

Connor, Clark & Lunn

CAPITAL MARKETS INC.

2020

**ROC Pref II Corp.**  
Annual Report

**ROC Pref II Corp Message to Shareholders**  
**March 15<sup>th</sup>, 2005**

**Dear Investor,**

We welcome the opportunity to provide you with the financial statements for ROC Pref II Corp for the period from October 1, 2004 (inception date) to December 31<sup>st</sup>, 2004, along with an update on the company's performance.

ROC Pref II Corp was launched on October 1<sup>st</sup>, 2004. The company was created to invest, in a tax-efficient manner, in an A- rated credit-linked note structured to provide an enhanced return relative to comparably rated debt securities. The return on the credit-linked note ("CLN") is linked to the credit performance of a globally diversified, equally-weighted portfolio of 140 investment grade companies (the "Reference Companies") with a weighted average credit rating of A-. The portfolio of Reference Companies is broadly diversified by industry and geographic region and its composition is actively managed by Connor, Clark & Lunn Investment Management. Connor, Clark & Lunn employs a disciplined, risk-averse style of fixed income management, appropriate to the principal goal of avoiding Reference Companies that are likely to default on their senior debt during the term of the note.

At December 31st, 2004 the NAV of ROC Pref II Corp was \$25.39, up from the initial NAV of \$24.15. The closing price on the TSX was \$25.50, the shares having traded in a range from \$24.87 to \$25.65 since inception. ROC Pref II Corp preferred shares continue to be rated P-1 Low by Standard & Poors, a division of The McGraw Hill Companies, Inc ("S&P").

The outlook for global credit markets is relatively strong. Continuing compression in credit spreads evidences investors' willingness to pay almost as much for the investment-grade debt of companies as for government bonds. That said, a strong fundamental picture is underpinning these tightening valuations, corporate balance sheets look very healthy and liquidity is at its historic best. Growth is stable as the economy continues to benefit from the stimulus of aggregate demand-enhancing fiscal and monetary policies. These factors have resulted in a steady slide in global default rates and an overall improving global credit market. With the caveat that central bank tightening in the U.S., flattening yield curves and rising energy costs should eventually impact economic growth, we remain optimistic for the credit environment during the remainder of 2005 and are confident that the investment objectives of ROC Pref. II Corp shareholders will be met.

On December 31st, ROC Pref II Corp paid a cash distribution of \$0.290625 per Preferred Share. The distribution was 100% return of capital. ROC Pref II Corp remains on track to provide Holders with quarterly fixed cumulative preferential distributions yielding 4.65% on the subscription price of \$25.00.

Yours truly,



Neil Murdoch  
Chief Executive Officer  
ROC Pref II Corp.

## Management Discussion and Analysis

The following is an analysis of the investments, operations and financial position of ROC Pref II Corp. (“the Company”). **It should be read in conjunction with the consolidated financial statements and accompanying notes, together with the prospectus dated September 24, 2004 qualifying the public offering of the preferred shares of the Company (“the Prospectus”).**

### *Issue of Preferred Shares of the Company*

On October 1, 2004, preferred shares of the Company were issued and began trading on the Toronto Stock Exchange. The offering is summarised below. Please refer to the Prospectus for more details:

<i>Issue date:</i>	October 1, 2004
<i>Maturity date:</i>	December 31, 2009
<i>Number of preferred shares issued:</i>	12,000,000
<i>Par value per preferred share:</i>	\$25.00
<i>Price preferred share:</i>	Issued at par
<i>Total raised:</i>	\$300,000,000
<i>Expenses of issue:</i>	\$10,213,702
<i>Net amount raised:</i>	\$289,786,398
<i>Trading symbol:</i>	RPA.PR.A
<i>Rating:</i>	P-1 (low) by Standard & Poor’s
<i>Terms:</i>	Retractable at any time, cumulative, will be redeemed at par value at maturity and otherwise only under specific circumstances as described in the Prospectus.
<i>Distributions:</i>	Quarterly fixed cumulative preferential cash distributions of \$0.290625 per share, to yield 4.65% on the original issue price of \$25.00.

### *Use of the proceeds of issue*

The proceeds of the public offering were invested in order to provide exposure to a credit-linked note (the “CLN”) with a credit rating established by S&P of A-. This has been accomplished by:

- (i) Investing the proceeds of the offering (net of issuance expenses) in a portfolio of publicly traded *common shares*, and
- (ii) Entering into a forward purchase and sale agreement (the “Forward Agreement”) with HSBC Bank USA National Association (“HBUS”) under which the company has agreed to sell the portfolio of common shares on, or prior, to December 31, 2009 in exchange for the value of Credit Trust II, a vehicle formed to purchase a credit linked note (“CLN”) from HSBC Bank Canada (“HBCN”).

### *Investments of the Company*

#### *The common share portfolio*

On October 1, 2004, the Company purchased a portfolio of the common shares of 12 Canadian companies at an aggregate cost of \$289,775,000. The Company simultaneously entered the Forward Agreement, under which it agreed to sell the common share portfolio to HBUS on or prior to December 31, 2009 in exchange for the value of Credit Trust II on the date of such sale. Sale of the common share portfolio under the Forward Agreement is intended to ensure that preferred shareholders have economic exposure to changes in the value of, and

distributions effected by Credit Trust II. A fee of 0.45% per annum, calculated with reference to the net asset value of Credit Trust II, is payable to HBUS under the Forward Agreement.

The value of the common share portfolio decreased from \$289.775 million at inception to \$288.344 million at December 31, 2004. This decline resulted from the combination of an increase in the market value of the portfolio of \$2.322 million and the delivery of shares with an aggregate cost of \$3.753 million in order to partially settle under the Forward Agreement. The details of the common share portfolio at December 31, 2004 are set out in the Statement of Investments in the accompanying financial statements.

#### *Partial settlement of the Forward Agreement*

Quarterly payments of the 6.867% annual coupon on the CLN and the repayment of principal at maturity in December 2009 accrue to Credit Trust II. The Company partially settles the Forward Agreement from time to time, thus receiving some of the value that has built up in Credit Trust II, in order to fund distributions on the preferred shares and its own operating expenses.

On December 22, 2004, the Company delivered shares with a cost base of \$3.7531 million to HBUS in exchange for 1.29% of the value of Credit Trust II, or \$4.000 million.

#### *Other investments of the Company*

The Company has no other investments apart from cash and equivalents which are held in order to fund near-term operating expenses. As at December 31, 2004 the Company held \$308,967 in cash and short-term investments on a non-consolidated basis.

#### ***Investments of Credit Trust II***

##### *The CLN*

Credit Trust II purchased the CLN issued by HBCN on October 6th, 2004 at par, in a principal amount of \$289,775,000. The note matures on December 20, 2009, pays a coupon of 6.867% quarterly and is rated A- by S&P.

The return on the CLN is linked to the number of defaults experienced over the term of the note among the 140 reference companies in the credit linked note's reference portfolio (the "Reference Portfolio"). If losses due to cumulative defaults, net of recoveries, do not exceed a total of 3.43% of the initial value of the Reference Portfolio during the term of the CLN, Credit Trust II will receive its full coupon payments and par value on maturity. To the extent that cumulative defaults exceeded this amount, the amount that would be paid to Credit Trust II on maturity would decline. To the extent that cumulative losses due to defaults net of recoveries exceeded 4.33% there would be no amount paid to Credit Trust II and the value of the Preferred Shares would decline to the level of net current assets per share, possibly zero. Losses of 3.43% due to defaults net of recoveries (using an estimated historical recovery rate of 35.6%) would represent approximately 2.2x the worst level of defaults experienced among a mix of credits comparable to that of the Reference Portfolio in any five-year period since 1973, the earliest date from which reliable studies are available.

Changes in the overall credit quality of the Reference Portfolio as measured by the credit ratings of its constituents may affect the rating of the CLN and of the Preferred Shares, which would in turn affect net asset value and possibly trading price. S&P's rating anticipates some deterioration in the credit quality of the Reference Portfolio over time. The companies in the Reference Portfolio are listed in the Supplementary Financial Information as at December 31, 2004 (Unaudited). ***Please refer to the Prospectus for a detailed discussion of the CLN.***

### *Credit quality of the Reference Portfolio*

The following table describes the Reference Portfolio's ratings characteristics on the date of issuance on October 6, 2004, on December 31, 2004 and on February 28th, 2005:

Rating	Number of Issuers			Rating	Number of Issuers		
	October 6, 2004	December 31, 2004	February 28, 2005		October 6, 2004	December 31, 2004	February 28, 2005
AAA	3	3	3	BBB+	26	27	26
AA+	0	0	0	BBB	25	23	24
AA	3	3	3	BBB-	11	13	12
AA-	2	2	2	BB+	0	0	1
A+	18	17	16	BB	0	1	0
A	25	26	27	BB-	0	0	0
A-	27	24	25	N/R	0	1	1
Total					140	140	140

- 1) S&P's rating scale runs from AAA, indicating an extremely strong capacity to meet financial obligations, to D, indicating default. Ratings from AA to CCC may be modified by the addition of a plus or minus sign.
- 2) The company indicated as N/R, or not rated, is Man Group Plc. Man Group is not rated by S&P but is currently rated Baa1 by Moody's.

From inception to February 28, 2005 eight companies in the Reference Portfolio had their debt downgraded by S&P while one company was upgraded. The portfolio substitution described below helped to keep the overall ratings distribution of the portfolio approximately constant.

### *Value of the CLN*

The CLN is valued on the 10<sup>th</sup> and last business day of each month by HBCN. Factors affecting the value of the CLN include the market's assessment of overall credit quality of the Reference Portfolio, as measured by the trading price of the debt (and derivatives thereof) of companies in the portfolio, and interest rates as measured by the Canadian dollar swap rate to the date of maturity of the note. At December 31, 2004, the CLN value had increased from \$289.775 million at inception to \$304.562 million. At February 28 2005, the CLN value was \$304.174 million.

### *Substitutions in the Reference Portfolio*

The Reference Portfolio is managed by Connor, Clark & Lunn Investment Management Ltd. (the "Investment Manager"). The Investment Manager's goal is to reduce the likelihood of having exposure to companies that default on their senior obligations. To that end, the Investment Manager can add or remove companies through a substitution process executed in accordance with the terms of the CLN. If the Investment Manager decides to remove a company that, in its judgment, has increased in risk, and to replace it with a lower risk company, there may be a net cost to the Credit Trust depending on the credit spread comparison between the companies being substituted. The CLN features an embedded trading reserve account, initially in an amount of \$2.567 million, that is available to absorb net losses that may be incurred through these substitutions. Trading activity to date has resulted in an increase in the value of the trading reserve account to \$2.699 million as at February 28, 2005.

The Investment Manager made no substitutions in the Reference Portfolio prior to December 31 and made one substitution in February.

#### *Other investments of the Credit Trust*

The Credit Trust held \$77,944 in cash and short-term investments on December 31, 2004.

#### *Net Asset Value of the Preferred Shares*

The net asset value of the preferred shares is calculated as the value of the common share portfolio and any other investments held by the Company, plus the value of any gain or loss on the equity Forward Agreement, less any net liabilities of the Company, divided by the number of preferred shares outstanding.

On December 31, 2004, the value of the common share portfolio was \$288.344 million. Since the Company can deliver the value of the common share portfolio to HBUS in exchange for the value of Credit Trust II, the value of the Forward Agreement to the Company is equal to the value of Credit Trust II less the value of the common share portfolio. On December 31, 2004 value of the Forward Agreement was \$16.813 million. Other net assets in ROC Pref Corp. prior to consolidation totalled \$391,881 leaving a net asset value of \$305.549 million or \$25.39 per Preferred Share.

The net asset value per Preferred Share was \$25.36 as at February 28, 2005, the decrease being attributable to an decrease in the value of the CLN.

#### *Liquidity and Capital Resources*

The obligations of the Company include operating expenses and declared distributions to preferred shareholders. These funding obligations will be satisfied primarily through partial settlements under the Forward Agreement as described above. As at December 31, 2004, the Company had current assets of \$986,664 and current liabilities of \$386,066 (accounts payable and accrued liabilities of \$915,330 less accrued deferred management fees of \$529,264) on a consolidated basis.

#### *Expense Ratio*

The expense ratio represents the ratio of annual expenses that are required to operate the company to the value of issued Preferred Share capital. The annualized expense ratio (excluding deferred management fees which are only payable after full repayment of the original preferred share issue price and any accrued and unpaid distributions), for the period from inception to December 31, 2004 was approximately 0.93%.

#### *Distributions*

A distribution of \$0.290625 per share was paid on December 31, 2004 for the initial period from October 1, 2004 (inception date) to December 31, 2004.

**ROC Pref II Corp.**  
**Supplementary Financial Information**  
**CLN Portfolio (Reference Portfolio) as at December 31, 2004**  
(Unaudited)

<u>Company Name</u>			
3I GROUP PLC	A+	Israel Electric Corp Ltd	BBB+
Accor	BBB	J Sainsbury plc	BBB-
Ace Limited	BBB+	J.P. Morgan Chase & Co.	A+
Allstate Corp. (The)	A+	Kerr-McGee Corp	BBB
Alltel Corporation	A	Kimco Realty Corp	A-
Altria Group Inc.	BBB+	Kinder Morgan Energy Partners L.P.	BBB+
Ambac Financial Group Inc.	AA	Korea Electric Power Corporation	A-
AMERICAN STANDARD INC	BBB	Korea Telecom	A-
Amgen Inc.	A+	Lehman Brothers Holdings Inc.	A
Anglo American PLC	A-	Loews Corporation	A
Anheuser-Busch Companies Inc	A+	Man Group Plc	N/R
Aon Corporation	BBB+	Marathon Oil Corporation	BBB+
Arrow Electronics Inc.	BBB-	Marks & Spencer Plc	BBB
Autostrade Spa	A	Marriott International Inc.	BBB+
Autozone Inc	BBB+	MBIA Inc.	AA
Barrick Gold Corporation	A	Mckesson Corporation	BBB
Baxter International Inc.	A-	MeadWestvaco Corporation	BBB
Bayer Aktiengesellschaft	A	Merrill Lynch & Co. Inc.	A+
BCE Inc.	A	MGIC Investment Corporation	A
BHP Billiton Ltd.	A+	Morgan Stanley	A+
Boeing Capital Corporation	A	Mtr Corporation Ltd	A+
		National Rural Utilities Cooperative Finance Corporation	A
BorgWarner Inc.	A-	Newell Rubbermaid Inc.	BBB+
Bristol-Myers Squibb Company	A+	Noranda Inc	BBB-
British American Tobacco p.l.c.	BBB+	Nordstrom Inc.	A-
Cameco Corporation	BBB+	Omnicom Group Inc.	A-
Campbell Soup Co.	A	PCCW - HKT Telephone Limited	BBB
Cardinal Health Inc.	BBB	Petrolim Nasional Berhad	A-
Cargill Incorporated	A+	Placer Dome Inc	BBB+
Carrefour Sa	A+	POSCO	A-
Caterpillar Financial Services Corp	A	Qantas Airways Limited	BBB+
Centex Corporation	BBB	Quebecor World Inc.	BBB-
Centurytel Inc.	BBB+	RadioShack Corporation	A-
Chiron Corporation	A-	Rank Group Plc	BBB-
Cinergy Corp.	BBB+	Reuters Group plc	A
Cingular Wireless LLC	A	Safeway Inc.	BBB
CIT Group Inc.	A	Sara Lee Corp	A+
Clear Channel Communications Inc.	BBB-	Schering-Plough Corporation	A-
Coca-Cola Enterprises Inc	A	SCOR	BBB+
Comcast Cable Communications Inc.	BBB	Sealed Air Corp	BBB
Computer Sciences Corporation	A	Siemens Aktiengesellschaft	AA-
Constellation Energy Group Inc.	BBB+	Simon Property Group L.P.	BBB+
Cox Communications Inc.	BBB-	SLM Corporation	A
DaimlerChrysler AG	BBB	Sodexo Alliance Sa	BBB+
Deutsche Lufthansa AG	BBB	Southwest Airlines Co.	A
Dominion Resources Inc.	BBB+	Supervalu Inc.	BBB
Dte Energy Co	BBB	Takefuji Corporation	BBB
Duke Capital Corporation	BBB	Target Corporation	A+
EMI Group plc	BBB-	Telephone And Data Systems Inc	A-
Enbridge Inc	A-	Temple-Inland Inc	BBB
Eop Operating Limited Partnership	BBB+		
European Aeronautic Defense and Space Company EADS N.V.	A	Textron Financial Corporation	A-
Exelon Corporation	A-	The Bear Stearns Companies Inc.	A
Exelon Generation Co Llc	A-	The Dow Chemical Company	A-
Federal National Mortgage Association	AAA	The Export-Import Bank of Korea	A-
Federated Department Stores Inc.	BBB+	The Goldman Sachs Group Inc.	A+
Financial Security Assurance Inc	AAA	The Walt Disney Company	BBB+
Finmeccanica S.p.A.	BBB	Time Warner Inc.	BBB+
Ford Motor Credit Company	BBB-	Transalta Corp	BBB-
France Telecom	BBB+	Transocean Inc.	A-
Gatx Financial Corp	BBB-	Tyson Foods Inc.	BBB
General Electric Capital Corporation	AAA	UST Inc.	A
General Motors Acceptance Corporation	BBB-	Valero Energy Corporation	BBB
Harrah's Entertainment Inc.	BBB-	Verizon Global Funding Corp.	A+
Hca Inc.	BB+	Viacom Inc	A-
Hellenic Telecommunications Organiz Sa	BBB+	Vodafone Group Plc	A
Honeywell International Inc.	A	Volkswagen Aktiengesellschaft	A-
Humana Inc	BBB	Wal-Mart Stores Inc	AA
Hutchison Whampoa Limited	A-	WPP Group Plc	BBB+
International Business Machines Corporation	A+	Wyeth	A
International Lease Finance Corporation	AA-	XL Capital Ltd	A

## **Corporate Governance**

The Board of Directors of the Company (the “Board”) is responsible for overall stewardship of the Company’s affairs. The Company’s investment objectives and strategy are set out in the prospectus dated September 24, 2004. Changes to the objectives and strategy require approval of the Company’s preferred shareholders. The Company has retained Connor, Clark & Lunn Capital Markets Inc. (the “Manager”) to act as manager. The officers of the Company are also officers of the Manager. The Board is responsible for supervising the Manager to ensure that it meets its obligations under the management agreement.

The Board consists of two independent directors and two representatives of management. The Audit Committee is made up of the two independent directors and one representative of management. Only independent directors are compensated by the Company. In discharging his or her duties, each director must act honestly and in good faith with a view to the best interests of the Company and must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The Board has developed a summary of duties and responsibilities. The Board meets with the officers of the Manager regularly to receive reports on the performance of the Company. Such meetings are currently held quarterly. In addition, performance updates are distributed to the Board monthly.

Board approval is required for any determination relating to a number of matters set out in the schedule to the summary of duties and responsibilities. Such matters include approval for all significant policies or issues relating to strategy, risk management or matters outside the ordinary course of business. The Board is responsible for developing the Company’s approach to governance issues and for proposing new nominees to the Board (should the need arise) and has not assigned these responsibilities to a committee.

Given the nature of the Company’s business, its limited operations and term and that the Manager performs many day to day functions of the Company, the guidelines set forth in section 474 (2), (4), (5), (9) and (13) of the TSX’s Company Manual are either inapplicable or not appropriate.

## Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of **ROC Pref II Corp.** and all the information in this annual report are the responsibility of management and have been approved by the Board of Directors (the "Board").

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Financial statements are not precise since they include certain amounts based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management has ensured that the other financial information presented in this annual report is consistent with the financial statements. The financial statements have been audited by PricewaterhouseCoopers LLP on behalf of the shareholders.

The Board is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out these responsibilities through its Audit Committee (the "Committee").

The Committee is appointed by the Board. The Committee meets periodically with management and external auditors to discuss internal controls, the financial reporting process, various auditing and financial reporting issues, and to review the annual report, the financial statements and the external auditors' report. The Committee reports its findings semi-annually to the Board for consideration when approving the financial statements for issuance to the shareholders. The Committee also considers, for review by the Board and approval by the voting shareholders, the engagement or re-appointment of the external auditors. PricewaterhouseCoopers LLP has full and free, independent access to the Committee.



Neil Murdoch  
President and Chief Executive Officer



Philip Gow  
Chief Financial Officer

Toronto, Canada  
February 25, 2005

February 25, 2005

**Auditors' Report**

**To the Shareholders of  
ROC Pref II Corp.**

We have audited the consolidated statements of investments and net assets of **ROC Pref II Corp.** as at December 31, 2004 and the consolidated statements of operations and retained earnings, cash flow and changes in investments for the period from October 1, 2004 (inception date) to December 31, 2004. 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 audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations, its cash flows and changes in its investments for the period from October 1, 2004 (inception date) to December 31, 2004 in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

**Chartered Accountants**

# ROC Pref II Corp.

## Consolidated Statement of Net Assets

As at December 31, 2004

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### Assets

Cash	\$	87,594
Short-term investments		299,316
Investments at market value (cost - \$289,775,000)		304,562,362
Interest receivable		599,754
		<u>305,549,026</u>

### Liabilities

Accounts payable and accrued liabilities	\$	386,066
Deferred management fees payable		529,264
Preferred share capital (note 5)		304,633,596
		<u>305,548,926</u>

### Shareholders' Equity

Share capital (note 5)		100
Retained earnings		-
		<u>100</u>

**Total Liabilities and Shareholders' Equity** \$ 305,549,026

**Number of Preferred Shares outstanding** (note 5) 12,000,000

**Value per Preferred Share outstanding** \$ 25.39

Approved on behalf of the Manager,  
Connor, Clark & Lunn Capital Markets Inc.



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(See accompanying notes to the financial statements.)

# ROC Pref II Corp.

## Consolidated Statement of Operations and Retained Earnings

For the period from October 1, 2004 (inception date) to December 31, 2004

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	\$
<b>Revenue</b>	
Interest	4,771,834
<b>Expenses</b>	
Management fees	281,436
Deferred management fees	529,264
Forward and hedging fees	332,985
Directors' fees	7,854
Custodial fees	12,998
Sustaining fees	8,322
Rating agency fees	10,671
Printing and mailing charges	5,335
Audit fees	21,749
Transfer agent fees	8,008
Legal fees	4,002
Other	1,774
	<u>1,224,398</u>
<b>Net investment income before the undernoted:</b>	3,547,436
Distributions paid on Preferred Shares	<u>(3,487,500)</u>
<b>Net investment income</b>	59,936
Net realized gain on investments	247,458
Unrealized loss on Forward Agreement (notes 2 and 6)	(247,458)
Unrealized appreciation on investments	<u>14,787,362</u>
<b>Increase in net assets from operations</b>	14,847,298
<b>Retained earnings, beginning of period</b>	-
Expenses of issue of preferred shares	(10,213,702)
Less amount attributable to preferred shareholders (note 5)	<u>(4,633,596)</u>
<b>Retained earnings, end of period</b>	<u>-</u>
<b>Distributions paid per Preferred Share</b>	
Return of capital	<u>0.2906</u>
<b>Increase in net assets from operations per Preferred Share</b>	<u>1.2373</u>

(See accompanying notes to the financial statements.)

# ROC Pref II Corp.

## Consolidated Statement of Cash Flow

For the period from October 1, 2004 (inception date) to December 31, 2004

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	\$
<b>Operating Activities</b>	
Increase in net assets from operations	14,847,298
Items not affecting cash:	
Net realized gain on investments	(247,458)
Unrealized loss on Forward Agreement (notes 2 and 6)	247,458
Unrealized appreciation on investments	(14,787,362)
Changes in non-cash working capital	
Increase in interest receivable	(599,754)
Increase in accounts payable and accrued liabilities	915,330
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<b>Net cash flow provided by operating activities</b>	<b>375,512</b>
	<hr/>
<b>Investing Activities</b>	
Purchase of common stocks	(289,775,000)
Purchase of Credit-Linked Note	(289,775,000)
Proceeds on disposition of investments	-
Cash received from the Counterparty to fund the purchase of the Credit-Linked Note (note 2)	289,775,000
	<hr/>
<b>Net cash used in investing activities</b>	<b>(289,775,000)</b>
	<hr/>
<b>Financing Activities</b>	
Proceeds from issuance of preferred shares	300,000,000
Proceeds from issuance of Class A shares	100
Share issue costs	(10,213,702)
	<hr/>
<b>Net cash flow provided by financing activities</b>	<b>289,786,398</b>
	<hr/>
<b>Net increase in cash and short-term investments</b>	<b>386,910</b>
<b>Cash and short-term investments - Beginning of period</b>	<b>-</b>
	<hr/>
<b>Cash and short-term investments - End of period</b>	<b>386,910</b>
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 <b>Supplemental cash flow information:</b>	
Distributions paid on preferred shares	3,487,500

(See accompanying notes to the financial statements.)

# ROC Pref II Corp.

## Consolidated Statement of Changes in Investments

For the period from October 1, 2004 (inception date) to December 31, 2004

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	\$
<b>Investments at average cost - Beginning of period</b>	-
Cost of common stocks purchased	289,775,000
Cost of Credit-Linked Note purchased	289,775,000
Cost of investments sold or delivered under the Forward Agreement	(3,752,542)
Cost of investments pledged to the Counterparty under the Forward Agreement (notes 2 and 6)	<u>(286,022,458)</u>
<b>Investments at average cost - End of period</b>	289,775,000
Unrealized depreciation on investments	<u>14,787,362</u>
<b>Investments at market value</b>	<u>304,562,362</u>
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	4,000,000
Cost of investments delivered on partial pre-settlement	<u>(3,752,542)</u>
Realized gain on partial pre-settlement	<u>247,458</u>
<b>Realized gain on investments</b>	<u>247,458</u>
Original liability to Counterparty under Forward Agreement	289,775,000
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	(4,000,000)
Liability to Counterparty under Forward Agreement at period end, at cost	<u>286,022,458</u>
<b>Unrealized loss on Forward Agreement</b>	<u>(247,458)</u>

(See accompanying notes to the financial statements.)

# ROC Pref II Corp.

## Consolidated Statement of Investments

As at December 31, 2004

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	Maturity date	Number of shares or par value	Average cost \$	Market value \$	% of Portfolio
<b>Short-term investments</b>					
<b>Bankers' acceptance</b>					
Bank of Nova Scotia	01/31/05	300,000	299,316	299,316	100.0%
<b>Total short-term investments</b>			<u>299,316</u>	<u>299,316</u>	<u>100.0%</u>
<b>Investments</b>					
<b>Canadian credit-linked notes</b>					
HSBC Bank Canada 6.867% Bond	12/20/09	289,775,000	289,775,000	304,562,362	100.0%
			<u>289,775,000</u>	<u>304,562,362</u>	<u>100.0%</u>
<b>Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>					
<b>Materials</b>					
Inco Ltd.		479,696	24,147,897	21,106,624	6.9%
Masonite International		754,622	24,147,904	31,150,796	10.2%
Prec. Drilling		324,569	24,147,934	24,511,451	8.0%
			<u>72,443,735</u>	<u>76,768,871</u>	<u>25.2%</u>
<b>Consumer products</b>					
Cott Corporation		663,404	24,147,906	19,689,831	6.5%
<b>Biotechnology/Pharmaceuticals</b>					
Angiotech Pharmaceuticals, Inc.		948,093	24,147,929	21,066,626	6.9%
Biovail Corporation		1,049,909	24,147,907	20,777,699	6.8%
			<u>48,295,836</u>	<u>41,844,325</u>	<u>13.7%</u>
<b>Industrials</b>					
Nortel Networks Corporation		5,488,163	24,147,917	22,830,758	7.5%
<b>Technology – hardware</b>					
ATI Technologies		1,100,922	22,271,652	25,607,446	8.4%
Celestica Inc.		1,452,943	24,147,913	24,554,737	8.1%
Open Text Corporation		1,047,632	24,147,918	25,247,931	8.3%
			<u>70,567,483</u>	<u>75,410,114</u>	<u>24.8%</u>

(See accompanying notes to the financial statements.)

# ROC Pref II Corp.

Consolidated Statement of Investments ...*continued*

As at December 31, 2004

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	<b>Maturity date</b>	<b>Number of shares or par value</b>	<b>Average cost \$</b>	<b>Market value \$</b>	<b>% of Portfolio</b>
<b>Communications and media</b>					
Research in Motion		239,300	<u>22,271,651</u>	<u>23,638,054</u>	7.8%
<b>Merchandising</b>					
Alimentation		793,296	<u>24,147,930</u>	<u>28,162,008</u>	9.2%
<b>Total Canadian common stocks</b>			286,022,458	288,343,961	94.7%
<b>Payable to the Counterparty under the Forward Agreement</b>			<u>(286,022,458)</u>	<u>(288,343,961)</u>	(94.7%)
<b>Total investments</b>			<u>289,775,000</u>	<u>304,562,362</u>	100.0%

(See accompanying notes to the financial statements.)

# ROC Pref II Corp.

## Notes to Consolidated Financial Statements

### December 31, 2004

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#### 1 Corporate Activities

ROC Pref II Corp. (the "Company") was incorporated under the laws of the Province of Ontario on August 23, 2004, as a mutual fund corporation whose investment portfolio (the "Common Share Portfolio") consists of common shares of Canadian public companies that are Canadian securities for the purpose of the Income Tax Act (Canada) (the "Tax Act").

These consolidated financial statements include the accounts of Credit Trust II ("Credit Trust II"), which was established under the laws of Ontario as of September 24, 2004 by a Trust Agreement (the "Trust Agreement") made by Connor, Clark & Lunn Capital Markets Inc. (the "Manager") and The Royal Trust Company as trustee of Credit Trust II. Credit Trust II will terminate on or about December 31, 2009 (the "Termination Date") if not terminated earlier in accordance with its terms.

#### 2 Investment objectives

The Company's investment objectives as set out in the Prospectus dated September 24, 2004 are (i) to pay to holders of Preferred Shares ("Shareholders"), on or about December 31, 2009 (the "Redemption Date"), an amount per Preferred Share equal to the original subscription price of \$25.00 per Preferred Share; and (ii) to provide Shareholders with quarterly fixed cumulative preferential distributions of \$0.290625 per Preferred Share (\$1.1625 per annum to yield 4.65% on the original subscription price of \$25.00 per Preferred Share). Preferred Share distributions will consist primarily of returns of capital and may include capital gains dividends.

The Company will meet its investment objectives through a forward purchase and sale agreement (the "Forward Agreement") (note 6) with HSBC Bank USA (the "Counterparty") which will provide the Company with the economic return generated by a credit-linked note ("Credit-Linked Note"). Under the terms of the Forward Agreement, the Counterparty has agreed to pay to the Company on or about the Redemption Date, as the purchase price for the Common Share Portfolio acquired by the Company with the net proceeds of the offering of Preferred Shares (the "Offering"), the economic return provided by the Credit-Linked Note.

The Credit-Linked Note is owned by Credit Trust II. The Credit-Linked Note has been issued by HSBC Bank USA ("HSBC"), a global financial institution whose long-term debt is rated AA- as of December 31, 2004. The Credit-Linked Note is issued at par, will mature on December 20, 2009 and pays a Canadian dollar coupon of 6.867% per annum on the outstanding principal amount. The return on the Credit-Linked Note is linked to the number of defaults experienced over the term of the Credit-Linked Note among companies in an equally weighted portfolio (the "CLN Portfolio") of approximately 140 companies (the "Reference Companies") all of which were rated investment grade by Standard & Poor's, a division of The McGraw Hill Companies, Inc. ("S&P") as of the issue date of the Credit-Linked Note on October 1, 2004.

In the event HSBC determines that a default has occurred in respect of one or more Reference Companies in the CLN Portfolio and the market value of any of such companies' debt obligations, as selected by HSBC, has declined as compared to their par value, a loss amount will be calculated in respect of such decline in value. A default in respect to the Reference Companies in the CLN Portfolio includes the occurrence of bankruptcy, failure to pay or restructuring. The principal amount of the Credit-Linked Note will be reduced to the extent that the aggregate of all such loss amounts exceeds 3.43% of the initial value of the CLN Portfolio. As a result, the amount payable upon redemption of the Credit-Linked Note may be substantially less than the initial principal amount thereof and, in some cases, may be nil. In addition, interest on the Credit-Linked Note will cease to accrue on the portion of the principal amount of the Credit-Linked Note that has been reduced.

The Company may have exposure to cash and cash equivalents by virtue of the Forward Agreement because the Credit-Linked Note pays cash distributions to Credit Trust II. Any excess received by Credit Trust II over what is paid out will be reinvested by Credit Trust II and held in cash, cash equivalents and other evidences of indebtedness.

#### 3 Summary of significant accounting policies

These consolidated financial statements, prepared in accordance with Canadian generally accepted accounting principles, include estimates and assumptions by management that affect the reported amounts of assets, liabilities, income and expenses during the reporting period. Actual results could differ from these estimates. The following is a summary of the significant accounting policies of the Company.

##### Principles of consolidation

These consolidated financial statements include the accounts of the Company and of Credit Trust II (note 1). The financial statements of the Company and Credit Trust II have been consolidated for financial reporting purposes by virtue of the fact that the activities of Credit Trust II are considered to be an extension of the operations of the Company and as such, Credit Trust II forms an integral part of the Company's business activities. Although not sharing common ownership, both the Company and Credit Trust II are subject to common influence over the management of its individual operations.

##### Valuation of investments

Common shares or other securities are valued at the last board lot sale price on the principal stock exchange on which they are traded or, if no sale price is available, at the average of the bid and the ask price.

Short-term investments are valued at cost, which together with accrued interest approximates market value.

The Credit Trust II's investment in the Credit-Linked Note is valued with reference to the CLN Portfolio. The Trust's investment in the Credit-Linked Note is valued at fair value by the Manager using a price indication provided by HSBC. This price indication is determined with reference to a number of factors, including but not limited to (a) the diversification and credit quality of the CLN Portfolio and (b) the level of defaults, net of recoveries, that the CLN Portfolio can experience without affecting the payment of interest on and the principal value of the Credit-Linked Note.

##### Investment transactions, income and expenses

Investment transactions are accounted for on the trade date. Realized and unrealized gains and losses on investments are determined using the average cost basis.

Interest income and expenses are recognized on an accrual basis.

# ROC Pref II Corp.

## Notes to Consolidated Financial Statements

### December 31, 2004

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#### Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the end of the period.

Purchases and sales of investments and income and expenses are translated into Canadian dollars at the exchange rate prevailing on the transaction dates.

#### Foreign currency forward contracts

The Company may enter into foreign currency forward contracts to hedge against exposure to foreign currency fluctuations. The carrying value of these contracts is the gain or loss that would be realized if the position were closed out on the valuation date, and is recorded as an unrealized gain or loss. Upon closing of a contract, the gain or loss is recorded as a net realized gain or loss on foreign currency forward contracts.

#### Forward contracts

Forward contracts entered into by the Company are valued at an amount that is equal to the gain or loss that would be realized if the position were to be closed out, which is equivalent to the difference between the deliverable asset and the value of the asset to be received. Changes in the value of a forward contract or the assets deliverable under such a contract are included as unrealized gains or losses on investments.

#### Preferred share capital

The Company accounts for preferred share capital and retained earnings attributable to preferred shareholders as a financial liability, in accordance with the recommendations contained in section 3860 of the Handbook of the Canadian Institute of Chartered Accountants.

#### Value per preferred share

The value per preferred share presented in the statement of net assets represents the assets of the Company less its liabilities (excluding preferred share capital) and the value of Class A shares outstanding, divided by the number of preferred shares outstanding.

## 4 Custodian

Pursuant to a custodian agreement ("the Custodian Agreement"), the Company has retained The Royal Trust Company ("the Custodian") to act as custodian of the assets of the Company. The Custodian is also responsible for certain aspects of the Company's day-to-day operations. In consideration for these services, the Company will pay a fee to the Custodian.

## 5 Share capital

The Company is authorized to issue an unlimited number of redeemable, retractable cumulative preferred shares (the "Preferred Shares") and Class A shares.

#### Preferred Shares

The holders of Preferred Shares are entitled to receive quarterly fixed cumulative preferential cash distributions of \$0.290625 per Preferred Share on the last business day of March, June, September and December in each year (each, a "Distribution Payment Date").

Preferred Shares may be surrendered at any time for retraction to the Company's registrar and transfer agent, but will be retracted only on the last day of the month (a "Valuation Date"). On retraction, holders will be entitled to receive a retraction price per share ("Preferred Share Retraction Price") equal to 95% of the net asset value per Preferred Share determined as of the relevant Valuation Date less \$0.25 per share. Any declared and unpaid distributions payable to holders of record on or before a Valuation Date in respect of Preferred Shares tendered for retraction on such Valuation Date will also be paid on the retraction payment date.

For purposes of determining the Preferred Share Retraction Price, the net asset value per Preferred Share will be equal to the aggregate value of (i) the Forward Agreement, and (ii) any other assets of the Company, less liabilities of the Company (excluding preferred share capital) and less the amount paid for the Company's Class A Shares, divided by the number of Preferred Shares outstanding.

Preferred Shares will be redeemed by the Company on the Redemption Date at a price per Preferred Share (the "Preferred Share Redemption Price") equal to the lesser of (i) \$25.00 plus the Residual Amount, if any, and (ii) the amount received on settlement of the Forward Agreement (which will be an amount equal to the maturity value of the Credit-Linked Note) less liabilities of the Company (excluding preferred share capital) and less the amount paid for the Company's Class A Shares, divided by the number of Preferred Shares outstanding. The Residual Amount is equal to the amount, if any, remaining after payment of \$25.00 per Preferred Share issued and outstanding on the Redemption Date together with any accrued and unpaid distributions, setting aside of the amount payable on the Company's Class A Shares and payment to the Manager of any deferred management fees and any fees and expenses previously funded by the Manager on behalf of the Company.

On October 1, 2004, the Company issued 12,000,000 Preferred Shares at a price of \$25.00 per Preferred Share for aggregate gross proceeds of \$300 million. Issue costs of \$10,213,702 incurred in connection with the share issuance have been charged against retained earnings. No Preferred Shares were retracted or redeemed during the period from October 1, 2004 (inception date) to December 31, 2004. At December 31, 2004, retained earnings attributable to preferred shareholders totalled \$4,633,596.

#### Class A Shares

The holders of Class A Shares are entitled to receive dividends, as and when declared by the board of directors of the Company in their discretion. However, holders of Class A Shares are not entitled to receive any dividends on the Class A Shares at any time when there are Preferred Shares outstanding.

The holders of the Class A Shares will be entitled to one vote per share. The Class A Shares are retractable at any time. For retractions occurring at a time when any Preferred Shares are outstanding prior to the Redemption Date, the retraction will be \$1.00 per share; for other retractions, the retraction price will be based on the net asset value of the

# ROC Pref II Corp.

## Notes to Consolidated Financial Statements

### December 31, 2004

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Company. The Class A Shares are redeemable by the Company at any time for a redemption price equal to \$1.00 per share when any Preferred Shares are outstanding; for other redemptions, the redemption price will be based on the net asset value of the Company. The Class A Shares rank subsequent to the Preferred Shares with respect to dividends, distributions on retractions and redemptions, and distributions on the dissolution, liquidation or winding-up of the Company. Each Class A Share entitles the holder thereof to participate in the distribution of the remaining net assets of the Company on a dissolution, liquidation or winding-up of the Company.

On August 23, 2004, the Company issued 100 Class A Shares for cash consideration of \$100.

A trust, a related party, was established for the benefit of the Class A Shareholders and owns all of the issued and outstanding Class A Shares of the Company.

#### 6 Forward Agreement and Common Share Portfolio

The Company will partially settle the Forward Agreement prior to the Redemption Date in order to fund quarterly distributions as well as retractions of Preferred Shares by holders and expenses and other liabilities of the Company. In addition, the Manager may, on behalf of the Company, settle all or part of the Forward Agreement prior to the Redemption Date and invest the net proceeds (after any distributions to holders necessary to ensure that the Company is not liable for income tax) in additional investments such as cash and cash equivalents. Similarly, the Manager may, on behalf of the Company, dispose of securities in the Common Share Portfolio and reinvest the proceeds in the Common Share Portfolio or adjust the Forward Agreement and enter into additional forward purchase and sale agreements to provide exposure to the Credit Trust II.

The payment obligations of the Counterparty to the Company under the Forward Agreement will be determined by reference to the performance of Credit Trust II. The Counterparty may hedge its exposure under the Forward Agreement to the economic performance of the Credit Trust II. While the value of the Forward Agreement will be based primarily on the value of the Credit-Linked Note, the Counterparty will have no involvement in the pricing or valuation of the Credit-Linked Note.

The Company will pay to the Counterparty a fee under the Forward Agreement of approximately 0.45% per annum of the net asset value of Credit Trust II.

#### 7 Distributions

Targeted quarterly distributions are \$0.290625 per Preferred Share. During the period from October 1, 2004 (inception date) to December 31, 2004, the Company met its targeted quarterly distribution and paid total distributions of \$3,487,500, or \$0.290625 per unit, representing return of capital to holders of Preferred Shares.

#### 8 Management fees and other expenses

Pursuant to a management agreement ("the Management Agreement") the Company has retained Connor, Clark & Lunn Capital Markets Inc. ("the Manager") to act as manager. As compensation for management services rendered to the Company, the Manager will receive an annual management fee in an amount equal to 0.25% of the net asset value of the Company, to be calculated and payable monthly in arrears, plus applicable taxes.

As compensation for management services rendered to Credit Trust II, the Manager will also receive an annual management fee in an amount equal to 0.10% of the net asset value of Credit Trust II, to be calculated and payable monthly in arrears, plus applicable taxes.

The Manager is entitled to an additional one-time management fee, the "Deferred Management Fee", payable on the Redemption Date and calculated on the quarterly net asset value of the Company on an effective basis of up to 0.65% per annum together with any fees and expenses funded by the Manager, on behalf of the Company, plus applicable taxes, to be paid after the original issue price of the Preferred Shares together with any accrued and unpaid distributions have been paid to Shareholders.

#### 9 Income taxes

The Company qualifies as a mutual fund corporation as defined by the Income Tax Act (Canada). As a mutual fund corporation the Company is entitled to capital gains refunds in respect of (i) capital gains dividends paid by it; and (ii) qualifying redemptions to the extent that the Company has paid or is liable to pay Canadian federal income tax on its taxable capital gains. As a result thereof, and of the deduction of expenses in computing its taxable income, no provisions for income taxes are made in the financial statements.