



## SENIOR FLOATING RATE INCOME TRUST



### **Annual Report**

Period ended December 31, 2004

# Table of Contents

## **SENIOR FLOATING RATE INCOME TRUST**

<b>Market Commentary</b> .....	1
<b>Management's Discussion &amp; Analysis</b> .....	2
<b>Management and Auditors' Reports</b> .....	3
<b>Financial Statements</b>	
Statement of Net Assets .....	4
Statement of Operations .....	4
Statement of Changes in Net Assets .....	5
<b>Notes to Financial Statements</b> .....	6
<b>Corporate Information</b> .....	Inside Back Cover

# SENIOR FLOATING RATE INCOME TRUST

## Market Commentary

### MARKET UPDATE

The U.S. loan market maintained its upward momentum during the fourth quarter of 2004, capping off a strong performance for the year and achieving its twenty-sixth consecutive month of positive returns. Investor sentiment remained upbeat, sustained by a steady flow of positive macroeconomic data. Monthly employment reports, U.S. GDP growth, and inflation generally met analysts' expectations. However, volatile petroleum prices and commodity costs remained a central concern, pressuring profit margins and producing earnings shortfalls in certain sectors. The U.S. Federal Reserve Board hiked the benchmark interest rate by 25 basis points twice during the quarter to ensure that inflation remained benign. The U.S. CPI rose by just 0.2% each month during the quarter.

Overall, the U.S. economy continued its steady pace of growth throughout the year and credit fundamentals in the leveraged loan universe improved accordingly. The flexible nature and appealing risk profile of leveraged loans attracted investors, particularly in the context of the current interest rate environment. Leveraged loan assets as measured by the CSFB Leveraged Loan Index posted a 1.51% total quarterly return in the fourth quarter of 2004 versus a gain of 2.26% in the same period of 2003. The Index registered a 5.60% return for the year.

Institutional loan volume picked up during the fourth quarter and leveraged loan trading soared to U.S.\$153 billion for all of 2004, the busiest year on record. New issue volume totaled U.S.\$76 billion in the fourth quarter, the second-highest level on record. Strong inflows into the loan market were driven by investor appetite for adjustable-rate securities and improving credit metrics. The aggregate value of loans on the forward calendar increased 31% to U.S.\$22.7 billion at the end of the fourth quarter, indicating that leveraged loan volume will continue to be strong through the beginning of 2005.

Institutional M&A and LBO activity set new records during 2004. M&A-related institutional transactions climbed to U.S.\$65 billion for the year, more than double the 2003 level. Robust demand continued to drive loan re-pricings, compressing the average spread of institutional loans. Spreads for BB-rated loans tightened 72 basis points and those for B-rated loans tightened 77 basis points from 2003 levels to end the year at 220 basis points and 285 basis points respectively.

Secondary loans achieved record bid prices during the quarter. Investors were undeterred by tightening spreads and compressed yields. The average bid at the close of the fourth quarter was up 13 basis points from level in the third quarter to finish the year at 101.01, slightly lower than the record high of 101.12 attained in November 2004.

### MARKET OUTLOOK 2005

Our outlook on the loan market remains optimistic. We believe loans should remain an attractive asset class for investors looking to diversify portfolios and leverage interest rate increases.

### **Symphony Asset Management, LLC**

***Portfolio Manager, Senior Floating Rate Income Trust***

## SENIOR FLOATING RATE INCOME TRUST

### Management's Discussion & Analysis

The inception of the Trust was October 28, 2004. As at December 31, 2004, the Trust had net assets of \$73,380,067 or \$9.35 per unit.

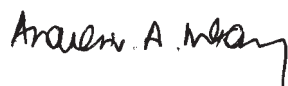
Total expenses, inclusive of administration and investment management fees, total return agreement fees, general and administrative costs and interest expense, from inception to December 31, 2004 were \$270,911. Net investment loss for the period was \$8,042.

During the period, the Trust had subscriptions of \$73,678,575 and no redemptions. The Trust also declared \$619,702 in distributions to unitholders in 2004. Unitholders are entitled to redeem their units at any time at a price calculated by reference to the Trust's net asset value.

## Management's Responsibility

The accompanying financial statements have been prepared by Fairway Advisors Inc., the Manager of the Trust, and approved by the Board of Directors of the Manager. The Trust's Manager is responsible for the information and representations contained in these financial statements and other sections of the Annual Report. Fairway Advisors Inc. maintains appropriate processes to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include certain amounts that are based on estimates and judgments. The significant accounting policies which management believes are appropriate for the Trust are described in Note 2 to the financial statements.

Ernst & Young LLP are the external auditors of the Trust. They have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the financial statements. Their report is set out below.



Chief Executive Officer  
Fairway Advisors Inc.



Chief Financial Officer  
Fairway Advisors Inc.

## Auditors' Report

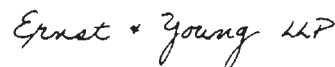
### TO THE UNITHOLDERS OF SENIOR FLOATING RATE INCOME TRUST

We have audited the statement of net assets of the Trust as at December 31, 2004 and the statements of operations and changes in net assets for the period from October 28, 2004 [date of inception] to December 31, 2004. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the net assets of the Trust as at December 31, 2004 and the results of its operations and the changes in its net assets for the period then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada,  
**April 15, 2005.**



**Chartered Accountants**

## SENIOR FLOATING RATE INCOME TRUST

### Statement of Net Assets

As at December 31, 2004

<b>Assets</b> (Note 6)	
Total Return Agreement, at market value	\$ 329,236
Cash and cash equivalents	73,749,445
	<u>74,078,681</u>
<b>Liabilities</b>	
Management fees payable (Note 4)	66,236
Accounts payable and accrued liabilities	12,676
Distributions payable	619,702
	<u>698,614</u>
<b>Net assets, at market value</b>	<b>\$ 73,380,067</b>
<b>Number of units outstanding</b> (Note 5)	<b>7,850,000</b>
<b>Net asset value per unit</b>	<b>\$ 9.35</b>

Approved on behalf of the Board of Directors of the Manager:



Andrew A. McKay  
Director



Paul Perrow  
Director

### Statement of Operations

From October 28, 2004 (Date of Inception) to December 31, 2004

<b>Investment income</b>	
Interest	\$ 4,391
Income on Total Return Agreement (Note 6)	258,478
	<u>262,869</u>
<b>Expenses</b>	
Management fees (Note 4)	66,237
Administration	12,675
Total Return Agreement fees (Note 4)	191,999
	<u>270,911</u>
<b>Net investment loss</b>	<b>(8,042)</b>
<b>Realized and unrealized gain on investments</b>	
Change in unrealized appreciation on Total Return Agreement (Note 6)	329,236
<b>Net gain on investments</b>	<b>329,236</b>
<b>Increase in net assets from operations</b>	<b>\$ 321,194</b>
<b>Increase in net assets from operations per unit</b>	<b>\$ 0.0414</b>

The accompanying notes are an integral part of these financial statements

# Statement of Changes in Net Assets

From October 28, 2004 (Date of Inception) to December 31, 2004

<b>Increase in net assets from operations</b>	\$	321,194
<b>Distributions to unitholders</b>		
Other income		(388,125)
Return of capital		(231,577)
		(619,702)
<b>Capital unit transactions (Note 5)</b>		
Net proceeds from issuance of trust units		73,678,575
		73,678,575
<b>Increase in net assets during the period</b>		73,380,067
<b>Net assets, beginning of period</b>		—
<b>Net assets, end of period</b>	\$	<b>73,380,067</b>

The accompanying notes are an integral part of these financial statements

# Notes to Financial Statements

December 31, 2004

## 1. THE TRUST

Senior Floating Rate Income Trust (the "Trust") is an investment trust established under the laws of the Province of Ontario by a Declaration of Trust dated October 28, 2004 ("Date of Inception").

The manager and trustee of the Trust is Fairway Advisors Inc. (the "Manager").

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. The following is a summary of significant accounting policies followed by the Trust in the preparation of its financial statements:

### *(a) Cash and cash equivalents*

Cash and cash equivalents consist of cash on deposit and short-term, interest bearing notes with a term to maturity of less than three months from the date of purchase.

### *(b) Valuation of Investments*

Investments in publicly traded securities are valued at the closing market price from the relevant exchange. Investments in securities for which closing market prices are not readily available are valued at the last reported sales price. If no sales price can be ascertained or if the securities are not quoted on an exchange, the value is based on the average of the last bid and ask prices quoted by a major dealer in such securities. Securities for which no such information is readily available are valued at fair value as determined by the Manager. The difference between market value and average cost, as recorded in the accounts, is shown as change in unrealized appreciation (depreciation) on investments.

Short-term investments, including notes and money market instruments, will be valued at cost plus accrued interest which approximate market value.

The value of any bonds, debentures and other debt obligations will be valued by taking the average of the bid and ask prices on the valuation date.

### *(c) Investment transactions and income recognition*

All investment transactions are accounted for on the trade date. Realized gains and losses from investment transactions and unrealized appreciation or depreciation in the value of investments are calculated on an average cost basis.

Interest income and expenses are recognized daily on an accrual basis.

Dividend income is recognized on the ex-dividend date.

### *(d) Foreign currency translation*

Investments at market value and other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange applicable on the valuation date. Investment transactions and income and expenses are translated at the rate of exchange on the date of such transactions.

### *(e) Total Return Agreement*

The value of the Total Return Agreement (see Note 6) is the gain or loss that would be realized if, on the valuation date, the position in the Total Return Agreement was closed out in accordance with its terms. The unrealized gains or losses on the Total Return Agreement are reported as part of change in unrealized appreciation or depreciation on Total Return Agreement in the statement of operations until it is closed out or partially settled.

### *(f) Accounting estimates*

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires the Manager to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

### *(g) Net asset value per unit*

The net asset value per unit is computed by dividing the net assets of the Trust by the corresponding total number of units outstanding of the Trust on the valuation date.

# Notes to Financial Statements (continued)

December 31, 2004

## 3. TAXATION

The Trust is a “unit trust” within the meaning of the Income Tax Act (Canada). A unit trust is subject to applicable federal and provincial taxes on the amount of its net income for tax purposes for the period, including net realized taxable capital gains, to the extent such net income for tax purposes has not been paid or made payable to unitholders in the period.

No provision for income taxes has been recorded in the accompanying financial statements as all income and net realized capital gains are distributed to the unitholders.

## 4. EXPENSES OF THE TRUST

### *(a) Management fees*

Pursuant to the Declaration of Trust, the Manager provides all administrative and management services required by the Trust, including the appointment of the investment advisors and the portfolio manager to the Trust.

Pursuant to the Declaration of Trust, the Manager receives a fee payable monthly at the annual rate of 0.40%, plus applicable taxes, of the value of the Senior Floating Rate Portfolio (see Note 6). The management fee is calculated and payable monthly in arrears. The Manager is responsible for payment of the investment management fees of the Trust’s investment advisors and portfolio manager out of the annual management fees.

### *(b) Total Return Agreement fees*

Under the Total Return Agreement (see Note 6), the Trust pays the counterparty monthly payments calculated on a floating rate basis of LIBOR plus a spread negotiated on commercial terms of the value of the Senior Floating Rate Portfolio minus the amount of the cash collateral pledged by the Trust to the counterparty to the Total Return Agreement.

### *(c) Other expenses*

The Trust is responsible for all other expenses incurred in connection with its operation and administration, such as custody, valuation, reporting, audit and legal fees.

## 5. UNITHOLDERS’ EQUITY

The Trust is authorized to issue an unlimited number of transferable, redeemable trust units of one class, each of which represents an equal, undivided interest in the net assets of the Trust. Unitholders are entitled to redeem their units daily, at the net asset value per unit on such date. On November 15, 2004, the Trust completed a private placement of 7,500,000 units at \$9.42831 per unit for cash proceeds of \$70,712,325. On November 29, 2004, the Trust completed a further private placement of 350,000 units at \$8.475 per unit for additional cash proceeds of \$2,966,250. As at December 31, 2004, there were 7,850,000 units outstanding.

The Trust will terminate operations on November 30, 2014 (the “Termination Date”) and the net assets will be distributed pro rata to unitholders unless an alternative later termination date is approved by the unitholders.

Units of the Trust may be surrendered for redemption at any time. Unitholders of the Trust will receive a redemption price per unit calculated in reference to the net asset value per unit of the Trust.

## 6. TOTAL RETURN AGREEMENT

To provide the Trust with the means to meet its investment objectives, the Trust has entered into a total return swap agreement (the “Total Return Agreement”) with The Bank of Nova Scotia (the “Counterparty”) which will provide the Trust with economic exposure to the total return on a portfolio comprised primarily of senior loans and other debt securities (the “Senior Floating Rate Portfolio”). Under the Total Return Agreement, the Counterparty will agree to make monthly payments to the Trust of all interest, fees and realized capital gains on the Senior Floating Rate Portfolio after deduction of a monthly fee calculated on a floating rate basis by reference to interest rates and any expenses associated with Senior Floating Rate Portfolio transactions. To the extent the fee payable to the Counterparty under the Total Return Agreement exceeds the amount of interest, fees and realized capital gains, the Trust will be required to make a payment to the Counterparty equal to the amount of the deficiency. In addition to monthly payments received by the Trust under the Total Return Agreement, the Trust may partially settle the

# Notes to Financial Statements (continued)

December 31, 2004

Total Return Agreement prior to the Termination Date in order to fund monthly distributions by the Trust as well as redemptions of the Trust's units. The terms of the Total Return Agreement impose restrictions on the composition of the Senior Floating Rate Portfolio and failure to meet those restrictions may result in early termination of the Total Return Agreement.

The Trust is provided leverage through the Total Return Agreement at a floating rate based on LIBOR.

As general and continuing collateral for its obligations under the Total Return Agreement, the Trust has granted the Counterparty a security interest in assets of the Trust, including \$70,778,804 in cash deposited as collateral with the Counterparty.

As at December 31, 2004, the Senior Floating Rate Portfolio was comprised as follows:

Securities	Description	Market Value
<b>Senior Loans</b>		
2,000,000	Affinia Group Inc. <i>Term Loan B</i>	2,447,106
7,182,322	Alderwoods Group, Inc. <i>Term Loan B2</i>	8,732,864
4,000,000	Allegheny Energy Supply Company <i>Term Loan</i>	4,900,227
1,995,081	Allied Waste North America, Inc. <i>Term Loan B</i>	2,438,661
2,900,000	Allied Waste North America, Inc. <i>Term Loan D</i>	3,538,490
3,035,740	American Commercial Lines, LLC <i>Term Loan B</i>	3,757,302
997,000	American Commercial Lines, LLC <i>Term Loan C</i>	1,231,877
3,011,765	Amsted Industries Inc. <i>Term Loan B1</i>	3,681,203
5,984,962	Charter Communications Operating LLC <i>Tranche B Term Loan</i>	7,215,511
5,774,436	Conseco, Inc. <i>Term Loan</i>	7,081,827
4,000,000	Constellation Brands, Inc. <i>Term Loan B</i>	4,883,384
1,940,257	Dex Media East LLC <i>Term Loan B</i>	2,362,044
3,000,000	Dole Holding Company <i>Second Lien Term Loan</i>	3,698,405
3,990,000	Dresser Rand, Inc. <i>Term Loan B</i>	4,878,976
6,125,000	El Paso Corporation <i>Term Loan B</i>	7,443,190
2,000,000	Fitness Holdings Worldwide, Inc. <i>Term Loan B</i>	2,437,782
6,000,000	General Growth Properties (Ggp L.P. And Ggplp, LLC) <i>Term Loan B</i>	7,247,515
4,000,000	Graham Packaging Company, L.P. <i>Tranche C</i>	4,942,335

(Continued)

Securities	Description	Market Value
<b>Senior Loans</b>		
4,000,000	Huntsman LLC <i>Term Loan</i>	4,902,633
4,000,000	Jarden Corporation <i>Term Loan</i>	4,863,532
5,000,000	Jostens, Inc. <i>New Term Loan B</i>	6,070,287
6,000,000	K&F Industries, Inc. <i>Term Loan B</i>	7,344,176
3,424,789	Kinetic Concepts, Inc. <i>Term Loan B1</i>	4,154,699
4,000,000	LNR Property Corp. <i>Term Loan</i>	4,836,463
1,995,000	Loews Cineplex Entertainment Corp. <i>New Term Loan B</i>	2,434,875
3,990,000	Nortek, Inc. <i>Term Loan</i>	4,886,375
4,000,000	R.H. Donnelley, Inc. <i>Term Loan D</i>	4,867,043
3,989,950	Regal Cinemas, Inc. <i>Term Loan</i>	4,852,512
2,000,000	Reliant Energy Resources Corp. <i>Term Loan B</i>	2,439,537
6,000,000	Rockwood Specialties Group Inc. <i>Term Loan D</i>	7,274,433
99,710	Smurfit-Stone Container Corp. <i>Deposit Funded Loan</i>	121,935
1,263,818	Smurfit-Stone Container Corp. <i>Term Loan B</i>	1,544,638
636,472	Smurfit-Stone Container Corp. <i>Term Loan C</i>	778,063
2,000,000	Texas Genco LLC <i>Term Loan</i>	2,441,219
<b>Total Senior Loans</b>		<b>146,731,119</b>
<b>Bonds</b>		
4,000,000	Cablevision Systems Corp. <i>7.88% Dec 15/07</i>	5,185,362
2,000,000	Chesapeake Energy <i>8.13% Jan 04/11</i>	2,616,743
4,000,000	MGM Grand Inc. <i>9.75% Jun 01/07</i>	5,365,827
3,600,000	Navistar International <i>9.38% Jun 01/06</i>	4,655,998
4,000,000	Park Place Entertainment <i>9.38% Feb 15/07</i>	5,317,703
4,000,000	Solelectron Corp. <i>9.63% Feb 15/09</i>	5,317,703
4,000,000	Tesoro Petroleum Corp. <i>8.00% Apr 15/08</i>	5,257,548
<b>Total Bonds</b>		<b>33,716,884</b>
<b>Total Senior Floating Rate Portfolio</b>		<b>180,448,003</b>

# Notes to Financial Statements (continued)

December 31, 2004

## 7. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

In addition to the risks of investing in senior loan and other debt markets generally, the Trust is subject to other risks, including the following:

### ***Currency risk***

The Trust invests in securities denominated in currencies other than its reporting currency, the Canadian dollar. Consequently, the Trust is exposed to risks that the exchange rate of the Canadian dollar relative to the other currencies may change in a manner which has an adverse effect on the reported value of that portion of the Trust's assets. The Trust manages a portion of its currency risk through foreign currency hedging strategies.

### ***Interest rate risk***

The Trust invests in interest-bearing securities. The income of the the Trust may be affected by changes in interest rates relevant to particular securities or as a result of the Manager being unable to secure similar returns on the expiry or sale of securities.

### ***Credit risk***

Credit risk on financial instruments is the risk of a financial loss occurring as a result of the default of a counterparty on its obligation to the Trust. Credit risk is managed by dealing with counterparties the Trust believes to be creditworthy and by regular monitoring of credit exposures. The Trust's significant credit concentration is with The Bank of Nova Scotia under the Total Return Agreement (see Note 6).

# Corporate Information

Manager and Trustee

**Fairway Advisors Inc.**

BCE Place

181 Bay Street, Suite 840

Toronto, Ontario M5J 2T3

Phone: (416) 507-4110

Fax: (416) 601-2434

Toll Free: (1-866) 299-7929

[www.fairwaycapital.com](http://www.fairwaycapital.com)

[info@fairwaycapital.com](mailto:info@fairwaycapital.com)

Valuation Agent

**State Street Fund Services Toronto Inc.**

30 Adelaide Street East

Suite 1100

Toronto, Ontario M5C 3G6

Auditors

**Ernst & Young LLP**

Ernst & Young Tower, 222 Bay Street

P.O. Box 251, Toronto-Dominion Centre

Toronto, Ontario M5K 1J7

Legal Counsel

**McMillan Binch LLP**

BCE Place, Suite 4400

Bay Wellington Tower

181 Bay Street

Toronto, Ontario M5J 2T3

## About Fairway

Fairway is a specialized financial services firm focused on the creation, marketing, distribution and management of investment products in both traditional and alternative asset classes. Fairway's products are structured to provide yield enhancement, tax advantages and other benefits that complement the needs of Canadian investors. Fairway's principals are experienced investment professionals who share a strong track record as innovators in the Canadian securities industry.

BCE Place, 181 Bay Street  
Suite 840, P.O. Box 750  
Toronto, ON M5J 2T3

**[www.fairwaycapital.com](http://www.fairwaycapital.com)**