

**Somerset Entertainment Ltd.**  
**3<sup>rd</sup> Quarter Results Conference Call**  
**November 14, 2007**

**Operator:** Good morning. My name is Dawson and I will be your conference operator today. At this time would like to welcome everyone to the Somerset Entertainment Third Quarter Results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

Mr. Burgess, you may begin your call.

**Andy Burgess:** Today we will be reviewing our results for the three months ended September 30<sup>th</sup>, 2007. Please note that this conference call will contain forward-looking statements which reflect management's current beliefs and expectations regarding the Fund's future growth and results of operation. Actual results may differ materially from those anticipated.

New customers and continued improvement from the Compass business contributed to significantly improved earnings during our third quarter. Despite the strengthening Canadian dollar, Somerset achieved revenue increases in the United States and internationally. Sales increased from \$22.9 million in the previous year to 24.4 million during the period, a 6.5% increase. Replenishment sales represented 91.4% of sales for the quarter. In the U.S., sales increased 7.5% to \$19.8 million. Excluding Compass, U.S. sales increased 8.8% to 14.5 million. The Compass division contributed \$5.3 million in sales compared with 5.1 million for the same quarter in the prior year.

In Canada, sales during the quarter decreased 14.1% over last year to 2.1 million as a result of lower replenishment sales to a mass merchant customer. Internationally, sales increased 20.9% to 2.6 million for the quarter as a result of replenishment sales to new mass merchant retailers in the UK, France and Italy, sales to a new distributor in Spain and from increased replenishment sales in the UK, France and Mexico.

Now Somerset CFO, Rob Meier, will update you on profitability.

**Rob Meier:** Thanks, Andy. Gross profit for the third quarter increased to \$10 million compared with 8.3 million in the previous year. Gross profit as a percentage of sales during the period was 40.9% compared with 36.4% previously. EBITDA for the quarter was \$5.8 million, an increase of 32.9% compared with the prior year. The Compass business generated EBITDA of \$1.1

million compared with a loss of \$200,000 in the prior year, while the Somerset business generated EBITDA of \$4.7 million compared with 4.6 million in the prior year.

The Fund generated \$5.1 million of distributable cash including the non-controlling interest share or \$0.29 per unit. Three cash distributions totaling \$2.7 million were made during the quarter resulting in a payout ratio of 52% compared with 84.6% in the previous year. The increase in distributable cash compared with the prior year was primarily due to higher EBITDA generated in the quarter. We believe that the Fund has sufficient liquidity to meet its working capital and capital needs for the next 12 months.

I will now let Andy review the Fund's third quarter operational highlights.

**Andy Burgess:** Thank you, Rob. During the quarter Somerset shipped a box set program to 380 doors of a leading U.S. club retailer. Strong sell-through at retail has led to sizable replenishment sales on the program for the quarter. This club retailer has now launched the program in five markets, including Canada, the U.S., Mexico, Japan and the UK. In Canada, Somerset strengthened this seasonal distribution throughout the U.S. and Canada with a shipment of Christmas programs to 2,800 locations of a major U.S. mass merchant in the quarter and the planned shipment to 1,350 locations of a major U.S. drug chain in the fourth quarter. In addition, a specialty retailer added 580 Christmas displays as a second location in all stores, while in Canada a major grocery chain committed to a seasonal corrugate program for the fourth quarter.

Internationally, Somerset expanded its Reflections program to additional locations of a major hypermarket in Italy. In Spain, Somerset experienced a resurgence with its new distributor and has secured commitments to re-launch its program at three of its four former Spanish customers, including 70 locations of the largest retailer in Spain, 90 locations of a major hypermarket and 47 locations of another major hypermarket. Through its Compass division, Somerset will ship an exclusive 12-title Rolling Stone compilation line to all locations of the leading U.S.-based consumer electronics retailer in the fourth quarter. Approximately 80% of the stores will feature the program on an interactive display located on a main aisle end-cap.

We're pleased to report significantly stronger sales and earnings compared with last year. By creating unique products and programs for both new and existing retail partners, Somerset will continue to deliver a positive result even when the rest of the music industry is in decline. Securing two major new customers demonstrates our team's ability to create and deliver relevant programs for retailers today. Congratulations to our team on the hard work and these positive results.

For more details on the Fund, I invite you to visit our corporate website, [www.somersetent.com](http://www.somersetent.com), as well as SEDAR for a complete report of operating and financial results, including financial statements. Thank you for your attention. Rob and I will now take any questions you might have.

Operator, do you want to facilitate the question period?

**Operator:** At this time I would like to remind everyone, in order to ask a question please press star, then the number one on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

Your first question comes from Mr. Wong (sp?).

**Mr. Wong:** Hi. I'm very happy with your results, and I've heard that even though the Canadian dollar has been appreciated quite a bit, you still can manage to have such a wonderful return. But I think, just want to understand how are you going to managing the impact of a strong Canadian dollar if it keeps on going there, maybe higher? And would that be, have any impact on your American revenue?

**Andy Burgess:** Well, it certainly will have an impact on our U.S. or American revenue. We have a forward hedging strategy which has significant hedges through most of 2008; however, as we put on new hedges in accordance with our FX hedging strategy, they will obviously be at less attractive rates for the Company. So beginning late 2008 and beyond, we're going to be hedging at more along the current FX rates, and that is going to cut into the firm's profitability at that time.

**Mr. Wong:** Thank you for the answer. I think that is a very good strategy. Thank you.

**Operator:** Your next question comes from Guy Gottfried.

**Guy Gottfried:** Hi. Just a quick, it's Gottfried by the way, just a quick accounting question. When gains on effective cash flow hedges are actually realized, does that go into foreign exchange gain? Or since it's an effective hedge, does that flow through sales in the income statement?

**Rob Meier:** We record it through the FX gain on the P&L. The, all the other lines, the sales, the cost of sales, the overheads are always, we've always recorded those at the actual average rate, and gains on our forwards or losses on our forwards run through that separate line item.

**Guy Gottfried:** So even if it's an effective hedge, it still goes through foreign exchange gain, just to make sure?

**Rob Meier:** Yes.

**Guy Gottfried:** I understand.

**Rob Meier:** Yes.

**Guy Gottfried:** Okay. Just one more question. The, you know, a couple of major customers that, you know, you, one that you starting rolling out to the clubs, the club store retailer and the electronics retailer you just announced, like when will we start seeing those roll-out sales shift into, like replenishment-type sales? How long does that normally take on a big contract?

**Andy Burgess:** Well we've, I think that's the point with this major retailer that was shipped in the third quarter, we've started to see those replenishment sales. Really, you know, if the product is selling well, you see it within two weeks. And this program was generally shipped during back half of August, first week of September, so we saw some replenishment sales already.

**Guy Gottfried:** And, but since the, I understand, but with the bulk of the, you know, with some of those even being sent in September or late, you know, back half of the quarter, like will the, you know, will there be an acceleration in the, you know, the proportion of sales to the customer that are of the replenishment variety?

**Andy Burgess:** Yes. Yes, there will be. I mean these...

**Guy Gottfried:** Because now you're getting three months of it, right?

**Andy Burgess:** Yes. I mean now there's no, the point that we made with replenishment sales was that we don't have some of the up-front costs, including display costs, associated with the product that's being shipped on a replenishment basis.

**Guy Gottfried:** Right. And how generally, in, all right, obviously with varied contract (inaudible), but how in generally would the profitability on replenishment sales compare to the profitability on a roll-out? The, is the roll-out usually kind of a break-even transaction?

**Andy Burgess:** Yes. I think, well, the word usually is the operative word here. We have a number of different types of customers and, you know, various product and situations so on average we're really not making money out of the gate, but over time with replenishment, that's where the profitability kicks in.

**Guy Gottfried:** Okay. And, you know, with the, in terms of customer concentration, like with the major new announcement, major new roll-out that took place, can we see sales to this new customer starting to rival sales to your two already very large customers?

**Andy Burgess:** It's difficult to say this early. And I wouldn't want to, you know, anticipate future results.

**Guy Gottfried:** Right.

**Andy Burgess:** So, you know, we're always hopeful but it really remains to be seen how it's going to sell at retail.

**Guy Gottfried:** So toward, it sort of depends on whether the, how successful the roll-out goes?

**Andy Burgess:** Yes. And I mean it depends, at the end of the day it depends on consumer uptake.

**Guy Gottfried:** Right.

**Andy Burgess:** On our product.

**Guy Gottfried:** Okay. All right. I'll call back afterwards with additional stuff. Okay. Thank you very much.

**Andy Burgess:** Okay. Nice to talk to you.

**Operator:** Your next question comes from Jeff Tkachuk.

**Andy Burgess:** Hi, Jeff.

**Jeff Tkachuk:** Hi. Thank you. Couple of questions. The two re-launched product lines at Target, looks like they're finally starting to gain some traction. Is it both product lines that are performing well? Or is it just one?

**Andy Burgess:** If you were to ask Target they would say both products lines are performing well. Yes, our team has worked very hard in the Minneapolis group for the past year, has a very strategic approach now to developing that product, both from a conceptual stage right through the packaging and the recording stage. So you can now see the consumer really embracing that, and both those lines are comping up significantly, versus previous year.

**Jeff Tkachuk:** And then I'm assuming that's carrying over into the fourth quarter?

**Andy Burgess:** Yes, it is.

**Jeff Tkachuk:** Okay. Just on Canada, it sounds like the decline, it was a timing issue? Is that correct? Or is that business that was in Q3 '06 not coming back at all?

**Andy Burgess:** I don't think it's necessarily a timing issue. I think that overall this year, year-to-date we're down in Canada. Last year we had a couple of programs that were selling very well, and we're comping against that. We're hopeful that we're going to narrow that difference versus last year in the fourth quarter, but I wouldn't say it was necessarily a timing issue. However, going forward, we have a couple of initiatives under way; we're in conversations with a, more than a couple of retailers who are interested in some of the products that we create, and we're optimistic that we will be building new markets for our music.

**Jeff Tkachuk:** Are these discussions, they're with new customers? Or your expanding relationship with existing customers?

**Andy Burgess:** Both.

**Jeff Tkachuk:** Okay. In Spain, can you maybe elaborate as to what's going on there? It sounds like there is, you're now able to deal with your new distributor.

**Andy Burgess:** Yes. We were out of business there for almost a year and a half as the previous distributor prevented us from distributing our own product in that territory based on his misunderstanding of our distribution agreement. When he finally went into liquidation, that obviously nullified that distribution agreement, and we were free to deal with our new distributor. We've been able, the new distributor and us have worked diligently to renew the relationships with three of the four previous major customers in that territory, and we're seeing very good sales results with each of those customers. So going forward, we're hopeful to regain that business. That was about a, it was a significant territory for us, just less than \$1 million annually in sales, so we're hopeful we'll get back there.

**Jeff Tkachuk:** So over the year and a half where you weren't able to distribute, what, like did you have to ship new displays? Or were there, or the three of the four customers are just using the old displays and just re-ordering stock?

**Andy Burgess:** Both. I mean one customer still had the old displays; another customer doesn't. So there's going to be some money spent on displays to start up that business.

**Jeff Tkachuk:** And the, when you say three of the four of the relationships have been established, when did you actually start shipping them product? Or have you not (inaudible)?

**Andy Burgess:** We have shipped product to the distributor, and that distributor has shipped to all three of those customers thus far. I believe shipment started to the first customer back in May, and then during the third quarter, they really renewed in more significant volume.

**Jeff Tkachuk:** Okay. So you would say those three customers are now fully stocked? Or they were fully stocked in the third quarter?

**Andy Burgess:** That, it's difficult for where we're sitting to be sure of that, but our estimate would be that they're pretty much fully stocked, yes.

**Jeff Tkachuk:** Okay. And I just want to touch on this Rolling Stone thing. So nothing got shipped in the third quarter, is that correct?

**Andy Burgess:** That's correct.

**Jeff Tkachuk:** Okay. When does it ship? Like, it's, I'm assuming that it's going to get up and running before Christmas?

**Andy Burgess:** Yes, it will.

**Jeff Tkachuk:** Okay. Is it like, is it up and running? It's not currently up and running now?

**Andy Burgess:** It's being set in stores as we speak.

**Jeff Tkachuk:** Okay. Okay. Any feedback as to how it's performing? Or is it still too early?

**Andy Burgess:** It's a little early to tell yet.

**Jeff Tkachuk:** Okay. Gross profit margins in the quarter were up significantly year-over-year. I know there were some issues in Q3 '06. I'm just wondering what was the main driver there?

**Andy Burgess:** I think one of the key drivers, and then I'll pass it to Rob, was that the previous year, we spent a significant amount of money marking down products with one of our major customers. We also spent significant amounts on designing new products for that customer, so the total of that was approximately \$850,000 that hit our, that was above the line on the gross profit line in the previous year.

**Jeff Tkachuk:** Okay. I haven't done the math, but I'm assuming your margins are still up post that, aren't they, if you take that out?

**Rob Meier:** Yes. I'd say, the only other, there were two other factors. Last year on the Somerset side in Q3 we shipped a one-time special promotional set of CDs for the hallmark business that had, because they were promotional in nature had very low margins. So this year we don't have that in our sales so the cost percentage improves. And then the other thing is, we are getting a bit of a benefit as well on the percentage line by having a lower five star product sales in the Compass division because that tended to be a very high cost of sales program.

**Jeff Tkachuk:** Okay.

**Rob Meier:** So it's really those three items that are affecting our margins compared to last year.

**Jeff Tkachuk:** Okay. Any guidance on 2008 cap ex?

**Andy Burgess:** I don't, we don't, certainly don't give guidance but the one thing that's a bit different for next year is that our warehouse lease is expiring in February, and we'll be looking at what our alternatives are there, and if we do, in fact, move facilities, which is a high possibility, then we would have to spend some money on cap ex on that front.

**Jeff Tkachuk:** How much in a, on the dollar sense are you looking at for that? Is it a few hundred thousand dollars, or?

**Andy Burgess:** Yes, that, it'll be a couple of hundred thousand.

**Jeff Tkachuk:** Okay.

**Andy Burgess:** Is my guess. I mean we haven't gone through the budgeting because we haven't even determined what route we're going yet.

**Jeff Tkachuk:** Right.

**Andy Burgess:** But it will be additive to what we usually spend.

**Jeff Tkachuk:** Okay. When I look at the core Somerset margins, if you strip out Compass, it looks like the margins are down a couple of hundred basis points. I'm just wondering what's going on there?

**Andy Burgess:** Do you mean gross margin or EBITDA margin?

**Jeff Tkachuk:** EBITDA margins, sorry.

**Andy Burgess:** I mean the big thing on the Somerset side was in the quarter on the overhead line as we've had to accrue this quarter an additional amount for bonuses based on our projected results. So that's one anomaly this quarter that's driven up our costs a bit higher. But other than that, we're fairly consistent with where we were last year on the Somerset business.

**Jeff Tkachuk:** Okay. And lastly, on, debt is down to, or net debt's down to I think I remember 17 million or 16.8 million. If I do a sort of a back in the envelope I get 1.1 times debt to trailing 12 months EBITDA. Where, I guess what I want to know is, is how far is that debt going to, or how long will the debt continue to decline? Or do you have other uses for excess cash?

**Rob Meier:** No, we, as you can see from the payout ratio, you know, during the quarter we paid out just over half of what we created in distributable cash, and the board of trustees' intention, stated intention as of I believe first quarter of this year was to pay down debt with excess cash. So we will continue to be doing that unless the board decides otherwise.

**Jeff Tkachuk:** Okay. Thank you very much.

**Andy Burgess:** Yes. Thank you.

**Operator:** Again, if you would like to ask a question press star, then the number one on your telephone keypad. There are no further questions. Please go ahead.

**Andy Burgess:** Thank you, Operator. We look forward to speaking with you all again with the results of our year end in 2008. Thank you.

**Operator:** This concludes today's conference call. You may now disconnect.