



CONNOR, CLARK & LUNN

CAPITAL MARKETS

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**ROC Pref II Corp.**

Annual Report

December 31, 2006

## ROC Pref II Corp. Message to Shareholders

March 15, 2007

Dear Investor,

We thank you for your investment in ROC Pref II Corp. (the “Company”) and are pleased to present the Company’s annual report for the year ended December 31, 2006. We are now about half way through the term of the Company. The reference portfolio’s credit quality has held up well and the preferred shares continue to be rated P-1 (low) by Standard & Poor’s. Connor, Clark & Lunn Investment Management Inc. (the “Investment Advisor”) has performed well in terms of maintaining credit quality and the value of the trading reserve account. All scheduled distributions on the preferred shares have been paid.

Launched on October 1, 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 142 investment grade companies (the “Reference Companies”) with a weighted average credit rating of BBB+. The portfolio of Reference Companies is broadly diversified by industry and geographic region and its composition is actively managed by the Investment Advisor. The Investment Advisor 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.

The Investment Advisor believes that global credit markets continue to benefit from healthy corporate balance sheets and a strong global economic environment. The result is that defaults remain at historically low levels. In this positive overall environment, the Investment Advisor is monitoring the increase in M&A and LBO activity. While an increase in such activity reflects good credit conditions, it may become a concern where transactions are heavily debt financed, which in some cases may lead to downgrades of the companies involved. Other factors the Investment advisor is monitoring include the sub-prime mortgage, the impact of volatile energy costs. They would not be surprised to see some modest widening in credit spreads as a result of these factors but are managing the portfolio with this in mind and are confident that the investment objectives of the Company’s shareholders will continue to be met.

Yours truly,



W. Neil Murdoch  
Chief Executive Officer  
ROC Pref II Corp.

## Management Report of Fund Performance

This annual management report of fund performance for ROC Pref II Corp. (the “Company”) contains financial highlights but does not contain the complete annual financial statements of the Company. **The annual financial statements and accompanying notes are attached to this report.**

### Investment Objectives and Strategy

The Company’s investment objectives are to pay holders of its preferred shares (the “Preferred Shares”) an amount per Preferred Share equal to the original subscription price of \$25.00 on or about December 31, 2009 and to pay quarterly, fixed cumulative distributions of \$0.290625 per preferred share to yield 4.65% per annum on the original issue price.

In order to meet its objectives, the Company’s strategy is to maintain exposure, in a tax-efficient manner, to the returns of a credit-linked note (“CLN”). The CLN was issued by HSBC Bank Canada (“HSBC”) on October 1, 2004 matures on December 20, 2009, is currently rated A- by Standard & Poor’s and is structured to provide an enhanced return compared to comparably rated debt securities. The return on the CLN is linked to the performance of a globally diversified, portfolio of 142 companies (the “Reference Portfolio”). The Reference Portfolio is actively managed by Connor, Clark & Lunn Investment Management. Please refer to the Supplementary Financial Information - CLN Portfolio Schedule as of December 31, 2006 for listing of the Reference Portfolio.

In order to provide exposure to the CLN, the Company:

- (i) Purchased a portfolio of the common shares of 12 publicly traded Canadian companies on October 1, 2004 at an aggregate cost of \$289,775,000 million; and
- (ii) Entered into a forward purchase and sale agreement (the “Forward Agreement”) with the HSBC Bank USA (the “Counterparty”), under which the company 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. 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, plus certain hedging costs, calculated with reference to the net asset value of Credit Trust II are payable to Counterparty under the Forward Agreement.

### Risk

The risks associated with an investment in the Company’s preferred shares are best defined by the credit rating of the CLN and the credit rating of the Preferred Shares, which itself is largely derived from the rating of the CLN. Factors that might affect the rating of the CLN include the ratings of the companies in the Reference Portfolio and the time remaining to maturity of the CLN. Factors that influence the rating of the Preferred Shares include the rating of the CLN and the level of cash available to the Company. The CLN was issued with a rating of A- and the Preferred Shares were issued with a rating of P-1 low, both by Standard & Poor’s (“S&P”), with respect to payment of quarterly coupons and the re-payment of principal at maturity. Both the CLN and the Preferred Shares continue to hold those ratings.

A number of events could lead to the revision of the ratings on the CLN and, correspondingly, on the Preferred Shares. These events include:

- (i) Changes in the credit ratings on the companies in the Reference Portfolio;
- (ii) Occurrence of company defaults in the Reference Portfolio, which could result in the remaining first-loss amount falling below that required to affirm the rating on the CLN, which affects the ratings on the Preferred Shares; and
- (iii) Changes to the credit ratings on the Counterparty or HSBC.

For full disclosure of risks associated with an investment in the Preferred Shares, please refer to the latest Annual Information Form.

## Results of Operations

### *Investments of the Company*

#### *The common share portfolio*

The value of the common share portfolio increased from \$257.58 million on December 31, 2005 to \$304.96 million at December 31, 2006. This increase resulted from the combination of an increase in the market value of the portfolio of \$61.54 million, and the delivery of shares with a cost base of \$14.16 million in order to partially settle under the Forward Agreement.

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

Quarterly payments of the 6.867% annual coupon on the CLN and the repayment of principal at maturity on December 31, 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.

During the year ended December 31, 2006, the Company delivered shares with a cost base of \$14.16 million to the Counterparty in exchange for \$16.73 million in cash.

#### *Other investments of the Company*

The Company has no other investments apart from cash and cash equivalents, which are held in order to fund near-term operating expenses. As at December 31, 2006 the Company held \$479,117 in cash and short-term investments on a non-consolidated basis. In order to return the full principal amount per preferred share at maturity on December 31, 2009 the Company must have accumulated at least \$10,225,000 in cash and short-term investments on a consolidated basis by that time. Any amounts received by Credit Trust II that are not required to fund distributions and expenses are retained and invested in short-term debt instrument maturing on or before December 31, 2009. On December 31, 2006, the Company had (on consolidated basis) \$6,563,014 in cash, short-term investments and AAA-rated investments maturing prior to December 31, 2009.

Given the amount by which the CLN coupon exceeds the distribution and expenses requirements of the Company and Credit Trust II, the Company is on track to accumulate in excess of \$10,225,000 by the maturity date of the preferred shares.

### *Investments of Credit Trust II*

#### *The CLN*

Credit Trust II purchased the CLN on October 6, 2004 at par for \$289,775,000. The CLN matures on December 20, 2009, pays a coupon of 6.867% and is currently 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 142 reference companies in the CLN's Reference Portfolio. Based on the Reference Portfolio's credit quality, S&P assigns a minimum level of subordination, which reflects the degree of net losses that a portfolio must be able to absorb without impacting cash flows to shareholders. In order to retain an A- credit rating, the CLN's required level of subordination is currently 3.16%. The actual level of subordination structured into the CLN is 3.43%. 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, subsequent coupon payments and 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 37.3%) would represent approximately 2.7 times the worst level of defaults experienced among a mix of credits

comparable to that of the Reference Portfolio in any three-year period since 1981.

The CLN features an embedded trading reserve account, initially in an amount of \$2,567,010, which stood at \$2,919,696 on December 31, 2006. The trading reserve account is available to absorb net losses that might be incurred when the Connor, Clark & Lunn Investment Management Ltd. (the "Investment Advisor") makes substitutions in the Reference Portfolio. The trading reserve account can also be used to purchase additional subordination from HSBC. At December 31, 2006 the trading reserve account would have purchased an additional 0.16% of subordination, bringing total percentage loss that could have been absorbed in the Reference Portfolio without affecting payments of interest or principal to 3.59%. The amount of additional subordination that can be purchased using the trading reserve account will vary in response to changing market conditions. The ability to absorb 3.59% losses in the portfolio currently translates into a coverage ratio of 6.1x the average level of defaults over a three-year period for a portfolio with the same ratings characteristics and term as the Reference Portfolio.

### *Credit quality of the Reference Portfolio*

Risk in the CLN is a function of Reference Portfolio credit quality and time to maturity. As the CLN ages, the risk of default for companies with a given rating decreases. Balanced against that time benefit is the fact that credit ratings have historically moved lower over time. The composition of the Reference Portfolio is designed with the objective that the CLN will maintain its initial rating as these two effects act on the portfolio. Changes in credit quality as it is measured by the market can be seen through changes in the average credit spread of the Reference Portfolio. A good indication of the performance of the Reference Portfolio is the movement in credit spread of the Reference Portfolio versus that of a corresponding index. Lower credit spread indicates less risk. The index that best corresponds to the Reference Portfolio is the Dow Jones CDX North America Investment Grade 3 Index:

	2005		2006	
	June 30 <sup>th</sup>	December 31 <sup>st</sup>	June 30 <sup>th</sup>	December 31 <sup>st</sup>
Dow Jones IG 3 index	65.27	77.36	71.03	44.06
Reference Portfolio spread	53.12	53.06	48.38	55.84

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 in turn may affect the trading price. The following table describes the Reference Portfolio's ratings characteristics on December 31, 2004, 2005 and 2006:

Exposure to Issuers				Exposure to Issuers			
Rating <sup>(1)</sup>	2004	2005	2006	Rating <sup>(1)</sup>	2004	2005	2006
AAA	3	3	4	BBB	23	21	24
AA+	0	0	0	BBB-	13	5	3
AA	3	3	4	BB+	0	3	3.5
AA-	2	6	8	BB	1	2	4.5
A+	17	19	16	BB-	0	1	1
A	26	24	21.5	B+	0	0	1
A-	24	23	25.5	B	0	0	1
BBB+	27	30	23	N/R	1	0	0
				<b>Total</b>	<b>140</b>	<b>140</b>	<b>140</b>

<sup>(1)</sup> 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.

As described above, S&P's rating anticipates deterioration in the average credit rating of the companies in the Reference Portfolio over time, reflecting the fact that credit ratings tend to migrate lower over time. The maintenance of the A- rating and the increase in the CLN's cushion over the required subordination level indicate that the Reference Portfolio has performed better than required to maintain the CLN's credit rating. Over the twelve months period, as a result of ratings

changes and trading activity, the Reference Portfolio experienced 16 reference company upgrades averaging 1.9 rating categories, or notches, per upgrade for a total 33 notch increase and 31 reference company downgrades averaging 1.4 notches per downgrade for a total 44 notch decrease, leaving the portfolio's average rating approximately constant. The companies in the Reference Portfolio are listed in the Supplementary Financial Information as at December 31, 2006.

### *Substitutions in the Reference Portfolio*

The Reference Portfolio is managed by the Investment Advisor. The Investment Advisor's goal is to reduce the likelihood of having exposure to companies that default on their senior obligations. To that end, the Investment Advisor can add or remove companies through a substitution process executed in accordance with the terms of the CLN. If the Investment Advisor 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 trading reserve account depending on the credit spread comparison between the companies being substituted. The trading reserve account described above is available to absorb net losses that may be incurred through these substitutions.

The Investment Advisor made 20 substitutions in the Reference Portfolio from October 1, 2004 (commencement of operations) to December 31, 2006.

### *Value of the CLN*

The CLN is valued on the 10<sup>th</sup> and last business day of each month by HSBC. CLN value reflects the amount that HSBC is willing to pay in order to discharge its obligations under the CLN and is based on HSBC's proprietary assumptions concerning current and future market conditions and events. 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 Reference Portfolio, interest rates as measured by the Canadian dollar swap rate to the date of maturity of the note, the value of the trading reserve account and other factors, such as correlation, that are proprietary to HSBC. At December 31, 2006, the CLN value was \$311.865 million, up from \$298.65 million on December 31, 2005.

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

On December 31, 2006 the Credit Trust II held \$6,083,897 in cash, short-term investments and AAA-rated investments maturing prior to December 31, 2009, compared to total other investments of \$3,137,698 on December 31, 2005.

### *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, 2006, the value of the common share portfolio was \$304.961 million. Since the Company can deliver the value of the common share portfolio to HSBC 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, 2006 value of the Forward Agreement was \$13.581 million. Other net assets in the Company, prior to consolidation, totalled \$(4.371) million leaving a net asset value of \$314.171 million or \$26.18 per Preferred Share. The net asset value per Preferred Share was \$24.99 on December 31, 2005. The increase in net asset value over the period is primarily attributable to the increase in the value of the CLN.

## ***Liquidity and Capital Resources***

The obligations of the Company include operating expenses and declared distributions to preferred shareholders. The funding of these obligations will be satisfied primarily through partial settlements under the Forward Agreement as described above. As at December 31, 2006, the Company had current assets of \$4,242,603 and current liabilities of \$233,350 on a consolidated basis.

## **Management Expense Ratio**

The management expense ratio (MER) represents the ratio of annual expenses that are required to operate the company to the average value of issued Preferred Share capital. The base MER excluding all distributions paid to preferred shareholders and deferred management fees, which are only payable after full repayment of the original preferred share issue price, for the year ended on December 31, 2006 was approximately 0.98%. If the fees and expenses described above exceed 1.00% of the par value of the Preferred Shares per year (being \$3,000,000 per year), the Manager will agree to fund such excess out of, but only to the extent of, its Deferred Management Fee (as defined below in “Related Party Transactions – Management fees”).

The annualized MER for the same period including all distributions paid to preferred shareholders and deferred management fees was approximately 6.28%.

Please refer to the Financial Highlights section of this document for more information.

## **Distributions**

During the year ended on December 31, 2006, the Preferred Shares paid regular quarterly distributions of \$0.290625 per share for a total of \$1.1625 per share (\$1.1625 per share for the year ended on December 31, 2005), representing a yield of 4.65% on the \$25.00 par value.

## **Related Party Transactions**

### ***Management Fees***

Pursuant to a management agreement (“the Management Agreement”) the Company and Credit Trust II have retained Connor, Clark & Lunn Capital Markets Inc. (“the Manager”) to act as a manager. As compensation for coordinating the organization of and managing the ongoing business and administrative affairs of the Company and Credit Trust II, the Manager receives an annual management fee in an amount equal to 0.25% per annum 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% per annum of the net asset value of the Credit Trust II to be calculated and payable monthly in arrears, plus applicable taxes.

The total management fees charged to the Company for the year ended on December 31, 2006 were \$1,163,860 (\$1,153,414 for the year ended on December 31, 2005) including GST on a consolidated basis.

To the extent that any assets remain after the original issue price of the preferred shares of the Company, together with any accrued and unpaid distributions, have been paid to shareholders, the Manager will be paid an amount equal to any fees and expenses funded by the Manager on behalf of the Company and an additional one-time deferred management fee payable on redemption of the preferred shares of up to 0.65% per annum, calculated based on quarterly NAV of the Company. The deferred management fees accrued for the year ended December 31, 2006 were \$2,098,072 (\$2,068,378 for the year ended December 31, 2005).

The Manager pays the Investment Advisor out of the above management fees.

## Recommendations or Reports by the Independent Committee

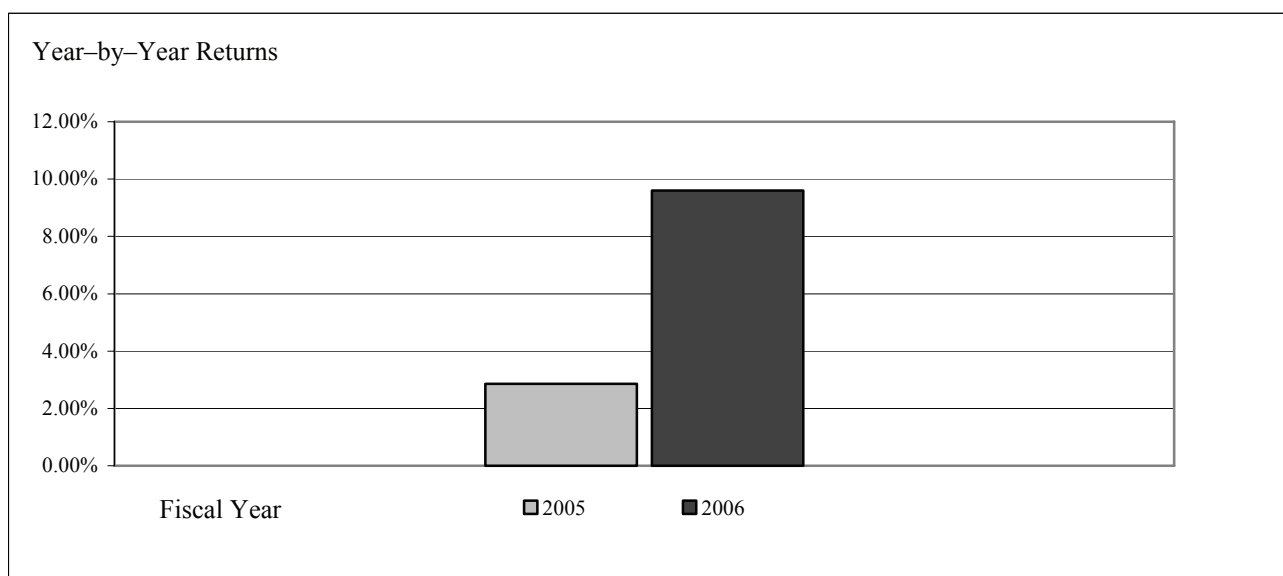
The Independent Committee of the Board of Directors tabled no special reports and made no reportable material recommendations to management of the Company in the year ended December 31, 2006.

## Past Performance

The following bar chart and table indicate the performance of the Preferred Shares by showing both annual returns by fiscal year and annualized compound returns from inception assuming all the distributions made by the Company in the periods shown were reinvested. Past performance is not necessarily indicative of future performance.

### Year – by –Year Returns

The following bar chart shows the Company’s annual performance for the years shown. This bar chart shows, in percentage terms, how much an investment made on the first day of the financial year would have grown or decreased by the last day of the financial year.



### Annual Compound Returns

	Past Year	Since Inception <sup>(1)</sup>
Based on NAV <sup>(2)</sup>	9.60 %	8.48%
Based on share price <sup>(3)</sup>	4.74%	3.98%
Bloomberg / EFFAS <sup>(4)</sup> Canada Government 3-5 year Index	3.92%	3.87%

<sup>(1)</sup> Annualized for the period October 1, 2004 (Commencement of operations) to December 31, 2006.

<sup>(2)</sup> Calculated from initial net asset value of \$24.15 and December 31, 2005 net asset value of \$24.99 assuming all distributions reinvested.

<sup>(3)</sup> Calculated from issue price of \$25.00 and December 31, 2005 market price of \$24.60 assuming all distributions reinvested.

<sup>(4)</sup> Index of Canadian Government bonds with 3 to 5 years to maturity. EFFAS: European Federation of Financial Analyst Societies.

## Financial Highlights

The following tables show selected key financial information about the Company and are intended to help explain the Company's financial performance since inception. This information is derived from the Company's audited annual financial statements:

The Company's Net Asset Value per share:

	2006	2005	2004 <sup>(1)</sup>
<b>Net Asset Value, beginning of period</b>	<b>24.99</b>	<b>25.39</b>	<b>25.00</b>
<b>Increase (decrease) from operations:</b>			
Total revenues	1.67	1.66	0.40
Total expenses	(0.42)	(0.41)	(0.10)
Issue expenses <sup>(2)</sup>	—	—	(0.85)
Realized gains (losses) for the period	0.21	(0.11)	0.02
Unrealized gains (losses) for the period	0.89	(0.38)	1.21
<b>Total increase (decrease) from operations <sup>(3)</sup></b>	<b>2.35</b>	<b>0.76</b>	<b>0.68</b>
<b>Distributions:</b>			
From income (excluding dividends)	—	—	—
From dividends	—	—	—
From capital gains	—	—	—
Return of capital	(1.16)	(1.16)	(0.29)
<b>Total Annual Distributions <sup>(4)</sup></b>	<b>(1.16)</b>	<b>(1.16)</b>	<b>(0.29)</b>
<b>Net Asset Value, end of period <sup>(5)</sup></b>	<b>26.18</b>	<b>24.99</b>	<b>25.39</b>

<sup>(1)</sup> Results for the period October 1, 2004 (Commencement of operations) to December 31, 2004.

<sup>(2)</sup> Issue expense of \$10,213,702 incurred in connection with the Share issuance, which has been treated as a reduction of capital.

<sup>(3)</sup> Net asset value and distributions are based on the actual number of shares outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of shares outstanding over the financial period.

<sup>(4)</sup> Distributions were paid in cash.

<sup>(5)</sup> This is not a reconciliation between the opening and the closing net asset values per Share.

Ratios and Supplemental Data:

	2006	2005	2004 <sup>(1)</sup>
Net assets (000's)	314,171	299,856	304,634
Number of Preferred shares outstanding	12,000,000	12,000,000	12,000,000
Base Management expense ratio <sup>(2)</sup>	0.98%	0.93%	0.93%
Management expense ratio <b>including distributions on preferred shares</b> , deferred management fees and issue expenses <sup>(2)(3)</sup>	6.28%	6.28%	9.79%
Management expense ratio before waivers or absorptions <sup>(2)(3)</sup>	6.28%	6.28%	9.79%
Portfolio turnover rate <sup>(4)</sup>	20.94%	50.08%	1.40%
Trading expense ratio <sup>(5)</sup>	0.00%	0.00%	0.00%
Closing market price (TSX)	23.65	24.60	25.50

<sup>(1)</sup> Results for the period October 1, 2004 (Commencement of operations) to December 31, 2004.

<sup>(2)</sup> A separate base management expense ratio has been presented to include the normal operating expenses of the Fund and exclude (i) deferred management fees (payable on maturity date), (ii) distributions on preferred shares and (iii) the one time initial share offering issue expenses.

<sup>(3)</sup> Management expense ratio is based on total expenses for the stated period and is expressed as an annualized percentage of daily average net assets during the period. The MER for the period ending December 31, 2004 annualizes expenses incurred from commencement of operations on October 1, 2004 to December 31, 2004 and it also includes all Agents' fees and other offering expenses, which are one time expenses and therefore not annualized. To the extent that assets remain in the Company after the original issue price of the Preferred Shares together with any accrued and unpaid distributions have been paid to Shareholders, the Manager is entitled to: (a) 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; and (b) to recover any fees and expenses funded by it on behalf of the Company, plus applicable taxes.

<sup>(4)</sup> The Company's turnover rate indicates how actively the Company's portfolio adviser manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Company's buying and selling all of the securities in its portfolio once in the course of the year. In the case of the Company, a high turnover rate may lead to a marginal increase in trading costs and may increase the chance of an investor receiving taxable capital gains in that year. There is not necessarily a relationship between turnover rate and the performance of the Company.

<sup>(5)</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net assets during the period.

## Summary of Investment Portfolio as of December 31, 2006

The summary of investment portfolio may change due to ongoing portfolio transactions of the Fund. A quarterly update is available at [www.cclcapitalmarkets.com](http://www.cclcapitalmarkets.com) and at [www.sedar.com](http://www.sedar.com).

			Market Value \$	% of NAV
<b>Portfolio by Category</b>				
Credit-linked notes			311,864,691	99.3%
Information Technology			139,148,020	44.3%
Materials			95,508,258	30.4%
Industrials			27,632,691	8.8%
Consumer Discretionary			25,872,714	8.2%
Consumer Staples			11,072,213	3.5%
Health Care			5,726,774	1.8%
Cash and Cash Equivalents			3,569,740	1.1%
Corporate bonds			2,993,274	1.0%
	<b>Rate %</b>	<b>Maturity date</b>	<b>Market Value \$</b>	<b>% of NAV</b>
<b>Top 25 Holdings</b>				
HSBC Bond	6.87%	12/20/2009	311,864,691	99.3%
Lionore Mining International Ltd.			59,268,058	18.9%
Kinross Gold Corp.			36,240,200	11.5%
Research In Motion			35,655,700	11.3%
Cognos Inc.			31,662,153	10.1%
Bombardier Inc. Class B			27,632,691	8.8%
Rona Inc.			25,872,714	8.2%
CGI Group Class A			25,109,277	8.0%
Open Text Corp.			23,098,850	7.4%
Celestica Inc.			13,281,498	4.2%
Cott Corp.			11,072,213	3.5%
Nortel Networks Corp.			10,340,542	3.3%
Angiotech Pharmaceuticals Inc.			5,726,774	1.8%
Cash and Cash Equivalents			3,569,740	1.1%
Golden Credit Card Trust	4.16%	10/15/2008	2,993,274	1.0%
<b>Net asst value (NAV)</b>			<b>314,171,404</b>	<b>100.0%</b>

## Supplementary Financial Information:

The following is a listing of CLN Portfolio (Reference Portfolio) as at December 31, 2006:

CLN Portfolio (Reference Portfolio) as at December 31, 2006 (Unaudited)			
Entity Description	S&P Rating	Industry	Country
3I Group Plc	A+	Brokers, Dealers & Investment houses	Britain
American Standard Inc	BBB	Industrial equipment	USA
Accor	BBB	Lodging & casinos	France
Alcan Inc.	BBB+	Nonferrous metals/minerals	Canada
Allstate Corp. (The)	A+	Insurance	USA
Alltel Corporation	A-	Telecommunications	USA
Altria Group, Inc.	BBB+	Beverage & Tobacco	USA
Ambac Financial Group, Inc.	AA	Insurance	USA
Amgen Inc.	A+	Drugs	USA
Anglo American PLC	A	Nonferrous metals/minerals	Britain
Anheuser-Busch Companies Inc	A	Beverage & Tobacco	USA
Aon Corporation	BBB+	Insurance	USA
Autostrade Spa	A	Surface transport	Italy
BCE Inc.	A-	Telecommunications	Canada
BHP Billiton Ltd.	A+	Nonferrous metals/minerals	Australia
Barrick Gold Corporation	A-	Nonferrous metals/minerals	Canada
Baxter International Inc.	A	Health care	USA
Bayer Aktiengesellschaft	BBB+	Chemicals & plastics	Germany
Bear Stearns Companies Inc.	A+	Brokers, Dealers & Investment houses	USA
Bombardier Inc.	BB	Aerospace & Defence	Canada
BorgWarner, Inc.	A-	Automotive	USA
Bristol-Myers Squibb Company	A+	Drugs	USA
British American Tobacco p.l.c.	BBB+	Beverage & Tobacco	Britain
CIT Group Inc.	A	Financial intermediaries	USA
Compass Group Plc	BBB+	Food service	Britain
Cameco Corporation	BBB+	Nonferrous metals/minerals	Canada
Campbell Soup Co.	A	Food products	USA
Cardinal Health, Inc.	BBB	Food/drug retailers	USA
Cargill, Incorporated	A+	CW-NEG Farming/agriculture	USA
Carrefour Sa	A	Food/drug retailers	France
Caterpillar Financial Services Corp	A	Industrial equipment	USA
Centex Corporation	BBB	Building & Development	USA
Centurytel Inc.	BBB	Telecommunications	USA
Cingular Wireless LLC	A	CW-NEG Telecommunications	USA
Clear Channel Communications Inc.	BB+	CW-NEG Radio & Television	USA
Coca-Cola Enterprises Inc	A	Beverage & Tobacco	USA
Comcast Cable Communications Inc.	BBB+	Cable & satellite television	USA
Computer Sciences Corporation	A-	CW-NEG Electronics/electrical	USA
Constellation Energy Group, Inc.	BBB+	Utilities	USA
Deutsche Bank AG	AA-	Financial intermediaries	Germany
DaimlerChrysler AG	BBB	Automotive	Germany
Deutsche Lufthansa AG	BBB	Air transport	Germany
Dominion Resources, Inc.	BBB	Utilities	USA
Domtar, Inc.	BB-	CW-DEV Forest products	Canada
Dte Energy Co	BBB	Utilities	USA
Duke Capital LLC	BBB	Utilities	USA
Duke Energy LLC	BBB	Utilities	USA
EMI Group plc	BB	Leisure goods/activities/movies	Britain
Enbridge Inc	A-	Utilities	Canada
Eop Operating Limited Partnership	BBB	REITs and REOCs	USA
European Aeronautic Defense and Space Company EADS N.V.	A-	CW-NEG Aerospace & Defence	Netherlands
Exelon Generation Co Llc	BBB+	CW-NEG Utilities	USA
Federal National Mortgage Association	AAA	U.S. Agency (Explicitly Guaranteed)	USA
Federated Department Stores, Inc.	BBB	Retailers (except food & drug)	USA
Financial Security Assurance Inc	AAA	Insurance	USA
Ford Motor Credit Company	B	Automotive	USA
France Telecom	A-	Telecommunications	France
Gannett Co Inc	AA-	CW-NEG Publishing	USA
General Electric Capital Corporation	AAA	Conglomerates	USA
General Motors Acceptance Corporation	BB+	CW-DEV Automotive	USA
Hannover Rueckversicherungs-AG	AA-	Insurance	Germany
Hellenic Telecommunications Organiz Sa	BBB+	Telecommunications	Greece
Honeywell International Inc.	A	Aerospace & Defence	USA
Humana Inc	BBB	Health care	USA

**CLN Portfolio (Reference Portfolio) as at December 31, 2006 (Unaudited)**

<b>Entity Description</b>	<b>S&amp;P Rating</b>	<b>Industry</b>	<b>Country</b>
Hutchison Whampoa Limited	A-	Conglomerates	Hong Kong
Idearc Inc	BB	Telecommunications	USA
International Business Machines Corporation	A+	Electronics/electrical	USA
International Lease Finance Corporation	AA-	Equipment leasing	USA
Israel Electric Corp Ltd	BBB+	Utilities	Israel
J.P. Morgan Chase & Co.	A+	CW-POS Financial intermediaries	USA
Kimco Realty Corp	A-	REITs and REOCs	USA
Kinder Morgan Energy Partners, L.P.	BBB+	CW-NEG Utilities	USA
Korea Electric Power Corporation	A	Utilities	South Korea
Korea Telecom	A-	Telecommunications	South Korea
Lehman Brothers Holdings Inc.	A+	Financial intermediaries	USA
Loews Corporation	A	Conglomerates	USA
Marsh & McLennan Companies Inc.	BBB	Insurance	USA
MBIA Inc.	AA	Insurance	USA
MGIC Investment Corporation	A	Insurance	USA
Muenchener Rueckversicherungs-Gesellschaft AG	A+	Insurance	Germany
Marriott International, Inc.	BBB+	Lodging & casinos	USA
MeadWestvaco Corporation	BBB	Forest products	USA
Merck & Co Inc	AA-	Drugs	USA
Merrill Lynch & Co., Inc.	AA-	Financial intermediaries	USA
Morgan Stanley	A+	Brokers, Dealers & Investment houses	USA
MTR Corporation Ltd	AA	Rail industries	Hong Kong
Novartis AG	AAA	Drugs	Switzerland
National Rural Utilities Coop Finance Corp	A	Electronics/electrical	USA
Newell Rubbermaid Inc.	BBB+	Home furnishings	USA
Noranda Inc	BBB+	Nonferrous metals/minerals	Canada
Norbord Inc	BBB	Forest products	Canada
Nordstrom, Inc.	A	Retailers (except food & drug)	USA
Omnicom Group Inc.	A-	Business equipment & services	USA
PCCW - HKT Telephone Limited	BBB	Telecommunications	Hong Kong
Pitney Bowes Credit Corporation	A+	Business equipment & services	USA
Petroleum Nasional Berhad	A-	Oil & gas	Malaysia
Placer Dome Inc	A-	Nonferrous metals/minerals	Canada
Qantas Airways Limited	BBB+	CW-NEG Air transport	Australia
Quebecor World Inc.	B+	Publishing	Canada
RadioShack Corporation	BB	Retailers (except food & drug)	USA
Reuters Group plc	A-	Business equipment & services	Britain
SCOR	A-	Insurance	France
Sherwin-Williams Company	A-	CW-NEG Chemicals & plastics	USA
SLM Corporation	A	Financial intermediaries	USA
Sabre Holdings Corporation	BB	CW-NEG Business equipment & services	USA
Sara Lee Corp	BBB+	Food products	USA
Schering-Plough Corporation	A-	Drugs	USA
Sealed Air Corp	BBB	Containers & glass products	USA
Siemens Aktiengesellschaft	AA-	Conglomerates	Germany
Simon Property Group, L.P.	A-	REITs and REOCs	USA
Sodexo Alliance Sa	BBB+	Food service	France
Southwest Airlines Co.	A	Air transport	USA
TXU Corporation	BBB-	Utilities	USA
Takefuji Corporation	BBB	CW-NEG Financial intermediaries	Japan
Target Corporation	A+	Retailers (except food & drug)	USA
Telecom Italia SpA	BBB+	Telecommunications	Italy
Telephone And Data Systems Inc	BBB	CW-NEG Telecommunications	USA
Temple-Inland Inc	BBB	Forest products	USA
Textron Financial Corporation	A-	Financial intermediaries	USA
The Dow Chemical Company	A-	Chemicals & plastics	USA
The Export-Import Bank of Korea	A	Uncorrelated (Corporate)	South Korea
The Goldman Sachs Group, Inc.	AA-	Brokers, Dealers & Investment houses	USA
Time Warner Inc.	BBB+	Leisure goods/activities/movies	USA
Transalta Corp	BBB	Utilities	Canada
Transocean Inc.	A-	Oil & gas	USA
Tribune Company	BB+	CW-NEG Publishing	USA
Tyson Foods, Inc.	BBB-	Food products	USA
Universal Corp.	BBB-	Beverage & Tobacco	USA
UST Inc.	A	Beverage & Tobacco	USA
Unilever N.V.	A+	Food products	Netherlands
Verizon Communications Inc	A	Telecommunications	USA
Viacom Inc	BBB	Radio & Television	USA
Vodafone Group Plc	A-	Telecommunications	Germany

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**CLN Portfolio (Reference Portfolio) as at December 31, 2006 (Unaudited)**

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<b>Entity Description</b>	<b>S&amp;P Rating</b>	<b>Industry</b>	<b>Country</b>
Volkswagen Aktiengesellschaft	A-	Automotive	Germany
WPP Group Plc	BBB+	Business equipment & services	Britain
Wal-Mart Stores Inc	AA	Retailers (except food & drug)	USA
Walt Disney Company	A-	Leisure goods/activities/movies	USA
Windstream	BB+	Telecommunications	USA
Wolters Kluwer N.V.	BBB+	Publishing	Netherlands
Wyeth	A	Drugs	USA
XL Capital Ltd	A-	Insurance	Bermuda
Zurich Insurance Company	A+	Insurance	Switzerland

## 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 will be submitted for approval by the Board of Directors (the "Board") on March 9, 2007.

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.



W. Neil Murdoch  
President and Chief Executive Officer



Philip Gow  
Chief Financial Officer

Toronto, Canada  
March 9, 2007

March 9, 2007

## Auditors' Report

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

We have audited the consolidated statement of investments of **ROC Pref II Corp.** as at December 31, 2006, the consolidated statements of net assets as at December 31, 2006 and 2005 and the consolidated statements of operations, changes in shareholders' equity and retained earnings, cash flows and changes in investments 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 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, 2006 and 2005 and the results of its operations, the changes in its shareholders' equity and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

**Chartered Accountants**

## ROC Pref II Corp.

### Consolidated Statements of Financial Position

As at December 31, 2006 and 2005

	2006	2005
	\$	\$
<b>Assets</b>		
Cash	50,537	68,196
Short-term investments	3,519,203	3,439,941
Interest receivable	638,266	601,897
Prepaid expenses	34,597	32,341
Investments at market value (cost - \$292,752,590; December 31, 2005 - \$289,775,000)	314,857,965	298,650,951
Investments pledged to counter party under forward agreement	304,960,670	257,580,507
	<u>624,061,238</u>	<u>560,373,833</u>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	135,292	110,703
Management fees payable	98,058	229,200
Payable to counterparty under forward agreement	304,960,670	257,580,507
Deferred management fees payable (note 8)	4,695,714	2,597,642
Preferred share capital (note 5)	314,171,404	299,855,681
	<u>624,061,138</u>	<u>560,373,733</u>
<b>Shareholders' Equity</b>		
Share capital (note 5)	100	100
Retained earnings	-	-
	<u>100</u>	<u>100</u>
<b>Total Liabilities and Shareholders' Equity</b>	<u>624,061,238</u>	<u>560,373,833</u>
<b>Number of Preferred Shares outstanding (note 5)</b>	<u>12,000,000</u>	<u>12,000,000</u>
<b>Net Asset Value per Preferred Share outstanding</b>	<u>26.18</u>	<u>24.99</u>
<b>Number of Class A Shares outstanding (note 5)</b>	<u>100</u>	<u>100</u>
<b>Net Asset Value per Class A Share outstanding</b>	<u>1.00</u>	<u>1.00</u>

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



Director



Director

## ROC Pref II Corp.

### Consolidated Statements of Operations

For the years ended December 31, 2006 & 2005

	2006	2005
	\$	\$
<b>Revenue</b>		
Interest	<u>20,092,708</u>	<u>19,941,941</u>
<b>Expenses</b>		
Deferred management fees (note 8)	2,098,072	2,068,378
Forward fees	1,405,352	1,316,448
Management fees	1,163,860	1,153,414
Capital tax expense	81,793	-
Custodial fees	68,756	88,474
Rating agency fees	40,851	11,888
Insurance Premiums	35,481	36,261
Audit fees	31,843	42,672
Sustaining fees	31,417	46,314
Directors' fees	31,048	34,828
Administration fees	19,504	-
Legal fees	16,446	18,450
Transfer agent fees	15,471	13,195
Printing and mailing charges	10,293	27,093
Other	<u>6,222</u>	<u>1,030</u>
	<u>5,056,409</u>	<u>4,858,445</u>
<b>Net investment income before distributions on Preferred Shares</b>	15,036,299	15,083,496
Distributions paid on Preferred Shares	<u>13,950,000</u>	<u>13,950,000</u>
<b>Net investment income</b>	1,086,299	1,133,496
Net realized gain (loss) on investments (note 6)	2,571,453	(1,368,520)
Unrealized gain (loss) on Forward Agreement (notes 2 and 6)	(2,571,453)	1,368,520
Change in unrealized gain (loss) on investments	<u>13,229,424</u>	<u>(5,911,411)</u>
<b>Increase (decrease) in net assets from operations</b>	<u>14,315,723</u>	<u>(4,777,915)</u>
<b>Increase (decrease) in net assets from operations per preferred share</b>	<u>1.19</u>	<u>(0.40)</u>
<b>Total distributions paid per Preferred Share (Return of Capital)</b>	<u>1.16</u>	<u>1.16</u>

(See accompanying notes to financial statements)

**ROC Pref II Corp.**

## Consolidated Statements of Changes in Shareholders' Equity and Retained Earnings

For the years ended December 31, 2006 &amp; 2005

	2006	2005
	\$	\$
<b>Changes in shareholders' equity</b>		
<b>Share capital - beginning of period</b>	100	100
Proceeds from issuance of class A shares	-	-
<b>Share capital - end of period</b>	<u>100</u>	<u>100</u>
<b>Changes in Retained Earnings</b>		
<b>Retained earnings - beginning of period</b>	-	-
Increase (decrease) in net assets from operations	14,315,723	(4,777,915)
(Surplus) deficit attributable to preferred shareholders (note 5)	<u>(14,315,723)</u>	<u>4,777,915</u>
<b>Retained earnings - end of period</b>	<u>-</u>	<u>-</u>

(See accompanying notes to financial statements)

## ROC Pref II Corp.

### Consolidated Statements of Cash Flows

For the years ended December 31, 2006 & 2005

	2006	2005
	\$	\$
<b>Operating Activities</b>		
Increase (decrease) in net assets from operations	14,315,723	(4,777,915)
Items not affecting cash:		
Net realized (gain) loss on investments	(2,571,453)	1,368,520
Unrealized (gain) loss on Forward Agreement	2,571,453	(1,368,520)
Change in unrealized (gain) loss on investments	(13,229,424)	5,911,411
Changes in non-cash working capital		
(Increase) decrease in interest receivable	(36,369)	(2,143)
(Increase) decrease in prepaid expenses	(2,256)	(32,341)
Increase (decrease) in accounts payable and accrued liabilities	24,589	(12,338)
Increase (decrease) in management fees payable	(131,142)	(33,825)
Increase (decrease) in deferred management fees payable	<u>2,098,072</u>	<u>2,068,378</u>
<b>Net cash flow provided by operating activities</b>	<u>3,039,193</u>	<u>3,121,227</u>
<b>Investing Activities</b>		
Purchase of investments	(57,113,160)	(130,203,805)
Proceeds on disposition of investments	<u>54,135,570</u>	<u>130,203,805</u>
<b>Net cash used in investing activities</b>	<u>(2,977,590)</u>	<u>-</u>
<b>Net increase in cash and short-term investments</b>	61,603	3,121,227
<b>Cash and short-term investments - beginning of period</b>	<u>3,508,137</u>	<u>386,910</u>
<b>Cash and short-term investments - end of period</b>	<u>3,569,740</u>	<u>3,508,137</u>

## ROC Pref II Corp.

### Consolidated Statements of Changes in Investments

For the years ended December 31, 2006 & 2005

	2006	2005
	\$	\$
<b>Investments at average cost - Beginning of period</b>	289,775,000	289,775,000
Cost of investments purchased	57,113,160	130,203,806
Cost of investments sold	(68,294,117)	(148,019,825)
Cost of investments released by (pledged to) the Counterparty under the Forward Agreement (notes 2 and 6)	<u>14,158,547</u>	<u>17,816,019</u>
<b>Investments at average cost - End of period</b>	292,752,590	289,775,000
Unrealized gain (loss) on investments	<u>22,105,375</u>	<u>8,875,951</u>
<b>Investments at market value</b>	<u>314,857,965</u>	<u>298,650,951</u>
Proceeds from investments sold	70,865,570	146,651,305
Cost of investments sold	<u>(68,294,117)</u>	<u>(148,019,825)</u>
<b>Net realized gain (loss) on investments</b>	<u>2,571,453</u>	<u>(1,368,520)</u>

## ROC Pref II Corp.

### Consolidated Statement of Investments

As at December 31, 2006

	Rate %	Maturity date	Number of shares or par value	Average cost \$	Market value \$	% of portfolio
<b>Short-term investments</b>						
<b>Bearer Deposit Notes</b>						
Bank of Nova Scotia		01/29/07	850,000	840,650	840,650	23.9%
Bank of Nova Scotia		02/22/07	800,000	791,312	791,312	22.5%
Royal Bank		02/27/07	1,450,000	1,438,618	1,438,618	40.9%
<b>Bankers Acceptance</b>						
Bank of Montreal		01/24/07	450,000	448,623	448,623	12.7%
<b>Total short-term investments</b>				<u>3,519,203</u>	<u>3,519,203</u>	<u>100.0%</u>
<b>Investments</b>						
<b>Corporate bonds</b>						
Golden Credit Card Trust	4.16%	10/15/2008	3,000,000	<u>2,977,590</u>	<u>2,993,274</u>	<u>1.0%</u>
<b>Credit-linked notes</b>						
HSBC Bond	6.87%	12/20/2009	289,775,000	<u>289,775,000</u>	<u>311,864,691</u>	<u>99.0%</u>
<b>Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>						
<b>Materials</b>						
Kinross Gold Corp.			2,622,301	20,611,286	36,240,200	11.5%
Lionore Mining International Ltd.			4,473,061	<u>14,838,089</u>	<u>59,268,058</u>	<u>18.8%</u>
				<u>35,449,375</u>	<u>95,508,258</u>	<u>30.3%</u>
<b>Industrials</b>						
Bombardier Inc. Class B			6,995,618	<u>22,176,109</u>	<u>27,632,691</u>	<u>8.8%</u>
<b>Consumer Discretionary</b>						
Rona Inc.			1,232,034	<u>27,067,787</u>	<u>25,872,714</u>	<u>8.2%</u>
<b>Consumer Staples</b>						
Cott Corp.			663,404	<u>24,147,906</u>	<u>11,072,213</u>	<u>3.5%</u>
<b>Health Care</b>						
Angiotech Pharmaceuticals Inc.			597,161	<u>15,209,691</u>	<u>5,726,774</u>	<u>1.8%</u>

(See accompanying notes to financial statements)

## ROC Pref II Corp.

Consolidated Statement of Investments .... *continued*

As at December 31, 2006

	<b>Number of shares or par value</b>	<b>Average cost \$</b>	<b>Market value \$</b>	<b>% of portfolio</b>
<b>Information Technology</b>				
CGI Group Class A	3,088,472	21,433,907	25,109,277	8.0%
Cognos Inc.	638,994	27,067,786	31,662,153	10.1%
Open Text Corp.	965,671	22,258,717	23,098,850	7.3%
Celestica Inc.	1,462,720	22,419,442	13,281,498	4.2%
Nortel Networks Corp.	330,580	14,545,520	10,340,542	3.3%
Research In Motion	239,300	22,271,651	35,655,700	11.3%
		<u>129,997,023</u>	<u>139,148,020</u>	<u>44.2%</u>
<b>Total Canadian common stocks</b>		<u>254,047,891</u>	<u>304,960,670</u>	<u>96.8%</u>
<b>Payable to the Counterparty under the Forward Agreement</b>		<u>(254,047,891)</u>	<u>(304,960,670)</u>	<u>-96.8%</u>
<b>Total investments</b>		<u>292,752,590</u>	<u>314,857,965</u>	<u>100%</u>

# ROC Pref II Corp.

## Notes to Consolidated Financial Statements

### December 31, 2006

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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 RBC Dexia Investor Services Trust ("RBC Dexia") (formerly "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. The Company commenced operations on October 1, 2004.

#### 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 in order to meet its investment objectives entered into a forward purchase and sale agreement (the "Forward Agreement") (note 6) with HSBC Bank USA (the "Counterparty") which provides 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 Canada ("HSBC"). 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, 2006

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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.

#### **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 RBC Dexia ("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 pays 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 (commencement of operations) to December 31, 2006.

##### **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 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.

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**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, calculated and payable quarterly in arrears.

The following table splits the changes in the Common Share Portfolio between (i) shares delivered to the Counterparty as a partial settlement under the forward agreement, and (ii) substitutions in the Common Share Portfolio for the years ended on December 31, 2006 and 2005:

	2006	2005
	\$	\$
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	16,730,000	16,447,500
Cost of investments delivered on partial pre-settlement	<u>(14,158,547)</u>	<u>(15,417,406)</u>
Realized gain on partial pre-settlement	2,571,453	1,030,094
Proceeds on sale of investments (subsequently reinvested)	54,135,570	130,203,805
Cost of investments sold	<u>(54,135,570)</u>	<u>(132,602,419)</u>
Realized loss on sale of investments	<u>—</u>	<u>(2,398,614)</u>
Realized gain (loss) on investments	<u>2,571,453</u>	<u>(1,368,520)</u>
Liability to Counterparty under Forward Agreement - Beginning of period	268,206,438	286,022,458
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	(16,730,000)	(16,447,500)
Liability to Counterparty under Forward Agreement at period end, at cost	<u>254,047,891</u>	<u>268,206,438</u>
Unrealized gain (loss) on Forward Agreement	<u>(2,571,453)</u>	<u>1,368,520</u>

**7 Distributions**

Targeted quarterly distributions are \$0.290625 per Preferred Share. During the year ended on December 31, 2006 the Company met its targeted quarterly distribution and paid total distributions of \$13,950,000, or \$1.1625 per unit (\$0.290625 per quarter), representing return of capital to holders of Preferred Shares (\$13,950,000 or \$1.1625 per unit for the year ended on December 31, 2005).

**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.

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#### 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.

As at December 31, 2006, the Company had net capital losses of \$ 1,368,520 (2005 - \$ 1,368,520), which may be carried forward to reduce future realized capital gains and non-capital losses of \$ 9,185,457 (2005 - \$ 5,382,664), which can also be carried forward to reduce future non-capital losses.

#### 10 Broker commission charges and soft dollar services

There were \$nil broker commissions paid during the year ended December 31, 2006 in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.

#### 11 Future Accounting Standards

The Canadian Institute of Chartered Accountants ("CICA") has issued Section 3855, Financial Instruments: Recognition and Measurement, effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The adoption of this section will impact the valuation and disclosure of the net asset value ("NAV") of the Company, and the way transaction costs are recorded for financial reporting purposes.

Section 3855 requires that the fair value of financial instruments which are traded in active markets be measured based on the bid price for long securities and the ask price for securities held short. Prior to this new section, the fair value was based on the last traded price for the day, when available. The impact of adopting the amended policy is not expected to be material to the financial statements, however, the effect has not yet been quantified.

Section 3855 also requires that transaction costs, such as brokerage commissions, incurred in the purchase and sale of securities be charged to net income in the period. Prior to this new section, these costs have been added to the cost of the securities purchased or deducted from the proceeds of sale. Adoption of this policy is not expected to have a material impact to the financial statements and does not impact the daily price of the Company.

On January 1, 2007, the Company adopted Section 3855 on a prospective basis for financial reporting purposes.

The Canadian Securities Administrators have granted temporary relief to investment funds from complying with Section 3855, for the purpose of calculating and reporting of NAV (other than for financial reporting purposes) until September 30, 2007, to permit review of the suitability of these financial reporting requirements for purposes other than the financial statements, such as the purchase and redemption price of an investment fund.