

The Franchise Company (U.S.) Inc.
Notes to Consolidated Financial Statements
December 31, 2005 and 2004

(expressed in US dollars)

21 Subsequent events

On January 1, 2006, the Company acquired select assets and the right to operate in the northern territory of the state of Connecticut from Creative Closets of Northern Connecticut, Connecticut. Cash consideration of \$315,000 was provided for these assets as well as issuing a vendor take-back note of \$300,000. The Company is in the process of determining the purchase price allocation.

The Franchise Company (U.S.) Inc.

Consolidated Financial Statements
For the years ended December 31, 2004 and 2003
(expressed in U.S. dollars)

Report of Independent Auditors

To the Stockholder of
The Franchise Company (U.S.) Inc.

We have audited the accompanying consolidated balance sheets of The Franchise Company (U.S.) Inc. (the "Company") at December 31, 2004 and 2003 and the related consolidated statements of income, changes in stockholder's equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Chartered Accountants

March 4, 2005

The Franchise Company (U.S.) Inc.

Consolidated Balance Sheets

At December 31, 2004 and 2003

(expressed in U.S. dollars)

	2004	2003
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	2,805,441	3,000,432
Restricted cash (note 2)	246,925	541,536
Due from franchisees - net of allowance for doubtful accounts of \$2,967,409 (2003 - \$2,471,926)	9,332,320	8,095,359
Notes receivable (note 4)	541,442	702,914
Due from parent (note 3)	-	653,697
Inventories	3,042,591	2,891,082
Prepaid expenses and other current assets	1,491,411	1,262,320
Deferred income taxes (note 10)	435,726	336,299
Assets of discontinued operations (note 19)	1,085,701	2,464,031
	<hr/>	<hr/>
	18,981,557	19,947,670
Notes receivable (note 4)	1,568,901	2,130,407
Investments (note 5)	75,000	-
Property and equipment (note 6)	4,360,568	3,008,861
Intangible assets (note 8)	24,679,398	25,594,067
Goodwill (note 9)	33,725,249	29,310,387
	<hr/>	<hr/>
	83,390,673	79,991,392

Approved by the Board

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

The Franchise Company (U.S.) Inc.

Consolidated Balance Sheets ...continued

At December 31, 2004 and 2003

(expressed in U.S. dollars)

	2004	2003
	\$	\$
Liabilities		
Current liabilities		
Accounts payable	5,093,853	3,001,186
Accrued liabilities	3,028,972	2,362,709
Bonuses payable	2,167,313	1,550,414
Current portion of notes payable (note 11)	2,170,260	1,124,000
Deferred revenue and customer deposits	1,419,633	1,316,709
Due to parent (note 3)	494,559	-
Income taxes payable	4,713,545	3,028,185
Current portion of obligations under capital leases (note 15)	344,439	209,070
Liabilities of discontinued operations (note 19)	255,600	509,015
	<u>19,688,174</u>	<u>13,101,288</u>
Obligations under capital leases (note 15)	524,817	473,609
Notes payable (note 11)	-	90,000
Due to parent (note 3)	13,407,836	22,691,825
Deferred income taxes (note 10)	10,360,891	10,634,279
Redeemable preferred stock, no par value, 100 shares authorized, issued and outstanding (aggregate liquidation preference of \$12,502,000 at December 31, 2004) (note 13)	12,502,000	12,502,000
Minority interest	1,054,314	567,157
	<u>57,538,032</u>	<u>60,060,158</u>
Stockholder's Equity		
Common stock, \$0.10 par value, 100 shares authorized, issued and outstanding	10	10
Additional paid-in capital	2,986,255	2,986,255
Retained earnings	22,866,376	16,944,969
	<u>25,852,641</u>	<u>19,931,234</u>
	<u>83,390,673</u>	<u>79,991,392</u>
Commitments and contingencies (note 14)		

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

The Franchise Company (U.S.) Inc.
Consolidated Statements of Income
For the years ended December 31, 2004 and 2003

(expressed in U.S. dollars)

	2004 \$	2003 \$
Revenues		
Royalties	31,478,617	27,115,431
Franchise fees	3,383,245	2,788,811
Merchandise sales	47,471,026	35,168,870
Administrative support and other	10,128,203	9,552,957
	<u>92,461,091</u>	<u>74,626,069</u>
Cost and expenses		
Franchise operating expenses	14,418,237	14,363,484
Cost of merchandise sales	33,172,210	23,214,580
General and administrative	22,932,266	21,820,440
Management fees to parent (note 3)	4,163,254	2,999,500
Depreciation and amortization	2,032,451	1,518,809
	<u>76,718,418</u>	<u>63,916,813</u>
Income from operations	<u>15,742,673</u>	<u>10,709,256</u>
Other income (expense)		
Interest income	151,788	156,855
Interest expense (note 3)	(2,567,037)	(2,387,483)
Dividends on shares subject to mandatory redemption (note 13)	(1,500,240)	(1,500,240)
Gain on dilution of investment interests in wholly owned subsidiaries (note 17)	409,420	2,344,303
	<u>(3,506,069)</u>	<u>(1,386,565)</u>
Income before minority interest	12,236,604	9,322,691
Minority interest in net income of consolidated subsidiaries	<u>(443,314)</u>	<u>(298,028)</u>
Income before income taxes	11,793,290	9,024,663
Provision for income taxes (note 10)	<u>4,575,930</u>	<u>2,818,598</u>
Net income from continuing operations	7,217,360	6,206,065
Net (loss) income from discontinued operations (note 19)	<u>(1,295,953)</u>	<u>144,244</u>
Net income for the year	<u>5,921,407</u>	<u>6,350,309</u>

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

The Franchise Company (U.S.) Inc.
Consolidated Statements of Changes in Stockholder's Equity
For the years ended December 31, 2004 and 2003

(expressed in U.S. dollars)

	Common stock, \$0.10 par value \$	Additional paid-in capital \$	Retained earnings \$	Total \$
Balance at December 31, 2002	10	2,986,255	10,594,660	13,580,925
Net income	-	-	6,350,309	6,350,309
Balance at December 31, 2003	10	2,986,255	16,944,969	19,931,234
Net income	-	-	5,921,407	5,921,407
Balance at December 31, 2004	10	2,986,255	22,866,376	25,852,641

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

The Franchise Company (U.S.) Inc.

Consolidated Statements of Cash Flows For the years ended December 31, 2004 and 2003

(expressed in U.S. dollars)

	2004 \$	2003 \$
Cash flows provided by (used in)		
Operating activities		
Net income from continuing operations	7,217,360	6,206,065
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation of property and equipment	1,053,163	649,657
Amortization of intangible assets	979,288	869,152
Deferred income taxes (note 10)	(372,815)	(171,303)
Minority interest in net income of consolidated subsidiaries	443,314	298,028
Writeoff of investment in territory (note 5)	-	47,500
Gain on dilution of investment interests in wholly owned subsidiaries (note 17)	(409,420)	(2,344,303)
Other	396,000	-
Change in non-cash working capital (note 12)	3,174,660	2,145,739
Cash flows provided by operating activities	<u>12,481,550</u>	<u>7,700,535</u>
Investing activities		
Purchases of property and equipment	(2,218,293)	(1,302,986)
Contingent consideration paid (note 9)	(1,182,230)	(520,200)
Payment for acquisitions including acquisition costs - net of cash acquired (note 7)	(1,215,772)	(8,612,999)
Purchase of royalty sharing rights (note 8)	(64,619)	(153,946)
Purchase of territory	(75,000)	-
Decrease in restricted cash	294,611	71,652
Cash flows used by investing activities	<u>(4,461,303)</u>	<u>(10,518,479)</u>
Financing activities		
Advances from parent	-	9,286,065
Payments to parent	(9,283,989)	(5,500,000)
Payments of notes payable	(368,000)	(90,000)
Payment of dividends to minority interest	(392,737)	(200,000)
Proceeds on sale of interest in subsidiary (note 17)	450,000	-
Increase in note payable to third parties	1,324,260	-
Cash flows used by financing activities	<u>(8,270,466)</u>	<u>3,496,065</u>
Net change in cash and cash equivalents from continuing operations	(250,219)	678,121
Cash generated from (used in) discontinued operation (note 19)	55,228	(64,431)
Cash and cash equivalents - Beginning of year	<u>3,000,432</u>	<u>2,386,742</u>
Cash and cash equivalents - End of year	<u>2,805,441</u>	<u>3,000,432</u>
Supplementary cash flow information		
Cash paid for interest	4,551,266	3,887,726
Cash paid for income taxes	3,359,549	2,667,759

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

The Franchise Company (U.S.) Inc.

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

(expressed in U.S. dollars)

1 Summary of business operations and basis of presentation

The Franchise Company (U.S.) Inc. (the "Company"), incorporated March 15, 1996, is a wholly owned subsidiary of The Franchise Company Inc., which is an 83% owned subsidiary of FirstService Corporation, a publicly owned Canadian diversified holding company.

Through the following subsidiaries, College Pro Painters (U.S.) Ltd., Certa ProPainters Ltd., Stained Glass Overlay, Inc., Paul Davis Restoration, Inc., California Closet Company, Inc., Pillar to Post, Inc., Floor Coverings International, Ltd. and The Franchise Development Centre Inc., the Company's principal function is recruiting, training and the operation of franchise systems throughout the United States. In addition, the Company controls five California Closet franchises that produce and install custom organization systems. Through Growers and Nomads Inc., a 60% owned subsidiary, the Company is also engaged in marketing and brand advertising.

2 Summary of significant accounting policies

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates made by management relate to the collectibility of accounts and notes receivable, valuation of inventories and fair values of goodwill and intangible assets. Actual results could differ from these estimates. Significant accounting policies are summarized as follows:

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions between the Company and its subsidiaries are eliminated on consolidation.

Revenue recognition

a) Royalties

Royalties are generally charged as a percentage of revenue, as defined by the franchise agreements, and recognized when sales are reported by the franchisees, with the exception of certain Certa ProPainters Ltd. franchise agreements, where franchisees are charged a fixed monthly amount.

b) Franchise fees

Revenue from the sale of franchises and master franchises is recognized in accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 45,

The Franchise Company (U.S.) Inc.

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(expressed in U.S. dollars)

which provides for the recognition of franchise fee revenue when all material services or conditions relating to the sale of the franchise have been substantially performed, the required deposits have been received, and collectibility of outstanding amounts is reasonably assured.

c) Merchandise sales and administrative support

Revenue from the sale of merchandise or the provision of administrative and other support services is recognized in accordance with Staff Accounting Bulletin No. 101, which provides for recognition of revenue when the product is shipped or services are provided, and collectibility is reasonably assured. Prices for sales of all merchandise or provision of services are fixed as at the date of sale.

Cash and cash equivalents

The Company considers all highly liquid investments purchased having an initial maturity of three months or less to be cash equivalents. Cash equivalents include money market funds and time deposits, which are carried at cost, plus accrued interest, which approximates market.

Restricted cash

Restricted cash is composed of cash restricted for marketing fund use. The Company is in custody of cash received by franchisees for use in their respective marketing funds of \$246,925 (2003 - \$541,536).

Investments

Investments are comprised of required franchisees and equity investments and are carried at net realizable value.

Inventories

Inventories consist of finished products, accessories and components of closet and workspace systems, painting kits, film, supplies held for resale and other equipment used by franchisees in their operations. The franchise agreement with franchisees provides that such inventory is purchased by the franchisees for use in their operations.

Inventories are valued at the lower of cost or market. Market is defined as the midpoint between net realizable value (NRV), NRV less normal profit margin and replacement cost. Cost is determined by the first-in, first-out method.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and any impairment in value. Depreciation is provided by use of the straight-line method over the estimated useful lives of the assets, except for leasehold improvements, which are depreciated on a straight-line basis over the lesser of the useful life of the asset or the remaining lease term. The half-year convention is applied in the year of acquisition.

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Maintenance and repairs are charged to operations as incurred, while betterments and additions are capitalized. Upon sale or retirement, the cost of the property and the related accumulated depreciation are removed from the respective accounts and any resulting gains or losses are reflected in operations.

Goodwill and intangible assets

Goodwill and intangible assets are accounted for in accordance with SFAS No. 141, "Business Combinations" ("SFAS 141"), and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Goodwill represents the excess of the purchase price over the fair value of identifiable assets acquired in a business combination and is not subject to amortization.

Amortizable intangible assets are amortized using the straight-line method over their 7 to 35 year estimated usable lives.

Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate the asset might be impaired, in which case the carrying value of the asset is written down to fair value. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using a discounted cash flow approach. If the carrying amount of the reporting unit exceeds its fair value, then a second step is performed to measure the amount of the impairment loss, if any.

Valuation of long-lived assets

The Company periodically reviews the carrying value of its long-lived assets, including, but not limited to, property and equipment, intangible assets and other assets. The carrying value of a long-lived asset is considered impaired when the undiscounted cash flow from such asset is estimated to be less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair market value of the long-lived asset. Fair market value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. Losses on long-lived assets to be disposed of would be determined in a similar manner, except that fair market values would be reduced by the cost of disposal.

Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109"). SFAS 109 is an asset and liability approach that requires the recognition of deferred income tax assets and liabilities for the expected future income tax consequences of temporary differences between the carrying amounts and the income tax bases of assets and liabilities. Deferred income tax assets are recognized, net of any valuation allowance, for deductible temporary differences and net operating loss and income tax credit carry-forwards, and deferred income tax liabilities are recognized for taxable temporary differences. Deferred income tax assets are recognized only to the extent that management determines it to be more likely than not that the deferred income tax assets will be realized. A valuation allowance is recorded when there is uncertainty regarding realization of an income tax asset. Deferred income tax assets and liabilities are adjusted for the effects of changes in income tax laws and rates on the date of enactment. The income tax expense or benefit is the income tax payable or refundable for the period plus or minus the change in deferred income tax assets and liabilities during the period.

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Fair value

Unless otherwise stated, the fair values of financial instruments approximate their carrying amounts. Included in financial instruments are cash and cash equivalents, restricted cash, due from franchisees, notes receivable, due to/from parent, accounts payable, accrued liabilities, bonuses payable, income taxes payable, notes payable and obligations under capital leases. The carrying values of these instruments approximate their fair values due to their immediate or short-term maturities.

Financial instruments also include amounts due to parent with a remaining maturity of five months and an interest rate of 12%. Management considers that no events have occurred subsequent to the arrangement of this loan that would indicate that its fair value differs substantially from its carrying value.

Concentration of credit risk

The Company's financial instruments exposed to credit risk include cash and cash equivalents, restricted cash, due from franchisees, notes receivable and due to/from parent. The Company places its cash and cash equivalents with institutions of high creditworthiness. Management routinely assesses the collectibility of its notes and amounts due from franchisees and, as a consequence, believes that credit risk exposure is limited.

3 Transactions with related parties

Management fees

The Company has a management agreement with its parent, The Franchise Company Inc., which provides certain administrative and management services to the Company. Costs for such services totalled \$4,163,254 (2003 - \$2,999,500) for the year ended December 31, 2004.

Due to/from parent

At December 31, 2004, the Company owed The Franchise Company Inc. \$494,559. At December 31, 2003, The Franchise Company Inc. owed the Company \$653,697. These amounts are uncollateralized, are due on demand and bear no interest. Balances with The Franchise Company Inc. fluctuate significantly during the period between amounts receivable and amounts payable as a result of the seasonal nature of certain Company operations.

At December 31, amounts due to FirstService Corporation, the ultimate parent of The Franchise Company Inc., consisted of the following:

	2004	2003
	\$	\$
Note payable, interest payable at 12%, no security, due June 1, 2007	13,407,836	22,691,825

The Franchise Company (U.S.) Inc.

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Interest expense on notes payable to the parent was \$2,320,163 (2003 - \$2,246,448). These transactions were in the normal course of operations and were measured at the exchange amount.

Included in notes receivable are amounts owing from certain minority interest shareholders. The total amount due from minority interests is \$1,246,623. These notes bear interest at 4% and are due on December 31, 2010.

Growers and Nomads Inc. earned fees of approximately \$295,000 from advertising funds, which are managed by the Company on behalf of franchisees.

4 Notes receivable

The Company has notes receivable from franchisees for various franchise fees and royalties. These notes bear interest at rates ranging from 7% to 12% and are repayable in monthly instalments. At December 31, 2004, annual maturities are as follows:

	\$
2005	541,442
2006	318,865
2007	87,357
2008	41,566
2009	11,757
Thereafter	<u>1,350,053</u>
	2,351,040
Less: Allowance for bad debts	<u>240,697</u>
	2,110,343
Less: Current portion	<u>541,442</u>
Long-term notes receivable	<u>1,568,901</u>

5 Investments

	2004	2003
	\$	\$
Territories	<u>75,000</u>	<u>-</u>

Included in investments in territories are costs related to the reacquisition of franchises, which are held for resale. The carrying value of these territories is periodically evaluated by the Company. An investment in a territory is considered impaired if the net realizable value of the territory exceeds its carrying amount. In 2003, the Company determined the carrying value of a territory of \$47,500 was not realizable and reduced its carrying value to \$nil.

The Franchise Company (U.S.) Inc.

Notes to Consolidated Financial Statements

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The Company has the ability to significantly influence the operations of California Closets UK Limited and, as a result, the investment is being accounted for using the equity method. Under this accounting treatment, the Company includes its proportionate share of the UK investment's earnings and losses into income. The Company's share of losses of California Closets UK Limited for 2004 amounted to \$42,338 (2003 - \$80,606). As the cumulative share of losses now exceeds the amount of the investment, it has been written down to \$nil. Profits from this equity investment will not be recorded until the profits exceed the losses previously not recognized in the amount of \$168,347 (2003 - \$126,009).

6 Property and equipment

Property and equipment consists of the following:

	Amortization period	2004 \$	2003 \$
Production equipment	5 to 7 years	1,959,425	1,223,375
Vehicles	5 to 12 years	1,094,222	917,578
Furniture and fixtures	5 to 10 years	1,119,619	1,049,439
Computers and equipment	3 to 5 years	3,267,742	3,437,975
Leasehold improvements	5 to 6 years	919,137	437,375
Internally developed software	3 to 5 years	1,254,250	646,750
		<u>9,614,395</u>	<u>7,712,492</u>
Less: Accumulated depreciation		<u>5,253,827</u>	<u>4,703,631</u>
		<u>4,360,568</u>	<u>3,008,861</u>

Depreciation expense totalled \$1,053,163 for the year ended December 31, 2004 (2003 - \$649,657).

Assets under capital lease included in property and equipment are comprised of internally developed software and production equipment. The cost and accumulated amortization of these assets are \$2,014,716 and \$469,588, respectively.

7 Acquisitions

2004 acquisitions

There were no acquisitions of new businesses completed in 2004. However, the Company purchased 5% of California Closet Company, Inc. sold in 2003 to an employee (note 17). The transaction resulted in an increase in goodwill of \$1,215,772.

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2003 acquisitions

During 2003, the Company acquired a California Closet franchise operation through a share purchase. The Company also acquired two franchise platforms through share purchases. All acquisitions have been accounted for using the purchase method and, accordingly, the consolidated financial statements include the results of operations of the acquired businesses from the date of the acquisitions. The purchase price has been allocated to the assets acquired and the liabilities assumed based on management's best estimate of fair values as noted below. Any excess of the purchase price over the fair value of assets has been allocated to goodwill and intangible assets as noted below.

More Than Closets, Inc.

On October 1, 2003, the Company acquired 100% of the common shares of More Than Closets, Inc. The share purchase agreement includes a contingent purchase price component, which is based on earnings of the acquired company for the two-year period ending October 1, 2005. During 2004, the Company reached an agreement to settle the remaining consideration and accrued contingent consideration of \$2,016,860. There is no remaining contingent consideration payable.

Floor Coverings International, Ltd.

On October 3, 2003, the Company acquired 80% of the common shares of Floor Coverings International, Ltd. The share purchase agreement includes a contingent purchase price component, which is based on earnings of the acquired company for the three-year period ending October 1, 2006. The maximum additional cost under the contingent purchase price is \$336,000 plus interest accrued at 5%. For the current year, no amounts have been recorded with respect to contingent consideration.

Pillar to Post, Inc.

On October 15, 2003, the Company acquired 100% of the common shares of Pillar to Post, Inc. The share purchase agreement includes a contingent purchase price component, which is based on earnings of the acquired company for the two-year period ending October 15, 2005. The maximum additional cost under the contingent purchase price is \$1,996,672 plus interest accrued at 5%. During 2004, contingent consideration of \$987,655 was paid, which was recorded in goodwill.

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The net assets acquired and the consideration given are summarized below:

	More Than Closets, Inc. \$	Pillar to Post, Inc. \$	Floor Coverings International, Ltd. \$	Total \$
Net assets acquired				
Cash	420,609	81,897	28,995	531,501
Accounts receivable	45,196	390,650	213,808	649,654
Inventory	39,972	-	21,847	61,819
Prepays and other assets	54,976	-	10,814	65,790
Total current assets	560,753	472,547	275,464	1,308,764
Property and equipment	195,770	21,683	93,874	311,327
Intangible assets -				
franchise agreements	-	2,748,385	117,000	2,865,385
Goodwill	4,390,513	1,631,787	851,616	6,873,916
Accounts payable and accrued liabilities	(311,808)	(132,987)	(240,420)	(685,215)
Deferred revenue and customer deposits	-	(173,920)	-	(173,920)
Deferred income taxes	-	(1,104,533)	(46,800)	(1,151,333)
Minority interest	-	-	(74,734)	(74,734)
Obligations under capital lease	(129,690)	-	-	(129,690)
	4,705,538	3,462,962	976,000	9,144,500
Consideration				
Cash	4,705,538	3,462,962	976,000	9,144,500

Pre-2003 acquisitions

During 2004, approximately \$194,575 was paid in respect of the contingent purchase price consideration relating to acquisitions, which occurred prior to 2003. These additional amounts have been recorded in goodwill.

At December 31, 2004, total contingent consideration of \$1,481,002 remains outstanding with respect to acquisitions completed in prior years. The contingencies will expire during the period extending to September 20, 2006.

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8 Intangible assets

	2004		
	Gross carrying amount \$	Accumulated amortization \$	Net \$
Amortized intangible assets			
Royalty sharing rights	627,416	94,903	532,513
Finite life franchise intangible assets			
Franchise agreements	28,379,275	4,232,390	24,146,885
	<u>29,006,691</u>	<u>4,327,293</u>	<u>24,679,398</u>
			2003
	Gross carrying amount \$	Accumulated amortization \$	Net \$
Amortized intangible assets			
Royalty sharing rights	562,797	52,903	509,894
Finite life franchise intangible assets			
Franchise agreements	28,379,275	3,295,102	25,084,173
	<u>28,942,072</u>	<u>3,348,005</u>	<u>25,594,067</u>

During the year ended December 31, 2004, the Company acquired the following intangible assets:

	Amount \$	Weighted average amortization period in years
Amortized intangible assets		
Royalty sharing rights	<u>64,619</u>	15

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The following is the estimated annual amortization expense for each of the next five years ending December 31:

	\$
2005	979,288
2006	979,288
2007	979,288
2008	979,288
2009	979,288
	<u>4,896,440</u>

9 Goodwill

Goodwill consists of the following:

	2004	2003
	\$	\$
Balance - January 1	29,310,387	21,916,271
Goodwill resulting from purchase price allocations (note 7)	1,215,772	6,873,916
Goodwill resulting from contingent acquisition payments (note 7)	<u>3,199,090</u>	<u>520,200</u>
Balance - December 31	<u>33,725,249</u>	<u>29,310,387</u>

Goodwill of \$636,000 has been classified as held for sale in 2003 and was charged to discontinued operations in 2004.

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(expressed in U.S. dollars)

10 Income taxes

The components of the provision for income taxes are as follows:

	2004	2003
	\$	\$
Current provision		
Federal	3,864,550	2,294,493
State	1,084,195	695,408
	<u>4,948,745</u>	<u>2,989,901</u>
Deferred provision		
Federal	(350,446)	(132,760)
State	(22,369)	(38,543)
	<u>(372,815)</u>	<u>(171,303)</u>
	<u>4,575,930</u>	<u>2,818,598</u>

Income tax expense differs from the federal statutory income tax rate as follows:

	2004	2003
	%	%
Federal statutory income tax rate	34.00	34.00
State income taxes, net of federal benefit	6.00	5.94
Permanent differences		
Dilution gains	(1.50)	(10.11)
Other	0.30	1.40
	<u>38.80</u>	<u>31.23</u>

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The components of deferred income tax assets and liabilities are as follows:

	2004 \$	2003 \$
Deferred income tax assets		
Accrued expenses	281,088	96,351
Other reserves	154,638	239,948
	<u>435,726</u>	<u>336,299</u>
Deferred income tax liabilities		
Purchased goodwill	469,419	302,817
Property and equipment	232,319	323,800
Intangible assets acquired on acquisitions	9,659,153	10,007,662
	<u>10,360,891</u>	<u>10,634,279</u>
Net deferred income tax liabilities	<u>(9,925,165)</u>	<u>(10,297,980)</u>

A valuation allowance has not been provided for the deferred income tax assets at December 31, 2004, as management believes that these assets will, more likely than not, be realized.

11 Notes payable

Notes payable are summarized as follows:

	2004 \$	2003 \$
Promissory note, unsecured, payable on demand, interest at 12%	1,324,260	-
Promissory note, unsecured, payable on demand, interest at 12%	600,000	800,000
Promissory note, unsecured, payable on demand, interest at 12%	84,000	84,000
Promissory note, unsecured, payable on demand, interest at 12%	72,000	150,000
Promissory note, unsecured, payable at \$90,000 per year beginning 2003, interest at 5%	90,000	180,000
	<u>2,170,260</u>	<u>1,214,000</u>
Less: Current portion	<u>2,170,260</u>	<u>1,124,000</u>
	<u>-</u>	<u>90,000</u>

All amounts included in notes payable are due to certain minority interest shareholders.

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12 Change in non-cash working capital

	2004	2003
	\$	\$
Due from franchisees	(1,236,961)	(774,969)
Due from parent	1,148,256	1,039,165
Inventories	(151,509)	(354,832)
Notes receivable	722,978	550,424
Prepaid expenses and other current assets	(229,091)	(149,084)
Accounts payable	75,807	1,693,141
Accrued liabilities	666,263	(355,544)
Bonuses payable	616,899	(251,150)
Deferred revenue and customer deposits	102,924	326,486
Income taxes payable	1,459,094	422,102
	<u>3,174,660</u>	<u>2,145,739</u>

13 Shares subject to mandatory redemption

In 2002, the Company purchased 100 Series A Redeemable Preferred Stock ("Series A stock") previously issued by its subsidiary, TFC 1197, from its parent, The Franchise Company Inc. In exchange for the Series A stock, the Company issued a promissory note payable for \$9,515,835 and 1 common share for proceeds of \$2,986,165. Subsequent to the purchase, the wholly owned subsidiary, TFC 1197, redeemed all of the Series A stock for \$12,502,000 and the Company repaid the promissory note to The Franchise Company Inc. Prior to redemption, dividends of \$1,339,940 (2001 - \$1,500,240) were paid to The Franchise Company Inc.

In 2002, the Company's wholly owned subsidiary, TFC 1102, issued 100 shares of no par value, Series A, preferred stock for \$125,020 per share, totalling approximately \$12,502,000, to The Franchise Company Inc. Series A stock and Series A, preferred stockholders are subject to the following rights and privileges:

Redemption and conversion

Series A, preferred stockholders are entitled at any time to cause all or a portion of the shares to be redeemed by the issuer at a price equal to \$125,020 per share plus cumulative unpaid dividends after December 31, 2009. In addition, the issuer shall be entitled to retract all or a portion of the shares any time after December 31, 2009 at a price of \$125,020 per share plus cumulative unpaid dividends. No redemption of the Series A, preferred stock shall be made unless the issuer has the funds legally available. If the issuer does not have sufficient funds to redeem all shares designated for redemption, then the issuer shall redeem such shares pro rata or in any other manner determined by the Board of Directors. The Series A, preferred stockholders are not entitled to any conversion rights.

Voting

Except as provided by law, Series A, preferred stockholders are not entitled to voting rights.

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Preferred stock dividends

Series A stockholders are entitled to receive dividends that are cumulative and carry an annual dividend yield of 12%. During fiscal 2004, dividends of \$1,500,240 (2003 - \$1,500,240) were paid on these shares. No dividends are in arrears.

Liquidation

In certain events, including liquidation, dissolution or the winding up of the Company, the preferred Series A stockholders shall be entitled to receive an amount equal to \$125,020 per share plus cumulative unpaid dividends before any payment is made to the common stockholders. The holders of the Series A shares shall have no further liquidation rights.

As described in note 14, the Company has an obligation to purchase this stock from The Franchise Company Inc.

14 Commitments and contingencies

The Company leases office space, automobiles and equipment under non-cancellable operating lease agreements. Future minimum lease payments for the years ending December 31 are approximately as follows:

	\$
2005	1,816,975
2006	1,447,817
2007	1,211,121
2008	822,741
2009	498,088
	<hr/>
Total minimum lease payments	<u>5,796,742</u>

Rent expense amounted to \$1,777,924 (2003 - \$1,528,484).

The Company is involved in legal proceedings and claims primarily arising in the normal course of its business. In the opinion of management, the Company's liability, if any, would not materially affect its financial condition or operations.

On November 22, 2002, the Company entered into a forward transfer agreement with its parent, The Franchise Company Inc. Under the terms of the arrangement, the Company is obligated to purchase 100 preferred Series A stocks of TFC 1102, a wholly owned subsidiary, from The Franchise Company Inc. The purchase date contemplated in the forward arrangement is December 31, 2007; however, the occurrence of certain specified events would permit the Company to purchase the stock at an earlier date. Per the agreement, the acquisition price is \$125,020 per share plus cumulative unpaid dividends.

The Company has shareholder agreements with the minority owners of its subsidiaries. These agreements allow the Company to "call" the minority position for a predetermined formula price, which is usually equal to a

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multiple of net earnings before extraordinary items, minority interest share of earnings, income taxes, interest, depreciation and amortization paid by the Company for the original acquisition. The minority owners may also "put" their interest to the Company at the same price subject to certain limitations. Acquisitions of these minority interests would be accounted for using the purchase method. The total obligation if all call or put options were exercised at December 31, 2004 would be approximately \$5,105,527 (2003 - \$4,817,807). The acquisition of all outstanding minority interests would materially increase net earnings.

The Company has granted a member of management options to purchase 111 shares (approximately 10%) of its wholly owned subsidiary, California Closet Company, Inc., at a predetermined price. These options vest over a period of four years. The Company has also granted members of management options to purchase 11 shares (approximately 10%) of its wholly owned subsidiary, College Pro Painters (U.S.) Ltd., at a predetermined price. These options vest over a period of two years.

15 Obligations under capital leases

The following is a schedule by year of the future minimum lease payments for the capital leases together with the balance of the obligations:

	\$
2005	344,439
2006	332,117
2007	190,122
2008	<u>103,674</u>
Total minimum lease payments	970,352
Less: Imputed interest	<u>101,096</u>
Balance of obligations	869,256
Less: Current portion	<u>344,439</u>
	<u>524,817</u>

16 Letters of credit

College Pro Painters (U.S.) Ltd. was required to obtain irrevocable letters of credit with a bank totalling \$2,180,000 (2003 - \$1,600,000). The letters of credit are to remain open for the duration of certain stop-loss insurance policies or until all insurance claims against College Pro Painters (U.S.) Ltd. have been settled.

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17 Gain on dilution of investment interests in wholly owned subsidiaries

On March 15, 2004, the Company sold a 5.6% interest in Certa ProPainters Ltd. and on June 30, 2004, sold an additional 2% to senior members of Certa ProPainters Ltd.'s management. The Company received consideration totalling \$450,000 in cash. The transaction resulted in a dilution gain of \$409,420.

On September 30, 2004, the Company sold a 20% interest in More Than Closets, Inc. to an employee. The Company received cash consideration of \$1,275,000 and a note payable of \$49,000. No dilution gain was recorded on the transaction.

On March 31, 2003, the Company sold a 7.49% interest in Paul Davis Restoration, Inc. ("PDR") to two senior members of PDR's management. The Company received consideration totalling \$1,246,623 in the form of two notes payable. The notes are secured by the stock and bear interest of 4%. Principal and interest are payable on December 31, 2010. The transaction resulted in a dilution gain of \$1,123,303.

On November 30, 2003, the Company sold a 5% interest in California Closet Company, Inc. to a senior member of management. The Company received consideration totalling \$825,000 in the form of a note payable. The note is secured by the stock and bears interest of 4%. Principal and interest are payable on December 31, 2010. The transaction resulted in a dilution gain of \$1,221,000.

18 Comparative figures

Certain comparative figures have been reclassified to conform with the current year's financial statement presentation.

19 Discontinued operations

On February 25, 2005, the Company sold its interest in a wholly owned subsidiary, Stained Glass Overlay, Inc. (SGO), to the president of SGO. The net proceeds from the sale were approximately \$700,000, net of transaction costs, which consisted of cash in the amount of \$360,000 and a note receivable for the remaining balance. The note receivable bears interest at the rate of 10% per annum and is to be repaid in quarterly instalments over a four-year period.

The results of SGO have been accounted for as a discontinued operation and, for reporting purposes, the results of operations, financial position and cash flows have been segregated from those of continuing operations for the current and prior periods.

A loss on disposal of \$1,100,801 was recorded and included a goodwill impairment of \$636,000 and a reduction in assets held for sale of \$464,801.

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The Company's assets and liabilities of discontinued operations consisted of the following:

	2004 \$	2003 \$
Assets		
Current assets	1,009,694	1,722,518
Long-term assets	76,007	105,513
Goodwill	-	636,000
	<u>1,085,701</u>	<u>2,464,031</u>
Liabilities		
Current liabilities	<u>255,600</u>	<u>509,015</u>

Financial results of discontinued operations:

	2004 \$	2003 \$
Revenue	<u>2,995,432</u>	<u>3,465,348</u>
(Losses) earnings from discontinued operations before income taxes	(1,426,055)	240,409
Recovery of (provision for) income taxes	<u>130,102</u>	<u>(96,165)</u>
	<u>(1,295,953)</u>	<u>144,244</u>

Cash flows from discontinued operations were comprised of the following:

	2004 \$	2003 \$
Operations	<u>55,228</u>	<u>(64,431)</u>

20 Defined contribution pension plan

The Company contributed \$103,452 (2003 - \$95,319) to its 401(k) plan during the year, which has been recorded as an expense in each of the respective years.

21 Subsequent events

On January 1, 2005, the Company acquired 80% of the common shares of Creative Closets Inc. d/b/a California Closets, located in Dallas, Texas for cash consideration of \$515,000, subject to working capital adjustments. The share purchase agreement includes a contingent purchase price component, which is based on earnings of the acquired company for the two-year period ending December 31, 2007 to a maximum of \$405,000 plus accrued interest of 5%. The Company is in the process of determining the purchase price allocation.