196
Depreciation and amortization	3,870	3,133
Amortization of intangible assets	490	-
Interest on lease obligations	145	208
Compensation costs relating to unit options (Note 13)	37	379
Loss on sale of property, plant and equipment	3	3
Life insurance proceeds (Note 15)	-	(3,000)
Interest income	(158)	(68)
	4,387	655
Earnings before income taxes and non-controlling nterest	2,377	8,541
Income tax expense (recovery) (Note 17)		
Current	(157)	(17)
Future	(48)	122
	(205)	105
Earnings before non-controlling interest	2,582	8,436
Non-controlling interest	(1)	(465)
Net earnings for the year	$ 2,581	$ 7,971
Net earnings per trust unit - basic	$ 0.19	$ 0.74
Net earnings per trust unit - diluted	$ 0.19	$ 0.73
Weighted average number of trust units outstanding		
- basic	13,291,426	10,715,003
- diluted for the effect of unit options and exchangable Class B LP Units	13,829,028	11,531,020

Source: Rainmaker Income Fund. (2005). Annual Report to Unitholders.

6.4.3 Rainmaker Income Fund Statement of Cash Flows

RAINMAKER INCOME FUND

Consolidated Statements of Cash Flows
For the years ended December 31,
Expressed in thousands of dollars

	2005	2004
Operating Activities		
Net earnings for the year	$ 2,581	$ 7,971
Items not involving cash		
Depreciation and amortization	4,360	3,133
Loss on sale of property, plant and equipment	3	3
Non-controlling interest	1	465
Compensation costs relating to unit options	37	379
Income tax (recovery) expense – future	(48)	122
	6,934	12,073
Changes in non-cash operating working capital items (Note 18)	2,631	(2,260)
	9,565	9,813
Financing Activities		
Payment of distributions	(6,570)	(7,286)
Payment of distributions to non-controlling interest	(270)	(425)
Proceeds of units issued for cash	19,069	-
Repayment of bank loan	(2,723)	-
Repayment of capital leases	(1,114)	(1,763)
	8,392	(9,474)
Investing Activities		
Purchase of property, plant and equipment, net of $951 (2004 - $841) financed with a capital lease	(1,231)	(1,950)
Proceeds on sale of property, plant and equipment	5	18
Acquisition of EP Canada LP, net of cash received	(6,474)	-
Acquisition of Canada Film Capital LP	(3,232)	-
Repayment of loans due from production subsidiaries	2,703	-
Release of restricted cash	-	713
Other	(177)	146
	(8,406)	(1,073)
Increase (decrease) in cash for the year	9,551	(734)
Cash at beginning of year	5,425	6,159
Cash at end of year	$ 14,976	$ 5,425
Supplemental Disclosure of Cash Flow Information		
Cash payments for interest	$ 142	$ 208
Cash payments for income taxes	$ 79	$ 113
Non-Cash Investing and Financing Activities		
Acquisition of property, plant and equipment financed with a capital lease	$ 951	$ 841

Source: Rainmaker Income Fund. (2005). Annual Report to Unitholders.

6.4.4 Rainmaker Income Fund Statement of Unitholders' Equity

RAINMAKER INCOME FUND
Consolidated Statement of Unitholders' Equity
For the years ended December 31,
Expressed in thousands of dollars

	Unitholders' Capital	Accumulated Earnings	Accumulated Distributions	Contributed Surplus	Total
Balance as at December 31, 2003, as previously reported	$ 15,249	$ 9,691	$(12,135)	$ 335	$ 13,140
Retroactive restatement to reclassify non-controlling interest (Note 3)	(841)	(791)	670	(19)	(981)
Balance December 31, 2003, as restated	14,408	8,900	(11,465)	316	12,159
Net earnings for the year	-	7,971	-	-	7,971
Distributions declared	-	-	(5,572)	-	(5,572)
Contributed surplus on compenstion costs relating to unit options	-	-	-	358	358
Balance December 31, 2004	14,408	16,871	(17,037)	674	14,916
Net earnings for the year	-	2,581	-	-	2,581
Distributions declared	-	-	(6,388)	-	(6,388)
Contributed surplus on compenstion costs relating to unit options	-	-	-	37	37
Reallocation of contributed surplus on exercise of unit options	80			(80)	-
Units issued on exercise of options	69	-	-	-	69
Units issued on private placement	19,000	-	-	-	19,000
Conversion of Class B LP Units	-	-	-	-	-
to Trust units (Note 14)	414	-	-	-	414
Balance December 31, 2005	$ 33,971	$ 19,452	$(23,425)	$ 631	$ 30,629

Source: Rainmaker Income Fund. (2005). Annual Report to Unitholders.

6.4.4 Rainmaker Income Fund Notes to the Financial Statements

Only those notes referenced in the financial statements above are provided here.

3. Change in accounting policy and retroactive restatement

The Fund retroactively adopted the new recommendations of the Canadian Institute of Chartered Accountants as described in EIC-151 "Exchangeable Securities issued by Subsidiaries of Income Trusts". The Class B Limited Partnership units (the "Class B LP units") issued by RNK Capital LP, a subsidiary of the Fund, which are held by third parties are entitled to receive distributions, are exchangeable for units of the Fund and are transferable in certain circumstances. EIC-151 requires that such securities be classified as non-controlling interests on the balance sheet. The retroactive effect of this change to the consolidated balance sheet as at December 31, 2004 is to increase non-controlling interest by $1,142,085, decrease unitholders' capital by $841,326, decrease accumulated distributions by $994,836, decrease contributed surplus by $39,357 and decrease accumulated earnings by $1,256,238. The effect of this change on the consolidated statements of operations for the year ended December 31, 2005 is to decrease the net earnings by $694.

4. Business acquisitions

(a) Acquisition of EP Canada Limited Partnership

RNK Capital LP, a subsidiary of the Fund, acquired EP Canada Limited Partnership ("EP Canada LP") for cash consideration of approximately $15.7 million including costs. Immediately prior to the acquisition by RNK Capital LP, the business of EP Canada Inc. ("EP Canada") was transferred to EP Canada LP, a newly formed limited partnership. EP Canada LP provides payroll services to the film and television production industry across Canada from offices in Toronto and Vancouver. EP Canada delivers some of its services under license from GEP Administrative Services, Inc. an affiliate of Entertainment Partners of Los Angeles.

The acquisition of EP Canada LP has been accounted for using the purchase method with earnings being included in the consolidated operations from August 4, 2005, the date of acquisition. A summary of the net assets of EP Canada LP acquired at fair value as at August 4, 2005 is as follows:

Cash	$ 9,239
Accounts receivable	1,393
Other current assets	167
Property, plant and equipment	5,148
Intangible asset - License agreement	6,400
Intangible asset - Customer contacts and relationships	700
	23,047
Accounts payable and accrued liabilities	8,987
Capital lease obligations payable	301
Net assets acquired	13,759
Goodwill	1,954
Purchase price	$ 15,713

4. Business acquisitions (continued)

(b) Acquisition of Canada Film Capital Limited Partnership

RNK Capital LP, a subsidiary of the Fund, acquired Canada Film Capital Limited Partnership ("Canada Film Capital LP") for cash consideration of approximately $3.2 million including costs. Immediately prior to the acquisition by RNK Capital LP, the business of Comweb Film Capital Corporation ("CFCC") was transferred to Canada Film Capital LP, a newly formed limited partnership. Canada Film Capital LP provides film tax credit administration services and financing through factoring tax credits.

The acquisition of Canada Film Capital LP was accounted for using the purchase method with earnings being included in the consolidated operations from August 4, 2005 the date of acquisition. A summary of the net assets of Canada Film Capital LP acquired at fair value as at August 4, 2005 is as follows:

Accounts receivable	$ 3,417
Loans due from production subsidiaries	19,871
Other current assets	309
Property, plant and equipment	15
Intangible asset - Customer contacts and relationships	451
	24,063
Accounts payable and accrued liabilities	1,589
Bank loan	19,242
Net assets acquired and purchase price	3,232

5. Property, plant and equipment

			2005	2004
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Operating equipment	$ 17,699	$ 7,062	$ 10,637	$ 11,897
Software	2,783	615	2,168	348
Leasehold improvements	1,880	496	1,384	855
Furniture and office equipment	557	113	444	160
	$ 22,919	$ 8,286	$ 14,633	$ 13,260

Operating equipment and software includes assets under capital lease, which have a cost at December 31, 2005 of $4,630,569 (2004 - $10,863,051) and $115,460 (2004 - $115,460), respectively, and a net book value of $2,807,162 (2004 - $4,229,666) and $Nil (2004 - $35,285), respectively.

Property, plant and equipment held for resale consists of two office buildings in North Vancouver, British Columbia that were acquired as part of the acquisition of EP Canada LP (Note 4(a)). The carrying amount represents the estimated net realizable value.

6. Intangible assets and goodwill

(a) Intangible assets

			2005	2004
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
License agreement	$ 6,400	$ 416	$ 5,984	$ -
Customer contacts and relationships	1,151	74	1,077	-
	$ 7,551	$ 490	$ 7,061	$ -

The intangible assets were acquired in connection with the acquisition of EP Canada LP and Canada Film Capital LP and are recorded at management's estimate of the fair value at the date of acquisition (Note 4).

(b) Goodwill

	2005	2004
EP Canada LP	$ 1,954	$ -

7. Other assets

	2005	2004
Current		
Prepaid expenses	$ 514	$ 239
Inventory	222	159
Other	34	34
	$ 770	$ 432
Non-Current		
Deferred lease commission	166	187
Deferred employee compensation	180	-
Investment in production subsidiaries, at cost	1	-
Other	37	33
	$ 384	$ 220

(a) Deferred lease commission

The deferred lease commission represents a commission paid to negotiate a long term building lease and is being amortized over the 15 year lease term.

(b) Deferred employee compensation

An amount of $180,000 was made available to a senior employee to assist with the purchase of a home upon relocation. The amount is non-interest bearing and may be forgiven over three years, commencing August 4, 2005, based on annual financial targets. Any amount that is forgiven will be recognized as compensation expense in the period it is earned.

(c) Investment in production subsidiaries

In order to provide its services of administration and financing of film tax credits, Canada Film Capital LP incorporates a single purpose production company (the "Producer"), on behalf of the foreign studio, which is used for the production of film and television programs. The Producer, which is wholly-owned by Canada Film Capital LP, and the foreign studio enter into a production services agreement under which the foreign studio is responsible for all costs.

Although Canada Film Capital LP is the sole shareholder, the Fund has concluded that these production subsidiaries are variable interest entities as the Fund does not have a controlling financial interest. As the Fund is not exposed to the majority of expected losses and does not benefit from a majority of the expected residual returns the Fund has concluded that it is not the primary beneficiary and as a result has not consolidated these entities. Consequently the investment in these companies is recorded at cost.

The Fund's exposure to loss in connection with these production subsidiaries is limited to the receivable for fees (Note 21(a)(i)) and the loans to production subsidiaries (Note 21(a)(iii)).

8. Liability for payroll disbursements

EP Canada LP receives advances from production companies for payroll disbursements in connection with provision of its payroll processing services which are recorded as a liability until such time as they are disbursed. Interest on these funds accrues to the benefit of the Fund.

9. Bank loan

The bank loan is advanced under a 364 day extendable revolving credit facility of up to $33.0 million which is available to Canada Film Capital LP for the purpose of providing financing to its production subsidiaries through which production services are provided to foreign studios. The revolving credit facility is extendable annually subject to appropriate approvals, with each extension having a duration of 364 days. The bank loan bears interest at prime plus one-half percent per annum and is repayable based on the terms of the credit facility.

Security for the bank loan includes:

- A general security agreement given by Canada Film Capital LP;
- Subordinations and postponements of claims given by RNK Capital LP and the Fund;
- Securities pledge agreements given by RNK Capital LP of its partnership units in Canada Film Capital LP;
- An unlimited recourse guarantee, secured by a general security agreement, given by RNK Capital LP, and
- An assignment of loans due from production subsidiaries with a carrying amount of approximately $17.2 million at December 31, 2005.

10. Other liabilities

	2005	2004
Deferred lease inducement	$ 669	$ 750
Other	50	127
	$ 719	$ 877

The deferred lease inducement represents funds received from the landlord for building renovations. The amount received has been deferred and is amortized to operations over the term of the lease.

11. Capital lease obligations payable

	2005	2004
Interest at 5.325% per annum expiring September 2010	$ 894	$ -
Interest at 5.525% per annum expiring April 2009	580	727
Interest at 6.225% per annum expiring July 2007	790	1,211
Interest at 7.475% per annum expiring December 2006	110	-
Interest at 6.30% per annum expiring December 2006	140	258
Interest at 9.267% per annum expiring July 2006	104	
Interest at 7.978% per annum expiring July 2006	12	-
Interest at 7.86% per annum expiring April 2005	-	296
	2,630	2,492
Less: Current portion	(1,133)	(982)
	$ 1,497	$ 1,510

The capital leases are secured by the related property, plant and equipment (Note 5). The future minimum lease payments are as follows:

2006	$ 1,257
2007	742
2008	391
2009	296
2010	186
	2,872
Less: imputed interest	(242)
	$ 2,630

12. Unitholders' capital

	2005		2004	
	Number of Trust Units	Amount	Number of Trust Units	Amount
Balance at beginning of year	10,715,003	$ 14,408	10,715,003	$ 14,408
Issued for cash pursuant to a private placement	5,846,155	19,000	-	-
Issued for cash on the exercise of unit options	43,334	69	-	-
Reallocation of contributed surplus on the exercise of unit options	-	80	-	-
Conversion of Class B LP Units to Trust Units (Note 14)	284,947	414	-	-
Balance at end of year	16,889,439	$ 33,971	10,715,003	$ 14,408

Each Trust Unit of the Fund is transferable and represents an equal undivided beneficial interest in the net assets of the Fund and entitles the holder to participate equally in distributions of the Fund. Each Trust Unit held entitles the unitholder to one vote at all meetings of unitholders. The Trust Units have no conversion, retraction, redemption or pre-emptive rights, except that they are redeemable at any time on demand of the holder at amounts related to market prices at the time of redemption, subject to an aggregate maximum of $50,000 in cash redemptions in any particular month. This limitation may be waived at the discretion of the Trustees of the Fund.

On August 4, 2005, the Fund completed a private placement of 5,846,155 Trust Units at a price of $3.25 per unit for net proceeds of $19,000,004.

During the year ended December 31, 2005, a total of 284,947 Trust Units were issued for no consideration on the exchange of an equal number of Class B LP units of RNK Capital LP. The exchange resulted in the reclassification of $414,016 from non-controlling interest (Note 14) to unitholders' capital.

13. Unit based compensation plan

The Fund has a variable price unit option plan and under this plan the Fund may grant options to its employees to allow them to purchase up to 680,000 Trust Units of the Fund. The exercise price of each option granted is equal to the Fund's closing unit price on the day prior to the date of grant and the maximum term is ten years. The exercise price is reduced by the amount of the monthly per unit distributions of the Fund.

As at December 31, 2005 there were unit options granted to allow employees to purchase a total of 360,000 Trust Units (2004 – 403,334 Trust Units). These options expire on June 3, 2012. As at December 31, 2005 the exercise price is $1.40 per unit (December 31, 2004 - $1.88) and it will decrease monthly by the amount of distributions declared and paid.

	2005	2004
Balance at beginning of year	403,334	425,000
Exercised in the year (Note 12)	(43,334)	-
Expired	-	(21,666)
Balance at end of year	360,000	403,334

The value of compensation to be recorded is measured each period using a variable accounting method based on the difference between the current unit price and the exercise price of the unit options at the end of the period. The quoted market price of the Trust Units as at December 31, 2005 was $3.25 (2004 - $3.94), whereas the exercise price as at December 31, 2005 was $1.40 (2004 - $1.88) per unit.

14. Non-controlling interest and special voting units

On the formation of the Fund on May 31, 2002, the former shareholders of Rainmaker Entertainment Group Ltd. either received Trust Units of the Fund or Class B LP Units of RNK Capital LP, a majority owned limited partnership of the Fund. The Class B LP Units have the same economic and voting rights equivalent, in all material respects, to the Trust Units and are exchangeable on a one for one basis for Trust Units of the Fund for no additional consideration at any time at the option of the holder. The Class B LP Units are transferable, with certain restrictions, and the holders are entitled to a pro-rata share of income and distributions.

Details of the Class B LP Units, which are recorded as non-controlling interest in these financial statements, are as follows:

	2005		2004	
	Number of Class B LP Units	Amount	Number of Class B LP Units	Amount
Balance at beginning of year	625,683	$ 1,142	625,683	$ 981
Allocation of earnings		1		465
Payment of distributions		(233)		(325)
Allocation of contributed surplus		-		21
Conversion of Class B LP Units to Trust Units (Note 12)	(284,947)	(414)		-
Balance at end of year	340,736	$ 496	625,683	$ 1,142

The Fund may issue special voting units from time to time to holders of record of securities. The holders of special voting units are entitled to such number of votes at meetings of unitholders as may be determined by the Trustees at the time of issuance but shall not be entitled to any distributions from the Fund. Special voting units have been issued to the holders of the Class B LP Units on the basis of one special voting unit for each Class B LP Unit held.

15. Life insurance proceeds

The life insurance proceeds relate to a key man term life insurance policy held by Rainmaker LP on the life of Bob Scarabelli, the former president and CEO, who died suddenly on September 8, 2004 from natural causes.

17. Income taxes

The Fund is a "mutual fund trust" as defined under the Income Tax Act (Canada) and accordingly is not taxable on its income to the extent that its income is distributed to its unitholders. This exemption does not apply to the Fund's corporate subsidiaries, such as REG, that are subject to income tax.

The significant variations between the combined statutory federal and provincial tax rates of 34.9% (2004 - 35.6%) and the effective tax rate are as follows:

	2005	2004
Earnings before income taxes and non-controlling interest	$ 2,377	$ 8,541
Net earnings of the Fund subject to tax in hands of unitholders	(2,656)	(8,649)
Net (loss) earnings of subsidiary companies before provision for income taxes	(274)	108
Expected (recovery) provision for income taxes at statutory rates	(99)	38
Valuation allowance on loss of foreign subsidiary	55	-
Revision of prior years estimates	(122)	(27)
Other	(39)	94
Income tax (recovery) expense	$ (205)	$ 105

Pursuant to Emerging Issues Committee Abstract 107 "Application of CICA 3465 to Mutual Fund Trusts, Real Estate Investment Trusts, Royalty Trusts and Income Trusts" the Fund does not recognize any future income tax assets or liabilities on temporary timing differences in the Fund. There are no material future income tax assets or liabilities on temporary differences relating to the Fund's consolidated corporate subsidiaries.

18. Changes in non-cash operating working capital

	2005	2004
Accounts receivable	$ 247	$ (74)
Other current assets	138	(95)
Accounts payable and accrued liabilities	671	(2,091)
Deferred revenue	1,575	-
	$ 2,631	$ (2,260)

21. Related party transactions

(a) The Fund does not consolidate certain of its subsidiaries as discussed in Notes 2(i) and 7(c) on the basis that the Fund does not have a controlling financial interest. Details of transactions with these non-consolidated production subsidiaries are as follows:

(i) As at December 31, 2005, accounts receivable includes $4,568,032 (2004- $Nil) due from production subsidiaries.

(ii) As at December 31, 2005, accounts payable and accrued liabilities includes $686,981 (2004 -$Nil) due to production subsidiaries.

(iii) Loans due from production subsidiaries earn a financing fee, are due on demand and are secured by an assignment of and security interest over film production tax credits due to the production subsidiaries.

(iv) Revenue for the year ended December 31, 2005 includes $2,784,566 (2004 - $Nil) for fees and services provided to production subsidiaries at market rate for these services.

(b) As at December 31, 2005 accounts receivable includes $295,129 due from companies controlled by a Trustee of the Fund.

22. Subsequent events

Subsequent to December 31, 2005, the Fund:

(a) sold one of its two properties held for resale (Note 5) for net proceeds of approximately $1.8 million, which approximates the carrying amount.

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