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## AUDITORS' REPORT TO THE UNITHOLDERS

We have audited the consolidated balance sheets of Clearwater Seafoods Income Fund as at December 31, 2006 and 2005 and the consolidated statements of earnings and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*KPMG LLP*

Chartered Accountants

Halifax, Canada

February 9, 2007 except as to note 12 which is as of February 19, 2007

# CLEARWATER SEAFOODS INCOME FUND

## Consolidated Balance Sheets

(In thousands of dollars)

December 31 2006 2005

### Assets

#### Current Assets

Distributions and interest receivable from Clearwater Seafoods Limited Partnership	\$ 1,486	\$ -
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Investment in Clearwater Seafoods Limited Partnership (note 3)	319,243	329,271
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	<u>\$ 320,729</u>	<u>\$ 329,271</u>
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### Liabilities and Unitholders' Equity

#### Current Liabilities

Distributions and interest payable	\$ 1,470	\$ -
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Convertible debentures (note 4)	46,430	49,278
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#### Unitholders' Equity

Trust units (note 5)	299,282	299,336
Deficit	(26,453)	(19,343)

	272,829	279,993
	<u>\$ 320,729</u>	<u>\$ 329,271</u>

*Subsequent event (note 12)*

*See accompanying notes to consolidated financial statements*

Approved by the Board of Trustees:

(Signed) Thomas D. Traves

(Signed) Bernard R. Wilson

# CLEARWATER SEAFOODS INCOME FUND

## Consolidated Statements of Earnings and Deficit

*(In thousands of dollars)*

<u>Years ended December 31</u>	<u>2006</u>	<u>2005</u>
Equity in net earnings of Clearwater Seafoods Limited Partnership	\$ 1,807	\$ 9,114
Interest income	3,511	3,510
<u>Interest expense</u>	<u>(3,605)</u>	<u>(3,616)</u>
Net earnings	1,713	9,008
<u>Deficit at beginning of year</u>	<u>(19,343)</u>	<u>(9,826)</u>
<u>Distributions declared during the year</u>	<u>(8,823)</u>	<u>(18,525)</u>
<u>Deficit at end of year</u>	<u>\$ (26,453)</u>	<u>\$ (19,343)</u>
<u>Basic and diluted net earnings per trust unit</u>	<u>\$ 0.06</u>	<u>\$ 0.31</u>

*See accompanying notes to consolidated financial statements*

# CLEARWATER SEAFOODS INCOME FUND

## Consolidated Statements of Cash Flows

(In thousands of dollars)

For the years ended December 31	2006	2005
Cash flows from operating activities		
Net earnings	\$ 1,713	\$ 9,008
Items not involving cash		
Equity in net earnings of Clearwater Seafoods Limited Partnership, net of cash distributions received of \$7,753, (2005 – \$18,525)	5,546	9,411
Other	944	106
	<u>7,353</u>	<u>18,525</u>
Cash flows (used in) from financing activities		
Distributions to unitholders	<u>(7,353)</u>	<u>(18,525)</u>
Increase (decrease) in cash	-	-
Cash - beginning of year	-	-
Cash - end of year	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to consolidated financial statements

# CLEARWATER SEAFOODS INCOME FUND

## Notes to Consolidated Financial Statements

*(Tabular amounts expressed in thousands of dollars)*

### 1. BASIS OF PRESENTATION

Clearwater Seafoods Income Fund (the "Fund") is a limited purpose, open-ended trust established under the laws of the Province of Ontario. The Fund was created to acquire and indirectly hold the securities of Clearwater Seafoods Limited Partnership ("Clearwater").

These consolidated financial statements consolidate the accounts of the Fund and its subsidiary, Clearwater Seafoods Holdings Trust ("CSHT"). CSHT owns 55.71% (December 31, 2005 – 55.71%) of the units of Clearwater. However, as the Fund does not have the right to nominate the majority of the board of directors, it does not consolidate the results of Clearwater's operations but rather accounts for the investment using the equity method. Under this method, the cost of the investment is increased by the Fund's proportionate share of Clearwater's earnings and reduced by any distributions paid to the Fund by Clearwater and amortization of the purchase price discrepancy. Due to the limited amount of information that this provides on the underlying operations of Clearwater, the financial statements of Clearwater are also enclosed.

### 2. ACCOUNTING POLICIES

The financial information contained in the accompanying consolidated financial statements has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

#### (a) Consolidation

These consolidated financial statements consolidate the accounts of the Fund and its subsidiary, Clearwater Seafoods Holdings Trust, from the date of acquisition on July 30, 2002.

#### (b) Intangible assets and goodwill

The excess of the Fund's cost of its investment in units of Clearwater has been allocated to licenses with indefinite lives, license agreements with finite lives, customer relationships and goodwill.

Licenses have indefinite lives, are not amortized and are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired.

License agreements are determined to have indefinite lives when the annual renewal fee is nominal (typically less than 1% of the estimated value of the license), Clearwater has both the ability and intent to renew or extend the life of the licenses and there has been a history of being able to obtain renewals from the government. License agreements that are determined to have finite lives are amortized over the term of the related agreement and tested for impairment if events or changes in circumstances indicate that the asset might be impaired.

The impairment test compares the carrying amount of the licenses with their fair value and license agreements with their net recoverable amount and an impairment loss would be recognized in the statement of earnings for any excess of the carrying value over fair value.

Customer relationships are amortized over their useful lives as estimated based on customer turnover rates.

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the net assets acquired, based on their fair values. Goodwill is not amortized and is tested for impairment annually, or more frequently if events or

changes in circumstances indicate that the asset might be impaired. When the fair value of goodwill is less than its carrying amount, the implied value of the reporting unit's goodwill is compared to the carrying value of goodwill and an impairment loss would be recognized in an amount equal to the excess in the statement of earnings.

(c) Convertible Debentures

Convertible debentures are classified in accordance with their component parts: the value ascribed to the holders' option to convert to units has been classified as equity and the remaining portion of the convertible debenture has been classified as debt. Interest on the debt is calculated by applying an interest rate of approximately 7.3% to the outstanding debt component. The difference between actual cash interest payments and interest expense is added to the debt component of the debentures.

(d) Income taxes

The Fund is a unit trust for income tax purposes. As such, the Fund is only taxable on any taxable income not allocated to the unitholders. As substantially all taxable income has been allocated to the unitholders, no provision for income taxes on earnings of the Fund has been made in these financial statements. Income tax liabilities relating to distributions of the Fund are the obligations of the unitholders.

Pursuant to the draft legislation announced on October 31, 2006 and issued on December 15, 2006 specified investment flow-throughs ("SIFTS") will be taxed, beginning in 2011, on distributions paid to unitholders. This tax will be at a total combined rate of 31.5%. In light of this new tax on income trusts, the Fund will be required to record any future income tax asset or liability on the temporary differences related to its investment in Clearwater. As the new legislation has not been substantively enacted as of the financial statement date this future income tax has not been recorded in the Fund. Assuming the new law relating to SIFTS is passed and the Fund is required to pay tax on a portion of its distributions in 2011, a future income tax asset or liability would be recorded in respect of the following temporary differences existing within the Fund as of December 31, 2006.

	Taxable (deductible) temporary differences
Investment in Clearwater	\$ 10,445
Convertible debentures	570
Loss carry forwards	(7,746)
<b>Total</b>	<b>\$ 3,269</b>

(e) Financial instruments

The carrying value of the distributions and interest receivable from Clearwater and distributions and interest payable to unitholders approximate fair values based on the short-term maturity of these instruments.

(f) Use of estimates

The preparation of the financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates are based on management's best knowledge of current events and actions that the Fund may undertake in the future.

The investment in Clearwater Seafoods Limited Partnership consists of the following:

	2006	2005
Investment in Class A Partnership units, at cost	\$298,454	\$298,454
Investment in Class C Partnership units	47,000	50,000
Add: Cumulative equity in earnings	77,852	76,045
Other	(12)	-
Less: Cumulative distributions received & receivable	(104,051)	(95,228)
	<u>\$ 319,243</u>	<u>\$ 329,271</u>

In June 2004, 4,081,633 Class C units were issued by Clearwater to the Fund concurrently with the issue by the Fund of an equivalent dollar amount of Convertible Debentures. The Class C units are convertible at any time and are redeemable and retractable at a price of \$12.25 per unit. These units exist under an agreement whereby they will be converted, redeemed or retracted in a manner that corresponds to any conversion, redemption or repurchase of the Convertible Debentures of the Fund and in a manner that ensures that the distributions on the Class C units will be able to fund the ongoing interest payments on the Convertible Debentures.

Included in equity in net earnings for the year is income of \$1,019,000 (2005 – expense of \$1,956,000). This amount included amortization and other adjustments relating to purchase price discrepancies recognized by the Fund in accounting for its investment in Clearwater using the equity method. Included in the expense for 2005 is a write down for the impairment of shrimp licenses and harvesting contracts of \$3,193,000. The write down was based on declining margins associated with shrimp licenses and harvesting. This impairment was included in "equity in earnings of Clearwater Seafoods Limited Partnership".

Details of the allocation of the excess of the Fund's cost over the historical cost of the assets recorded by Clearwater at year-end are as follows:

	2006	2005
Intangible assets		
Licenses – indefinite lives	189,260	189,260
Customer relationships and other	518	578
Goodwill	14,240	14,240
Long-term liabilities	504	606
Cumulative foreign currency translation account	<u>(6,254)</u>	<u>(7,435)</u>
	<u>\$ 198,268</u>	<u>\$ 197,249</u>

#### 4. CONVERTIBLE DEBENTURES

On June 15, 2004, the Fund completed an offering for \$50 million of 7% convertible unsecured subordinated debentures, which are due December 31, 2010.

The convertible debentures are convertible at any time up to maturity at the option of the holder into trust units of the Fund at a conversion price of \$12.25 per trust unit. The debentures pay interest semi-annually in arrears on June 30 and December 31, commencing December 31, 2004. The debentures are not redeemable before December 31, 2007. On and after December 31, 2007, but before December 31, 2008, the debentures may be redeemed at the option of the Fund provided that the market price of the trust units is not less than 125% of the conversion price. On and after December 31, 2008, the debentures may be redeemed at the option of the Fund at a price equal to their principal amount plus accrued interest. Subject to regulatory approval, the Fund may satisfy its obligation to repay the principal amount of the debentures on

redemption or at maturity, in whole or in part, by delivering that number of trust units equal to the amount due divided by 95% of the market price of the trust units at that time, plus accrued interest in cash.

The convertible debentures are classified in accordance with their component parts: the value ascribed to the holder's option to convert to units has been classified as equity and the remaining portion of the convertible debenture has been classified as debt.

The Fund filed a normal course issuer bid by which it can acquire up to \$5 million principal amount of convertible debentures in the 12-month period commencing August 2006. Any repurchase at the Fund level would be accompanied by a similar repurchase of Class C Partnership units by Clearwater. During 2006, \$3 million of the Class C units were repurchased and cancelled with the proceeds used to repurchase and cancel an equivalent amount of convertible debentures. Subsequent to year-end, an additional \$1 million of Partnership units were repurchased and cancelled with proceeds used by the Fund to repurchase and cancel an equivalent amount of convertible debentures.

The estimated fair value of the Fund's convertible debentures at December 31, 2006 was \$45,590,000 based on the quoted market value of the debentures Clr.db on the Toronto Stock Exchange.

#### 5. TRUST UNITS AND SPECIAL TRUST UNITS

The Declaration of Trust provides that an unlimited number of units and an unlimited number of Special Trust Units may be issued. Each unit is transferable and represents an equal undivided beneficial interest in any distributions of the Fund and in the net assets of the Fund in the event of termination or winding up of the Fund. All units have equal rights and privileges. Each unit entitles the holder thereof to participate equally in the distributions and to one vote at all meetings of unitholders for each whole unit held. The issued units are not subject to future calls or assessments. Units are redeemable at any time at the option of the holder at amounts related to market price at the time, subject to a maximum of \$50,000 in aggregate cash redemptions by the Fund in any particular month. This limitation may be waived at the discretion of the Trustees of the Fund. Redemption in excess of this amount, assuming no waiving of the limitation, shall be paid by way of a distribution in specie of assets of the Fund, namely notes of Clearwater Seafoods Holdings Trust.

The Special Trust Units have been issued solely to provide voting rights to Clearwater Class B units ("CSLP Exchangeable Units"). Special Trust Units were issued in conjunction with the CSLP Exchangeable Units and cannot be transferred separately from them. Special Trust Units entitle the holders thereof to the number of votes at any meeting of unitholders of the Fund equal to the number of units which may be obtained upon exchange of the CSLP Exchangeable Units to which they relate and do not otherwise entitle the holder to any rights with respect to the Fund's property or income.

	Units	Special Trust Units	Total \$ (in 000's)
Balance December 31, 2004, no change to December 31, 2006	29,407,626	23,381,217	\$ 298,454
Equity component of Convertible Debentures			828
<b>Balance December 31, 2006</b>			<b>\$299,282</b>

As at December 31, 2006 and 2005 there were in total 52,788,843 units outstanding.

On January 24, 2007, the Fund received approval for a normal course issuer bid which will enable it to purchase, from time to time, up to 2.5 million outstanding trust units (the "Units"), which amount represents less than 10% of the public float. Any such purchases of Units would be made



during the 12-month period commencing on January 24, 2007 and in accordance with the requirements of the TSX. Any Units purchased by the Fund will be cancelled and will be accompanied by a similar repurchase of units by Clearwater.

## 6. EARNINGS PER UNIT

The computations for earnings per unit are as follows (in thousands except per share data):

	2006	2005
Basic		
Net earnings	\$ 1,713	\$ 9,008
Weighted average number of units outstanding	29,408	29,408
Earnings per unit	\$ 0.06	\$ 0.31

The effect of potential dilutive securities, being the Convertible Debentures and Special Trust Units, were not included in the calculation of diluted earnings per unit as the result would be anti-dilutive.

## 7. GUARANTEES

The Fund guarantees Clearwater's term credit facility (see note 5(e) to Clearwater's financial statements). The guarantee is limited to the value of the convertible debentures and the value of the units held in Clearwater. As of December 31, 2006 and December 31, 2005 there was no balance outstanding on the term credit facility.

## 8. DISTRIBUTIONS

The Fund was set up to make monthly cash distributions, based upon cash receipts of the Fund in respect of such month, after satisfaction of administrative and other expenses (including reasonable reserves for such expenses), any debt service obligations (principal and interest) and any amounts payable by the Fund in connection with any cash redemptions or repurchases of Units. The Fund may make additional distributions in excess of the monthly distributions during the year in the sole discretion of the Trustees. Any amounts of net income and net capital gains of the Fund for a taxation year not otherwise distributed during the year and that would otherwise result in the Fund being liable to tax will be payable on December 31 of that year.

Any income of the Fund which is applied to any cash redemptions of Units or is otherwise unavailable for cash distribution will, to the extent necessary to ensure that the Fund does not have an income tax liability under Part I of the Tax Act, be distributed to unitholders in the form of additional Units. Such additional Units will be issued pursuant to applicable exemptions under applicable securities laws, discretionary exemptions granted by applicable securities regulatory authorities or a prospectus or similar filing.

The Fund declared distributions in 2006 on a monthly basis with the current distribution set at a rate of \$0.05 per month, \$0.60 on an annualized basis (for total distributions when annualized of approximately \$18 million). The amounts to be distributed are determined by the Board of Trustees subject to the criteria previously noted. The ability of the Fund to make distributions is dependent upon the amount of distributions received from Clearwater. Please refer to Note 15 of Clearwater's financial statements for more information on Clearwater's distribution policy.

	2006	2005
Distributions paid and payable	8,823	18,525
Per unsubordinated unit	0.30	0.63

In 2005, the Fund paid monthly distributions of \$0.07 cents per unit to its unitholders from January to September. The Fund resumed paying distributions in July 2006 at a monthly rate of \$0.05 cents per unit.

## 9. ADMINISTRATION AGREEMENT

The Fund has an Administration Agreement with Clearwater. Under the terms of the agreement, Clearwater is responsible to provide administrative and support services to the Fund and is to provide these services for no additional consideration, other than payment of out-of-pocket expenses. There were no charges for out-of-pocket expenses for the years ended December 31, 2006 and 2005.

## 10. CAPITAL STRUCTURE

The Fund's capital structure includes a combination of equity and convertible debentures. The Fund's objective when managing its capital structure is to obtain the lowest cost of capital available while maintaining flexibility and reducing refinancing risk as appropriate.

The Fund lowers its cost of capital through the use of leverage, in particular lower cost debt. The Fund maintains some flexibility in its capital structure as the amount of capital available to Clearwater can be impacted by known and unknown risks, uncertainties, and other factors outside management's control including, but not limited to, total allowable catch levels, selling prices, weather, exchange rates, fuel and other input costs as well as capital expenditures and distributions paid. The Fund maintains flexibility in its capital structure by regularly reviewing forecasts of future results and making any required changes on a timely basis. These changes can include repaying debt early or repurchasing units, issuing new debt or equity, extending the term of existing debt and if required, limiting distributions paid. Refinancing risk is reduced by staggering the maturities of debt instruments and a policy whereby maturing debt agreements are revisited and updated or replaced as required well in advance of maturity dates.

The Fund's total capital structure is as follows:

	2006	2005
Equity – Partnership units (see note 5)	\$ 299,282	\$ 299,336
Convertible debentures, due in 2010 (see note 4)	46,430	49,278
<b>Total capital</b>	<b>\$ 345,712</b>	<b>\$ 348,614</b>

## 11. COMPARATIVE FIGURES

For presentation purposes, in the 2006 financial statements, Clearwater has combined cumulative earnings and cumulative distributions into one line item entitled deficit.

## 12. SUBSEQUENT EVENT

On February 19, 2007, the Fund and Clearwater announced that the Fund has entered into an agreement with a syndicate of underwriters to issue to the public on a bought-deal basis, convertible unsecured subordinated debentures for gross proceeds of \$43,500,000 (the "Offering"). In addition, the Fund has granted the syndicate an over-allotment option, exercisable for a period of 30 days following closing, to purchase an additional \$6,525,000 of debentures which, if exercised, would increase the gross proceeds of the offering to \$50,025,000. The Debentures will be convertible into units of the Fund (the "Units") at the option of the holder at a

conversion price of \$5.90 per Unit. The Debentures will bear interest at a rate of 7.25% per annum, payable semi-annually in arrears on March 31 and September 30 of each year commencing on September 30, 2007. The Debentures will mature on March 31, 2014.



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## AUDITORS' REPORT TO THE UNITHOLDERS

We have audited the consolidated balance sheets of Clearwater Seafoods Limited Partnership as at December 31, 2006 and 2005 and the consolidated statements of earnings and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 consolidated financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*KPMG LLP*

Chartered Accountants

Halifax, Canada

February 9, 2007 except as to note 19 which is as of February 19, 2007

# CLEARWATER SEAFOODS LIMITED PARTNERSHIP

## Consolidated Balance Sheets

(In thousands of dollars)

December 31 2006 2005

### Assets

#### Current Assets

Cash (note 5(f))	\$ 10,850	\$ 9,726
Accounts receivable	59,388	54,912
Inventories	53,669	43,419
Prepays and other	6,122	6,458
	130,029	114,515

Other long-term assets	9,858	10,643
Property, plant and equipment (note 3)	156,816	151,945
Licenses (note 4)	102,714	103,181
Goodwill	10,378	10,378
	\$ 409,795	\$ 390,662

### Liabilities and Unitholders' Equity

#### Current Liabilities

Accounts payable and accrued liabilities	\$ 64,864	\$ 36,597
Distributions payable	2,639	-
Income taxes payable	5,481	2,144
Current portion of long-term debt (note 5)	868	1,008
	73,852	39,749

Long-term debt (note 5)	189,392	193,437
Future income taxes (note 6)	8,309	7,958
Due to joint venture partner	2,280	2,023
Minority interest	2,258	2,181

#### Unitholders' Equity

Partnership units (note 7)	173,079	173,133
Deficit	(27,054)	(12,734)
Cumulative foreign currency translation account (note 8)	(12,321)	(15,085)
	133,704	145,314
	\$ 409,795	\$ 390,662

Commitments and contingencies (note 12)

Subsequent event (note 19)

See accompanying notes to consolidated financial statements

Approved by the Board of CS ManPar Inc.:

(Signed) John Risley  
Chairman

(Signed) Colin MacDonald  
Chief Executive Officer

# CLEARWATER SEAFOODS LIMITED PARTNERSHIP

## Consolidated Statements of Earnings and Deficit

(In thousands of dollars)

Years ended December 31	2006	2005
Sales	\$ 315,736	\$ 314,839
Cost of goods sold	229,064	242,601
Gross profit	86,672	72,238
Administration and selling	38,245	33,594
Loss (gain) on disposal and other, net	2,143	(4,102)
Other income (note 13)	(5,853)	(1,660)
Foreign exchange and derivative income realized (note 9)	(13,040)	(8,114)
Foreign exchange and derivative loss (income) unrealized (note 9)	23,030	(3,598)
Bank interest and charges	953	786
Interest on long-term debt	13,110	12,450
Depreciation and amortization	14,766	15,400
Reduction in foreign currency translation account (note 8)	2,369	1,236
	75,723	45,992
Earnings before the undernoted	10,949	26,246
Income taxes (note 6)	3,853	2,975
Earnings before minority interest	7,096	23,271
Minority interest	5,633	3,398
Net earnings	1,463	19,873
Deficit at beginning of year	\$ (12,734)	\$ (5,241)
Distributions declared during the year	(15,837)	(27,366)
Adjustment for cancellation of Class C units)	54	-
Deficit at end of year	(27,054)	(12,734)
Basic and diluted net earnings per unit (note 10)	\$ 0.03	\$ 0.38

See accompanying notes to consolidated financial statements

# CLEARWATER SEAFOODS LIMITED PARTNERSHIP

## Consolidated Statements of Cash Flows

(In thousands of dollars)

Years ended December 31

2006

2005

### Cash flows from (used in) operating activities

Net earnings	\$ 1,463	\$ 19,873
Items not involving cash		
Depreciation and amortization	14,766	15,400
Foreign exchange on long-term debt	(4,886)	(1,555)
Accrued interest on long term bonds payable	4,983	1,413
Future income taxes (recovery)	(2,120)	424
Reduction in foreign currency translation account	2,369	1,236
Minority interest	5,633	3,398
Unrealized loss (gains) exchange on currency option contracts	23,880	(2,881)
Unrealized losses on swap contracts	4,036	-
Loss (gain) on disposal and other, net	954	(2,723)
	51,078	34,585
Change in non-cash operating working capital	(6,430)	1,557
	44,648	36,142

### Cash flows from (used in) financing activities

Proceeds from long-term debt	-	52,112
Reduction of long-term debt and payments on swap contracts	(5,509)	(26,983)
Purchase of convertible debentures	(3,024)	-
Distributions to minority partners	(6,125)	(3,092)
Distributions to unitholders	(13,198)	(27,365)
Other	1,263	160
	(26,593)	(5,168)

### Cash flows from (used in) investing activities

Increase in other long-term assets and other	1,817	(1,492)
Purchase of property, plant and equipment, licenses and other	(20,647)	(28,600)
Proceeds on disposal and other, net	1,899	9,416
	(16,931)	(20,676)

Increase in cash	1,124	10,298
Cash - beginning of year	9,726	(572)

Cash - end of year	\$ 10,850	\$ 9,726
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### Supplementary cash flow information

Interest paid	\$ 14,412	\$ 12,097
Income taxes paid	1,950	6,032

### Change in non-cash working capital consists of changes in the following accounts:

Accounts receivable	(4,476)	6,130
Inventories	(10,250)	2,273
Foreign exchange on currency options contracts	(23,880)	2,881
Prepays and other	336	(1,713)
Accounts payable and accrued liabilities	28,503	(6,923)
Income taxes payable	3,337	(1,091)
	\$ (6,430)	\$ 1,557

There were no material non-cash transactions during the year  
See accompanying notes to consolidated financial statements

# CLEARWATER SEAFOODS LIMITED PARTNERSHIP

## Notes to Consolidated Financial Statements

*(Tabular amounts expressed in thousands of dollars)*

### 1. BASIS OF PRESENTATION

Clearwater Seafoods Limited Partnership ("Clearwater") is a limited partnership that acquired the seafood business of Clearwater Fine Foods Incorporated ("CFFI") on July 30, 2002.

As CFFI maintained the right to nominate the majority of the board of directors both before and after the acquisition of its seafood business by Clearwater Seafoods Limited Partnership, the acquisition was accounted for using the book values of the assets and liabilities as recorded by CFFI.

### 2. ACCOUNTING POLICIES

The financial information contained in the accompanying consolidated financial statements has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

#### (a) Consolidation

These consolidated financial statements include the accounts of Clearwater, its subsidiaries, variable interest entities and Clearwater's proportionate share of the assets, liabilities, revenues and expenses of joint ventures over which it exercises joint control. Clearwater has consolidated the results of the variable interest entities due to its level of influence and economic interest as a result of the related credit agreements.

#### (b) Inventories

Inventories, which consist primarily of finished goods, are valued at the lower of cost and net realizable value. Cost includes the cost of materials plus direct labor applied to the product and the applicable share of manufacturing overheads. Cost is determined using the weighted average method.

#### (c) Property, plant and equipment

Property, plant and equipment are stated at cost less government assistance. Depreciation is provided on a straight-line basis to depreciate the cost of these assets over their estimated useful lives. Estimated useful lives range from 10 to 40 years for buildings and wharves, 3 to 17 years for equipment and 10 to 20 years for vessels. Additions are depreciated at one-half the normal rates in the first year of use except significant additions, which are depreciated commencing in the month they are put into use.

Clearwater capitalizes interest on capital projects for which the total estimated cost is greater than \$5 million and the period of construction is greater than 18 months. As a result of adopting this policy \$2,604,000 of interest was capitalized in 2006 (2005 - \$1,389,000).

#### (d) Impairment of long-lived assets

Clearwater reviews long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of a group of assets is less than its carrying amount, it is considered to be impaired. An impairment loss is measured as the amount by which the carrying amount of the group of assets exceeds its fair value.

#### (e) Licenses and license agreements



Licenses and license agreements represent intangible assets acquired directly or in a business combination that meet the specified criteria for recognition, apart from goodwill, and are recorded at their fair value at the date of acquisition.

Licenses have indefinite lives, are not amortized and are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired.

License agreements are determined to have indefinite lives when the annual renewal fee is nominal (typically less than 1% of the estimated value of the license), Clearwater has both the ability and intent to renew or extend the life of the licenses and there has been a history of being able to obtain renewals from the government. License agreements are determined to have finite lives, are amortized over the term of the related agreement and tested for impairment if events or changes in circumstances indicate that the asset might be impaired.

The impairment test compares the carrying amount of the licenses with their fair value and license agreements with their net recoverable amount, and an impairment loss would be recognized in the statement of earnings for any excess of the carrying value over fair value.

#### (f) Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the net assets acquired, based on their fair values.

Goodwill is not amortized and is tested for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. When the fair value of a reporting unit is less than its carrying amount, the implied value of the goodwill is compared to the carrying value of the goodwill and an impairment loss is recognized in the statement of earnings. For the fiscal years ended December 31, 2006 and December 31, 2005, no such impairment was recorded.

#### (g) Due to joint venture partner

The amount due to joint venture partner of \$2,280,000 (2005 - \$2,023,000) is a non-interest bearing capital advance that is repayable only upon dissolution of the joint venture partnership.

#### (h) Class C Partnership units

Class C Partnership units are classified in accordance with their component parts: the value ascribed to the debenture holders' option to convert to Class A Partnership units has been classified as equity and the remaining portion of the units has been classified as debt. Issue costs have been classified as deferred financing costs and are being amortized over the estimated term to maturity. Interest on the debt is calculated by applying an interest rate of approximately 7.4% to the outstanding debt component. The difference between actual cash payments and interest expense is added to the debt component.

#### (i) Translation of foreign currencies

The accounts of a subsidiary company, which is a self-sustaining operation, have been translated to Canadian dollars using the current rate method. Assets and liabilities are translated at the rate of exchange in effect at the balance sheet date and revenue and expense items are translated at the rates in effect on the dates of such transactions. Gains or losses arising from the translation of the financial statements of the self-sustaining foreign operation are deferred in a "cumulative translation account" in unitholders' equity. The cumulative translation account arises substantially from the translation of the vessels of the subsidiary located in Argentina.

Foreign monetary assets and liabilities of the Canadian operations and integrated foreign subsidiaries have been translated into Canadian dollars using the rate of exchange in effect at the balance sheet date and foreign non-monetary balances are translated at historical exchange rates. Exchange gains or losses arising from translation of these foreign monetary balances are

reflected in the current period's earnings. Revenues and expenses are translated at rates in effect at the time of the transactions.

(j) Hedging and derivative financial instruments

Forward exchange contracts, interest rate swaps and cross currency swaps are used by Clearwater in the management of its foreign currency and interest rate exposures. Clearwater's policy is not to utilize derivative financial instruments for trading or speculative purposes.

Prior to the second quarter of 2006, Clearwater accounted for certain of these contracts as hedges and certain of them as non-hedges.

Due to the increasing complexity of applying the accounting standards as well as the requirement to adopt the Comprehensive Income accounting standard in the future, beginning the second quarter of 2006, Clearwater no longer designated any contracts as hedges for accounting purposes.

As a result, it recorded the fair value of these contracts as an asset (\$1.9 million at April 1, 2006) with the offsetting gain deferred and amortized at that time. From that point forward, these contracts were marked to market each reporting period and any gains or losses, both realized and unrealized, were included in foreign exchange income.

Prior to the second quarter of 2006, Clearwater formally documented all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process included linking all derivatives to specific forecasted transactions. Clearwater also formally assessed at inception and on an ongoing basis, whether the derivatives that were used in hedging transactions were effective in offsetting changes in fair values or cash flows of hedged items.

To qualify for hedge accounting, the hedging relationship must be appropriately documented at the inception of the hedge and there must be reasonable assurance, both at the inception and throughout the term of the hedge, that the hedging relationship will be effective. Effectiveness requires a high correlation of changes in fair values or cash flows between the hedged item and the hedging item. All hedging instruments and relationships used by Clearwater as at December 31, 2005, met the criteria relating for hedge effectiveness.

Foreign exchange translation gains and losses on foreign currency denominated derivative financial instruments that were used to hedge anticipated U.S. dollar, Japanese Yen and European Euro denominated sales are recognized in the consolidated financial statements when the related transaction occurs. Realized and unrealized gains and losses on derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred under other current, or non-current assets and liabilities on the balance sheet and recognized in income in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in income.

Foreign currency options, which mature over a short period of time, are stated at estimated quoted market prices. Realized and unrealized gains and losses on these securities are included in earnings. At expiry of these contracts, Clearwater will either have no obligation or will be called to deliver foreign currency at a rate management deemed acceptable upon entering into these contracts.

Clearwater enters into interest rate swaps and foreign currency swaps to hedge its exposures to reduce the impact of fluctuating interest rates and exchange rates on long term debt. The interest rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which payments are based. The swap agreements are accounted for as non-qualifying hedges and as such any realized and unrealized gain or loss is recognized in income.

(k) Income taxes

Income taxes are accounted for by the asset and liability method of tax allocation. Under this method, future income taxes are recognized for temporary differences between the tax and accounting basis of assets and liabilities based on income tax rates and income tax laws that are enacted or substantially enacted. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

(l) Revenue recognition

Clearwater sells seafood, in a fresh or frozen state to customers. These sales are evidenced by purchase orders/invoices, which set out the terms of sale, including pricing and shipping terms. Revenue is recognized when evidence of an arrangement exists, the risks of ownership have effectively passed to customers, selling price is fixed and determinable, and collectibility is reasonably assured.

(m) Refits

In September 2006, the Financial Accounting Standards Board in the United States issued FASB AUG AIR-1, Accounting for Planned Major Maintenance Activities. This standard, which is effective January 1, 2007, amends the guidance for planned major maintenance activities; specifically it precludes the use of the previously acceptable "accrue in advance" method, the method currently used by Clearwater.

In the absence of specific guidance in Canada on this topic we believe it appropriate to follow FASB AUG AIR-1 and therefore will adopt this standards on January 1, 2007. As a result of adopting this standard, we will reduce refit accruals by \$4.9 million, reduce future tax assets by \$295,000 and reduce the deficit by \$4.6 million.

(n) Use of estimates

The preparation of the financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates are based on management's best knowledge of current events and actions that Clearwater may undertake in the future.

3. PROPERTY, PLANT AND EQUIPMENT

	Cost	Accumulated depreciation	2006 Net
Land and land improvements	\$ 3,143	\$ 842	\$ 2,301
Buildings and wharves	63,082	44,361	18,721
Equipment	72,440	62,213	10,227
Vessels	168,338	80,062	88,276
Construction in progress	45,696	-	45,696
	352,699	187,478	165,221
Less: Deferred government assistance			(8,405)
	\$ 352,699	\$ 187,478	\$ 156,816

	Cost	Accumulated depreciation	2005 Net
Land and land improvements	\$ 3,684	\$ 777	\$ 2,907
Buildings and wharves	64,446	42,630	21,816
Equipment	77,328	62,768	14,560
Vessels	167,650	71,933	95,717

Construction in progress	27,079	-	27,079
	340,187	178,108	162,079
Less: Deferred government assistance			(10,134)
	<u>\$ 340,187</u>	<u>\$ 178,108</u>	<u>\$ 151,945</u>

#### 4. LICENSES

	Gross carrying amount	Accumulated amortization	Net
2006	\$122,557	\$ 19,843	\$102,714
2005	\$ 123,009	\$ 19,828	\$ 103,181

During 2005, a provision for the impairment of shrimp harvesting contracts of \$1,636,000 was taken. The provision was based on declining margins associated with shrimp harvesting contracts. This impairment is recorded in "gain on disposals and other, net".

#### 5. LONG-TERM DEBT

	2006	2005
Notes payable (a)		
Canadian dollars	\$ 63,000	\$ 63,000
United States dollars	23,308	23,296
Class C Partnership Units (b)	46,430	49,280
Bond payable, including accrued interest (c)	46,795	46,873
Marine mortgage, due in 2017 (d)	5,584	6,133
Term loan, due in 2091 (e)	3,500	3,500
Other loans	1,643	2,363
	190,260	194,445
Less current portion	868	1,008
	<u>\$ 189,392</u>	<u>\$ 193,437</u>

(a) Notes payable, Senior secured notes issued in four series:

- \$43,000,000 Canadian Series A Notes issued in 2003, bearing interest at 6.4% payable semi-annually, maturing December 8, 2008.
- \$15,000,000 U.S. dollar Series B Notes issued in 2003, bearing interest at 5.65% payable semi-annually, maturing December 8, 2008.
- \$20,000,000 Canadian Series C Notes issued in 2003, bearing interest at 7.23% payable semi-annually, maturing December 8, 2013.
- \$5,000,000 U.S. dollar Series D Notes issued in 2005, bearing interest at 6.12% payable semi-annually, maturing December 8, 2013. Clearwater has an additional \$20,000,000 U.S. dollar available to draw on this facility until December 31, 2007.

The notes are secured by mortgages and charges on all of the present and future property and assets of Clearwater and certain of its wholly owned subsidiaries, the interests of the Fund in Clearwater Seafoods Holdings Trust ("CSHT") and all the issued shares of CS ManPar Inc., the general partner of Clearwater. The security arrangement is guaranteed by an inter-creditor agreement with the banking syndicate members participating in the term credit facility disclosed in section (f) of this note.

- (b) In June 2004, 4,081,633 Class C units were issued concurrently with the issue by the Fund of \$50 million of Convertible Debentures and are held by the Fund through CSHT. The Class C units are redeemable and retractable at a price of \$12.25 per unit and are due December 31, 2010. These units exist under an agreement whereby they will be converted, redeemed or retracted in a manner that corresponds to any conversion, redemption or repurchase of the Convertible Debentures of the Fund and in a manner that ensures that the distributions on the Class C units will be able to fund the ongoing interest payments on the Convertible Debentures. The Class C units are classified in accordance with their component parts: the value ascribed to the holders option to convert to Class A units has been classified as equity and the remaining portion of the units has been classified as debt. Interest on the debt is calculated by applying an interest rate of approximately 7.3% to the outstanding debt component. The difference between actual cash payments, which will approximate 7.02%, and interest expense is added to the debt component of the units.

The Fund filed a normal course issuer bid by which it can acquire up to \$5 million principal amount of convertible debentures in the 12-month period commencing August 2006. Any repurchase at the Fund level would be accompanied by a similar repurchase of Class C Partnership units by Clearwater. During 2006, \$3 million of the Class C units were repurchased and cancelled with the proceeds used to repurchase and cancel an equivalent amount of convertible debentures. Subsequent to year-end, an additional \$1 million of Partnership units were repurchased and cancelled with proceeds used by the Fund to repurchase and cancel an equivalent amount of convertible debentures.

- (c) Senior unsecured bond in the amount of 2,460,000,000 ISK due September 27, 2010 at a fixed rate of 6.7% accrued annually and paid at maturity. Both the bond and the interest are adjusted for changes in the Icelandic Consumer Price Index (CPI). Clearwater has entered into a number of swap agreements to economically fix the currency and CPI exposure associated with the debt. There are also interest rate swap agreements in place.

Clearwater has no intention to unwind the swap agreements, however the agreements do not qualify for hedge accounting and therefore the gains and losses related to the fair value of these hedges are taken into income during the period.

The swap agreements have effectively resulted in the following:

- \$25,000,000 Canadian dollar liability with an effective interest rate of 8.58%
- \$5,000,000 U.S. dollar liability with an effective interest rate of 9.32%
- \$4,707,502 U.S. dollar liability with an effective interest rate of 8.51%
- 3,000,000 Pound Sterling liability with an effective interest rate of 9.67%
- 2,500,000 Euro liability with an effective interest rate of 8.03%

The fair market value of the loan based on the spot rates as of December 31, 2006 is \$47 million.

Interest expense on the bond is recorded using the effective interest rate method that takes into account estimated future Icelandic inflation rates. Interest accrued is \$5 million for the year (2005 - \$1.4 million) for total accrued interest of \$6.4 million. As previously noted interest exposure on this bond has been hedged and the cash payment on the related swaps was \$3.8 million (2005 - \$nil).

	2006	2005
Face value of bond	\$ 40,369	\$ 45,461
Accrued interest	6,426	1,412
	<u>\$ 46,795</u>	<u>\$ 46,873</u>

Refer to note 11(c) for further information on the related swaps.

- (d) Marine mortgage payable in the principal amount of CDN \$4,549,000 (December 31, 2005 - \$5,583,000), DKK 17,871,000 (December 31, 2005 - DKK 19,262,000) and YEN 297,671,000 (December 31, 2005 - 317,516,000) bearing interest at UNIBOR plus 1% payable semi-annually, 50% of which represents Clearwater's proportionate share. Principal payments are required annually with CDN \$517,000, DKK 1,391,000 and YEN 19,845,000 due in 2007, CDN \$776,000, DKK 2,087,000 and YEN 29,767,000 due in 2008-2012, CDN \$152,000 due in 2013, DKK 2,087,000 and YEN 29,767,000 due in 2013-2014, DKK 1,871,000 due in 2015, YEN 29,767,000 due in 2015-2016 and YEN 9,923,000 due in 2017, 50% of which represents Clearwater's proportionate share. The loan matures in 2017 and is secured by a first mortgage over the related vessel and covenants concerning certain fishing licenses.
- (e) Term loan, payable in 2091. In connection with this loan Clearwater makes a royalty payment of \$275,000 per annum in lieu of interest.
- (f) Term credit facility with available credit of up to \$60 million (December 31, 2005 - \$115 million), maturing in May 2008. In May 2007, the banking syndicate at the request of Clearwater may extend the credit for an additional two years until May 2009. This facility is part of a master netting agreement and, on December 31, 2006, was in a net cash position of CDN \$8.9 million (December 31, 2005 - CDN \$7.9 million). The facility bears interest at rates ranging from prime plus 0.5 - 1.25% and Libor plus 1.5 - 2.25% and has no scheduled repayments. The facility is secured by mortgages and charges on all of the present and future property and assets of Clearwater and of certain of its wholly-owned subsidiaries, the interests of the Fund in CSHT, the interests of CSHT in Clearwater and all the issued shares of CS ManPar Inc., and is subject to the maintenance of certain financial covenants. As part of the master netting arrangement, bank account balances associated with the facility are netted with the term credit facility balance.

Clearwater's debt facilities contain various covenants. Clearwater is in compliance with all debt covenants at December 31, 2006.

Principal repayments required in each of the next five years are approximately as follows:

2007	868
2008	61,664
2009	1,108
2010	94,160
2011	868

The estimated fair value of Clearwater's long-term debt at December 31, 2006 was not materially different from its carrying value. Fair value has been estimated based on discounting expected future cash flows at the discount rates which represent borrowing rates presently available to Clearwater for loans with similar terms and maturities.

## 6. INCOME TAXES

### (a) Future tax liability

A portion of Clearwater's income is earned through partnerships. Therefore, that portion of Clearwater's income is not subject to income tax at the partnership level and the taxable income is allocated directly to its partners. A provision for income taxes is recognized for Clearwater's corporate subsidiaries that are subject to tax. Significant temporary differences in Clearwater's corporate subsidiaries that would give rise to future income taxes are noted below.

	2006	2005
Future income tax asset		
Loss carry-forwards and future deductible expenses		
of foreign subsidiaries, included in other long-term assets	\$ 3,141	\$ 674
Future income tax liabilities		
Licenses	5,159	5,329
Property, plant and equipment	3,150	2,629
	<u>\$ 8,309</u>	<u>\$ 7,958</u>

The partnerships have temporary differences between the carrying value and income tax bases of assets and liabilities which flow through to the partners and that would result in future income tax assets and liabilities if the partnerships were subject to income tax, as outlined below.

	2006	2005
Deductible temporary differences:		
Licenses	\$ 23,187	\$ 30,676
Financing fees	1,755	5,740
Foreign exchange contracts	12,501	-
Other	4,112	175
	<u>\$ 41,555</u>	<u>\$ 36,591</u>
Taxable temporary differences:		
Accounts receivable	\$ -	\$ 5,234
Property, plant and equipment	10,696	14,723
Foreign exchange contracts	-	7,634
	<u>\$ 10,696</u>	<u>\$ 27,591</u>
Net deductible temporary differences	<u>\$ 30,859</u>	<u>\$ 9,000</u>

### (b) Income tax expense

The components of the income tax expense for the year are as follows:

	2006	2005
Current	\$ 5,973	\$ 2,551
Future (recovery)	(2,120)	424
	<u>\$ 3,853</u>	<u>\$ 2,975</u>

The provision for income taxes in the consolidated statement of earnings represents an effective tax rate different from the Canadian statutory rate of 38.1% (2005 – 38.1%). The differences are as follows:

	2006	2005
--	------	------

	Amount	%	Amount	%
Income tax expense computed at statutory rates	\$ 4,173	38.1	\$ 10,005	38.1
Income of the partnership distributed directly to unitholders	4,078	37.3	(4,898)	(18.7)
Income of foreign subsidiary not subject to tax	(8,124)	(74.2)	(3,418)	(13.0)
Other tax differences	3,726	34.0	1,286	4.9
	<u>\$ 3,853</u>	<u>35.2</u>	<u>\$ 2,975</u>	<u>11.3</u>

## 7. PARTNERSHIP UNITS

Clearwater is authorized to issue an unlimited number of Class A limited partnership units, an unlimited number of Class B general partnership units, issuable in series, an unlimited number of Class C limited partnership units and an unlimited number of Class Y general partnership units, issuable in series. Each unit (other than the Class Y units) entitles the holder thereof to one vote, except in certain situations as described pursuant to the Limited Partnership Agreement governing Clearwater. Each issued Class B unit is accompanied by a Special Trust Unit issued by the Fund entitling the holder to receive notice of, to attend and to vote at meetings of unitholders of the Fund.

The right of 40% of the holders of Class B units, or 9,352,487 units, to receive distributions from Clearwater was subordinated to the rights of holders of Class A units until December 31, 2005. Class B units that were subject to such subordination were entitled to receive distributions from Clearwater only quarterly, rather than monthly, and only after distributions of at least \$0.0958 per unit in respect of each month during such quarter have first been paid to the holders of Class A units and Class B units that at the time are not subject to such subordination. Class B units are no longer subject to subordination and may at any time at the option of the holder thereof be exchanged for units of the Fund whereupon CSHT will be issued Class A units and the Class B units that were so exchanged will be cancelled.

In June 2004, 4,081,633 Class C units in the amount of \$50 million were issued concurrently with the issue by the Fund of \$50 million of Convertible Debentures and are held by the Fund through CSHT. The Class C units are non-voting, redeemable and retractable at a price of \$12.25 per unit. These units exist under an agreement whereby they will be converted, redeemed or retracted in a manner that corresponds to any conversion, redemption or repurchase of the Convertible Debentures of the Fund and in a manner that ensures that the distributions on the Class C units will be able to fund the ongoing interest payments on the Convertible Debentures. Class C Partnership units are classified in accordance with their component parts: the value ascribed to the holder's option to convert to units has been classified as equity and the remaining portion of the units has been classified as debt.

	Class A Units	Class B Units	\$(in 000's)
Balance December 31, 2004, no change			
to December 31, 2006	29,407,626	23,381,217	\$ 172,251
Equity component of Class C Units			828
Balance December 31, 2006			\$ 173,079

As at December 31, 2006 and December 31, 2005 there were in total 52,788,843 units outstanding.

On January 24, 2007, the Fund received approval for a normal course issuer bid which will enable it to purchase, from time to time, up to 2.5 million outstanding trust units (the "Units"), which amount represents less than 10% of the public float. Any such purchases of Units would be made during the 12-month period commencing on January 24, 2007 and in accordance with the requirements of the TSX. The Units will be purchased by the Fund for cancellation and will be accompanied by a similar repurchase of units by Clearwater.



## 8. CUMULATIVE FOREIGN CURRENCY TRANSLATION ACCOUNT

The reduction in the foreign currency translation account is a non-cash adjustment, which relates to the reduction of Clearwater's net investment in its' 80% owned subsidiary in Argentina. The cumulative translation account largely arose because of the significant devaluation of the peso in Argentina versus the Canadian dollar in 2001. It is Clearwater's desire to continue to manage its exposure to Argentine pesos by repatriating its capital as quickly as possible while not impairing local operations. Dividends declared have resulted in a reduction in Clearwater's net investment in that subsidiary and accordingly, a proportionate share of the cumulative translation account has been recognized in earnings. Clearwater anticipates that continued repayments of its advances to and the payment of dividends from the subsidiary in Argentina may result in additional reduction of the cumulative translation account in the future. The cumulative translation account is included in the Unitholders Equity section of the balance sheet and the remaining balance at December 31, 2006 is \$12,321,000 (December 31, 2005 - \$15,085,000).

## 9. FOREIGN EXCHANGE AND DERIVATIVE CONTRACTS

Foreign exchange and derivative contract detail:

	2006	2005
Realized (gain) loss		
Foreign exchange cash option income	\$ (14,834)	\$ (7,796)
Other	1,794	(318)
	<u>\$ (13,040)</u>	<u>\$ (8,114)</u>
Unrealized (gain) loss		
Foreign exchange on long-term debt	(4,886)	(737)
Mark to market on option contracts	23,880	(2,881)
Mark to market on interest and currency swaps	4,036	20
	<u>23,030</u>	<u>(3,598)</u>
<b>Total loss (gain)</b>	<u><b>\$ 10,599</b></u>	<u><b>\$ (11,712)</b></u>

## 10 EARNINGS PER UNIT

The computations for earnings per unit are as follows (in thousands except per unit data):

	2006	2005
Basic		
Net earnings	\$ 1,463	\$ 19,873
Average number of units outstanding	52,789	52,789
Earnings per unit	\$ 0.03	\$ 0.38

The effect of potential dilutive securities, being the Class C Partnership Units, was not included in the calculation of diluted earnings per unit as the result would be anti-dilutive.

## 11. FINANCIAL INSTRUMENTS

In the ordinary course of business, Clearwater enters into derivative financial instruments to reduce underlying fair value and cash flow risks associated with foreign currency and interest rates.

At December 31, 2006 and December 31, 2005, Clearwater had outstanding forward contracts as follows (as converted to Canadian dollars at contracted rates):

Currency	Notional Amount	Average Exchange Rate	Maturity	Fair Value Asset (Liability)
United States dollar				
December 31, 2006	41,500	1.133	2007	(982)
December 31, 2005	62,000	1.257	2006	6,516
Euro				
December 31, 2006	9,550	1.442	2007	(913)
December 31, 2005	12,000	1.498	2006	1,334

At December 31, 2006 and December 31, 2005, Clearwater had outstanding foreign currency option and expandable forward contracts as follows (as converted to Canadian dollars at contracted rates):

Currency	Notional Amount	Exchange Range	Maturity	Fair value asset (liability)
United States dollar				
December 31, 2006	180,000	1.1003 – 1.252	2007	(5,345)
	500– 72,000	1.131 – 1.202	2007	(1,931)
December 31, 2005	170,000	1.172 – 1.255	2006	(1,214)
	20,000	1.180 – 1.135	2007	161
	22,500 – 45,000	1.229 – 1.271	2006	1,951
	17,500 – 35,000	1.187 – 1.202	2007	315
Japanese Yen				
December 31, 2006	2,000,000	0.009 – 0.010	2007	(189)
December 31, 2005	1,000,000	0.01125	2006	(12)
Euro				
December 31, 2006	55,000	1.390 – 1.585	2007	(6,466)
December 31, 2005	29,000	1.215 – 1.478	2006	(741)
Sterling				
December 31, 2006	25,700	2.013 – 2.101	2007	(5,995)
December 31, 2005	5,000	2.020	2006	(157)

Although Clearwater has no intention of settling these contracts, at December 31, 2006, if it settled these contracts it would have made a payment of \$21,821,000 (December 31, 2005 - \$7,547,000). The liability or asset recorded is included in accounts payable and accrued liabilities or prepaids and other, as appropriate, and the resulting loss or gain is included in income.

(b) Credit risk

Clearwater is exposed to credit risk in the event of non-performance by counter parties to its derivative financial instruments, but does not anticipate non-performance by any of the counter parties as Clearwater only deals with highly rated financial institutions.

Clearwater has significant accounts receivable from customers operating in the United States, Europe and Asia. Clearwater has a policy of utilizing a combination of credit reporting agencies, credit insurance, letters of credit and secured forms of payment to mitigate customer specific credit risk and country specific credit risk.

(c) Interest rate risk and fair values

As indicated in the note entitled "Long-Term Debt", Clearwater uses cross currency and interest rate swaps to hedge its exposures to changes in foreign currencies and interest rates. The terms of the swap agreements related to the Icelandic bonds also effectively hedge the changes in the CPI. These agreements do not qualify for hedge accounting. Although Clearwater has no intention of settling these contracts prior to maturity, at December 31, 2006, if it settled these contracts it would have made a payment of \$4,605,000 (December 31, 2005 - made a payment of \$563,000). The liability is included in accounts payable and accrued liabilities and the resulting non-cash loss is included in income. See note 5(c) for additional information relating to the swaps.

The carrying value of cash, accounts receivable and accounts payable and accrued liabilities approximate fair value.

(d) Commodity contracts

As of December 31, 2006, Clearwater had crude oil options for 25,000 barrels per month effective for the period to February 28, 2007 with a strike price of \$68 US per barrel. Although Clearwater has no intention of settling these contracts prior to maturity, if it settled these contracts it would have made a payment of \$533,000 (December 31, 2005 - \$nil).

On January 19, 2007, Clearwater entered into a crude oil option for 13,000 barrels per month effective for the period from March 1, 2007 to August 31, 2007 with a strike price of \$60 US per barrel.

## 12. COMMITMENTS AND CONTINGENCIES

(a) Clearwater is committed directly, and through its proportionate share of its joint ventures, to various license and lease agreements, the payments on which aggregate \$22,682,000 as of December 31, 2006 (\$23,967,000 as of December 31, 2005). These commitments require approximate minimum annual payments in each of the next five years as follows:

2007	4,462
2008	4,199
2009	3,201
2010	2,694
2011	2,603

Included in commitments are amounts to be paid to a company controlled by a relative of an officer of Clearwater over a period of years ending in 2008 for vehicle leases, which aggregate approximately \$225,000 (2005 - \$188,000).

(b) In addition to the commitments previously noted above, Clearwater has commitments for the construction of a vessel.

In July 2004, Clearwater entered into a contract to construct a new factory freezer clam vessel. The total estimated cost of the vessel, including owner supplied materials and related costs, is expected to be approximately \$50 million, of which \$42.4 million has been spent to date.

- (c) From time to time, Clearwater is subject to claims and lawsuits arising in the ordinary course of operations. In the opinion of management, the ultimate resolution of such pending legal proceedings will not have a material effect on Clearwater's consolidated financial position.

### 13. JOINT VENTURES

The financial statements include Clearwater's proportionate share of the assets, liabilities, sales and expenses of such joint ventures, the material elements of which are as follows:

- (a) Proportionate share of assets and liabilities as at December 31:

	<u>2006</u>	<u>2005</u>
Current assets	\$ 7,246	\$ 5,541
Property, plant, equipment and other long-term assets	13,734	14,580
Current liabilities	2,961	2,080
Long-term liabilities	5,380	6,008

- (b) Proportionate share of sales, expense and earnings before taxes

The following is a summary of the transactions included in the financial statements for the year ended:

<u>December 31</u>	<u>2006</u>	<u>2005</u>
Sales	9,450	9,655
Expenses	8,509	7,438
Earnings before taxes	941	2,217

- (c) Balances, transactions and guarantees with joint venture partners

Clearwater receives and provides services to the joint ventures at amounts agreed between the parties. The following is a summary of the balances included in the financial statements as at December 31:

	<u>2006</u>	<u>2005</u>
Accounts receivable from joint venture partner	\$151	\$244
Accounts payable to joint venture partner	438	64
Due to joint venture partner, long term	2,280	2,023

The following is a summary of the transactions included in the financial statements for the year ended:

<u>December 31</u>	<u>2006</u>	<u>2005</u>
Commissions charged to joint ventures	\$1,625	\$1,959
Interest charged to joint ventures (charged by)	(47)	(16)

As at December 31, 2006, Clearwater was contingently liable for the obligations of the joint venture partners in the amount of \$5,586,000 (2005 - \$6,133,000). However, the joint venture partners' share of the assets is available for the purpose of satisfying such obligations. The book value of these assets is \$15,655,000 (2005 - \$15,545,000).

#### 14. OTHER INCOME

	2006	2005
Quota rental and royalties	\$ 2,109	\$ 705
Export rebate	1,687	1,009
Investment income	1,243	557
Other income/(expense)	814	(611)
	<u>\$5,853</u>	<u>\$ 1,660</u>

#### 15. SEGMENTED INFORMATION

##### (a) General information

Clearwater operates primarily within one industry, that being the harvesting, procurement, processing and sale of seafood with no separately reportable business segments. The products are sold primarily to customers in the United States, Asia, Europe and Canada.

##### (b) Net sales to customers by product category

	2006	2005
Scallops	\$110,139	\$ 98,571
Lobster	76,236	70,954
Clams	62,268	49,242
Cold water shrimp	40,406	39,994
Groundfish and other	12,633	29,934
Crab	7,025	15,111
Hedging program	7,029	11,033
	<u>\$ 315,736</u>	<u>\$ 314,839</u>

##### (c) Geographic information

	2006	2005
Sales		
United States	\$ 84,935	\$95,940
Europe		
France	60,983	51,545
Denmark	24,189	16,656
UK	14,297	19,630
Other	17,798	18,565
Asia		
Japan	29,914	31,531
Other	29,497	19,247
Canada	45,653	49,158
Other, including hedging program	8,470	12,567
	<u>\$ 315,736</u>	<u>\$314,839</u>

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Property, plant, equipment, licenses and goodwill		
Canada	\$ 251,282	\$ 246,503
Argentina	18,024	18,295
Other	602	706
	<u>\$ 269,908</u>	<u>\$ 265,504</u>

## 16. RELATED PARTY TRANSACTIONS

Clearwater had the following transactions and balances with CFFI during the years of 2006 and 2005.

	2006	2005
<b>Transactions</b>		
Charge by CFFI for use of a corporate airplane	\$ 252	\$65
Charged to CFFI for rent and other services	234	280
Charged by CFFI for management fees	200	90
<b>Balances, as at December 31, 2006 and December 31, 2005</b>		
Receivable from CFFI (payable to)	\$(8)	\$639
Distribution payable to CFFI	1,169	-

In addition, Clearwater was charged approximately \$139,000 for vehicle leases in 2006 (2005 - \$175,000) and approximately \$81,000 for other services (2005 - \$51,000) by companies controlled by a relative of an officer of Clearwater. The receivable balance in 2005 relates to payments Clearwater remitted on behalf of CFFI and subsequently recharged the amounts to CFFI for certain professional services. The payable to CFFI relates to distributions on Class B units payable to CFFI, net of amounts owing from CFFI.

These transactions are in the normal course of operations and have been recorded at the exchange amount.

## 17. DISTRIBUTIONS

Clearwater declared distributions in 2006 on a monthly basis with the current distribution set at a rate of \$0.05 per month, \$0.60 on an annualized basis (for total distributions when annualized of approximately \$31.7 million). In making decisions regarding distributions the board considers the financial results, on-going capital expenditure requirements, leverage and expectations regarding future earnings. Future earnings can be impacted by a number of factors including but not limited to, total allowable catch levels, selling prices, weather, exchange rates and fuel and other input costs. For additional information, please refer to the Distributable Cash, Liquidity and Capital Resources and Definitions and Reconciliations sections of the Management's Discussion and Analysis for 2006.

	2006	2005
Distributions declared	15,837	27,366
Per unsubordinated unit	0.30	0.63

In 2005, Clearwater paid monthly distributions of \$0.07 cents per unit to its unsubordinated unitholders from January to September. On December 31, 2005, subordination on 9,352,487 units expired, as a result all units (52,788,843 units) now participate in distributions. Clearwater resumed paying distributions in July 2006 at a monthly rate of \$0.05 cents per unit.

## 18. CAPITAL STRUCTURE

Clearwater's capital structure includes a combination of equity and various types of long-term debt. Clearwater's objective when managing its capital structure is to obtain the lowest cost of capital available while maintaining flexibility and reducing exchange and refinancing risk as appropriate.

Clearwater lowers its cost of capital through the use of leverage, in particular lower cost revolving and term debt. Clearwater maintains some flexibility in its capital structure as the amount of capital available to Clearwater can be impacted by known and unknown risks, uncertainties, and other factors outside management's control including, but not limited to, total allowable catch levels, selling prices, weather, exchange rates, fuel and other input costs as well as capital expenditures and distributions paid. Clearwater maintains flexibility in its capital structure by regularly reviewing forecasts of future results and making any required changes on a timely basis. These changes can include repaying debt early or repurchasing units, issuing new debt or equity, extending the term of existing debt, selling assets to repay debt and if required, limiting distributions paid. Clearwater borrows in a basket of currencies such that, when combined with other foreign currency denominated assets and liabilities, the balance sheet impact is neutral. Refinancing risk is reduced by staggering the maturities of debt instruments and a policy whereby maturing debt agreements are revisited and updated or replaced as required well in advance of maturity dates.

Clearwater's total capital structure is as follows:

	2006	2005
Equity – Partnership units (note 7)	\$ 173,079	\$ 173,133
Convertible debt, Class C units, due in 2010 (note 5)	46,430	49,280
Non-amortizing debt (note 5)		
Term notes due in 2008 - 2013	86,308	86,296
Bond payable, due in 2010	46,795	46,873
Term loan, due in 2091	3,500	3,500
	<u>136,603</u>	<u>136,669</u>
Amortizing debt (note 5)		
Marine mortgage	5,584	6,133
Other loans	1,643	2,363
	<u>7,227</u>	<u>8,496</u>
<u>Total capital</u>	<u>\$ 363,339</u>	<u>\$ 367,578</u>

## 19. SUBSEQUENT EVENT

On February 19, 2007, the Fund and Clearwater announced that the Fund has entered into an agreement with a syndicate of underwriters lead to issue to the public on a bought-deal basis, convertible unsecured subordinated debentures for gross proceeds of \$43,500,000 (the "Offering"). In addition, the Fund has granted the syndicate an over-allotment option, exercisable for a period of 30 days following closing, to purchase an additional \$6,525,000 of debentures which, if exercised, would increase the gross proceeds of the offering to \$50,025,000. The Debentures will be convertible into units of the Fund (the "Units") at the option of the holder at a conversion price of \$5.90 per Unit. The Debentures will bear interest at a rate of 7.25% per annum, payable semi-annually in arrears on March 31 and September 30 of each year commencing on September 30, 2007. The Debentures will mature on March 31, 2014.

## 20. COMPARATIVE FIGURES

For presentation purposes, in the 2006 financial statements, Clearwater has combined cumulative earnings and cumulative distributions into one line item entitled deficit. Also,

Clearwater has separated foreign exchange and derivative income into two line items entitled foreign exchange and derivative income realized and foreign income and derivative unrealized.