BALLARD POWER SYSTEMS INC
Form 6-K
November 24, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

REPORT OF FOREIGN PRIVATE ISSUER

PURSUANT TO RULE 13a-16 OR 15d-16

UNDER THE SECURITIES EXCHANGE ACT OF 1934

November, 2008

Commission File Number: 000-25270

Ballard Power Systems Inc.

_____

(Translation of registrant's name into English)

Canada

_____

(Jurisdiction of incorporation or organization)

9000 Glenlyon Parkway

Burnaby, BC

V5J 5J8

Canada

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F: o Form 20-F x Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934: o Yes x No

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): n/a

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Ballard Power Systems Inc.

Date: November 24, 2008

By: /s/ Glenn Kumoi
Name: Glenn Kumoi
Title: VP Human Resources & Chief Legal Officer

EXHIBIT INDEX

Exhibit No.	**Description**
99.1	Notice of Special Meeting of Securityholders and Management Information Circular

EXHIBIT 99.1

Ballard Power Systems Inc.

Notice of Special Meeting of Securityholders

and Management Information Circular

November 14, 2008

These materials are important and require your immediate attention. They require securityholders of Ballard Power Systems Inc. to make important decisions. If you are in doubt as to how to make such decisions, please contact your financial, legal or other professional advisors.

If you have any questions or require more information with regard to voting your securities of Ballard Power Systems Inc., please contact D. F. King & Co., Inc. at (212) 269-5550 (call collect) or 1-888-887-1266 (toll free in North America).

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BALLARD POWER SYSTEMS INC.

9000 Glenlyon Parkway

Burnaby, B.C.

V5J 5J8

November 14, 2008

Dear Securityholder,

We invite you to attend a special meeting (the "**Meeting**") of the holders of common shares, stock options, restricted share units and deferred share units (the "**Securityholders**") of Ballard Power Systems Inc. ("**Ballard**") to be held at 1:00 pm (Vancouver time), on Thursday, December 18, 2008 at the Hilton Vancouver Metrotown, 6083 McKay Avenue, Burnaby, British Columbia, V5H 2W7. Your board of directors (the "**Board of Directors**") and management look forward to personally greeting you if you are able to attend.

The attached Notice of Special Meeting and Information Circular describe the formal business to be transacted at the Meeting. The principal purpose of the Meeting is to seek the approval of Securityholders for an arrangement (the "**Arrangement**") with Superior Plus Income Fund ("**Superior Plus**"). Under the Arrangement, Ballard will cause its entire business and operations, including all assets and liabilities, to be transferred to a new company ("**Newco**"), which will have all of the same assets, liabilities, directors, management and employees as Ballard has currently, except for Ballard's tax attributes. Newco will also receive a cash payment of approximately C$46.3 million for allowing Superior Plus to use Ballard as the corporate vehicle through which Superior Plus will complete its conversion from an income trust to a corporation.

The key benefits Newco will derive from the Arrangement include: (1) the cash payment of approximately C$46.3 million which, net of expenses, will increase Newco's cash reserves and shareholders' equity by approximately C$41 million; (2) this increase in cash reserves is expected to allow Newco to execute its growth plan without any need for public market financing for the foreseeable future; and (3) the transfer of Ballard's assets to Newco under the Arrangement is expected to create a new Canadian tax basis, which Newco may apply in sheltering future taxable income. Based on these benefits and other factors, including an opinion it received that the Arrangement is fair from a financial point of view to the Ballard Shareholders, **the Board of Directors has unanimously approved the Arrangement and unanimously recommends that Securityholders vote FOR the Arrangement Resolution.**

After completion of the Arrangement, the former holders of common shares of Ballard (the "**Ballard Shareholders**") will hold all of the outstanding shares of Newco and Newco will carry on the same business that Ballard carried on prior to the completion of the Arrangement. Former holders of stock options, restricted share units and deferred share units of Ballard (the "**Ballard Rightsholders**") will hold substantially the same rights in Newco.

The Arrangement will only take effect if a special resolution (the "**Arrangement Resolution**") is passed by Securityholders, such resolution requiring the positive approval of at least two thirds of the votes cast by Securityholders, voting together as a single class, in person or by proxy at the Meeting. For these purposes, Ballard Rightsholders will be entitled to one vote at the Meeting for each Ballard Share that Ballard Rightsholders are entitled to receive on exercise of their Ballard Rights.

At the Meeting, Ballard Shareholders will also be asked to consider and approve an ordinary resolution (the "**Option Resolution**") approving an increase in the number of shares reserved for issuance under our Share Distribution Plan and a corresponding decrease in the number shares reserved for issuance under our 2002 Option Plan. To be passed, the Option Resolution requires the positive approval of more than one half of the votes cast by Ballard Shareholders in person or by proxy at the Meeting (with Ballard Rightsholders being excluded from such vote unless they are also Ballard Shareholders, in which case they will be entitled to vote any Ballard Shares held).

The Arrangement is an important matter affecting the future of Ballard, and it is important that your Ballard Shares and Ballard Rights be represented at the Meeting. Regardless of whether you plan to attend the Meeting, please complete the appropriate enclosed forms of proxy (white in the case of Ballard Shares and yellow in the case of Ballard Rights) and return it in the manner described to ensure that you are represented at the Meeting.

We ask that you carefully review the enclosed materials and participate at the Meeting by voting your Ballard Shares and Ballard Rights.

Sincerely,

"John Sheridan"

John Sheridan

President and CEO

Your Vote Is Important

Please vote your Ballard Shares and Ballard Rights by promptly signing, dating and mailing your proxy card or voting instruction form today. Internet and telephone voting may also be available to you. Please refer to your proxy card or voting instruction form for instructions. If you have any questions regarding the materials or need assistance voting your Ballard Shares and Ballard Rights please call D. F. King & Co., Inc. at (212) 269-5550 (call collect) or 1-888-887-1266 (toll free in North America).

BALLARD POWER SYSTEMS INC.

9000 Glenlyon Parkway

Burnaby, B.C.

V5J 5J8

NOTICE OF SPECIAL MEETING

A special meeting (the "**Meeting**") of the holders of common shares, stock options, restricted share units and deferred share units (the "**Securityholders**") of Ballard Power Systems Inc. ("**Ballard**") will be held at 1:00 pm (Vancouver time), on Thursday, December 18, 2008 at the Hilton Vancouver Metrotown, 6083 McKay Avenue, Burnaby, British Columbia, V5H 2W7.

The purpose of the Meeting is for:

1. Securityholders to consider, pursuant to an order of the Supreme Court of British Columbia dated November 10, 2008 (the "**Interim Order**") and, ifdeemed advisable, to pass a special resolution (the "**Arrangement Resolution**") to approve an arrangement (the "**Arrangement**") under section 192 of the *Canada Business Corporations Act* (the "**CBCA**") involving, among others, the Securityholders, Ballard, Newco and Superior Plus Income Fund, all as more particularly set forth and described in the accompanying management information circular of Ballard (the "**Information Circular**"); and
2. holders of common shares of Ballard (the "**Ballard Shareholders**") to consider and, if deemed advisable, to pass an ordinary resolution (the "**Option Resolution**") to approve an increase in the number of shares reserved for issuance under our Share Distribution Plan and a corresponding decrease in the number of shares reserved for issuance under our 2002 Option Plan, all as more particularly set forth and described in the Information Circular.

In addition, Securityholders will be asked to transact such other business as may properly come before the Meeting or any adjournment thereof.

The accompanying Information Circular contains additional information relating to the subject matter of the Meeting, including the full text of the Arrangement Resolution and the Option Resolution.

If you are a registered Securityholder and are unable to attend the Meeting in person and wish to ensure that your Ballard Shares and Ballard Rights will be voted at the Meeting, you must complete, date and execute the enclosed forms of proxy (white in the case of Ballard Shares and yellow in the case of Ballard Rights) and deliver it by hand or by mail in accordance with the instructions set out in the forms of proxy and in the Information Circular accompanying this Notice. If you plan to attend the Meeting you must follow the instructions set out in the forms of proxy and in the Information Circular to ensure that your Ballard Shares and Ballard Rights will be voted at the Meeting.

Take notice that, pursuant to the Interim Order, if you are a registered Ballard Shareholder you may, prior to 4:00 pm (Vancouver time) on December 16, 2008, deliver a notice of dissent with respect to the Arrangement Resolution to the headquarters of Ballard at 9000 Glenlyon Parkway, Burnaby, B.C., V5J 5J8. As a result of delivering a notice of dissent, if Ballard completes the Arrangement, you will be entitled to be paid by Newco the fair value of your Ballard Shares, subject to strict compliance with Section 190 of the CBCA, as modified by the Interim Order and the Plan of Arrangement. Failure to strictly comply with such requirements may result in the loss or unavailability of any right of dissent.

DATED at Burnaby, British Columbia, November 14, 2008.

BY ORDER OF THE BOARD
"Glenn Kumoi"

Glenn Kumoi
Vice-President, Human Resources,
Chief Legal Officer and Corporate Secretary

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BALLARD POWER SYSTEMS INC.

9000 Glenlyon Parkway

Burnaby, B.C.

V5J 5J8

INFORMATION CIRCULAR

Introduction

The Board of Directors is delivering this Information Circular to you in connection with the solicitation of proxies by the management of Ballard for use at the special meeting of Securityholders to be held on December 18, 2008 and any adjournment thereof (the "Meeting").

The principal purpose of the Meeting is to seek the approval of Securityholders for an arrangement (the "Arrangement") with Superior Plus Income Fund ("Superior Plus"). Under the Arrangement, Ballard will transfer its entire business and operations, including all assets and liabilities, to a new company ("Newco") which will have all of the same assets, liabilities, directors, management and employees as Ballard has currently, except for Ballard's tax attributes. Newco will also receive a cash payment of approximately C$46.3 million for allowing Superior Plus to use Ballard as the corporate vehicle through which Superior Plus will complete its conversion from an income trust to a corporation.

This Information Circular and a form of proxy will be mailed on or about November 24, 2008 to Ballard Securityholders of record on November 12, 2008.

This Information Circular does not constitute an offer to sell, or a solicitation of an offer to purchase, any securities, or the solicitation of a proxy, by any person in any jurisdiction in which such an offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such an offer or solicitation of an offer or a proxy solicitation. Neither the delivery of this Information Circular nor any distribution of the securities referred to in this Information Circular will, under any circumstances, create an implication that there has been no change in the information set forth herein since the date as of which such information is given in this Information Circular.

The information concerning the Fund contained in this Information Circular has been provided by management of Superior Plus. Although Ballard has no knowledge that would indicate that any of such information is untrue or incomplete, Ballard does not assume any responsibility for the accuracy or completeness of such information or the failure by Superior Plus to disclose events which may have occurred or may affect the completeness or accuracy of such information but which is unknown to Ballard.

All summaries of, and references to, the Arrangement in this Information Circular are qualified in their entirety by reference to the complete text of the Plan of Arrangement, a copy of which is attached as Exhibit H to this Information Circular. Ballard Securityholders are urged to carefully read the full text of the Plan of Arrangement.

No person has been authorized to give any information or make any representation in connection with the matters proposed to be considered at the Meeting other than those contained in or incorporated by reference into this Information Circular and, if any other information has been given or any other representation has been made, any such information or representation must not be relied upon as having been authorized. All capitalized terms used in this Information Circular but not otherwise defined herein have the meanings set forth under "Glossary of Terms" in Appendix A. Unless otherwise noted, the information provided in this Information Circular is given as of November 12, 2008.

Notice to United States Securityholders

The Newco Securities to be issued to the Securityholders under the Arrangement have not been registered under the U.S. Securities Act, or the securities laws of any state of the United States. Such securities are being issued in reliance on the exemption from registration requirements set forth in Section 3(a)(10) of the

U.S. Securities Act and exemptions provided under the securities laws of each applicable state of the United States. The restrictions on resale imposed by the U.S. Securities Act will depend on whether the holder of the Newco Securities issued pursuant to the Arrangement is an "affiliate" of Newco after the Effective Time or within 90 days before the Effective Time. As defined in Rule 144 under the U.S. Securities Act, an "affiliate" of an issuer is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer. Usually, this includes the directors, executive officers and major shareholders of the issuer. See "Securities Law Considerations – U.S. Securities Laws".

This solicitation of proxies is not subject to the requirements of Section 14(a) of the U.S. Exchange Act. Instead, such solicitation is made in the United States with respect to securities of a Canadian "foreign private issuer", as such term is defined in Rule 405 promulgated under the U.S. Securities Act, in accordance with Canadian corporate and securities laws and this Information Circular has been prepared in accordance with disclosure requirements applicable in Canada. Securityholders in the United States should be aware that such requirements are different from those of the United States applicable to registration statements under the U.S. Securities Act and proxy statements under the U.S. Exchange Act.

The historical financial information for Ballard and the pro-forma financial information for Newco included or incorporated by reference in this Information Circular have been prepared in accordance with Canadian generally accepted accounting principles ("**Canadian GAAP**"), which differ from United States generally accepted accounting principles ("**U.S. GAAP**") in certain respects and are subject to Canadian auditing and auditor independence standards, and thus are not comparable in all respects to financial statements prepared in accordance with U.S. GAAP. The audited consolidated financial statements for Ballard for the financial year ended December 31, 2007 incorporated by reference herein contain a reconciliation to U.S. GAAP at Note 19 to the financial statements.

The unaudited pro-forma financial information included in this Information Circular have been presented in accordance with the requirements of Section 7110 of the Canadian Institute of Chartered Accountants Handbook and prepared in accordance with Canadian GAAP. The unaudited pro-forma financial information does not purport to be in compliance with Article 11 of Regulation S-X of the rules and regulations of the SEC, or in compliance with the standards of the Public Company Accounting Oversight Board (United States) and has not been prepared in accordance with or reconciled to U.S. GAAP.

Enforcement by Securityholders of civil liabilities under the United States securities laws may be affected adversely by the fact that each party to the Arrangement is organized under the laws of a jurisdiction other than the United States, that some or all of their officers and directors are residents of countries other than the United States and that some or all of the experts named in this Information Circular are residents of Canada.

United States Securityholders should be aware that the issuance to them of the Newco Securities described herein may have tax consequences both in the United States and in Canada. Such consequences for the Securityholders who are residents in, or citizens of, the United States may not be fully described herein. See "Certain Canadian Federal Income Tax Considerations" and "Certain United States Federal Income Tax Considerations".

THE NEWCO SECURITIES TO BE ISSUED PURSUANT TO THE ARRANGEMENT HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SEC OR THE SECURITIES REGULATORY AUTHORITY IN ANY STATE OF THE UNITED STATES OR PROVINCE OR TERRITORY OF CANADA, NOR HAS THE SEC OR ANY SECURITIES REGULATORY AUTHORITY IN ANY STATE OF THE UNITED STATES OR PROVINCE OR TERRITORY OF CANADA PASSED UPON THE ACCURACY OR ADEQUACY OF THIS INFORMATION CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE.

Forward-Looking Statements

This Information Circular and the documents incorporated by reference herein contain forward-looking statements that are based on the beliefs of management and reflect our current expectations as contemplated under the safe harbor provisions of Section 21E of the U.S. Exchange Act. When used in this Information

Circular, the words "estimate", "project", "believe", "anticipate", "intend", "expect", "plan", "predict", "may", "should", "will", the negatives of these words or other variations thereof and comparable terminology are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events based on currently available information and are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in those forward-looking statements, including, without limitation:

- we may not be able to achieve commercialization of our products on the timetable we anticipate, or at all;
- we expect our cash reserves will be reduced due to future operating losses, and we cannot provide certainty as to how long our cash reserves will last or that we will be able to access additional capital when necessary;
- we cannot assure you that we will be able to successfully execute our business plan;
- potential fluctuations in our financial and business results makes forecasting difficult and may restrict our access to funding for our commercialization plan;
- a mass market for our products may never develop or may take longer to develop than we anticipate;
- we are dependent on third party suppliers for the supply of key materials and components for our products;
- regulatory changes could hurt the market for our products;
- we depend on our intellectual property and our failure to protect our intellectual property could adversely affect our future growth and success;
- we may be involved in intellectual property litigation that causes us to incur significant expenses or prevents us from selling our products;
- we currently face and will continue to face significant competition;
- we could lose or fail to attract the personnel necessary to run our business;
- we could be liable for environmental damages resulting from our research, development or manufacturing operations;
- our products use inherently dangerous, flammable fuels, which could subject us to product liability claims; and
- the other risks and uncertainties discussed in the section of this Information Circular entitled "Risk Factors" and the section of our annual information form, incorporated by reference in this Information Circular, entitled "Risk Factors".

Various assumptions are typically applied in drawing conclusions or making the forecasts or projections set out in forward-looking statements. Those assumptions and factors are based on information currently available to Ballard, including information obtained from third party industry analysts and other third party sources. In some instances, material assumptions and factors are presented elsewhere in this Information Circular in connection with the forward-looking statements. You are cautioned that the following list of material factors and assumptions is not exhaustive. Specific material factors and assumptions include, but are not limited to:

- the performance of the Ballard’s businesses, including current business and economic trends;
- the ability of Ballard to obtain products, raw materials, equipment, services and supplies in a timely manner to carry out its activities;
- the ability of Ballard to market its products and services successfully to existing and new customers;

- the ability of Ballard to obtain financing on acceptable terms;
- currency, exchange and interest rates;
- the timely receipt of required regulatory approvals; and
- a stable competitive environment.

The forward-looking statements contained in this Information Circular speak only as of the date of this Information Circular. Except as required by applicable regulations, Ballard does not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this Information Circular, including the occurrence of unanticipated events.

Documents Incorporated By Reference

The following public filings of Ballard (the "**Incorporated Documents**") are incorporated by reference in, and form an integral part of, this Information Circular:

- our annual information form dated March 4, 2008, together with the management information circular dated March 20, 2008 incorporated therein by reference;
- our annual consolidated financial statements as at December 31, 2007 and 2006 and for each of the years in the three year period ended December 31, 2007, together with the auditors' report thereon and management's discussion and analysis filed in connection with those annual consolidated financial statements;
- our interim consolidated financial statements as at and for the three and nine months ended September 30, 2008, together with management's discussion and analysis filed in connection with those interim consolidated financial statements;
- our material change report dated October 17, 2008;
- our material change report dated November 6, 2008 in connection with the Arrangement described in this Information Circular; and
- material change reports issued by us after the date hereof.

Copies of the Incorporated Documents and all our other public filings providing additional information relating to us are located and may be obtained at www.sedar.com and at www.sec.gov or upon request and without further charge from our Corporate Secretary at 9000 Glenlyon Parkway, Burnaby, British Columbia, Canada, V5J 5J8.

Any documents of the type required by National Instrument 44-101 - Short Form Prospectus Distributions to be incorporated by reference in a short form prospectus, including interim financial statements and related interim management's discussion and analysis, material change reports (except confidential material change reports) and business acquisition reports, filed by Ballard with the securities commissions or similar authorities in any of the provinces of Canada subsequent to the date of this Information Circular and prior to completion of the Arrangement shall be deemed to be incorporated by reference in this Information Circular.

Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for the purposes of this Information Circular to the extent that a statement contained herein or in any other subsequently filed document which also is, or is deemed to be, incorporated by reference herein modifies or supersedes such statement. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document that it modifies or supersedes. The making of a modifying or superseding statement shall not be deemed an admission for any purposes that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. Any statement so modified or superseded shall not be deemed, except as so modified

or superseded, to constitute a part of this Information Circular.

Canadian/U.S. Exchange Rates

Unless otherwise noted, all references in this Information Circular to monetary amounts are expressed in United States dollars and "$" means United States dollars. References to “C$” means Canadian dollars.

The following table sets forth, for each period indicated, the high and low exchange rates for one U.S. dollar expressed in Canadian dollars, the average of such exchange rates on the last day of each month during such period, and the exchange rate at the end of the period, in each case, based upon the Bank of Canada Closing Rate of Exchange.

	Year Ended December 31			Nine Months Ended September 30, 2008
	2005	**2006**	**2007**	
High	1.270	1.172	1.186	1.077
Low	1.152	1.098	0.922	0.977
Average	1.212	1.134	1.075	1.019
Period End	1.163	1.165	0.991	1.064

On November 12, 2008, the exchange rate for one U.S. dollar expressed in Canadian dollars was 1.2374, based upon the Bank of Canada Closing Rate of Exchange.

SUMMARY

This summary is qualified in its entirety by the more detailed information appearing elsewhere in the Notice of Special Meeting and this Information Circular, including the Appendices which are incorporated into and form part of this Information Circular. Terms with initial capital letters in this Summary are defined in the Glossary of Terms contained in Appendix A to this Information Circular.

The Meeting

The Meeting will be held at 1:00 pm (Vancouver time), on Thursday, December 18, 2008 at the Hilton Vancouver Metrotown, 6083 McKay Avenue, Burnaby, British Columbia, V5H 2W7. The principal purpose of the Meeting is to consider and vote on the Arrangement Resolution and the Option Resolution and to conduct such other business as may properly come before the Meeting.

Background to and Reasons For Arrangement

The Arrangement, to be implemented by way of Plan of Arrangement under section 192 of the CBCA, will result in Ballard causing its entire business and operations, including the assets and liabilities, to be transferred to Newco, which will have the same assets, liabilities, directors, management and employees as Ballard has currently, except for Ballard's tax attributes. Newco will also receive a cash payment of approximately C$46.3 million for allowing Superior Plus to use Ballard as the corporate vehicle through which Superior Plus will complete its conversion from an income trust to a corporation.

Benefits of the Arrangement

There are a number of benefits which are anticipated to result from the Arrangement and enhance overall Securityholder value. These benefits include: (1) Newco receiving a cash payment of C$46.3 million which, net of the expenses of the Arrangement, will increase Newco's cash reserves by approximately C$41 million; (2) this increase in cash reserves is expected to allow Newco to execute its growth plan without any need for public market financing for the foreseeable future; and (3) the transfer of Ballard's assets to Newco under the Arrangement is expected to create new Canadian tax basis, which Newco may apply in sheltering future taxable income.

Audit Committee Deliberations

The Audit Committee met three times during the course of negotiations between Ballard and Superior Plus to examine the Arrangement and review the Arrangement Agreement. The Audit Committee concluded that the Arrangement is in the best interests of Ballard and the Ballard Shareholders, and is fair to the Ballard Shareholders. Accordingly, the Audit Committee recommended that the Board of Directors: (1) approve the Arrangement on the terms and subject to the conditions set out in the Arrangement Agreement; and (2) recommend to the Ballard Shareholders that they vote in favour of the Arrangement Resolution.

Fairness Opinion

The Audit Committee engaged PricewaterhouseCoopers LLP ("**PwC**") to address the fairness to the Ballard Shareholders, from a financial point of view, of the Arrangement. In connection with this mandate, PwC prepared the Fairness Opinion which states that, as of the date of the opinion, the Arrangement is fair from a financial point of view to the Ballard Shareholders. The Fairness Opinion is subject to the assumptions and limitations contained therein and should be read in its entirety. A copy of the Fairness Opinion is attached hereto as Appendix E.

Recommendation of the Board of Directors Concerning the Arrangement Resolution

The Board of Directors, based partly on the unanimous recommendation of the Audit Committee and the Fairness Opinion, has determined that the terms of the Arrangement are in the best interests of Ballard and the Securityholders, as a whole, and are fair, from a financial point of view, to the Securityholders. As such, the Board of Directors has unanimously approved the Arrangement and authorized the submission of the Arrangement to the Securityholders for approval.

The Board of Directors unanimously recommends that Securityholders vote FOR the Arrangement Resolution.

The Arrangement

Description of the Arrangement

The Plan of Arrangement provides for the implementation of the following steps, in the following sequence.

1. Ballard will cancel all existing outstanding Ballard DSUs and Ballard RSUs without payment of any consideration;
2. The Fund Trust Indenture will be amended as necessary to implement the steps of the Plan of Arrangement;
3. Ballard will borrow the Fund Loan (C$46,319,148) from Superior Plus on a demand interest bearing basis;
4. Ballard will transfer all of its assets (including the proceeds of the Fund Loan) to Subco in consideration for Subco's issuing to Ballard 100,000,000 Subco Shares and assuming all of Ballard's liabilities except for Ballard's obligation to repay the Fund Loan. Ballard and Subco will agree to elect pursuant to Section 85(1) of the Tax Act to transfer all such assets at the amounts to be determined by Subco;
5. The Ballard Shares (including those held by dissenters, if any) will be exchanged 1:1 for common shares of Newco ("**Newco Shares**"), Newco will become a holding corporation of Ballard and Ballard Shareholders will become Newco Shareholders and will hold the same interest in Newco upon completion of the Arrangement as they held in Ballard immediately prior to the Effective Time;
6. Newco will adopt option, deferred share unit and restricted share unit plans substantially the same as the Ballard Option Plan, Ballard DSUP and Ballard RSUP, respectively;
7. Newco will grant to each person whose Ballard DSUs or Ballard RSUs were cancelled under the Arrangement substantially similar Newco DSUs and Newco RSUs;
8. The Ballard Optionholders will exchange all of their Ballard Options for substantially similar Newco Options;
9. The authorized capital of Ballard will be altered to (a) amend the rights attached to the Ballard Shares so that they are redeemable at the option of Ballard 1:1 for Subco Shares, and (b) authorize a new class of ordinary common shares ("**New Superior Shares**");
10. Superior Plus will transfer all of its assets (including the right to receive repayment of the Fund Loan) to Ballard in exchange for approximately 88 million New Superior Shares (equal to the number of Trust Units then outstanding) and Ballard's assumption of all of the liabilities of Superior Plus;
11. Superior Plus will redeem its outstanding Trust Units through the issuance of an equal number of the New Superior Shares to Superior Plus Unitholders;
12. Ballard will redeem the Ballard Shares (previously held by Ballard Shareholders, but which are now held by Newco), and will pay the redemption price by distributing the Subco Shares on a 1:1 basis to Newco;

13. Newco Shares held by dissenters will be cancelled and dissenters will be paid the fair value of their interest;
14. Subco will commence liquidation and distribute all of its assets (including the proceeds of the Fund Loan but excluding any obligation to repay the Fund Loan) to Newco, which will assume all of Subco's liabilities;
15. Ballard will change its name to Superior Plus Corp. and carry on business as a successor to the Superior Plus Income Fund; and
16. Newco will change its name to Ballard Power Systems Inc. and carry on Ballard's business as a successor to Ballard.

Effect of the Arrangement

Upon completion of the Arrangement, the Ballard Shareholders will be the holders of all issued and outstanding Newco Shares and Newco will be the holder of the assets (including the associated contractual obligations and liabilities) formerly owned by Ballard and will carry on the business previously carried on by Ballard, with additional net cash of C$41 million. Newco will have no obligation to repay the Fund Loan.

Newco will assume and be bound by and observe, carry out, perform, fulfill and pay all of the outstanding covenants, conditions, obligations and liabilities of Ballard, including those contained in the contracts to which Ballard is a party. In addition, Newco will offer employment to each of Ballard's employees on terms and conditions of employment which are the same as those governing such employees' employment with Ballard. Furthermore, Newco will, going forward, fully indemnify and save Ballard and its directors, officers and employees harmless from and against all liabilities, losses, costs, expenses, claims and damages (including legal costs), to which any of them may be subject in relation to, among other things, the assets and the business carried out by Ballard prior to the Effective Date and by Newco thereafter, other than for certain tax liabilities.

The Arrangement Agreement

The Arrangement is being effected pursuant to an Arrangement Agreement. The Arrangement Agreement contains covenants, representations and warranties of and from each of Superior Plus and Ballard and various conditions precedent, both mutual and with respect to each party. See "The Arrangement – The Arrangement Agreement".

Indemnity Agreement

The Arrangement Agreement provides that New Superior, Newco and Subco will enter into the Indemnity Agreement on or before the Effective Time. The Indemnity Agreement is primarily designed to provide New Superior with indemnification from Newco, the resulting entity that will carry on the business previously carried on by Ballard, for claims relating to Newco's business that are brought against New Superior in the future. See "The Arrangement – Indemnity Agreement".

Divestiture Agreement

Newco will acquire all of the assets of Ballard (including the proceeds of the Fund Loan) and assume all of the obligations of Ballard (except Ballard's obligation to repay the Fund Loan) pursuant to the terms of the Divestiture Agreement and in accordance with the Plan of Arrangement. See "The Arrangement – Divestiture Agreement".

Required Approvals

The respective obligations of Ballard and Superior Plus to complete the transactions contemplated by the Arrangement are subject to a number of conditions which must be satisfied or waived in order for the Arrangement to become effective, including the following required approvals.

Securityholder Approval

The Interim Order provides that the Arrangement Resolution must be approved by at least two-thirds of the votes cast by the Securityholders, voting as a single class, present in person or represented by proxy at the Meeting. Each Ballard Shareholder shall be entitled to one vote for each Ballard Share held by such shareholder and each Ballard Rightsholder shall be entitled to one vote for each Ballard Share issuable upon exercise of the Ballard Rights held by such rightsholder.

Fund Unitholder Approval

The Interim Order provides that the Fund Resolution must be approved by at least two thirds of the votes cast by the Fund Unitholders, present in person or represented by proxy at the Fund Meeting. Each Fund Unitholder shall be entitled to one vote for each Trust Unit held by such holder.

Court Approval

The CBCA requires that the Arrangement receives Court approval. On November 10, 2008, Ballard and Superior Plus obtained the Interim Order providing for the calling and holding of the Meeting and the Fund Meeting and other procedural matters. See the Interim Order included in Appendix D attached hereto.

Subject to the terms of the Arrangement Agreement and the adoption of the Arrangement Resolution at the Meeting and the Fund Resolution at the Fund Meeting, both in the manner required by the Interim Order, Ballard and Superior Plus will apply to the Court for the Final Order at the British Columbia Supreme Court on December 22, 2008 or as soon thereafter as counsel may be heard. See "The Arrangement – Procedure for the Arrangement to Become Effective" and “The Arrangement – Required Approvals – Court Approval”.

Regulatory Approvals

Consummation of the Arrangement is subject to the approval of the Commissioner of Competition in Canada (the "**Commissioner**") as well as the approval of the Minister of Transport of Canada (the "**Minister**"). See "Regulatory Matters".

Stock Exchange Listings

The Ballard Shares are listed and posted for trading on the TSX under the symbol "BLD" and on NASDAQ under the symbol "BLDP". On October 30, 2008, being the last trading day prior to the date of announcement of the Arrangement, the closing price of the Ballard Shares on the TSX was C$2.83 per Ballard Share and on NASDAQ was $2.34, and on November 12, 2008 was C$2.91 and $2.36 respectively.

Ballard has made an application to list the Newco Shares on the TSX. The TSX has conditionally approved the listing of the Newco Shares on the TSX under the symbol "BLD", which approval is subject to the realization of certain conditions prior to the end of the first business day after the Effective Date, including (i) the Securityholders approving the Arrangement at the Meeting, (ii) the closing of the Arrangement, (iii) the filing of all documents required by the TSX and the paying of the fees required pursuant to the policies of the TSX, and (iv) Newco meeting the continued listing requirements of the TSX.

Ballard has notified NASDAQ of the substitution listing of the Newco Shares for the Ballard Shares on NASDAQ upon completion of the Arrangement. The Newco Shares will trade on NASDAQ under the symbol "BLDP". NASDAQ's acceptance of the substitution listing of the Newco Shares for the Ballard Shares is subject to receipt by NASDAQ of all forms and documents, and the payment of all fees, required by NASDAQ, as well as compliance by Newco with the continued listing requirements of NASDAQ.

Newco expects that it will be able to satisfy all of the requirements of the TSX and NASDAQ relating to the listing of the Newco Shares prior to or upon completion of the Arrangement.

Other Third Party Approvals

Consummation of the Arrangement is subject to receipt by each of Ballard and Superior Plus of approvals of counterparties to certain of their respective key contractual relationships.

Timing

If the Meeting and the Fund Meeting are held as scheduled and are not adjourned and the other necessary conditions of the Arrangement are satisfied or waived, Ballard and Superior Plus will apply to the Court for the Final Order approving the Arrangement. If the Final Order is obtained on December 22, 2008, in form and substance satisfactory to Ballard and Superior Plus, and all other conditions to completion are satisfied or waived, Ballard expects the Effective Date of the Arrangement to be on or about December 31, 2008.

Costs and Expenses of the Arrangement

The estimated costs to be incurred by Ballard relating to the Arrangement, including transfer taxes, legal and financial advisor fees, insurance costs, the costs of preparation, mailing and printing of this Information Circular and the costs of holding the Meeting are expected to be approximately C$5.3 million. Newco will be responsible for these costs which, when netted against the cash payment of approximately C$46.3 million received by Newco, will result in Newco's cash reserves and shareholders' equity increasing by approximately C$41 million.

Certificates representing Newco Shares

Upon the Arrangement becoming effective, the existing certificates for Ballard Shares will represent Newco Shares. Ballard Shareholders do not need to take any action to replace the certificates representing their Ballard Shares for certificates representing Newco Shares.

Certificates representing Newco Options, Newco DSUs and Newco RSUs

Upon the Arrangement becoming effective, certificates representing Ballard Options, Ballard DSUs and Ballard RSUs will represent Newco Options, Newco DSUs and Newco RSUs, as the case may be. Ballard Rightsholders do not need to take any action to replace the certificates for Ballard Options, Ballard DSUs and Ballard RSUs.

Risk Factors

In connection with the Arrangement, Securityholders should be aware that there are various risks factors relating to the Arrangement, including: (1) the possibility that no active post-Arrangement market for trading of the Newco Shares will develop or be maintained; (2) the lack of assurance that Newco will continue to meet the continued listing requirements of the TSX and NASDAQ; (3) the possibility of delay or failure in obtaining regulatory approvals and third party consents; and (4) the risks relating to Ballard's business which are set forth in Ballard's annual information form, which is incorporated by reference. Securityholders should carefully consider these risk factors, together with other information included in this Information Circular, before deciding whether to approve the Arrangement. See "Risk Factors".

Dissent Rights

The Interim Order provides that each registered Ballard Shareholder will have the right to dissent and to have his, her or its Newco Shares cancelled in exchange for a cash payment from Newco equal to the fair value of his, her or its Ballard Shares as of the day before the Meeting. In order to dissent validly, any such Ballard Shareholder must provide Ballard with written objection to the Arrangement by 4:00 p.m. (Vancouver time) on Tuesday, December 16, 2008, must not vote any of his, her or its Ballard Shares in favour of the Arrangement Resolution, and must otherwise strictly comply with the dissent procedures provided under the Interim Order. Ballard Shareholders that are not registered holders but wish to exercise Dissent Rights must arrange for the registered Ballard Shareholder holding their Ballard Shares to deliver the required written objection.

It is important that Ballard Shareholders who wish to dissent comply strictly with the dissent procedures described in this Information Circular, which are different from the statutory dissent procedures of the CBCA. See "Dissent Rights".

If a registered Ballard Shareholder dissents, there can be no assurance that the amount of the cash payment from Newco that he, she or it will receive equal to the fair value of his, her or its Ballard Shares as of the day before the Meeting, will be more than or equal to the consideration offered under the Arrangement.

The Arrangement Agreement provides that it is a condition to the completion of the Arrangement, unless waived by Ballard, that the number of Ballard Shares held by Ballard Shareholders who have exercised Dissent Rights in respect of the Arrangement Resolution that have not been withdrawn as of the Effective Date is not more than 2% of the outstanding Ballard Shares.

Certain Canadian Federal Income Tax Considerations

For Canadian federal income tax purposes, each Ballard Shareholder who is a resident of Canada and whose Ballard Shares constitute capital property generally should be able to exchange the Ballard Shares for Newco Shares under the Arrangement on a tax-deferred basis. A Ballard Shareholder who wishes to realize a capital gain or capital loss on the exchange may do so by including an amount in income in respect of the exchange in the Ballard Shareholder's tax return, in which case the Ballard Shareholder will realize a capital gain (capital loss) equal to the amount by which the fair market value of the Newco Shares on the Effective Date exceeds (is exceeded by) the adjusted cost base of the Ballard Shareholder's Ballard Shares and reasonable costs of disposition. Each Ballard Shareholder who is a non-resident of Canada and whose Ballard Shares do not constitute "taxable Canadian property" generally will not incur any liability for Canadian federal income tax as a result of the Arrangement. It is expected that Ballard Optionholders, whether or not resident in Canada, should not incur any liability for Canadian federal income tax as a consequence of the exchange of Ballard Options for Newco Options pursuant to the Arrangement. A summary of the principal Canadian federal income tax considerations in respect of the Arrangement is set out under "Certain Canadian Federal Income Tax Considerations", and the foregoing is qualified in full by the information set out in that section.

Certain U.S. Federal Income Tax Considerations

There is no legal authority directly addressing the proper characterization of the Arrangement for U.S. federal income tax purposes. In addition, the Arrangement will be effected under applicable provisions of Canadian law, which are technically different from analogous provisions of U.S. law. Accordingly, the U.S. federal income tax consequences of the Arrangement to U.S. Holders are uncertain. Subject to such uncertainty, the exchange of Ballard Shares for Newco Shares pursuant to the Arrangement is intended by Ballard to qualify as a tax-deferred exchange pursuant to Section 351 of the Code and/or to qualify as a tax-deferred "reorganization" within the meaning of Section 368(a)(1) of the Code (in either case, a "Tax-Deferred Transaction"). There can be no assurance that the U.S. Internal Revenue Service, or the U.S. courts, will agree with this characterization.

If the Arrangement qualifies as a Tax-Deferred Transaction, subject to the "passive foreign investment company" rules discussed in this Information Circular, holders of Ballard Shares who are U.S. Holders (as defined in the Section titled "Certain United States Federal Income Tax Considerations," below) will not recognize gain or loss on the exchange of Ballard Shares for Newco Shares pursuant to the Arrangement.

If the Arrangement does not qualify as a Tax-Deferred Transaction for U.S. federal income tax purposes, subject to the "passive foreign investment company" rules discussed in this Information Circular, U.S. Holders will recognize gain or loss in an amount equal to the difference, if any, between (1) the fair market value (expressed in U.S. dollars) of the Newco Shares received in exchange for Ballard Shares pursuant to the Arrangement and (2) the adjusted tax basis (expressed in U.S. dollars) of such U.S. Holder in the Ballard Shares exchanged.

The foregoing is a brief summary only and is qualified in its entirety by the more detailed summary of the United States federal income tax considerations of the Arrangement to U.S. holders set forth in the section titled "Certain United States Federal Income Tax Considerations." U.S. Holders should consult their own U.S. tax advisors regarding the tax consequences of the Arrangement to them and the proper tax reporting of an exchange of Ballard Shares for Newco Shares pursuant to the Arrangement.

Information Respecting Newco

Newco was incorporated under the CBCA on November 12, 2008 for the express purpose of participating in the Arrangement. Newco has not carried on, and will not carry on, any other business from its incorporation to the Effective Date. From the date of incorporation to the Effective Date, the sole shareholder

of Newco has been and will be Ballard. Immediately prior to the Effective Date, Newco's authorized capital and bylaws will be the same as those of Ballard.

Following the completion of the Arrangement, Newco will use its assets and the proceeds of the Fund Loan, net of expenses, of approximately C$41 million to carry out the business as carried on by Ballard prior to the completion of the Arrangement. Newco's head office is located at 9000 Glenlyon Parkway, Burnaby, B.C., V5J 5J8.

Newco will adopt the Newco Option Plan, the Newco DSUP, the Newco RSUP and the Newco SDP (collectively, the "**Newco Share Incentive Plans**"). The Newco DSUP, the Newco RSUP and the Newco SDP will be substantially the same as the Ballard DSUP, the Ballard RSUP and the Ballard SDP, respectively. Ballard has three stock option plans (each of which is substantially the same), a 1997 Option Plan, a 2000 Option Plan and a 2002 Option Plan. Newco will adopt three option plans which are substantially the same as the Ballard Stock option plans. The Newco Share Incentive Plans are described in more detail in Appendix J.

The Newco Option Plan, the Newco RSUP, the Newco DSUP and the Newco SDP will be substantially the same as the Ballard Option Plan, the Ballard RSUP, the Ballard DSUP and the Ballard SDP, respectively, but with amendments necessary to implement the Arrangement including, in respect of the Newco RSUP and the Newco Option Plan, amendments necessary to continue to preserve the rights of persons whose employment was transferred by Ballard to AFCC Automotive Fuel Cell Cooperation Corp. in connection with the sale of Ballard's automotive fuel cell assets on January 31, 2008. Such rights are similarly preserved under the existing Ballard Option Plans and Ballard RSUP.

Immediately prior to the completion of the Arrangement, the board of directors of Newco will consist of those same individuals who then make up the Board of Directors, currently being Ian A. Bourne (Chair), Ed Kilroy, Dr. C. S. Park, John Sheridan, Dr. Gerri Sinclair, David J. Smith, David B. Sutcliffe, Mark Suwyn and Douglas W. G. Whitehead. In addition, the management team of Newco will consist of the same individuals who then make up the management team of Ballard, currently being John Sheridan (President and Chief Executive Officer), Bill Foulds (President Ballard Material Products, Vice-President Ballard Power Systems Inc.), Christopher Guzy (Vice-President and Chief Technical Officer), Glenn Kumoi (Vice-President, Human Resources, Chief Legal Officer and Corporate Secretary), Noordin Nanji (Vice-President, Corporate Strategy and Development) and David Smith (Vice-President and Chief Financial Officer).

Newco will adopt the same corporate governance guidelines, board mandate, terms of reference for directors, committee mandates, committee chair terms of reference, chief executive officer terms of reference, code of ethics, and all other policies, guidelines and operational practices as are currently in effect for Ballard.

Amendments to Share Incentive Plans

Background

Regardless of whether the Arrangement becomes effective, in order to maintain our conservative approach to cash expenditures, we will continue to meet certain compensation obligations through the issuance of Ballard Shares rather than cash. This method of compensation has created the need for additional Ballard Shares to be available for issuance under the Ballard SDP. In order to increase the number of Ballard Shares available for issuance under the Ballard SDP, the TSX requires that Ballard seek the approval of Ballard Shareholders.

Option Resolution

The Ballard Shareholders are being asked to consider and, if deemed advisable, to pass the Option Resolution approving: (1) the increase in the number of Ballard Shares reserved for issuance under the Ballard SDP by 1,250,000 Ballard Shares, such that the total number of Ballard Shares reserved for issuance under Ballard's 2003 Share Distribution Plan is 7,050,000; (2) the corresponding decrease in the number of Ballard Shares reserved for issuance under the 2002 Ballard Option Plan by 1,250,000 Ballard Shares, such that the total number of Ballard Shares reserved for issuance under the 2002 Ballard Option Plan is 2,750,000; and (3)

that if the Arrangement Resolution is approved, the share incentive plans adopted by Newco have these same changes in the number of shares reserved for issuance applied to them.

If the Option Resolution is approved by the Ballard Shareholders, but the Arrangement Resolution is not approved by the Ballard Securityholders, the Ballard Option Plan, the Ballard DSUP, the Ballard RSUP and the Ballard SDP will continue in force without change, save that the Ballard Shares reserved for issuance under the Ballard SDP will be increased by 1,250,000 Ballard Shares and there will be a corresponding decrease of 1,250,000 Ballard Shares reserved for issuance under the 2002 Ballard Option Plan.

The Option Resolution must be approved by a simple majority (more than 50%) of the votes cast by Ballard Shareholders, present in person or by proxy, at the Meeting. A copy of the Option Resolution is attached as Appendix C to this Information Circular. Each Ballard Shareholder is entitled to one vote per Ballard Share held. Ballard Rightsholders are not entitled to vote on the Option Resolution unless they are also Ballard Shareholders, in which case they will be entitled to vote any Ballard Shares held by them.

If the Arrangement is approved, the Newco Share Incentive Plans, when adopted, will reflect these same amendments.

Recommendation of the Board of Directors Concerning the Option Resolution

The Board of Directors has determined that the adoption of the Option Resolution is in the best interest of Ballard and the Ballard Shareholders. As such, the Board of Directors has unanimously approved the Option Resolution and authorized the submission of the Option Resolution to the Ballard Shareholders for approval.**The Board of Directors unanimously recommends that you vote FOR the Option Resolution**.

THE MEETING

The Board of Directors is delivering this Information Circular to you in connection with the solicitation of proxies by the management of Ballard for use at the Meeting.

The principal purpose of the Meeting is to seek the approval of Securityholders for the Arrangement. Under the Arrangement, Ballard will transfer its entire business and operations, including all assets and liabilities, to Newco, which will have the same assets, liabilities, directors, management and employees as Ballard has currently, except for Ballard's tax attributes. Newco will also receive a cash payment of approximately C$46.3 million for allowing Superior Plus to use Ballard as the corporate vehicle through which it will complete its conversion from an income trust to a corporation.

The terms and conditions of the Arrangement are set out in the Arrangement Agreement. The Arrangement Agreement has been approved by the Board of Directors. However, completion of the Arrangement remains subject to, among other things, receipt of the approval of the Arrangement Resolution by Securityholders and the receipt of all required regulatory approvals and third party consents.

BACKGROUND TO AND REASONS FOR THE ARRANGEMENT

Background to the Arrangement

Ballard's Audit Committee regularly reviews Ballard's tax position and, as Ballard was not expected to be in a position to use its tax attributes for the foreseeable future, as early as 2005 management was tasked to review opportunities related to extracting value from these tax attributes. As a result, management had a number of discussions with several accounting and investment banking firms across Canada to assess options that were available to Ballard in this regard. Ballard regularly maintained dialogue with these advisors, indicating that it would be interested in pursuing a transaction if one was presented.

After completion of the sale of Ballard's automotive fuel cell business to AFCC Automotive Fuel Cell Cooperation Corp. in January 2008, Ballard again revisited the issue of its tax attributes. Ballard requested three firms to submit proposals to represent Ballard in this regard. Ballard selected PricewaterhouseCoopers Corporate Finance Inc. ("**PwCCF**"), reached a general understanding on terms in July 2008, and executed a formal engagement letter on August 15, 2008, and an amendment on October 20, 2008.

Prior to engaging PwCCF, Ballard rejected a proposed transaction in July 2008 which it deemed to be unsuitable, and which, in retrospect, was inferior to the Arrangement. In August 2008, PwCCF identified Superior Plus as a party with which Ballard might be able to complete a transaction. Ballard entered into a confidentiality agreement with Superior Plus in September 2008. Subsequently, Superior Plus provided Ballard, PwCCF and Ballard's tax and legal advisors with a proposal to restructure Ballard to enable Superior Plus to convert from an income trust to a corporation, and to provide Ballard with a cash payment as consideration for completing the transaction.

The terms of the initial proposal were negotiated, resulting in the execution of a letter of intent in late September 2008. At the time that the Board of Directors approved the execution of the letter of intent, it also appointed the Audit Committee, as a committee consisting of independent directors, to oversee the negotiation of the proposed transaction. Following further analysis of the proposal, negotiations between the parties and respective due diligence, on October 30, 2008, Ballard and Superior Plus entered into the Arrangement Agreement providing, among other things, for the terms and conditions of the Arrangement.

Benefits of the Arrangement

There are a number of benefits which are anticipated to result from the Arrangement and enhance overall Securityholder value. These benefits include: (1) Newco's receiving a cash payment of C$46.3 million which, net of the expenses of the Arrangement, will increase Newco's cash reserves by approximately C$41 million; (2) this increase in cash reserves is expected to allow Newco to execute its growth plan without any need for public market financing for the foreseeable future; and (3) the transfer of Ballard's assets to Newco

under the Arrangement is expected to create new Canadian tax basis, which Newco may apply in sheltering future taxable income.

Audit Committee

Organization of the Audit Committee

On September 25, 2008 the Board of Directors tasked the Audit Committee with the mandate of reviewing and considering the Arrangement. The Audit Committee's mandate included the consideration of whether the Arrangement would be in the best interests of Ballard and the Ballard Shareholders and the provision of a recommendation to the Board of Directors with respect to the Arrangement.

The Audit Committee consists of Ed Kilroy (Chair), Ian A. Bourne, David B. Sutcliffe, Mark Suwyn and Douglas W. G. Whitehead. Each member of the Audit Committee is independent of the management of Ballard. The Audit Committee engaged PwC to address the fairness, from a financial point of view, of the Arrangement.

Deliberations of the Audit Committee

The Audit Committee met three times during the course of negotiations between Ballard and Superior Plus. The meetings and deliberations of the Audit Committee allowed the Audit Committee to examine the Arrangement and to consider whether it is appropriately valued and structured in a manner which would be in the best interests of Ballard and fair to the Ballard Shareholders.

The Arrangement Agreement and certain other principal documents required to undertake and implement the Arrangement were prepared by and negotiated between management and legal counsel for each of Ballard and Superior Plus and reported upon to the Audit Committee by management. The Audit Committee considered the terms of these principal documents. At the request of the Audit Committee, representatives of management and Ballard's advisors were present at meetings of the Audit Committee to assist the Audit Committee, in particular with the background to the Arrangement, and to report on the negotiation of the Arrangement Agreement. However, management did not participate in the deliberations of the Audit Committee and management was excluded from a portion of each Audit Committee meeting.

On October 27, 2008, PwC gave an oral presentation to the Audit Committee of its Fairness Opinion to the effect that, as of October 27, 2008 and based upon and subject to the various considerations, limitations and assumptions set forth in the Fairness Opinion, the consideration to be received by Ballard under the Arrangement is fair, from a financial point of view, to the Ballard Shareholders.

During the course of its deliberations and in arriving at its recommendation, the Audit Committee relied upon the legal, financial and other advice and information it received. The following is a summary of the factors, among others, which the Audit Committee reviewed and considered:

(a) following the Arrangement, the Ballard Shareholders will hold 100% of the Newco Shares, and Newco will carry on the same business that Ballard carried on prior to completion of the Arrangement, but with additional net cash of C$41 million, without any dilution to Ballard Shareholders;
(b) the Fairness Opinion concluded that the Arrangement is fair, from a financial point of view, to the Ballard Shareholders;
(c) the Arrangement will not proceed unless the Arrangement Resolution receives a favourable vote of at least two thirds of the votes cast at the Meeting by Securityholders, voting as a single class;
(d) the Arrangement will only become effective if the Court grants the Final Order after considering the fairness of the Arrangement;
(e) the purpose and benefits of the Arrangement as outlined herein;

(f) information concerning the financial condition, results of operations, the business plans and prospects of Ballard;
(g) the transaction has been structured as a plan of arrangement, which provides for Dissent Rights for registered Ballard Shareholders;
(h) Ballard's ability to access the capital that it would require to continue to fund the ongoing development of products on terms that would not be unduly dilutive to Ballard Shareholders;
(i) historical information concerning Ballard's businesses, including Ballard's financial performance and condition, operations, technologies and intellectual property; and
(j) the view of management as to Ballard's anticipated financial condition, results of operations and business both with and without giving effect to the Arrangement.

The foregoing discussion of the information and factors reviewed by the Audit Committee is not intended to be exhaustive, but is believed to include all material factors considered by the Audit Committee. In reaching its determination, the Audit Committee did not assign any relative or specific weights to the foregoing factors which were considered, and individual members of the Audit Committee may have given different weights to different factors.

Conclusions and Recommendation of the Audit Committee

The Audit Committee concluded that the Arrangement is in the best interests of Ballard, and is fair to the Ballard Shareholders. Accordingly, the Audit Committee recommended that the Board of Directors: (1) approve the Arrangement on the terms and subject to the conditions set out in the Arrangement Agreement and (2) recommend that the Ballard Shareholders vote in favour of the Arrangement Resolution.

Fairness Opinion

Securities legislation does not require that Ballard obtain and provide to the Securityholders a formal valuation or a fairness option from an independent valuator. However, the Audit Committee engaged PwC to provide an opinion as to the fairness of the Arrangement from a financial point of view to Ballard Shareholders. PwC is to be paid a fixed fee by Ballard for the Fairness Opinion, the payment of which is not subject to completion of the Arrangement. In addition, PwC is to be reimbursed for reasonable expenses incurred in the preparation of the Fairness Opinion and to be indemnified by Ballard in certain circumstances.

PwC is one of the world's largest professional services organizations. Drawing on the knowledge and skills of more than 146,000 people in 150 countries, PwC provides clients with expertise in a wide array of services, including corporate finance, mergers and acquisitions, business valuations, tax services and auditing. In Canada, PwC and its related entities have more than 4,300 partners and staff across the country. PwC's valuation practice has extensive experience in providing valuation and fairness opinions with respect to securities or assets. PwC has been involved in numerous transactions requiring fairness opinions from a financial point of view with respect to consideration offered to shareholders and/or stakeholders.

PwC is not the auditor of Ballard or Newco. PwCCF, a member firm of PwC, acted as the financial advisor to Ballard for the Arrangement, and is entitled to work fees as well as contingent success fees should the Arrangement be successfully completed. PwC has used a separate team of qualified Chartered Business Valuators, including Partners and senior staff members (together the "**PwC Fairness Committee**") to prepare the Fairness Opinion. Members of the PwC Fairness Committee are separate from the PwCCF team. The PwC Fairness Committee has confirmed that, to the best of its knowledge, after all due and reasonable inquiry, PwC has disclosed to the Audit Committee and the Board of Directors all material facts, which could reasonably be considered to be relevant to qualifications and independence of PwC for the purposes of this engagement.

In connection with the preparation and rendering of the Fairness Opinion, PwC has reviewed and, where it considered appropriate, relied upon, among other things, various documents prepared by Ballard and

discussions with management of Ballard. PwC has been provided with full access to all information and documents requested from management of Ballard, the Audit Committee and the Board of Directors.

The Fairness Opinion has been provided for the use of the Audit Committee and the Board of Directors and should not be construed as a recommendation to vote in favour of the Arrangement.

PwC has relied upon the accuracy, completeness and fair presentation of all financial and other information that was obtained from public sources or that was provided by management of Ballard (collectively the "**Information**"). Parts of the Information were received or obtained by PwC directly or indirectly, and in various ways (oral, written, inspection), from third parties (i.e. individuals or entities other than Ballard and its directors, officers and employees). PwC has assumed that this information was complete, accurate, and not misleading and did not omit any material facts. The Fairness Opinion is conditional upon such completeness, accuracy, and fair presentation. Subject to the exercise of professional judgment and except as expressly described herein, PwC has not attempted to verify independently the completeness, accuracy or fair presentation of any of the Information.

The Fairness Opinion must be considered in its entirety, as selecting and relying on only a specific portion of the analysis or factors considered by PwC, without considering all factors and analyses together, could create a misleading view of the processes underlying the Fairness Opinion. Nothing contained in the Fairness Opinion is to be construed as a tax or legal interpretation, an opinion on any contract or document, or a recommendation to invest or divest.

The Fairness Opinion is limited to the fairness of the Arrangement, from a financial point of view, to the Ballard Shareholders, not the strategic merits of the Arrangement. The Fairness Opinion is rendered as of October 30, 2008, on the basis of financial, economic, market and other general business and financial conditions currently prevailing, and the conditions and prospects, financial and otherwise, of Ballard as they were reflected in the information and documents reviewed by PwC and as they were represented to PwC in discussions with management of Ballard.

PwC has said that the assessment of fairness from a financial point of view must be determined in the context of each particular transaction. PwC has based this Fairness Opinion on methods, approaches and techniques that it considers appropriate in the circumstances.

Based on PwC’s scope of review and subject to the restrictions, limitations and assumptions contained in the Fairness Opinion, PwC is of the opinion that the Arrangement is fair from a financial point of view to the Ballard Shareholders.

The summary of the Fairness Opinion set forth in this Information Circular is qualified in its entirety by reference to the full text of the Fairness Opinion, which is attached as Appendix E to this Information Circular, and Securityholders are urged to read the Fairness Opinion carefully and in its entirety.

The Fairness Opinion does not constitute a recommendation to any Securityholder as to how to vote at the Meeting.

Recommendation of the Board of Directors

The Board of Directors reviewed and considered the same factors which the Audit Committee reviewed and considered and, based on those factors, the unanimous recommendation of the Audit Committee and the Fairness Opinion, the Board of Directors has determined that the terms of the Arrangement are in the best interests of Ballard and the Securityholders, as a whole, and are fair, from a financial point of view, to the Securityholders. As such, the Board of Directors has unanimously approved the Arrangement and authorized the submission of the Arrangement to the Securityholders for approval.

The Board of Directors unanimously recommends that Securityholders vote FOR the Arrangement Resolution.

THE ARRANGEMENT

Description of the Arrangement

The Plan of Arrangement provides for the implementation of the following steps, in the following sequence.

1. Ballard will cancel all existing outstanding Ballard DSUs and Ballard RSUs without payment of any consideration;
2. The Fund Trust Indenture will be amended as necessary to implement the steps of the Plan of Arrangement;
3. Ballard will borrow the Fund Loan (C$46,319,148) from Superior Plus;
4. Ballard will transfer all of its assets (including the proceeds of the Fund Loan) to Subco in consideration for Subco's issuing to Ballard 100,000,000 Subco Shares and assuming all of Ballard's liabilities except for Ballard's obligation to repay the Fund Loan. Ballard and Subco will agree to elect pursuant to Section 85(1) of the Tax Act to transfer all such assets at amounts to be determined by Subco;
5. The Ballard Shares (including those held by dissenters, if any) will be exchanged 1:1 for Newco Shares and Newco will become a holding corporation of Ballard;
6. Newco will adopt the Newco Share Incentive Plans;
7. Newco will grant to each person whose Ballard DSUs or Ballard RSUs were cancelled under the Arrangement substantially similar Newco DSUs and Newco RSUs;
8. The Ballard Optionholders will exchange all of their Ballard Options for substantially similar Newco Options;
9. The authorized capital of Ballard will be altered to (a) amend the rights attached to the Ballard Shares so that they are redeemable at the option of Ballard 1:1 for Subco Shares, and (b) authorize New Superior Shares;
10. Superior Plus will transfer all of its assets (including the right to receive repayment of the Fund Loan) to Ballard in exchange for approximately 88 million New Superior Shares (equal to the number of then outstanding Trust Units) and Ballard's assumption of all of the liabilities of Superior Plus;
11. Superior Plus will redeem its outstanding Trust Units through the issuance of an equal number of New Superior Shares to Superior Plus Unitholders;
12. Ballard will redeem the Ballard Shares (previously held by Ballard Shareholders, but which are now held by Newco), and will pay the redemption price by distributing the Subco Shares on a 1:1 basis to Newco;
13. Newco Shares held by dissenters will be cancelled and dissenters will be paid the fair value of their interest;
14. Subco will commence liquidation and distribute all of its assets (including the proceeds of the Fund Loan but excluding any obligation to repay the Fund Loan) to Newco, which will assume all of Subco's liabilities;
15. Ballard will change its name to Superior Plus Corp. and carry on business as a successor to the Superior Plus Income Fund; and
16. Newco will change its name to Ballard Power Systems Inc. and carry on Ballard's business as a successor to Ballard.

Effect of the Arrangement

Upon completion of the Arrangement, the Ballard Shareholders will be the holders of all issued and outstanding Newco Shares and Newco will be the holder of the assets (including the associated contractual obligations and liabilities) formerly owned by Ballard and will carry on the business previously carried on by Ballard, but with additional net cash of C$41 million. Newco will have no obligation to repay the Fund Loan.

Newco will assume and be bound by and observe, carry out, perform, fulfill and pay all of the outstanding covenants, conditions, obligations and liabilities of Ballard, including those contained in the contracts to which Ballard is a party. In addition, Newco will offer employment to each of Ballard's employees on terms and conditions of employment which are the same as those governing such employees' employment with Ballard. Furthermore, Newco will, going forward, fully indemnify and save Ballard and its directors, officers and employees harmless from and against all liabilities, losses, costs, expenses, claims and damages (including legal costs), to which any of them may be subject in relation to, among other things, the assets and the business carried out by Ballard prior to the Effective Date and by Newco thereafter, other than for certain tax liabilities.

The Arrangement Agreement

The Arrangement is being effected pursuant to the Arrangement Agreement. The Arrangement Agreement contains covenants, representations and warranties of and from each of Superior Plus and Ballard and various conditions precedent, both mutual and with respect to each party.

The following is a summary of certain provisions of the Arrangement Agreement. This summary is qualified in its entirety by reference to the complete text of the Arrangement Agreement which is attached to the material change report of Ballard dated November 6, 2008 and which is available on the Canadian securities regulatory authorities' website at www.sedar.com.

Mutual Covenants Regarding Non-Solicitation

Under the Arrangement Agreement the Parties have agreed to certain non-solicitation covenants as follows:

(a) Each Party shall immediately cease and cause to be terminated all existing discussions and negotiations (including, without limitation, through any advisors or other parties on its behalf), if any, with any parties conducted before the date of the Arrangement Agreement with respect to any Acquisition Proposal and shall immediately request the return or destruction of all information provided to any third parties who have entered into a confidentiality agreement with such Party relating to an Acquisition Proposal and shall use all reasonable commercial efforts to ensure that such requests are honoured.

(b) Neither Party shall, directly or indirectly, do or authorize or permit any of its officers, directors or employees or any financial advisor, expert or other representative retained by it to do, any of the following:

  (i) solicit, facilitate, initiate or encourage any Acquisition Proposal;

  (ii) enter into or participate in any discussions or negotiations regarding an Acquisition Proposal, or furnish to any other Person any information with respect to its business, properties, operations, prospects or conditions (financial or otherwise) in connection with an Acquisition Proposal or otherwise cooperate in any way with, or assist or participate in, facilitate or encourage, any effort or attempt of any other Person to do or seek to do any of the foregoing;

  (iii) waive, or otherwise forbear in the enforcement of, or enter into or participate in any discussions, negotiations or agreements to waive or otherwise forbear in respect of, any rights or other benefits under confidential information agreements executed in connection with an Acquisition Proposal, including, without limitation, any "standstill provisions" thereunder; or

(iv) accept, recommend, approve or enter into an agreement to implement an Acquisition Proposal;

provided, however, that notwithstanding any other provision of the Arrangement Agreement, each Party and its officers, directors and advisers may:

(v) enter into or participate in any discussions or negotiations with a third party who (without any solicitation, initiation or encouragement, directly or indirectly, after the date of the Arrangement Agreement, by such Party or any of its officers, directors or employees or any financial advisor, expert or other representative retained by it, whether or not such solicitation, initiation or encouragement was in relation to an Acquisition Proposal or a transaction that would constitute an Acquisition Proposal but for the fact that such transaction does not preclude, delay or have an adverse effect on, the Arrangement) has made a written bona fide Material Acquisition Proposal which the Board of Directors or the Superior Plus board of directors, as the case may be, determines in good faith that the funds or other consideration necessary for the Material Acquisition Proposal are likely to be available (an "**Alternative Proposal**") and, subject to execution of a confidentiality agreement with a standstill covenant that prevents such third party from making an Acquisition Proposal without the written consent of the Board of Directors or the Superior Plus board of directors, as the case may be, (provided that such confidentiality agreement shall provide for disclosure thereof (along with all information provided thereunder) to the Other Party (as defined in the Arrangement Agreement) as set out below), may furnish to such third party information concerning such Party and its business, properties and assets, if:

(A) the Board of Directors or the Superior Plus board of directors, as the case may be, has received the advice of outside counsel that it is necessary to do so in order to properly discharge its fiduciary duties under Applicable Laws or the constating documents of such Party; and

(B) prior to furnishing such information to or entering into or participating in any such discussions or negotiations with such third party, such Party provides prompt notice to the Other Party to the effect that it is furnishing information to or entering into or participating in discussions or negotiations with such third party together with a copy of the confidentiality agreement referenced above and if not previously provided to the Other Party, copies of all information provided to such third party that is relevant to the Arrangement concurrently with the provision of such information to such third party, and provided further that such Party shall notify the Other Party orally of, and disclose in writing, any inquiries, offers or proposals with respect to an Alternative Proposal (which written disclosure shall include, without limitation, a copy of any such proposal (and any amendments or supplements thereto), the identity of the third party making it, if not previously provided to the Other Party, copies of all information provided to such third party and all other information reasonably requested by the Other Party), within 24 hours of the receipt thereof, shall keep the Other Party informed of the status and details of any such inquiry, offer or proposal and answer the Other Party's questions with respect thereto; or

(vi) accept, recommend, approve or enter into an agreement to implement an Alternative Proposal, if the Board of Directors or the Superior Plus board of directors, as the case may be, determines the Alternative Proposal to be in the best interests of its shareholders or Fund Unitholders, as the case may be, and such Party complies with its obligations set forth in Section 3.4(c) of the Arrangement Agreement and terminates the Arrangement Agreement in accordance with Section 7.1(c) of the Arrangement Agreement and concurrently therewith pays the Termination Fee (as defined below) to the Other Party.

(c) Each Party in receipt of an Alternative Proposal (a "**Receiving Party**") shall give the Other Party (the "**Responding Party**"), orally and disclose in writing, at least three Business Days (as defined in the Arrangement Agreement) advance notice of any decision by the Board of Directors or the Superior Plus board of directors, as the case may be, to accept, recommend, approve or enter into an agreement to implement an Alternative Proposal, which notice shall confirm that the Board of Directors or the Superior Plus board of directors, as the case may be, of the Receiving Party has determined that such Acquisition Proposal constitutes an Alternative Proposal, shall identify the third party making the Alternative Proposal and shall provide a true and complete copy thereof and any amendments thereto. During such three Business Day period, the Receiving Party agrees not to accept, recommend, approve or enter into any agreement to implement such Alternative Proposal and not to release the third party making the Alternative Proposal from any standstill provisions and shall not withdraw, redefine, modify or change its recommendation in respect of the Arrangement.

(d) Each Party agrees that all information that may be provided to it by the Other Party with respect to any Alternative Proposal pursuant to Section 3.4 of the Arrangement Agreement shall be confidential and shall not be disclosed or used except in order to enforce its rights under the Arrangement Agreement in legal proceedings.

(e) Each Party shall ensure that its officers, directors and employees and any investment bankers or other advisers or representatives retained by it are aware of the provisions of Section 3.4 of the Arrangement Agreement. Superior Plus shall be responsible for any breach of this Section of the Arrangement Agreement by Superior Plus' officers, directors, employees, investment bankers, advisers or representatives, and Ballard shall be responsible for any breach of this Section of the Arrangement Agreement by its officers, directors, employees, investment bankers, advisers or representatives.

Termination Fee

If the Arrangement Agreement:

(a) is terminated by a Party in the circumstances contemplated in Section 7.1(b) of the Arrangement Agreement as a result of the failure of the other Party’s securityholders to approve the Arrangement Resolution (as defined in the Arrangement Agreement), and the terminating Party’s securityholders have approved the Arrangement Resolution; or

(b) is to be terminated by a Party in the circumstances contemplated in paragraph (c) below under the heading "-Termination";

the Party whose securityholders have failed to approve the Arrangement, or the Party which wishes to terminate the Arrangement Agreement to enter into an Alternative Proposal, as the case may be, must pay to the Other Party, in immediately available funds to an account designated by the Other Party, C$2 million (the "**Termination Fee**").

Termination

The Arrangement Agreement may be terminated at any time prior to the Effective Date:

(a) by mutual written consent of Superior Plus and Ballard;

(b) as provided in Section 5.4(b) of the Arrangement Agreement; or

(c) by either Superior Plus or Ballard in order to enter into an Alternative Proposal in accordance with Section 3.4(b)(vi) of the Arrangement Agreement, provided that such Party has complied with its obligations set forth in Section 3.4(c) of the Arrangement Agreement and concurrently therewith pays the Termination Fee.

If the Arrangement Agreement is terminated in the circumstances set out in paragraphs (a) through (c) above, the Arrangement Agreement shall forthwith become void and neither Party shall have any liability or further obligation to the Other Party hereunder, except with respect to the obligations set forth in Article 7 and Article 8 of the Arrangement Agreement which shall survive such termination.

Conditions Precedent to the Arrangement

Mutual Conditions Precedent

The respective obligations of the Parties to consummate the transactions contemplated by the Arrangement Agreement, are subject to the satisfaction, on or before the Effective Date or such other time specified, of the following conditions, any of which may be waived by the mutual consent of such Parties without prejudice to their right to rely on any other of such conditions:

(a) the Interim Order:
  (i) shall have been granted in form and substance satisfactory to each of Superior Plus and Ballard, acting reasonably;
  (ii) shall provide that the obligation to comply with any dissent rights granted to Ballard Shareholders in connection with the Arrangement, including without limitation the obligation to pay the fair value of such Ballard Shares to the holders of any such securities which have exercised such dissent rights, shall be an obligation of Newco; and
  (iii) shall not have been set aside or modified in a manner unacceptable to Superior Plus and Ballard, acting reasonably, on appeal or otherwise;

(b) the Arrangement Resolution and the Fund Resolution shall have been passed by the requisite majorities specified in the Interim Order and in form and substance satisfactory to each of Superior Plus and Ballard, acting reasonably;

(c) the Final Order shall have been granted in form and substance satisfactory to Superior Plus and Ballard, acting reasonably and shall not have been set aside or modified in any manner unacceptable to Superior Plus or Ballard, acting reasonably, on appeal or otherwise;

(d) the Articles of Arrangement to be filed with the Director in accordance with the Arrangement shall be in form and substance satisfactory to each of Superior Plus and Ballard, acting reasonably and be capable of being filed in sufficient time to ensure that the Arrangement may become effective on or prior to the Deadline (as defined in the Arrangement Agreement); and

(e) there shall be no action taken under any existing Applicable Law, nor any statute, rule, regulation or order which is enacted, enforced, promulgated or issued by any Governmental Entity, that:
  (i) makes illegal or otherwise directly or indirectly restrains, enjoins or prohibits the Arrangement or any other transactions contemplated in the Arrangement Agreement; or
  (ii) results in a judgment or assessment of material damages directly or indirectly relating to the transactions contemplated in the Arrangement Agreement.

The foregoing conditions are for the mutual benefit of Ballard and Superior Plus and may be asserted by Ballard and Superior Plus regardless of the circumstances and may be waived by Ballard and Superior Plus (with respect to such Party) in their sole discretion, in whole or in part, at any time and from time to time without prejudice to any other rights which Ballard or Superior Plus may have.

Additional Conditions to Obligations of Superior Plus

The obligation of Superior Plus to consummate the transactions contemplated by the Arrangement Agreement is subject to the satisfaction, on or before the Effective Date or such other time specified, of the following conditions:

(a) except as affected by the transactions contemplated by the Agreement, the representations and warranties of Ballard contained in Section 4.2 of the Arrangement Agreement shall be true in all material respects (provided that those representations which are subject to qualifications or limitations as to materiality or Material Adverse Effect or Material Adverse Change (as defined in the Arrangement Agreement) shall be true in all respects) as at the Effective Date, or as at the date specified in such representation or warranty, where applicable, with the same effect as though such representations and warranties had been made at and as of such time and Ballard shall have complied in all material respects with its covenants in the Arrangement Agreement and Superior Plus shall have received a certificate to that effect dated the Effective Date from the Chief Executive Officer and Chief Financial Officer of Ballard acting solely on behalf of Ballard and not in their personal capacity, to the best of their respective information and belief having made reasonable inquiry and Superior Plus will have no knowledge to the contrary;

(b) holders of not more than 2% of the outstanding Trust Units shall have exercised rights of dissent in respect of the Arrangement that have not been withdrawn as of the Effective Date;

(c) immediately prior to the Effective Time, but after completion of the Pre-Arrangement Transactions (as defined in the Arrangement Agreement), the aggregate of federal tax account balances in respect of the pools set out in the Disclosure Letter (as defined in the Arrangement Agreement) shall not be less than 90% of the amounts set out in the Disclosure Letter, and the applicable expiry horizons will not be materially different than as set out in the Disclosure Letter;

(d) at the Effective Time:

  (i) Ballard shall have no Subsidiaries (as defined in the Arrangement Agreement) other than those being transferred to Newco in connection with the Arrangement or agreements of any nature to acquire any Subsidiary, or to acquire or lease any other business, assets or operations;

  (ii) Ballard shall not have in effect any bonus plan, commission plan, profit sharing plan, pension plan, royalty plan or arrangement or employee benefit plan for the benefit of any employees, officers, directors or shareholders of Ballard that will not be terminated, whether pursuant to the Arrangement or otherwise;

  (iii) Ballard will have no officers, employees or consultants other than those being transferred to Newco in connection with the Arrangement; and

  (iv) there shall be no amounts payable by Ballard under any obligations or liabilities of Ballard to pay any amount to its officers, directors, employees or consultants or any other person not dealing at arm's length with Ballard or any associate or affiliate of any such persons including all severance, termination, change of control arrangements, pay to stay or retention arrangements and salaries and bonuses;

(e) there shall not have been after the date of the Arrangement Agreement and prior to the Effective Time any enactment, promulgation or public announcement of any change or proposed change in law (including a specific proposal to amend the Tax Act publicly announced by the Department of Finance of Canada) or applicable case law, or written and published interpretative guidance or policy of the Canada Revenue Agency or provincial

equivalent that, in the opinion of Superior Plus, acting reasonably, could result in any material impairment of, or materially adversely affect: (i) the benefit to Superior Plus, or the completion, of the Arrangement, or (ii) the ability of Ballard to utilize, the account balances referred to in the Disclosure Letter after the Effective Date;

(f) during the period commencing immediately prior to the date of the Arrangement Agreement and ending immediately prior to the Effective Time, there will not have been any "acquisition of control" of Ballard, as that term is used for purposes of the Tax Act with the exception of any "acquisition of control" that has occurred on or after the date of the Arrangement Agreement as a result of the execution of the Arrangement Agreement or the completion of the transactions contemplated in the Arrangement Agreement, including the Plan of Arrangement;

(g) the New Superior Shares and Superior Plus Debentures (as defined in the Arrangement Agreement) to be assumed by Ballard (including the New Superior Shares to be issued pursuant to the Arrangement or issuable upon conversion, redemption or maturity of such debentures) shall be conditionally listed so as to be listed and posted for trading on the TSX on the first trading day following the Effective Date and the Ballard Shares shall be delisted from the NASDAQ (as defined in the Arrangement Agreement);

(h) Superior Plus shall have received resignations and releases, in the form settled between Ballard and Superior Plus on or prior to the date of the Arrangement Agreement, from the directors and officers of Ballard;

(i) between the date of the Arrangement Agreement and the Effective Time, there shall not have occurred any Material Adverse Change as described in section (i) or (ii) of the definition of Material Adverse Change or any Material Adverse Change described in section (iii) of such definition in the Arrangement Agreement which, in the opinion of Superior Plus, acting reasonably, has a material adverse effect on Newco’s financial capacity to fulfill its obligations under the indemnity under the Indemnity Agreement (as defined below) which, for greater certainty, shall include a decision by a credit rating agency to downgrade the credit rating or outlook on Superior Plus LP's debt as a result of such Material Adverse Change;

(j) Ballard shall have;

  (i) been added as an additional insured to the general insurance policies; and

  (ii) been added as a named insured to the directors' and officers' liability insurance policy of Newco, or shall have secured "run off" directors’ and officers’ liability insurance, which policies shall have a scope and coverage no less advantageous in scope and coverage to that provided pursuant to Ballard's insurance policies immediately prior to the date of the Arrangement Agreement and, in the case of the "run off" directors' and officers' liability insurance policy shall cover claims made prior to or within six years after the Effective Time;

(k) there shall be no security registrations against Ballard under the Personal Property Security Act (British Columbia) or other security registration legislation in other jurisdictions, with the exception of registrations relating to specific goods which, for greater certainty, excludes registrations relating to equipment or other categories of personal property where no specific good is listed, or such other arrangements shall have been made with respect to the discharge of such security registrations as are satisfactory to Superior Plus;

(l) Newco and Subco shall have entered into an indemnity agreement indemnifying Ballard in the form attached as Schedule "B" to the Arrangement Agreement (the "**Indemnity Agreement**"); and

(m) the Fund Required Approvals shall have been received by Superior Plus on a basis acceptable to Superior Plus, acting reasonably.

The foregoing conditions are for the exclusive benefit of Superior Plus and may be asserted by Superior Plus regardless of the circumstances or may be waived by Superior Plus in its sole discretion, in whole or in part, at any time and from time to time without prejudice to any other rights which Superior Plus may have.

Additional Conditions to Obligations of Ballard

The obligation of Ballard to consummate the transactions contemplated by the Arrangement Agreement, is subject to the satisfaction, on or before the Effective Date or such other time specified, of the following conditions:

(a) except as affected by the transactions contemplated by the Arrangement Agreement, the representations and warranties of Superior Plus contained in Section 4.1 of the Arrangement Agreement shall be true in all material respects (provided that those representations which are subject to qualifications or limitations as to materiality or Material Adverse Effect or Material Adverse Change shall be true in all respects) as at the Effective Date, or as at the date specified in such representation or warranty, where applicable, with the same effect as though such representations and warranties had been made at and as of such time and Superior Plus shall have complied in all material respects with its covenants in the Arrangement Agreement and Ballard shall have received a certificate to that effect dated the Effective Date from the Chief Executive Officer and Chief Financial Officer of the Administrator (as defined in the Arrangement Agreement) acting solely on behalf of the Administrator and not in their personal capacity, to the best of their respective information and belief having made reasonable inquiry and Ballard will have no knowledge to the contrary;

(b) holders of not more than 2% of the outstanding Ballard Shares shall have exercised rights of dissent in respect of the Arrangement that have not been withdrawn as of the Effective Date;

(c) the Newco Shares (including the Newco Shares issuable to Ballard Shareholders pursuant to the Arrangement) shall be conditionally listed so as to be listed and posted for trading on the TSX and NASDAQ on the first trading day following the Effective Date and any required approvals of the TSX and NASDAQ of the Newco DSUP, Newco RSUP, Newco Option Plan and Newco SDP and the listing of the Newco Shares issuable thereunder by the TSX and NASDAQ shall have been received;

(d) Ballard shall have entered into the Indemnity Agreement indemnifying Newco; and

(e) the Ballard Required Approvals shall have been received by Ballard on a basis acceptable to Ballard, acting reasonably.

The foregoing conditions are for the exclusive benefit of Ballard and may be asserted by Ballard regardless of the circumstances or may be waived by Ballard in its sole discretion, in whole or in part, at any time and from time to time without prejudice to any other rights which Ballard may have.

Notice and Effect of Failure to Comply with Conditions

(a) Each of Superior Plus and Ballard shall give prompt notice to the other of the occurrence, or failure to occur, at any time from the date of the Arrangement Agreement to the Effective Date of any event or state of facts which occurrence or failure would, or would be likely to: (i) cause any of the representations or warranties of any Party contained in the Arrangement Agreement to be untrue or inaccurate in any material respect, or (ii) result in the failure to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by any Party under the Arrangement Agreement; provided, however, that no such notification

will affect the representations or warranties of the Parties or the conditions to the obligations of the Parties under the Arrangement Agreement.

(b) If any of the conditions precedent set forth in Sections 5.1, 5.2 or 5.3 of the Arrangement Agreement shall not be complied with or waived by the Party or Parties for whose benefit such conditions are provided on or before the date required for the performance thereof, then a Party for whose benefit the condition precedent is provided may terminate the Arrangement Agreement as provided in Section 7.1 of the Arrangement Agreement; provided that, prior to the filing of the Articles of Arrangement for the purpose of giving effect to the Arrangement, the Party intending to rely thereon has delivered a written notice to the Other Party, specifying in reasonable detail all breaches of covenants, representations and warranties or other matters which the Party delivering such notice is asserting as the basis for the non-fulfillment of the applicable conditions precedent. More than one such notice may be delivered by a Party.

Satisfaction of Conditions

The conditions set out in Article 5 to the Arrangement Agreement are conclusively deemed to have been satisfied, waived or released when, with the agreement of the Parties, Articles of Arrangement are filed under the CBCA to give effect to the Arrangement.

Indemnity Agreement

The Arrangement Agreement provides that New Superior, Newco and Subco will enter into the Indemnity Agreement on or before the Effective Time. The Indemnity Agreement is designed to provide New Superior with indemnification from Newco, the resulting entity that will carry on the business previously carried on by Ballard, for claims relating to Newco's business that are brought against New Superior in the future.

The Indemnity Agreement provides that Newco is liable to New Superior for all Losses (as defined in the Indemnity Agreement) which it may suffer, sustain, pay or incur, and will indemnify and hold New Superior harmless from and against all Losses which may be brought against or suffered by New Superior or which New Superior may suffer, sustain, pay or incur arising out of, resulting from, attributable to or connected with:

(a) any debts, liabilities, commitments or obligations of any nature (whether matured or unmatured, accrued, fixed, contingent or otherwise) of any kind whatsoever resulting from any matters, actions, events, facts or circumstances related to the activities, affairs or business of Ballard which occurred prior to the Effective Time, including without limitation, as a result of: i) Claims (as defined in the Indemnity Agreement) relating to the Intellectual Property (as defined in the Indemnity Agreement) of Ballard or the activity of Ballard and/or of its Subsidiaries (as defined in the Arrangement Agreement) in relation to the Intellectual Property, including without limitation the development, reproduction, use, and sale or distribution, of all or any part thereof, which infringes upon, or misappropriates, the Intellectual Property Rights (as defined in the Indemnity Agreement) of any third Person; ii) Claims relating to Taxes of Ballard for any period of time prior to the Effective Time, including without limitation any Taxes relating to the current audit being conducted with respect to sales taxes; iii) Claims related to any public disclosure of Ballard, including without limitation the Public Record (as defined in the Arrangement Agreement) of Ballard and any disclosure relating to Ballard included in this Information Circular, for any period of time prior to the Effective Time; iv) any violation of Applicable Laws, including without limitation applicable Canadian Securities Laws (as defined in the Arrangement Agreement), that occurred prior to the Effective Time; v) any failure to comply with the terms of any agreements, contracts, indentures, licenses, permits, approvals to which it is or was party or which it is or was subject to, or which has been entered into on its behalf or its constating documents; vi) Claims relating to the operation, performance, warranty, maintenance, service, malfunction or liability of Ballard's products prior to the Effective Time; vii) Claims relating to workers' compensation, including without limitation, premiums in Canada or the United States; viii) Claims relating to personal injuries or property damage; or ix) Claims relating to

violations of Environmental Laws (as defined in the Arrangement Agreement) or the release of Hazardous Substances (as defined in the Arrangement Agreement);

(b) any debts, liabilities, commitments or obligations of any nature (whether matured or unmatured, accrued, fixed, contingent or otherwise) of any kind whatsoever resulting from any matters, actions, events, facts or circumstances related to the activities, affairs or business of Newco or Subco which occur on or after the date of the Indemnity Agreement; and

(c) any breach (including any failure or inaccuracy) of any of the representations and warranties of Ballard under the Arrangement Agreement, or any failure of Ballard to perform or observe any covenant or agreement to be performed by it under the Arrangement Agreement as though such representations, warranties, covenants and agreements survived the closing of the Arrangement; but, notwithstanding anything to the contrary implied or contained elsewhere in this Agreement, excluding any Losses which New Superior may suffer, sustain, pay or incur, relating to or based upon the existence or availability of New Superior's Tax Pools (as defined in the Indemnity Agreement), other than as a result of fraud or wilful misrepresentation.

The Indemnity Agreement also provides that New Superior will be liable to Newco for all Losses which it may suffer, sustain, pay or incur and will indemnify and hold Newco harmless from and against all Losses which may be brought against or suffered by Newco or which Newco may suffer, sustain, pay or incur arising out of, resulting from, attributable to or connected with:

(a) any breach (including any failure or inaccuracy) of any of the representations and warranties of Superior Plus under the Arrangement Agreement, or any failure of Superior Plus to perform or observe any covenant or agreement to be performed by it under the Arrangement Agreement as though such representations, warranties, covenants and agreements survived the closing of the Arrangement; and

(b) any failure of New Superior to perform or observe any covenant or agreement to be performed by it under the Divestiture Agreement.

The Indemnity Agreement does not contain any limit on the amount of the claims that can be indemnified nor is there any threshold before indemnification is provided. In addition, the Indemnity Agreement specifically extends the limitation period within which a party is entitled to make a claim under the Indemnity Agreement to two years after the notice of claim with respect to such obligation was given. However, with the exception of certain limited adjustments to address differences in the amount of specific Tax Pools (as defined in the Indemnity Agreement) of Ballard which is described below, the indemnification provisions of the Indemnity Agreement do not provide indemnification to New Superior in respect of the amount or the availability of the Tax Pools.

The Indemnity Agreement also provides for certain compensation payments to be made by New Superior and Newco depending on the final determination of the amount of certain Tax Losses (as defined in the Indemnity Agreement) of Ballard to the extent that such amounts are more or less than the amounts estimated at the time the Arrangement Agreement was executed or to the extent that such Tax Pools are used to reduce Ballard's income, taxable income, or income taxes for any period ending at any time at or before the completion of the Arrangement. Newco's obligations under the Indemnity Agreement relating to NCL Obligations (as defined in the Indemnity Agreement) are limited to an aggregate of C$7,350,000 with a threshold amount of C$500,000 before there is an obligation to make a compensation payment.

The Indemnity Agreement provides detailed procedures for claims under the Indemnity Agreement which, provided Newcoacknowledges liability under the Indemnity Agreement with respect to such matter, gives Newcothe right to elect to take carriage and control of the dispute process relating to such claims.

Divestiture Agreement

Newco will acquire all of the assets of Ballard (including the proceeds of the Fund Loan) and assume all of the obligations of Ballard (except Ballard's obligation to repay the Fund Loan) pursuant to the terms of the Divestiture Agreement and in accordance with the Plan of Arrangement.

The Divestiture Agreement contains provisions to ensure that Newco receives all of the rights and obligations that are intended to be transferred as a result of the transfer of all of the assets of Ballard. In particular, the Divestiture Agreement contains provisions that provide that New Superior will hold certain rights in trust for the benefit of Newco and will take certain actions at the request, expense and direction of Newco that are necessary or proper in order that the obligations of Ballard may be performed in such a manner that the value of such assets are preserved and enure to the benefit of Newco.

The Divestiture Agreement also provides that any obligations or liabilities with respect to such rights will be paid or funded by Newco in the first instance so that New Superior does not have fund such obligations in the first instance and then rely on the Indemnity Agreement to get reimbursed.

The Indemnity Agreement also provides that New Superior appoints Newco and its permitted assignees as agent and attorney of New Superior to perform each act and obligation of New Superior pursuant to all or any of these obligations and rights and to take legal action to collect or enforce any right or obligation or claim which was intended to be assigned.

Procedure for the Arrangement to Become Effective

The Arrangement is proposed to be carried out pursuant to Sections 192 of the CBCA. The following procedural steps must be taken for the Arrangement to become effective:

(a) the Arrangement must be approved by at least two thirds of the votes cast by the Securityholders, voting as a single class, at the Meeting;
(b) the Arrangement must be approved by at least two thirds of the votes cast by the Fund Unitholders at the Fund Meeting;
(c) all conditions set forth in the Arrangement Agreement must be satisfied or waived by the appropriate parties;
(d) the Arrangement must be approved by the Court pursuant to the Final Order;
(e) the Articles of Arrangement must be filed with the CBCA Director in the form prescribed by the CBCA; and
(f) the Certificate must be issued by the CBCA director.

Required Approvals

The respective obligations of Ballard and Superior Plus to complete the transactions contemplated by the Arrangement are subject to a number of conditions which must be satisfied or waived in order for the Arrangement to become effective, including the following required approvals.

Securityholder Approval

Ballard Securityholder Approval

Pursuant to the Interim Order, the Arrangement Resolution must be approved by at least two thirds of the votes cast by the Securityholders, voting as a single class, present in person or by proxy, at the Meeting. A copy of the Arrangement Resolution is attached as Appendix B to this Information Circular. Each Ballard Shareholder is entitled to one vote per Ballard Share held, and Ballard Rightsholders are entitled to one vote per Ballard Share such holders are entitled to receive upon exercise of their Ballard Rights.

The Board of Directors has approved the Arrangement, and recommends that you vote in favour of the Arrangement Resolution. See "Background to and Reasons for the Arrangement" and "Recommendation of the Board of Directors".

If the Arrangement does not receive Securityholder approval, we will not be able realize the benefits described under "Benefits of the Arrangement".

Fund Unitholder Approval

The Interim Order also provides that the Fund Resolution must be approved by at least two thirds of the votes cast by the Fund Unitholders, present in person or represented by proxy at the Fund Meeting. Each Fund Unitholder shall be entitled to one vote for each Trust Unit held by such holder.

Court Approval

On November 10, 2008, Ballard obtained the Interim Order providing for the calling and holding of the Meeting and other procedural matters. See the Interim Order included in Appendix D attached hereto.

The CBCA provides that the Arrangement requires Court approval. Subject to the terms of the Arrangement Agreement and the adoption of the Arrangement Resolution at the Meeting and the adoption of the Fund Resolution at the Fund Meeting, both in the manner required by the Interim Order, Ballard and Superior Plus will apply to the Court for the Final Order at the Courthouse located at 850 Smythe Street, Vancouver, British Columbia on December 22, 2008 or as soon thereafter as counsel may be heard. See the Notice of Petition included in Appendix D attached hereto.

The Court has broad discretion under the CBCA when making orders with respect to the Arrangement, and the Court, in hearing the application for the Final Order, will consider, among other things, the fairness of the Arrangement to the Securityholders.

The Newco Securities to be issued pursuant to the Arrangement will not be registered under the U.S. Securities Act, and are being issued in reliance upon the exemption from the registration requirements under the U.S. Securities Act provided by Section 3(a)(10) thereof. The Court will be advised, prior to the hearings of the applications for the Interim Order and the Final Order, that the Court's determination that the Arrangement is fair and reasonable will form the basis for an exemption from the registration requirements of the U.S. Securities Act with respect to the Newco Securities to be issued and distributed pursuant to the Arrangement.

Competition Act

Under the Competition Act, the acquisition of assets of an operating business in Canada may require pre-merger notification if certain size of parties and size of transaction thresholds are exceeded (a "**Notifiable Transaction**"). If a transaction constitutes a Notifiable Transaction, certain information must be provided to the Commissioner and the transaction may not be completed until the expiry, termination or waiver of a statutory waiting period. Notification may be made either on the basis of a short-form filing (in respect of which there is a 14-day statutory waiting period) or a long-form filing (in respect of which there is a 42-day statutory waiting period). If a short-form filing is made, the Commissioner may, within the 14-day waiting period, require that the parties make a long-form filing, thereby extending the waiting period for a further 42 days following receipt of the long-form filing.

If a transaction does not raise substantive issues under the Competition Act, the Commissioner may issue an Advance Ruling Certificate (an "**ARC**") in respect of the transaction. If an ARC is issued, the parties to the transaction are not required to a file a short-form or a long form pre-merger notification. In addition, if the transaction to which the ARC relates is substantially completed within one year after the ARC is issued, the Commissioner cannot seek an order of the Competition Tribunal under the merger provisions of the Competition Act in respect of the transaction solely on the basis of information that is the same or substantially the same as the information on the basis of which the ARC was issued. If the Commissioner determines not to issue an ARC she may still provide a letter in which she advises that she is of the view that grounds do not exist to file an application pursuant to the merger provisions of the Competition Act in connection with the

Arrangement and waives the obligation to make a pre-closing merger filing in accordance with subsection 113(c) of the Competition Act (a "**no-action letter**").

The Commissioner's review of a transaction may take longer than the statutory waiting period, depending upon a number of factors, including whether a transaction is classified by the Commissioner as non-complex, complex or very complex. Under the Competition Act, the Commissioner may decide to seek an interim order of the Competition Tribunal to prevent or delay closing. The Commissioner may also challenge a transaction by filing an application in the Competition Tribunal pursuant to section 92 of the Competition Act to seek a remedial order that could prevent closing, or if closing has occurred seeking remedies such as dissolution or divestiture of assets, and/or shares, if she proves that the transaction is likely to prevent or lessen competition substantially.

The Arrangement is a Notifiable Transaction under the Competition Act, and as such, the Fund and Ballard must comply with the merger notification provisions of the statute. To do so, on November 3, 2008, the Fund and Ballard requested the issuance of an ARC, or in the alternative, a no-action letter. Completion of the Arrangement is, among other things, subject to the condition that the Commissioner shall have (a) issued an ARC under section 102 of the Competition Act in connection with the Arrangement or (b) the applicable waiting period under the Competition Act shall have expired or shall have been terminated or the obligation to make a pre-closing merger filing shall have been waived by the Commissioner and the Commissioner shall have advised, in writing, that she is of the view that grounds do not exist to file an application pursuant to the merger provisions of the Competition Act in connection with the Arrangement.

Canada Transportation Act

The parties to a proposed transaction involving a "transportation undertaking" which is a Notifiable Transaction under the Competition Act are required by the Canada Transportation Act (the "**CTA**") to give notice of the transaction to the Minister no later than the date on which notification to the Commissioner under the Competition Act is made or required.

Where a transaction is subject to notification under the CTA, the Minister is required to assess whether the transaction will raise any issues with respect to the public interest as it relates to national transportation. If the Minister concludes that a proposed transaction does not raise any issues, the Minister is required to notify the parties accordingly within 42 days of receipt of a notification. In these circumstances, the proposed transaction is not subject to further review under the CTA and can be completed. If, however, the Minister is of the opinion that the proposed transaction does raise public interest issues, the Minister may direct the Canadian Transportation Agency (the "Agency") or another person to examine them, and the proposed transaction may not be completed until it is approved by the Governor in Council.

Within 150 days of being directed to examine a proposed transaction (or any longer period that the Minister may allow), the Agency or other person is required to report to the Minister. The Commissioner is required to report to the Minister and the parties on any concerns she may have regarding a "potential prevention or lessening of competition" within 150 days of being notified under subsection 114(1) of the Competition Act (or any longer period that the Minister may allow).

Following receipt of the Commissioner's report, but before making a recommendation to the Governor in Council as to whether a proposed transaction should be approved, the Minister is required to consult with the Commissioner regarding any overlap between their concerns, and to request that the parties address the Commissioner's concerns and any concerns of the Minister. After conferring with the Minister and the Commissioner, the parties are required to inform them of any measures they are prepared to undertake to address their concerns, and they may at that time propose modifications to the proposed transaction. Prior to making a recommendation to the Governor in Council as to whether a proposed transaction should be approved, the Minister is required to obtain the Commissioner's assessment as to the adequacy of any undertakings or modifications to the proposed transaction proposed by the parties. If the Governor in Council is satisfied that it is in the "public interest" to approve a proposed transaction, taking into account any undertakings or modifications by the parties, on the recommendation of the Minister, the Governor in Council may approve a proposed transaction and specify any terms and conditions which are considered appropriate. Completion of the

Arrangement is conditional upon the Arrangement being cleared by the Minister giving notice of his opinion that the Arrangement does not raise issues with respect to the public interest or the Governor in Council approving the Arrangement.

On November 3, 2008, Ballard filed a notice with the Minister in respect of the Arrangement under the CTA.

Stock Exchange Listings

The Ballard Shares are listed and posted for trading on the TSX under the symbol "BLD" and on NASDAQ under the symbol "BLDP". On October 30, 2008, being the last trading day prior to the date of announcement of the Arrangement, the closing price of the Ballard Shares on the TSX was C$2.83 per Ballard Share and on NASDAQ was $2.34, and on November 12, 2008 was C$2.91 and $2.36 respectively.

Ballard has made an application to list the Newco Shares on the TSX. The TSX has conditionally approved the listing of the Newco Shares on the TSX under the symbol "BLD", which approval is subject to the realization of certain conditions prior to the end of the first business day after the Effective Date, including (i) the Securityholders approving the Arrangement at the Meeting, (ii) the closing of the Arrangement, (iii) the filing of all documents required by the TSX and the paying of the fees required pursuant to the policies of the TSX, and (iv) Newco meeting the continued listing requirements of the TSX.

Ballard has notified NASDAQ of the substitution listing of the Newco Shares for the Ballard Shares on NASDAQ upon completion of the Arrangement. The Newco Shares will trade on NASDAQ under the symbol "BLDP". NASDAQ's acceptance of the substitution listing of the Newco Shares for the Ballard Shares is subject to receipt by NASDAQ of all forms and documents, and the payment of all fees, required by NASDAQ, as well as compliance by Newco with the continued listing requirements of NASDAQ.

Newco expects that it will be able to satisfy all of the requirements of the TSX and NASDAQ relating to the listing of the Newco Shares upon or prior to completion of the Arrangement.

Timing

If the Meeting and the Fund Meeting are held as scheduled and are not adjourned and the other necessary conditions of the Arrangement are satisfied or waived, Ballard and Superior Plus will apply to the Court for the Final Order approving the Arrangement. If the Final Order is obtained on December 22, 2008, in form and substance satisfactory to Ballard and Superior Plus, and all other conditions to completion are satisfied or waived, Ballard expects the Effective Date of the Arrangement to be on or about December 31, 2008.

Costs and Expenses of the Arrangement

The estimated costs to be incurred by Ballard relating to the Arrangement, including transfer taxes, legal and financial advisor fees, insurance costs, the costs of preparation, mailing and printing of this Information Circular and the costs of holding the Meeting are expected to be approximately C$5.3 million. Newco will be responsible for these costs which, when netted against the cash payment of approximately C$46.3 million received by Newco, will result in Newco’s cash reserves and shareholders’ equity increasing by approximately C$41 million.

Certificates

Certificates representing Newco Shares

Upon the Arrangement becoming effective, the existing certificates for Ballard Shares will represent Newco Shares. Ballard Shareholders do not need to replace the certificates representing their Ballard Shares for certificates representing Newco Shares.

Certificates representing Newco Options, Newco DSUs and Newco RSUs

Upon the Arrangement becoming effective, certificates representing Ballard Options, Ballard DSUs and Ballard RSUs will represent Newco Options, Newco DSUs and Newco RSUs, as the case may be. Ballard Rightsholders do not need to replace the certificates for Ballard Options, Ballard DSUs and Ballard RSUs.

Canadian Securities Laws Considerations

It is anticipated that the Newco Shares, the Newco Options, the Newco DSUs and the Newco RSUs to be issued to Securityholders pursuant to the Arrangement (including the Newco Shares issuable upon the valid exercise the Newco Options, Newco DSUs and Newco RSUs), as applicable, will be issued in reliance on exemptions from the prospectus and registration requirements of applicable securities laws. The first trade of Newco Shares (including Newco Shares issuable upon the valid exercise of the Newco Options, Newco DSUs and Newco RSUs) will not be subject to any restricted or hold period in Canada if:

(a) at the time of such first trade, Newco is and has been a reporting issuer, or the equivalent under the legislation of a jurisdiction of Canada, for at least four months (Newco will be a reporting issuer after closing of the Arrangement, or the equivalent in certain of such jurisdictions, and pursuant to National Instrument 45-102 (Resale of Securities) will be deemed to have been a reporting issuer, or the equivalent in certain of such jurisdictions, for more than four months);

(b) no unusual effort is made to prepare the market or to create a demand for the Newco Shares which are the subject of the trade;

(c) no extraordinary commission or consideration is paid to a person or company in respect of the trade;

(d) if the seller of the securities is an insider or officer of Newco, the seller has no reasonable grounds to believe that Newco is in default of any requirement of the applicable securities legislation; and

(e) the first trade is not from the holdings of a person or company or a combination of persons or companies holding a sufficient number of any securities of Newco so as to affect materially the control of Newco (a holding by any person, company or combination of persons and/or companies of more than 20% of the outstanding voting securities of Newco is deemed, in the absence of evidence to the contrary, to affect materially the control of Newco).

U.S. Securities Laws Considerations

The Newco Securities to be issued to the Securityholders pursuant to the Arrangement have not been and will not be registered under the U.S. Securities Act or the securities laws of any state of the United States. Such Newco Securities will be issued in reliance upon the exemption from registration provided by Section 3(a)(10) of the U.S. Securities Act and exemptions provided under the securities laws of each applicable state of the United States. Section 3(a)(10) of the U.S. Securities Act exempts from registration under such Act securities issued in exchange for one or more outstanding securities where the terms and conditions of the issuance and exchange of such securities have been approved by a court of competent jurisdiction, after a hearing upon the fairness of the terms and conditions of the issuance and exchange at which all persons to whom the securities will be issued have the right to appear. The Court is authorized to conduct a hearing at which the fairness of the terms and conditions of the Arrangement will be considered. The Final Order will constitute the basis for an exemption from the registration requirements of the U.S. Securities Act, with respect to the Newco Securities to be issued to Securityholders pursuant to the Arrangement. Prior to the hearing on the Final Order, the Court will be informed of the effect of the Final Order.

The Newco Options, Newco DSUs and Newco RSUs to be issued on the Effective Date are not transferable. The Newco Shares received pursuant to the Arrangement may be resold without restriction under the U.S. Securities Act by persons who are not "affiliates" of Newco after the Effective Time or within 90 days

before the Effective Time. An "affiliate" of an issuer is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with such issuer, whether through the ownership of voting securities, by contract, or otherwise. Usually, persons who are directors, executive officers and 10% or greater shareholders of an issuer are considered to be its affiliates. Ballard Shareholders who are affiliates of Newco after the Effective Time or within 90 days before the Effective Time will be subject to restrictions under the U.S. Securities Act on the resale of Newco Shares received by them in the Arrangement. However, such affiliates may resell such Newco Shares without registration under the U.S. Securities Act immediately, either (a) outside the United States pursuant to and in accordance with Regulation S under the U.S. Securities Act as described below or (b) in a transaction exempt from such registration requirements.

Subject to certain limitations, at any time that Newco is a "foreign private issuer", as defined in Rule 405 under the U.S. Securities Act, Ballard Shareholders who are affiliates of Newco after the Effective Time or within 90 days before the Effective Time may immediately resell the Newco Shares they receive under the Arrangement outside the United States without registration under the U.S. Securities Act pursuant to Regulation S under the U.S. Securities Act. Generally, such persons may resell such Newco Shares in an "offshore transaction" if (i) no offer is made in the United States, (ii) either (A) at the time the buyer’s buy order is originated, the buyer is outside the United States, or the seller and any person acting on its behalf reasonably believes that the buyer is outside the United States, or (B) the transaction is executed in, on or through a "designated offshore securities market" (which would include a sale through the TSX) if neither the seller nor any person acting on its behalf knows that the transaction has been pre-arranged with a buyer in the United States, and (iii) neither the seller, any affiliate of the seller or any person acting on any of their behalf engages in any "directed selling efforts" in the United States. For the purposes of Regulation S, "directed selling efforts" means "any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities being offered" in the resale transaction. Certain additional restrictions will apply to a person who is an affiliate of Newco other than solely by virtue of his or her status as an officer or director of Newco. Newco is under no obligation to remain a "foreign private issuer".

After the Effective Date Newco, intends to file a registration statement on Form S-8 with the SEC registering the Newco Shares issuable upon exercise of the Newco Options, as well as the Newco Shares underlying the Newco RSUs and Newco DSUs. Consequently, the Newco Options may be exercised and the Newco Shares issuable upon exercise thereof, as well as the Newco Shares underlying the Newco RSUs and Newco DSUs issued pursuant to the Arrangement, may be resold without restriction in the United States.

THE NEWCO SECURITIES TO BE ISSUED PURSUANT TO THE ARRANGEMENT HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SEC OR THE SECURITIES REGULATORY AUTHORITY IN ANY STATE OF THE UNITED STATES OR PROVINCE OR TERRITORY OF CANADA, NOR HAS THE SEC OR ANY SECURITIES REGULATORY AUTHORITY IN ANY STATE OF THE UNITED STATES OR PROVINCE OR TERRITORY OF CANADA PASSED UPON THE ACCURACY OR ADEQUACY OF THIS INFORMATION CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE.

The foregoing discussion is only a general overview of certain requirements of United States federal securities laws applicable to the Newco Securities received upon completion of the Arrangement. Holders of Newco Securities may be subject to additional restrictions, including, but not limited to, restrictions under written contracts, agreements or instruments to which they are parties or are otherwise subject, and restrictions under applicable United States state securities laws. All holders of Newco Securities are urged to consult with their counsel to ensure that the resale of Newco Securities complies with applicable securities legislation.

Risk Factors

Securityholders should carefully consider the following risk factors relating to the Arrangement before deciding to vote or instruct their vote to be cast to approve the matters relating to the Arrangement. In addition to the risk factors relating to the Arrangement set out below, Securityholders should also carefully consider the risks relating to our business, which are set forth in our annual information form, which is incorporated by reference. The risks described in our annual information form, including the risks relating to our ability to

achieve commercialization of our products, our dependence on OEMs, system integrators and third party suppliers, our need for the development of a fuel infrastructure and our exposure to changes in environmental policies, will continue to apply to us after the Arrangement, and some of these risks may increase. If any of the risks relating to the Arrangement or our business were to materialize, our financial condition, results of operations and prospects would likely be adversely affected. All of the risks below should be considered by the Securityholders in conjunction with other information included in this Information Circular, including the Appendices attached hereto.

Absence of Organized Market

Before the Arrangement, no market existed for the trading of the Newco Shares and there can be no assurance that an active post-Arrangement market will develop or be maintained. Factors such as the financial results of Newco, and the general economic condition of its industry could cause the price of the Newco Shares to fluctuate.

Exchange Listings

Although the TSX has conditionally approved the Arrangement and the listing of the Newco Shares and NASDAQ has been notified of the substitution of the Newco Shares for the Ballard Shares on NASDAQ, there can be no assurance that Newco will continue to meet the continued listing requirements of the TSX and NASDAQ.

Regulatory Requirements and Third Party Consents

A delay in obtaining regulatory approvals and third party consents, or the imposition of unfavourable terms or conditions for such approvals and third party consents, could prevent us from completing the Arrangement in a timely manner or at all or increase our costs associated with the Arrangement. Any significant delay in obtaining the required regulatory approvals and third party consents, or a failure to obtain such approvals and consents, could result in the failure to complete the Arrangement.

Dissent Rights

The following description of the right to dissent and appraisal to which Dissenting Shareholders are entitled is not a comprehensive statement of the procedures to be followed by a Dissenting Shareholder who seeks payment of the fair value of such Dissenting Shareholder's Ballard Shares and is qualified in its entirety by the reference to the full text of Section 190 of the CBCA, which is attached to this Circular as Appendix I as modified by the Interim Order which is attached to this Circular as Appendix D and the Plan of Arrangement which is attached to this Circular as Appendix H. Dissenting Shareholders who intend to exercise their right to dissent and appraisal ("**Dissent Rights**") should carefully consider and comply with the provisions of the CBCA, as modified by the Interim Order and the Plan of Arrangement, as failure to adhere to the procedures established therein may result in the loss or unavailability of Dissent Rights. Notwithstanding subsection (25) of section 190 of the CBCA, a Dissenting Shareholder shall not be entitled to withdraw such Dissenting Shareholder’s notice of dissent in the circumstances contemplated therein.

Section 190 of the CBCA provides registered shareholders of a corporation with the right to dissent from certain resolutions of such corporation that effect extraordinary corporate transactions or fundamental corporate changes. The Interim Order expressly provides registered Ballard Shareholders with the right to dissent from the Arrangement Resolution pursuant to section 190 of the CBCA, with modifications to the provisions of section 190 as provided in the Plan of Arrangement and the Interim Order. Any registered Ballard Shareholder who dissents from the Arrangement Resolution in accordance with section 190 of the CBCA, as modified by the Plan of Arrangement and the Interim Order, will be deemed to have exchanged the Ballard Shares held by such Dissenting Shareholder for Newco Shares on a one-for-one a basis and such Newco Shares will be cancelled and such Dissenting Shareholder will be entitled, in the event the Arrangement becomes effective, to be paid by Newco the fair value of the Ballard Shares held by such Dissenting Shareholder determined as of the close of business on the day before the day the Arrangement Resolution is adopted. Ballard Shareholders are cautioned that the fair value could be determined to be less than the consideration offered under the Arrangement.

Section 190 of the CBCA provides that a shareholder may only make a claim under that section with respect to all of the shares of a class held by the shareholder on behalf of any one beneficial owner and registered in the shareholder's name. One consequence of this provision is that a registered Ballard Shareholder may only exercise Dissent Rights in respect of Ballard Shares that are registered in that Ballard Shareholder's name.

In many cases, Ballard Shares beneficially owned by a non-registered holder are registered either (a) in the name of an intermediary that the non-registered holder deals with in respect of such shares, such as, among others, banks, trust companies, securities dealers and brokers and trustees or administrators of self-administered RRSPs, RRIFs, RESPs and similar plans, or (b) in the name of a depository, such as CDS, of which the Intermediary is a participant. Accordingly, a non-registered holder will not be entitled to exercise his, her or its Dissent Rights directly (unless the Ballard Shares are re-registered in the non-registered holder's name). A non-registered holder who wishes to exercise Dissent Rights should immediately contact the intermediary with whom the non-registered holder deals in respect of its Ballard Shares and either (i) instruct the intermediary to exercise the Dissent Rights on the non-registered holder's behalf (which, if the Ballard Shares are registered in the name of CDS or any other clearing agency, may require that such Ballard Shares first be re-registered in the name of the intermediary), or (ii) instruct the intermediary to re-register such Ballard Shares in the name of the non-registered holder, in which case the non-registered holder would be able to exercise the Dissent Rights directly.

A registered Ballard Shareholder who wishes to dissent must provide a dissent notice (the "**Dissent Notice**") to the headquarters of Ballard at 9000 Glenlyon Parkway, Burnaby, B.C., V5J 5J8, at or before 4:00 pm Vancouver time on December 16, 2008 or, in the case of any adjournment or postponement of the Meeting, no later than 48 hours before the time of such reconvened meeting. It is important that registered Ballard Shareholders strictly comply with this requirement, which is different from the statutory dissent provisions of the CBCA. Failure to strictly comply with these dissent procedures may result in the loss or unavailability of the right to dissent.

The filing of a Dissent Notice does not deprive a registered Ballard Shareholder of the right to vote at the Meeting. However, the CBCA provides, in effect, that a registered Ballard Shareholder who has submitted a Dissent Notice and who votes in favour of the Arrangement Resolution will no longer be considered a Dissenting Shareholder with respect to that class of shares voted in favour of the Arrangement Resolution, being the Ballard Shares. The CBCA does not provide, and Ballard will not assume, that a proxy submitted instructing the proxyholder to vote against the Arrangement Resolution, a vote against the Arrangement Resolution or an abstention constitutes a Dissent Notice, but a registered Ballard Shareholder need not vote his, her or its Ballard Shares against the Arrangement Resolution in order to dissent. Similarly, the revocation of a proxy conferring authority on the proxyholder to vote in favour of the Arrangement Resolution does not constitute a Dissent Notice. However, any proxy granted by a registered Ballard Shareholder who intends to dissent, other than a proxy that instructs the proxyholder to vote against the Arrangement Resolution, should be validly revoked in order to prevent the proxyholder from voting such Ballard Shares in favour of the Arrangement Resolution and thereby causing the registered Ballard Shareholder to forfeit his, her or its Dissent Rights.

Newco is required, within ten (10) days after Ballard Shareholders adopt the Arrangement Resolution, to notify each Dissenting Shareholder, if any, that the Arrangement Resolution has been adopted. Such notice is not required to be sent to any Ballard Shareholder who voted for the Arrangement Resolution or who has withdrawn his, her or its Dissent Notice.

A Dissenting Shareholder who has not withdrawn his, her or its Dissent Notice prior to the Meeting must then within twenty (20) days after receiving the notice from Newco or, if the Dissenting Shareholder does not receive the notice, within twenty (20) days after learning that the Arrangement Resolution has been adopted, send to Newco at its headquarters at 9000 Glenlyon Parkway, Burnaby, B.C., V5J 5J8, Attention: Chief Legal Officer a written notice (the "**Demand for Payment**") containing his, her or its name and address, the number of Ballard Shares in respect of which he, she or it dissents, and a demand for payment of the fair value of such Ballard Shares. Within thirty (30) days after sending the Demand for Payment, the Dissenting Shareholder must send to Newco certificate(s) representing Ballard Shares in respect of which he, she or it dissents. Newco

will endorse on share certificate(s) received from a Dissenting Shareholder a notice that the holder is a Dissenting Shareholder and will forthwith return the share certificate(s) to the Dissenting Shareholder. A Dissenting Shareholder who fails to send certificate(s) representing Ballard Shares in respect of which he, she or it dissents has no right to make a claim under section 190 of the CBCA.

Under section 190 of the CBCA, after sending a Demand for Payment, a Dissenting Shareholder ceases to have any rights as a Ballard Shareholder in respect of his, her or its Ballard Shares other than the right to have Newco Shares issued to the Dissenting Shareholder pursuant to the Arrangement and to be paid the fair value of the Ballard Shares on the cancellation of those Newco Shares as determined pursuant to the Interim Order, unless (i) the Dissenting Shareholder withdraws his, her or its Demand for Payment before Newco makes an offer to pay, or (ii) Newco fails to make an offer to pay in accordance with subsection 190(12) of the CBCA and the Dissenting Shareholder withdraws the Demand for Payment, in which case the Dissenting Shareholder's rights as a Newco Shareholder will be reinstated and such shareholder will be entitled to receive Newco Shares in accordance with the terms of the Plan of Arrangement. Pursuant to the Plan of Arrangement, in no case shall Newco or any other person be required to recognize any Dissenting Shareholder as a Newco Shareholder after the Effective Date, and the name of such Dissenting Shareholder shall be deleted from the register of Newco at the Effective Date.

Pursuant to the Plan of Arrangement, Dissenting Shareholders who are ultimately determined to be entitled to be paid fair value of their Ballard Shares shall be deemed to have transferred their Ballard Shares to Newco for Newco Shares and those Newco Shares shall be deemed to have been cancelled on the Effective Date. Pursuant to the Plan of Arrangement, Dissenting Shareholders who are ultimately determined not to be entitled, for any reason, to be paid fair value of their Ballard Shares, shall be deemed to have participated in the Arrangement on the same basis as any non-Dissenting Shareholder as at and from the Effective Date.

Newco is required, not later than seven days after the later of the Effective Date and the date on which Newco received the Demand for Payment of a Dissenting Shareholder, to send to each Dissenting Shareholder who has sent a Demand for Payment an offer to pay for his, her or its Newco Shares an amount considered by Newco to be the fair value of the Dissenting Shareholder's former Ballard Shares, accompanied by a statement showing the manner in which the fair value was determined. Every offer to pay must be on the same terms. Newco must pay the amount to the Dissenting Shareholder within ten days after an offer to pay has been accepted by the Dissenting Shareholder, but any such offer lapses if Newco does not receive an acceptance within thirty (30) days after the offer to pay has been made.

If Newco fails to make an offer to pay for a Dissenting Shareholder's Newco Shares, or if a Dissenting Shareholder fails to accept an offer to pay that has been made, Newco may, within fifty (50) days after the Effective Date or within such further period as a court may allow, apply to a court to fix a fair value of the Ballard Shares of Dissenting Shareholders. If Newco fails to apply to a court, a Dissenting Shareholder may apply to a court for the same purpose within a further period of twenty (20) days or within such further period as a court may allow. A Dissenting Shareholder is not required to give security for costs in such an application. Pursuant to the Interim Order, the court will be the Supreme Court of British Columbia.

If Newco or a Dissenting Shareholder makes an application to the Court, Newco will be required to notify each affected Dissenting Shareholder of the date, place and consequences of the application and of his, her or its right to appear and be heard in person or by counsel. Upon an application to the Court, all Dissenting Shareholders who have not accepted an offer to pay will be joined as parties and be bound by the decision of the Court. Upon any such application to the Court, the Court may determine whether any person is a Dissenting Shareholder who should be joined as a party, and the court will then fix a fair value of the Ballard Shares for all Dissenting Shareholders. The final order of the Court will be rendered against Newco in favour of each Dissenting Shareholder and for the amount of the fair value of his, her or its former Ballard Shares as fixed by the Court. The Court may, in its discretion, allow a reasonable rate of interest on the amount payable to each Dissenting Shareholder from the Effective Date until the date of payment.

Registered Holders who are considering exercising Dissent Rights should be aware that there can be no assurance that the fair value of their Ballard Shares as determined under the applicable provisions of the CBCA (as modified by the Plan of Arrangement and the Interim Order) will be more than or equal to the consideration

under the Arrangement. In addition, any judicial determination of fair value will result in delay of receipt by a Dissenting Shareholder of consideration for such Dissenting Shareholder's Ballard Shares.

CERTAIN CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

General

In the opinion of Borden Ladner Gervais LLP, special tax counsel to Ballard, the following fairly summarizes the principal Canadian federal income tax consequences generally applicable to

- Ballard Shareholders in respect of the exchange (the "**Share Exchange**") of Ballard Shares for Newco Shares, and
- Ballard Optionholders in respect of the exchange (the "**Option Exchange**") of Ballard Options for Newco Options,

pursuant to the Arrangement.

Comment in respect of the Share Exchange is restricted to Ballard Shareholders, wherever resident, each of whom for the purposes of the Tax Act at all material times

- deals at arm's length with Ballard and Newco,
- holds all Ballard Shares, and will hold all Newco Shares received on the Share Exchange, solely as capital property,
- is not affiliated with Ballard or Newco,
- is not a "financial institution" or "specified financial institution",
- is not exempt from tax under Part I of the Tax Act, and
- will not, and no person with whom the Ballard Shareholder does not deal at arm's length will, alone or in any combination immediately after the Arrangement control Newco or hold shares in its capital representing more than 50% of the fair market value of all issued shares in its capital,

and an interest in whom is not a "tax shelter investment" (each, in this summary, a "**Holder**").

A Holder's Ballard Shares generally will be considered to be capital property of the Holder unless they were held in the course of carrying on a business or an adventure in the nature of trade, or as "mark to market" properties. Certain Holders who are resident in Canada for the purposes of the Tax Act may be entitled to elect irrevocably under subsection 39(4) of the Tax Act that the Holder's Ballard Shares, and each other "Canadian security" (as defined for the purposes of the Tax Act) owned by the Holder in the year in which the election is made or any subsequent year, be deemed to be capital property.

Comment in respect of the Option Exchange is restricted to Ballard Optionholders, wherever resident, each of whom for the purposes of the Tax Act at all material times,

- is a current or former employee of Ballard or a corporation with which Ballard does not or did not deal at arm's length,
- deals at arm's length with Ballard or the corporation, and
- received all of his or her Ballard Options in the course of or by virtue of such employment at a time when Ballard was not a "Canadian-controlled private corporation" for the purposes of the Tax Act,

(each, in this summary, an "**Optionee**").

This summary is based on the current provisions of the Tax Act, the regulations thereunder, and all amendments thereto publicly announced by the government of Canada to the date hereof, and on counsel's understanding of the current published administrative and assessing practices of the Canada Revenue Agency (the "**CRA**"). It is assumed that all such amendments will be enacted as currently proposed, and that there will

be no other material change to any relevant law or practice, although no assurance can be given in these respects. This summary does not take into account or anticipate any provincial, territorial or foreign income tax considerations, or any tax treaty.

This summary is of a general nature only, is not exhaustive, and is not and is not to be construed as, tax advice to any particular Holder or Optionee. Each Holder and each Optionee is urged to consult the Holder's or Optionee's own tax advisers with respect to all tax consequences of the Arrangement applicable to the Holder's or Optionee's particular circumstances.

The Share Exchange

Holders Resident in Canada

This part of the summary is restricted to Holders who are resident in Canada for the purposes of the Tax Act (each, in this summary, a "**Resident Holder**").

A Resident Holder (including a Resident Dissenter, as defined below) whose Ballard Shares are exchanged for Newco Shares pursuant to the Share Exchange will not thereby realize any gain or loss unless the Resident Holder chooses to include an amount in income in respect of the exchange in the Resident Holder's tax return for the taxation year in which the Share Exchange occurs. Provided that the Resident Holder does not include any such amount in income, the Resident Holder will be deemed to have disposed of the Ballard Shares for proceeds of disposition, and to have acquired the Newco Shares at an aggregate cost, equal to the aggregate adjusted cost base ("**ACB**") of the Resident Holder's Ballard Shares, determined immediately before the Share Exchange.

A Resident Holder who chooses to include an amount in income in respect of the Share Exchange will be deemed to have realized a capital gain (capital loss) equal to the amount by which the fair market value of the Resident Holder's Newco Shares exceeds (is exceeded by) the ACB of the Resident Holder’s Ballard Shares determined immediately before the exchange, and reasonable costs of disposition. The Resident Holder will be required to include one half of any such capital gain ("taxable capital gain") in income in the taxation year in which the Share Exchange occurs, to be taxed at normal rates. The Resident Holder may deduct one half of any such loss ("allowable capital loss") from taxable capital gains realized in the taxation year and, to the extent not so deductible, from taxable capital gains realized in any of the three preceding taxation years or any subsequent taxation year. The Resident Holder will acquire the Newco Shares at a cost equal to the fair market value of the Resident Holder’s Ballard Shares at the time of the Share Exchange.

A capital loss incurred on the Share Exchange by a Resident Holder that is a corporation may, to the extent and under circumstances set out in the Tax Act, be reduced by the amount of certain dividends that it has previously received or been deemed to have been received on its Ballard Shares (or on other shares for which its Ballard Shares were substituted or exchanged). Similar rules may apply to Ballard Shares owned by a Resident Holder that is a partnership or trust of which a corporation, trust or partnership is a member or beneficiary.

A Resident Holder that is a "Canadian-controlled private corporation" (as defined in the Tax Act) may be required to pay an additional 6?% refundable tax in respect of net taxable capital gains, if any, that it realizes on the Share Exchange.

Holders Not Resident in Canada

This part of the summary is restricted to Holders

- who, for purposes of the Tax Act and at all relevant times, are not resident or deemed to be resident in Canada, and
- whose Ballard Shares are not at any relevant time "taxable Canadian property" or "designated insurance property" (as those terms are defined for the purposes of the Tax Act), and are not used or held, or deemed to be used or held, in the course of carrying on a business in Canada.

(each, in this summary, a "**Non-resident Holder**").

A Non-resident Holder's Ballard Shares generally will not be taxable Canadian property at any relevant time provided that neither the Non-resident Holder, nor any one or more other persons with whom the Non-resident Holder does not deal at arm's length, alone or in any combination directly or indirectly, at any time in the 60 months immediately preceding the Arrangement, held or had rights to acquire 25% or more of the issued shares of any class in Ballard's capital.

Subject to the foregoing restrictions and assumptions, a Non-resident Holder whose Ballard Shares are exchanged for Newco Shares pursuant to the Share Exchange will not thereby incur any liability for Canadian federal income tax.

Dissent Rights

General

Pursuant to the Arrangement, the Newco Shares received in exchange for Ballard Shares on the Share Exchange by a Holder who validly exercises dissent rights (in this summary, a "**Dissenting Holder**") will be cancelled, and the Dissenting Holder will be entitled to be paid an amount (the "**Dissent Payment**") by Newco equal to the fair value of the Dissenting Holder's cancelled Ballard Shares, determined as of the close of business on the day before the day on which the Arrangement Resolution is adopted.

Provided that the amount of the Dissent Payment does not exceed the paid-up capital of the Dissenting Holder's cancelled Newco Shares as determined for the purposes of the Tax Act ("**PUC**"), the Dissenting Holder will realize a capital gain (capital loss) equal to the amount by which the Dissent Payment, less reasonable costs of disposition and any portion of the Dissent Payment that is on account of interest, exceeds (is exceeded by) the ACB of the Newco Shares to the Dissenting Holder.

Whether the foregoing proviso is satisfied is a question of fact that can only be determined after the Effective Time. However, management of Ballard has advised tax counsel that it believes that the proviso will be satisfied in the circumstances of the Arrangement, and this view appears reasonable in those circumstances.

If the proviso is not satisfied , the Dissenting Holder will be deemed to have received a dividend from Newco equal to the amount by which the Dissent Payment exceeds the PUC of the Dissenting Holder's cancelled Newco Shares. The Dissenting Holder will also realize a capital gain (capital loss) equal to the amount by which the Dissent Payment, (net of the deemed dividend, reasonable costs of disposition, and any portion of the payment that is on account of interest) exceeds (is exceeded by) the ACB of the Newco Shares to the Dissenting Holder.

Dissenting Holders Resident in Canada

The Dissenting Holder, if resident in Canada for the purposes of the Tax Act (a "**Resident Dissenter**"), will be required to include in income that portion of the Dissent Payment, if any, that is deemed to be a dividend. If the Resident Dissenter is an individual, the gross-up and dividend tax credit rules generally applicable to taxable dividends received from taxable Canadian corporations will apply to the deemed dividend. Tax counsel has been advised that Newco currently does not intend to designate any such deemed dividend as an "eligible dividend" for the purposes of the enhanced gross-up and dividend tax credit rules. If the Resident Dissenter is a corporation, it will (subject to the potential application of the capital gains stripping rules in subsection 55(2) of the Tax Act) generally be entitled to deduct the amount of the deemed dividend, if any, from its taxable income. A corporate Resident Dissenter that is a "private corporation" (as defined in the Tax Act) or any other corporation controlled or deemed to be controlled by or for the benefit of an individual or a related group of individuals, may be liable under Part IV of the Tax Act to pay a refundable tax of 33 1/3% on the deemed dividend (if any).

The Resident Dissenter will also be required to include one half of any capital gain in income arising in respect of the Dissent Payment, or be entitled to deduct one half of any resulting capital loss, in accordance with the usual rules applicable to capital gains and losses. See "The Share Exchange - Holders Resident in Canada" above.

The Resident Dissenter will also be required to include in income that portion of the Dissent Payment, if any, that is on account of interest.

Dissenting Holders Not Resident in Canada

The Dissenting Holder, if not resident in Canada for the purposes of the Tax Act (a "**Non-resident Dissenter**") will be required to pay Canadian withholding tax on that portion of the Dissent Payment, if any, that is deemed to be a dividend at the rate of 25% of the gross amount of the deemed dividend, or such lower rate as may be available under an applicable tax treaty.

The Non-resident Dissenter will not incur any liability for Canadian federal income tax in respect of that portion of the Dissent Payment, if any, that is a capital gain, or that is on account of interest.

The Option Exchange

Optionees Resident in Canada

This part of the summary is restricted to Optionees who are resident in Canada for the purposes of the Tax Act (each, in this summary, a "**Resident Optionee**").

A Resident Optionee whose Ballard Options are exchanged for Newco Options pursuant to the Option Exchange will be deemed for Canadian federal income tax purposes not to have disposed of the Ballard Options, and consequently will not thereby have incurred any liability for Canadian federal income tax, provided that

- the total value, immediately after the Option Exchange, of the Newco Shares that the Resident Optionee is entitled to receive on exercise of the Newco Options, less the amount payable, if any, by the Resident Optionee to acquire the Newco Shares,

does not exceed

- the total value, immediately before the Option Exchange, of the Ballard Shares that the Resident Optionee would have been entitled to receive on exercise of the Ballard Options, less the amount, if any, that would have been payable by the Resident Optionee to acquire the Ballard Shares.

Whether this proviso will be satisfied is a question of fact that can only be determined as of the Effective Date. However, the exchange ratio and other terms affecting the Option Exchange under the Arrangement have been structured with the intent that no Optionee would receive an economic advantage or net benefit as a result of the Option Exchange, and consequently that the proviso would be satisfied.

A Resident Optionee whose Ballard Options are exchanged for Newco Options pursuant to the Option Exchange in circumstances in which the proviso is not satisfied will be deemed to have received a benefit from employment in the taxation year in which the Effective Time occurs equal to the amount, if any, by which the value of the Newco Options immediately after the Option Exchange exceeds the value of the Ballard Options immediately before the Option Exchange, and will be required to include the amount of the benefit in income for the year. The Resident Optionee may be entitled to deduct an amount equal to 50% of the benefit from his or her taxable income for the taxation year provided that certain conditions set out in the Tax Act are satisfied.

Optionees Not Resident in Canada

This part of the summary is restricted to Optionees who are not resident in Canada for the purposes of the Tax Act (each, in this summary, a "**Non-resident Optionee**").

A Non-resident Optionee whose Ballard Options are exchanged for Newco Options pursuant to the Option Exchange will, to the extent that he or she received the Ballard Options in the course of employment duties performed in Canada, generally be subject to the same Canadian federal income tax rules applicable to Resident Optionees described above (see "Optionees Resident in Canada").

The Non-resident Optionee generally will not be subject to Canadian federal income tax as a result of the Option Exchange to the extent that he or she received Ballard Options in respect of employment duties performed outside Canada.

CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following is a limited discussion of certain of U.S. federal income tax considerations applicable to a U.S. Holder (as defined below) arising from the Arrangement. This summary is for general information purposes only and does not purport to be a complete analysis or listing of all potential U.S. federal income tax considerations that may apply to a U.S. Holder as a result of the Arrangement. In addition, this summary does not take into account the individual facts and circumstances of any particular U.S. Holder that may affect the U.S. federal income tax considerations applicable to a U.S. Holder. Accordingly, this summary is not intended to be, and should not be construed as, legal or U.S. federal income tax advice with respect to any U.S. Holder. Moreover, this summary is not binding on the Internal Revenue Service (the "IRS") or the U.S. courts, and no assurance can be provided that the conclusions reached in this summary will not be challenged by the IRS or will be sustained by a U.S. court if so challenged. Ballard has not requested, and does not intend to request, a ruling from the IRS or an opinion from legal counsel regarding any of the U.S. federal income tax consequences of the Arrangement. Each U.S. Holder should consult its own financial advisor, legal counsel, or accountant regarding the U.S. federal, U.S. state and local, and foreign tax consequences of the Arrangement.

To ensure compliance with U.S. Treasury Department Circular 230, U.S. Holders are hereby notified that: (a) any discussion of U.S. federal tax issues in this Information Circular is not intended or written to be relied upon, and cannot be relied upon by a U.S. Holder, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code; (b) this summary was written in connection with the promotion or marketing of the transactions or matters addressed in this Information Circular; and (c) each U.S. Holder should seek advice based on such U.S. Holder's particular circumstances from an independent tax advisor.

Scope of this Disclosure

Authorities

This summary is based on the Internal Revenue Code of 1986, as amended (the "**Code**"), Treasury Regulations (final, temporary, and proposed), U.S. court decisions, published IRS rulings and published administrative positions of the IRS, that are applicable and, in each case, as in effect and available, as of the date of this Circular. Any of the authorities on which this summary is based could be changed in a material and adverse manner at any time, and any such change could be applied on a retroactive basis and could affect the U.S. federal income tax considerations described in this summary.

U.S. Holders

For purposes of this summary, a "U.S. Holder" is an owner of Ballard Shares receiving Newco Shares pursuant to the Arrangement and, as applicable, an owner of Ballard Options receiving Newco Options pursuant to the Arrangement that, for U.S. federal income tax purposes, is (a) an individual who is a citizen or resident of the U.S., (b) a corporation, or other entity classified as a corporation for U.S. federal income tax purposes, that is created or organized in or under the laws of the U.S. or any state in the U.S., including the District of Columbia, (c) an estate if the income of such estate is subject to U.S. federal income tax regardless of the source of such income, or (d) a trust if (i) such trust has validly elected to be treated as a U.S. person for U.S. federal income tax purposes or (ii) a U.S. court is able to exercise primary supervision over the administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of such trust.

Non-U.S. Holders

For purposes of this summary, a "Non-U.S. Holder" is an owner of Ballard Shares receiving Newco Shares pursuant to the Arrangement that is not a U.S. Holder and, as applicable, an owner of Ballard Options receiving Newco Options pursuant to the Arrangement that is not a U.S. Holder. This summary does not address the U.S. federal income tax considerations applicable to Non-U.S. Holders arising from the Arrangement. Accordingly, a Non-U.S. Holder should consult its own financial advisor, legal counsel, or

accountant regarding the U.S. federal, U.S. state and local, and foreign tax consequences (including the potential application of and operation of any tax treaties) of the Arrangement.

Transactions Not Addressed

This summary does not address the U.S. federal income tax consequences of transactions effectuated prior or subsequent to, or concurrently with, the Arrangement (whether or not any such transactions are undertaken in connection with the Arrangement), including, without limitation, the following:

- any exercise, conversion, assumption, disposition, exchange, or other transaction involving options, warrants, and other rights to acquire Ballard Shares other than the exchange of Ballard Options for Newco Options pursuant to the Arrangement;
- any conversion into Ballard Shares of any Ballard notes, debentures or other debt instruments;
- any vesting, conversion, assumption, disposition, exercise, exchange, or other transaction involving the Ballard RSUs, Ballard DSUs, Newco RSUs, and Newco DSUs;
- any exercise, conversion, assumption, disposition, exchange, or other transaction involving options, warrants, or other rights to acquire Newco Shares; and
- any transaction, other than the Arrangement, in which Ballard Shares or Newco Shares are acquired.

U.S. Holders Subject to Special U.S. Federal Income Tax Rules Not Addressed

This summary does not address the U.S. federal income tax considerations of the Arrangement to U.S. Holders that are subject to special provisions under the Code, including the following U.S. Holders: (a) U.S. Holders that are tax-exempt organizations, qualified retirement plans, individual retirement accounts, or other tax-deferred accounts; (b) U.S. Holders that are financial institutions, insurance companies, real estate investment trusts, or regulated investment companies or that are broker-dealers, dealers, or traders in securities or currencies that elect to apply a mark-to-market accounting method; (c) U.S. Holders that have a "functional currency" other than the U.S. dollar; (d) U.S. Holders that are liable for the alternative minimum tax under the Code; (e) U.S. Holders that own Ballard Shares as part of a straddle, hedging transaction, conversion transaction, constructive sale, or other arrangement involving more than one position; (f) U.S. Holders that acquired Ballard Shares in connection with the exercise of employee stock options or otherwise as compensation for services; (g) U.S. Holders of Ballard RSUs and Ballard DSUs; (h) U.S. Holders that hold Ballard Shares other than as a capital asset within the meaning of Section 1221 of the Code; (i) U.S. Holders who are U.S. expatriates or former long term residents of the United States; and (j) U.S. Holders that own, directly, indirectly, or by attribution, 5% or more, by voting power or value, of the outstanding Ballard Shares. U.S. Holders that are subject to special provisions under the Code, including U.S. Holders described immediately above, should consult their own financial advisor, legal counsel or accountant regarding the U.S. federal, U.S. state and local, and foreign tax consequences of the Arrangement.

If an entity that is classified as partnership (or "pass-through" entity) for U.S. federal income tax purposes holds Ballard Shares, the U.S. federal income tax consequences to such partnership (or "pass-through" entity) and the partners of such partnership (or owners of such "pass-through" entity) generally will depend on the activities of the partnership (or pass-through" entity) and the status of such partners (or owners). Partners of entities that are classified as partnerships (and owners of "pass-through" entities) for U.S. federal income tax purposes should consult their own financial advisors, legal counsel or accountants regarding the U.S. federal income tax consequences of the Arrangement.

Tax Consequences Other than U.S. Federal Income Tax Consequences Not Addressed

This summary does not address the state, local, estate and gift, or foreign tax consequences to U.S. Holders of the Arrangement. Each U.S. Holder should consult its own financial advisors, legal counsel, or accountants regarding the state, local, estate and gift, and foreign tax consequences to them of the Arrangement.

Tax Consequences of the Ownership of Newco Shares Not Addressed

This summary does not address the U.S. federal income tax consequences to U.S. Holders of the ownership and disposition of Newco Shares received pursuant to the Arrangement. Each U.S. Holder should consult its own financial advisors, legal counsel, or accountants regarding the U.S. federal income tax consequences to them of the ownership and disposition of Newco Shares received pursuant to the Arrangement.

U.S. Federal Income Tax Consequences of the Arrangement

Characterization of the Arrangement

There is no legal authority directly addressing the proper characterization of the Arrangement for U.S. federal income tax purposes. In addition, the Arrangement will be effected under applicable provisions of Canadian law, which are technically different from analogous provisions of U.S. law. Accordingly, the U.S. federal income tax consequences of the Arrangement to U.S. Holders are uncertain. Subject to such uncertainty, the exchange of Ballard Shares for Newco Shares pursuant to the Arrangement is intended by Ballard to qualify as a tax-deferred exchange pursuant to Section 351 of the Code and/or to qualify as a tax-deferred "reorganization" within the meaning of Section 368(a)(1) of the Code (in either case, a "Tax-Deferred Transaction"). However, Ballard has not requested, and does not intend to request, a ruling from the IRS or an opinion of counsel regarding any of the U.S. federal income tax consequences of the Arrangement. Thus, there can be no assurance that the IRS will not challenge the qualification of the Arrangement as a Tax-Deferred Transaction or that the U.S. courts will uphold the status of the Arrangement as a Tax-Deferred Transaction in the event of such an IRS challenge. The discussion below sets forth the U.S. federal income tax consequences of the Arrangement to U.S. Holders of Ballard Shares assuming that the Arrangement qualifies as a Tax-Deferred Transaction and also assuming, in the alternative, that the Arrangement is treated as a taxable transaction. U.S. Holders should consult their own U.S. tax advisors regarding the tax consequences of the Arrangement to them and the proper tax reporting of an exchange of Ballard Shares for Newco Shares pursuant to the Arrangement.

Tax Consequences if the Arrangement Qualifies as a Tax-Deferred Transaction

If the Arrangement qualifies as a Tax-Deferred Transaction, subject to the "passive foreign investment company" rules discussed below, then the following U.S. federal income tax consequences will result for U.S. Holders:

(a) no gain or loss will be recognized by a U.S. Holder on the exchange of Ballard Shares for Newco Shares pursuant to the Arrangement;
(b) the tax basis of a U.S. Holder in the Newco Shares acquired in exchange for Ballard Shares pursuant to the Arrangement will be equal to such U.S. Holder’s tax basis in Ballard Shares exchanged;
(c) the holding period of a U.S. Holder for the Newco Shares acquired in exchange for Ballard Shares pursuant to the Arrangement will include such U.S. Holder’s holding period for Ballard Shares; and
(d) U.S. Holders who exchange Ballard Shares for Newco Shares pursuant to the Arrangement generally will be required to report certain information to the IRS on their U.S. federal income tax returns for the taxable year in which the Arrangement occurs, and to retain certain records related to the Arrangement.

The IRS could challenge a U.S. Holder’s treatment of the Arrangement as a Tax-Deferred Transaction. If this treatment were successfully challenged, then the Arrangement would be treated as a taxable transaction, with the consequences discussed immediately below (including the recognition of any gain realized on the exchange of Ballard Shares for Newco Shares).

Treatment as a Taxable Transaction

If the Arrangement does not qualify as a Tax-Deferred Transaction for U.S. federal income tax purposes, subject to the "passive foreign investment company" ("PFIC") rules discussed below, then the following U.S. federal income tax consequences will result for U.S. Holders:

(a) a U.S. Holder will recognize gain or loss in an amount equal to the difference, if any, between (i) the fair market value (expressed in U.S. dollars) of the Newco Shares received in exchange for Ballard Shares pursuant to the Arrangement and (ii) the adjusted tax basis (expressed in U.S. dollars) of such U.S. Holder in Ballard Shares exchanged;

(b) the tax basis of a U.S. Holder in the Newco Shares received in exchange for Ballard Shares pursuant to the Arrangement would be equal to the fair market value (expressed in U.S. dollars) of such Newco Shares on the date of receipt;

(c) the holding period of a U.S. Holder for the Newco Shares received in exchange for Ballard Shares pursuant to the Arrangement will begin on the day after the date of receipt; and

(d) U.S. Holders who exchange Ballard Shares for Newco Shares pursuant to the Arrangement generally will be required to report certain information to the IRS on their U.S. federal income tax returns for the taxable year in which the Arrangement occurs, and to retain certain records related to the Arrangement.

If Ballard is not classified as a PFIC for any taxable year in which a U.S. Holder held Ballard Shares, any gain or loss described in clause (a) immediately above generally would be capital gain or loss, which will be long-term capital gain or loss if such Ballard Shares have been held for more than one year as of the date of the exchange. Preferential tax rates may apply to long-term capital gains of a U.S. Holder that is an individual, estate, or trust. There are currently no preferential tax rates for long-term capital gains of a U.S. Holder that is a corporation. Deductions for capital losses are subject to significant limitations under the Code.

Tax Consequences If Ballard Classified as a PFIC

A U.S. Holder of Ballard Shares or Ballard Options would be subject to special, adverse tax rules in respect of the Arrangement if Ballard was classified as a PFIC under the meaning of Section 1297 of the Code for any taxable year during which such U.S. Holder holds or held Ballard Shares or Ballard Options, as applicable.

A non-U.S. corporation is classified as a PFIC for each taxable year in which (i) 75% or more of its gross income is passive income (as defined for U.S. federal income tax purposes) or (ii) on average for such taxable year, 50% or more (by value) of its assets either produce or are held for the production of passive income. For purposes of the PFIC provisions, "gross income" generally means sales revenues less cost of goods sold, and "passive income" generally includes dividends, interest, royalties, rents, and gains from commodities or securities transactions, including certain transactions involving oil and gas. In determining whether or not it is classified as a PFIC, a non-U.S. corporation is required to take into account its pro rata portion of the income and assets of each corporation in which it owns, directly or indirectly, at least a 25% interest.

Ballard believes that during the taxable years 2002 through 2007, it did not constitute a PFIC, and based on current business plans and financial projections, Ballard does not expect to be a PFIC during the current taxable year. No determination has been made regarding Ballard’s status as a PFIC during taxable years prior to 2002.

PFIC classification is factual in nature, and generally cannot be determined until the close of the taxable year in question. In addition, the analysis depends, in part, on the application of complex U.S. federal income tax rules, which are subject to differing interpretations. Consequently, there can be no assurances regarding the PFIC status of Newco during any current, prior, or future taxable year. The application of the PFIC rules could have materially adverse tax consequences for a U.S. Holder. For example, under the default PFIC rules, the Arrangement may be treated as a taxable exchange even if the Arrangement otherwise qualifies

as a Tax Deferred Transaction, resulting in the recognition of gain but not the recognition of loss. Furthermore, if the Arrangement is treated as a taxable exchange under the PFIC rules, and the U.S. Holder realizes gain on such exchange, the holder would be required to recognize such gain ratably over the period during which the holder held the Ballard shares (including prior taxable years), pay income tax on such gain at the highest applicable tax rate for such years, and also pay an interest charge. U.S. Holders are urged to consult with their own tax advisors regarding the potential application of the PFIC rules to the Arrangement.

U.S. Holders of Ballard Options

As part of the Arrangement, the unexercised Ballard Options will be exchanged solely for Newco Options. U.S. Holders of Ballard Options should not recognize any taxable income or gain as a result of such exchange for U.S. federal income tax purposes. However, Ballard has not requested, and does not intend to request, a ruling from the IRS or an opinion of counsel regarding any of the tax consequences of such exchange. Thus, there can be no assurance that the IRS will not challenge the status of such exchange as a tax-deferred exchange or that the U.S. courts will uphold the status of such exchange as a tax-deferred exchange in the event of an IRS challenge. Notwithstanding the foregoing, the rules governing PFICs described above could have significant adverse tax effects on U.S. Holders of Ballard Options if Ballard was a PFIC for any taxable year in which a U.S. Holder held Ballard Options. U.S. Holders of Ballard Options are strongly advised to consult their own tax and legal advisors with respect to the U.S. federal tax consequences of the exchange of Ballard Options for Newco Options.

U.S. Holders Exercising Dissent Rights

A U.S. Holder that exercises dissent rights and is paid cash in exchange for all of such U.S. Holder’s Ballard Shares generally will recognize gain or loss in an amount equal to the difference, if any, between (a) the amount of cash received by such U.S. Holder in exchange for Ballard Shares (other than amounts, if any, that are or are deemed to be interest for U.S. federal income tax purposes, which amounts will be taxed as ordinary income) and (b) the tax basis of such U.S. Holder in such Ballard Shares surrendered. Subject to the PFIC rules discussed above, such gain or loss generally will be capital gain or loss, which will be long-term capital gain or loss if such Ballard Shares have been held for more than one year at the time of the disposition of the Ballard Shares. Preferential tax rates may apply to long-term capital gains of a U.S. Holder that is an individual, estate, or trust. Deductions for capital losses are subject to significant limitations under the Code.

However, notwithstanding the foregoing, a U.S. Holder of Ballard Shares that exercises dissent rights in the Arrangement would be subject to special, adverse tax rules if Ballard was classified as a PFIC for any taxable year during which such U.S. Holder holds or held Ballard Shares. U.S. Holders are urged to consult with their own tax advisors regarding the potential application of the PFIC rules to the Arrangement.

The amount of any Canadian dollars received as a result of Ballard Shareholders' exercising dissent rights under the Arrangement generally will be equal to the U.S. dollar value of such Canadian dollars based on the exchange rate applicable on the date of receipt (regardless of whether such Canadian dollars are converted into U.S. dollars at that time). A U.S. Holder that receives Canadian dollars and converts such Canadian dollars into U.S. dollars at a conversion rate other than the rate in effect on the date of receipt may have a foreign currency exchange gain or loss, which generally would be treated as U.S. source ordinary income or loss. Each U.S. Holder should consult its own U.S. tax advisor regarding the U.S. federal income tax consequences of receiving, owning, and disposing of Canadian dollars.

Foreign Tax Credit

A U.S. Holder that pays (whether directly or through withholding) Canadian income tax in connection with the Arrangement may be entitled, at the election of such U.S. Holder, to receive either a deduction or a credit for such Canadian income tax paid. Generally, a credit will reduce a U.S. Holder’s U.S. federal income tax liability on a dollar-for-dollar basis, whereas a deduction will reduce a U.S. Holder’s income subject to U.S. federal income tax. This election is made on a year-by-year basis and applies to all foreign taxes paid (whether directly or through withholding) by a U.S. Holder during a year.

Complex limitations apply to the foreign tax credit, including the general limitation that the credit cannot exceed the proportionate share of a U.S. Holder’s U.S. federal income tax liability that such U.S.

Holder's "foreign source" taxable income bears to such U.S. Holder's worldwide taxable income. In applying this limitation, a U.S. Holder's various items of income and deduction must be classified, under complex rules, as either "foreign source" or "U.S. source." Generally, gains recognized on the sale of stock of a foreign corporation by a U.S. Holder should be treated as U.S. source for this purpose, except as otherwise provided in an applicable income tax treaty, and if an election is properly filed under the Code. In addition, this limitation is calculated separately with respect to specific categories of income. The foreign tax credit rules are complex, and each U.S. Holder should consult its own U.S. tax advisor regarding the foreign tax credit rules.

Information Reporting; Backup Withholding Tax

Payments of cash made to U.S. Holders exercising dissent rights under the Arrangement generally will be subject to U.S. federal information reporting and may be subject to backup withholding tax, currently at the rate of 28%, if a U.S. Holder (a) fails to furnish such U.S. Holder's correct U.S. taxpayer identification number (generally on Form W-9); or (b) fails to certify, under penalty of perjury, that such U.S. Holder has furnished its correct U.S. taxpayer identification number and that the IRS has not notified such U.S. Holder that it is subject to backup-withholding tax. However, U.S. Holders that are corporations generally are excluded from these information-reporting and backup-withholding tax rules. Backup withholding is not an additional U.S. federal income tax. Any amounts withheld under the U.S. backup withholding tax rules will be allowed as a credit against a U.S. Holder's U.S. federal income tax liability, if any, or will be refunded to the extent it exceeds such liability, if such U.S. Holder furnishes required information to the IRS. A U.S. Holder that does not provide a correct U.S. taxpayer identification number may be subject to penalties imposed by the IRS. Each U.S. Holder should consult its own U.S. tax advisor regarding the information reporting and backup withholding tax rules.

INFORMATION RESPECTING NEWCO

Newco was incorporated under the CBCA on November 12, 2008 for the express purpose of participating in the Arrangement. Newco has not carried on, and will not carry on, any other business from its incorporation to the Effective Date. From the date of incorporation to the Effective Date, the sole shareholder of Newco has been and will be Ballard. Immediately prior to the Effective Date, Newco's authorized capital and bylaws will be the same as those of Ballard.

Following the completion of the Arrangement, Newco will use its assets and the proceeds of the Fund Loan, net of expenses, of approximately C$41 million to carry out the business as carried on by Ballard prior to the completion of the Arrangement. Newco's head office will be located at 9000 Glenlyon Parkway, Burnaby, B.C., V5J 5J8.

Newco will adopt the Newco Option Plan, the Newco DSUP, the Newco RSUP and the Newco SDP (collectively, the "**Newco Share Incentive Plans**"). The Newco DSUP, the Newco RSUP and the Newco SDP will be substantially the same as the Ballard DSUP, the Ballard RSUP and the Ballard SDP, respectively, but with amendments necessary to implement the Arrangement including, in respect of the Newco RSUP and the Newco Option Plan, amendments necessary to continue to preserve the rights of persons whose employment was transferred by Ballard to AFCC Automotive Fuel Cell Cooperation Corp. in connection with the sale of Ballard's automotive fuel cell assets on January 31, 2008. Such rights are similarly preserved under the existing Ballard Option Plans and Ballard RSUP.

Immediately prior to the completion of the Arrangement, the board of directors of Newco will consist of those same individuals who then make up the Board of Directors, currently being Ian A. Bourne (Chair), Ed Kilroy, Dr. C. S. Park, John Sheridan, Dr. Gerri Sinclair, David J. Smith, David B. Sutcliffe, Mark Suwyn and Douglas W. G. Whitehead. In addition, the management team of Newco will consist of the same individuals who then make up the management team of Ballard, currently being John Sheridan (President and Chief Executive Officer), Bill Foulds (President Ballard Material Products, Vice-President Ballard Power Systems Inc.), Christopher Guzy (Vice-President and Chief Technical Officer), Glenn Kumoi (Vice-President, Human Resources, Chief Legal Officer and Corporate Secretary), Noordin Nanji (Vice-President, Corporate Strategy and Development) and David Smith (Vice-President and Chief Financial Officer).

Newco will adopt the same corporate governance guidelines, board mandate, terms of reference for directors, committee mandates, committee chair terms of reference, chief executive officer terms of reference, code of ethics, and all other policies, guidelines and operational practices as are currently in effect for Ballard.

AMENDMENTS TO SHARE INCENTIVE PLANS

Ballard currently has the following share incentive plans: (1) the Ballard Option Plan; (2) the Ballard DSUP; (3) the Ballard RSUP; and (4) the Ballard SDP. The Ballard Option Plan is comprised of three stock option plans (each of which is substantially the same): a 1997 Option Plan, a 2000 Option Plan and a 2002 Option Plan, as well as a special-purpose Ballard/BGS Option Exchange Plan. A maximum of 10,096,108 Ballard Shares have been reserved and authorized for issuance under the Ballard Option Plan. As of November 12, 2008, a total of 7,491,920 Ballard Shares remained reserved for issuance under the Ballard Option Plan, as 1,168,597 Ballard Shares had been issued upon exercise of options granted under the Ballard Option Plan and 1,435,591 options had expired with the Ballard Shares reserved for issuance upon exercise of such options no longer being reserved under the Ballard Option Plan. Of the remaining 7,491,920 Ballard Shares reserved for issuance, 5,255,610 Ballard Shares were reserved for issuance on the exercise of then outstanding Ballard Options and a total of 2,236,310 Ballard Shares remain reserved for issuance under Ballard Options that may be granted in the future (of which 94,118 are only available in respect of options issued under the Ballard/BGS Option Exchange Plan).

The Ballard SDP is comprised of two share distribution plans: the 2000 Share Distribution Plan and the 2003 Share Distribution Plan. A maximum of 6,300,000 Ballard Shares have been reserved and authorized for issuance under the Ballard SDP (500,000 under the 2000 Share Distribution Plan and 5,800,000 under the 2003 Share Distribution Plan). As of November 12, 2008, a total of 4,031,220 Ballard Shares had been issued under the Ballard SDP, a total of 1,425,878 Ballard Shares had been reserved under the Ballard SDP for issuance upon the future redemption or conversion of outstanding Ballard DSUs and Ballard RSUs, leaving a total of 842,902 Ballard Shares that may be issued in the future under the Ballard SDP.

Regardless of whether the Arrangement becomes effective, in order to maintain our conservative approach to cash expenditures, we will continue to meet certain compensation obligations through the issuance of Ballard Shares rather than cash. This method of compensation has created the need for additional Ballard Shares to be available for issuance under the Ballard SDP. In order to increase the number of Ballard Shares available for issuance under the Ballard SDP, the TSX requires that Ballard seek the approval of Ballard Shareholders.

The Ballard Shareholders are being asked to consider and, if deemed advisable, to pass the Option Resolution approving: (1) the increase in the number of Ballard Shares reserved for issuance under the 2003 Share Distribution Plan by 1,250,000 Ballard Shares, such that the total number of Ballard Shares reserved for issuance under the 2003 Share Distribution Plan is 7,050,000; (2) the corresponding decrease in the number of Ballard Shares reserved for issuance under the 2002 Option Plan by 1,250,000 Ballard Shares, such that the total number of Ballard Shares reserved for issuance under the 2002 Option Plan is 2,750,000, of which: (i) 394,785 Ballard Shares have been issued or expired; (ii) 2,341,227 Ballard Shares are reserved for issuance under outstanding Ballard Options; and (iii) a total of 13,988 Ballard Shares remain reserved for issuance under Ballard Options that may be granted in the future; and (3) that if the Arrangement Resolution is approved, the share incentive plans adopted by Newco shall have these same changes in the number of shares reserved for issuance applied to them.

If the Option Resolution is approved by the Ballard Shareholders, but the Arrangement Resolution is not approved by the Ballard Securityholders, the Ballard Option Plan, the Ballard DSUP, the Ballard RSUP and the Ballard SDP will continue in force without change, save that the Ballard Shares reserved for issuance under the 2003 Share Distribution Plan will be increased by 1,250,000 Ballard Shares and there will be a corresponding decrease of 1,250,000 Ballard Shares reserved for issuance under the 2002 Option Plan. This will result in 986,310 Ballard Shares remaining reserved for issuance under Ballard Options that may be granted in the future under all Ballard Option Plans (94,118 of which are only available in respect of options issued under the Ballard/BGS Option Exchange Plan).

The Option Resolution must be approved by a simple majority (more than 50%) of the votes cast by Ballard Shareholders, present in person or by proxy, at the Meeting. A copy of the Option Resolution is attached as Appendix C to this Information Circular. Each Ballard Shareholder is entitled to one vote per Ballard Share held. Ballard Rightsholders are not entitled to vote on the Option Resolution. **The Board of Directors has considered and unanimously approved the Option Resolution, and unanimously recommends that you vote FOR the Option Resolution.**

VOTING INFORMATION

Who Can Vote

Registered holders of Ballard Shares at 5:00 p.m. (local time in Vancouver) on the Record Date can vote at the Meeting. Each Ballard Share has the right to one vote. Each Ballard Right entitles the holder thereof to one vote per Ballard Share that such holder is entitled to receive upon the exercise of such Ballard Right, provided that if such Ballard Right has been exercised, expired or otherwise been terminated or been repaid before the Meeting, such holder may not attend or vote in such capacity.

In accordance with the provisions of the CBCA, we have prepared a list of registered Securityholders as at 5:00 p.m. (local time in Vancouver) on the Record Date. Each registered Securityholder named in the list will be entitled to vote at the Meeting the number of Ballard Shares shown opposite the shareholder's name on such list, or in the case of a Ballard Rightsholder, the number of Ballard Shares that such holder is entitled to receive on the exercise of such Ballard Rights.

As of November 12, 2008 there are outstanding 82,122,135 Shares, 5,255,610 Ballard Options, 333,066 Ballard DSUs and 1,092,812 Ballard RSUs. To the knowledge of our directors and officers, as of November 12, 2008, no person or corporation beneficially owns, directly or indirectly, or exercises control or direction over, securities carrying more than 10% of the voting rights capable of being exercised at the Meeting.

As at 5:00 p.m. (local time in Vancouver) on November 12, 2008, the number of Ballard Shares and Ballard Rights owned by, or over which control or direction is exercised by, each director and senior officer, and to our knowledge, by each associate of a director or senior officer, is as follows:

	Shares	**Options**	**DSUs** [(1)]	**RSUs**
Directors				
Ian Bourne	1,824	0	77,706	0
Ed Kilroy	2,424	6,000	42,844	0
Dr. Chong Sup Park	17,091	0	0	0
Gerri Sinclair	176	0	25,355	0
David J. Smith	6,411	0	14,841	0
David Sutcliffe	3,600	0	25,528	0
Mark Suwyn	7,237	0	35,019	0
Douglas Whitehead	4,383	28,000	36,916	0

(1) In reviewing the status of the Ballard's share incentive plans and their assumption by Newco, Ballard has determined that 169,276 DSUs, representing less than 0.2% of the total votes which may be cast at the Meeting, have been issued in excess of the limitation on issuance to directors set out in the 2003 Share Distribution Plan. Newco will have its shareholders determine the continuing status of these DSUs at Newco's first annual general meeting in the spring of 2009. For the purposes of the Meeting, and consistent with the Interim Order, Ballard intends to permit these DSUs to be voted. Ballard will track and report to the Court the manner in which they are voted when Ballard seeks the Final Order.

	Shares	Options	DSUs	RSUs
Officers				
Bill Foulds	9,157	145,888	0	22,516
Christopher Guzy	30,496	200,037	0	69,307
Glenn Kumoi	1,558	77,234	0	32,906
Noordin Nanji	62,154	525,037	0	69,307
John Sheridan	119,799	389,975	57,943	560,417
David Smith	12,165	375,037	16,914	69,307

How You Can Vote

If you are a registered Securityholder, you may vote your Ballard Shares and Ballard Rights either by attending the Meeting in person or, if you do not plan to attend the Meeting, by completing the forms of proxy (white in the case of Ballard Shares and yellow in the case of Ballard Rights) and following the delivery instructions contained in the forms of proxy and this Information Circular. The giving of a proxy will not affect the right of a registered securityholder to attend and vote in person at the Meeting.

Only registered Securityholders, or the persons they appoint as their proxy holders, are customarily permitted to attend and vote at the Meeting. However, in many cases, Ballard Shares beneficially owned by non-registered holders are registered either (a) in the name of an intermediary that the non-registered holder deals with in respect of the Ballard Shares (the "**Intermediary**"), or (b) in the name of a depository in whose name Ballard Shares beneficially owned by a shareholder are registered ("**Depositary**"), such as The Canadian Depository for Securities Limited ("**CDS**"), in which the Intermediary is a participant.

In accordance with the requirements of Canadian securities laws, we have distributed copies of the Notice of Meeting, the Information Circular and the proxy (collectively, the "**Meeting Materials**") to Intermediaries and Depositaries for onward distribution to non-registered holders.

Intermediaries are required to forward Meeting Materials to non-registered holders unless a non-registered holder has waived the right to receive them. Very often, Intermediaries will use service companies to forward Meeting Materials to non-registered holders. Generally, non-registered holders who have not waived the right to receive Meeting Materials will either:

(a) be given a proxy that has already been signed by the Intermediary (typically by a facsimile, stamped signature), which is restricted as to the number of Shares beneficially owned by the non-registered holder but which is otherwise uncompleted. This proxy need not be signed by the non-registered holder; or

(b) more typically, be given a voting instruction form that must be completed and signed by the non-registered holder in accordance with the directions on the voting instruction form (which may in some cases permit the completion of the voting instruction form by telephone and internet with the use of a control number provided on the voting instruction form).

The purpose of these procedures is to permit non-registered holders to direct the voting of the Ballard Shares they beneficially own. Should a non-registered holder wish to attend and vote at the Meeting in person (or have another person attend and vote on behalf of the non-registered holder), the non-registered holder should strike out the names of the persons named in the proxy received from the Intermediary and insert the name of the non-registered holder (or such other person voting on behalf of the non-registered holder) in the blank space provided or, in the case of a voting instruction form, follow the corresponding instructions on the form. In either case, non-registered holders should carefully follow the instructions of their Intermediaries, including instructions regarding when and where the proxy (or voting instruction form) is to be delivered.

In either case, please ensure that you deliver your proxy in the manner described in this Information Circular or as instructed by your Intermediary. If you are a non-registered holder and do not follow these special procedures and attend the Meeting, you will not be entitled to vote at the Meeting.

Solicitation of Proxies

The information contained in this Information Circular is furnished in connection with the solicitation of proxies by or on behalf of management for use at the Meeting or any adjournment or postponement thereof. We are soliciting proxies primarily by mail, but our directors, officers and employees may solicit proxies personally, by telephone, by facsimile transmission or by other means of electronic communication. We pay all costs of soliciting proxies. We have appointed D. F. King & Co., Inc. to assist us with the solicitation of proxies.

Appointment and Revocation of Proxies

Two forms of proxy are being provided by Ballard management for use at the Meeting, a white form of proxy for use by Ballard Shareholders and a yellow form of proxy for use by holders of Ballard Rights. Ballard Shareholders are entitled to vote on the Arrangement Resolution and the Option Resolution. Holders of Ballard Rights are only entitled to vote on the Arrangement Resolution. The management representatives designated in the enclosed forms of proxy will vote the securities in respect of which they are appointed proxyholders on any ballot that may be called for in accordance with the instructions of the Ballard Securityholder as indicated on the forms of proxy. In the absence of such direction, the securities will be voted by the management representatives FOR the Arrangement Resolution and, as applicable, FOR the Option Resolution.

The persons named in the accompanying forms of proxy are our Chair of the Board of Directors (the "**Chair**") and our President & Chief Executive Officer. **You may also appoint some other person (who need not be a shareholder of Ballard) to represent you at the Meeting either by inserting such other person's name in the blank space provided in the forms of proxy or by completing another suitable form of proxy.** A proxy will not be valid unless the completed form of proxy is delivered to Computershare Investor Services Inc. ("**Computershare**"), Proxy Department, by mail or by hand at its office at 100 University Avenue, 9th Floor, Toronto, Ontario, M5J 2Y1 no later than 1:00 p.m. Pacific Standard Time on December 16, 2008.

You can revoke your proxy by:

- providing a written notice of revocation to Computershare before 5:00 p.m. on December 17, 2008,
- providing a written notice of revocation to us before 5:00 p.m. on December 17, 2008, at our registered office, which is located at the offices of Stikeman Elliott LLP, 1700 - 666 Burrard Street, Vancouver, British Columbia, V6C 2X8 Canada,
- advising the Chair of the Meeting that you are voting in person at the Meeting or any adjournment or postponement thereof, or
- any other manner provided by law.

Your revocation of a proxy will not affect a matter on which a vote is taken before the revocation.

A non-registered holder may revoke a proxy or voting instruction form which has been given to an Intermediary by written notice to the Intermediary. In order to ensure that an Intermediary acts upon a revocation of proxy form or voting instruction form, the written notice should be received by the Intermediary well in advance of the Meeting or any adjournment or postponement thereof.

Voting and Exercise of Discretion by Proxy Holders

The Ballard Shares and Ballard Rights represented by all properly executed proxies, not previously revoked, will be voted or withheld from voting at the Meeting, in accordance with the instructions contained in the proxy, on any ballot that may be called for. If a Securityholder specifies a choice with respect to any matter to be acted upon, the Ballard Shares and Ballard Rights will be voted accordingly. Forms of proxy containing no instructions regarding the matters specified therein will be voted in favour of all matters.

The nominees named in the accompanying forms of proxy will vote or withhold from voting the Ballard Shares and Ballard Rights represented by the proxy in accordance with your instructions. The proxy grants the nominees the discretion to vote on:

- each matter or group of matters identified in the proxy where you do not specify how you want to vote,
- any amendment to or variation of any matter identified in the proxy, and
- any other matter that properly comes before the Meeting.

As of the date of this Information Circular, we know of no amendment, variation or other matter that may come before the Meeting, but if any amendment, variation or other matter properly comes before the Meeting, each nominee named in the proxy intends to vote in accordance with the nominee's best judgment.

Interest of Informed Persons in Material Arrangements

To the best of the knowledge of management, no informed person or person who has been a director or executive officer of Ballard since December 31, 2007 (or any associate or affiliate of such persons) had any interest in any material transaction to be considered at the Meeting, except as disclosed in this Information Circular.

DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

We purchase and maintain insurance for the benefit of our directors and officers for losses arising from claims against them for certain actual or alleged wrongful acts they may undertake while performing their director or officer function. The total annual premium in respect of our directors' and officers' liability insurance program was approximately U.S.$750,000 for 2007 and U.S.$700,000 for 2008. The aggregate maximum coverage provided by the policy for all claims, for both directors and officers, in any single policy year is U.S.$40 million. In addition to the payment of the premiums, we are accountable for the payment of the policy deductible of U.S.$200,000 to U.S.$500,000 per claim. We have also agreed to indemnify each of our directors and officers against all expenses, liability and loss, reasonably incurred or suffered, arising from the performance of his or her duties as an officer or director of Ballard.

INDEBTEDNESS OF DIRECTORS AND OFFICERS

There is not as of the date hereof, and has not been since the beginning of Ballard's last completed financial year, any indebtedness, other than routine indebtedness, owing to Ballard by the current directors and officers of Ballard, or any of their associates or affiliates.

LEGAL MATTERS

Certain legal matters relating to the Arrangement are to be passed upon at the closing of the Arrangement by Stikeman Elliott LLP, on behalf of Ballard and Newco, and by Macleod Dixon LLP, on behalf of Superior Plus Income Fund and on behalf of Superior Plus Corp. As at November 12, 2008, the partners and associates of Stikeman Elliott LLP and Macleod Dixon LLP beneficially owned, directly or indirectly, less than 1% of the Ballard Shares on a fully diluted basis.

ADDITIONAL INFORMATION

Additional information relating to us is included in our annual report for the year ended December 31, 2007, which includes our audited financial statements for the year ended December 31, 2007 and the accompanying auditors report. Copies of the annual report and the relevant portion of any documents incorporated by reference in the annual report, copies of our most current annual information form and interim financial statements, as well as additional copies of this Information Circular, may be obtained upon request from our Corporate Secretary, at 9000 Glenlyon Parkway, Burnaby, British Columbia V5J 5J8 Canada. Financial information is provided in our comparative financial statements and management's discussion and analysis for the year ended December 31, 2007.

APPROVAL OF DIRECTORS

The contents and mailing of this Information Circular have been approved by the Board of Directors.

BY ORDER OF THE BOARD OF DIRECTORS

"Glenn Kumoi"

Glenn Kumoi

Vice-President, Human Resources, Chief Legal Officer and Corporate Secretary

Dated: November 14, 2008

CONSENT OF PRICEWATERHOUSECOOPERS LLP

We refer to the fairness opinion dated October 30, 2008 (the "**Fairness Opinion**"), prepared for the Audit Committee and the Board of Ballard Power Systems Inc., which provides an opinion as to the fairness of the Arrangement (as defined in Ballard Power Systems Inc.'s Information Circular dated November 14, 2008) from a financial point of view to the Ballard Shareholders. We consent to the filing of the Fairness Opinion with the securities commissions (and other applicable securities regulatory authorities) in each of the Provinces of Canada and the inclusion of the Fairness Opinion, and all references thereto, in this Information Circular. In providing such consent, we do not intend that any person other than the Audit Committee and the Board of Ballard Power Systems Inc. thereof rely upon the Fairness Opinion.

"*PricewaterhouseCoopers LLP*"

Dated: November 14, 2008

APPENDIX "A"

GLOSSARY OF TERMS

Unless the context otherwise requires, when used in this Information Circular the following terms have the meanings set forth below, words importing the singular number include the plural and vice versa, and words importing any gender include all genders. Unless otherwise indicated, these defined terms are not used in the appendices included herein.

"**Acquisition Proposal**" means, with respect to Superior Plus or Ballard, any inquiry or the making of any proposal to such Party or its unitholders or shareholders, as the case may be, from any Person which constitutes, or may reasonably be expected to lead to (in either case whether in one transaction or a series of transactions): (1) an acquisition from such Party or its unitholders or shareholders, as the case may be, or issuance of, any equity or debt securities of such Party (other than on exercise of currently outstanding Fund Rights or Ballard Rights, as applicable) or its Subsidiaries; (2) any acquisition of any of the assets of such Party or its Subsidiaries; (3) an acquisition, merger, amalgamation, reorganization, arrangement or similar transaction involving such Party or its Subsidiaries; or (4) any take-over bid, issuer bid, exchange offer, recapitalization, liquidation, dissolution or reorganization; except for any such transaction which does not preclude, or have an adverse effect on, the Arrangement;

"**Applicable Canadian Securities Laws**" means, collectively, and as the context may require, the securities legislation of each of the provinces and territories of Canada, and the rules, regulations and policies published and/or promulgated thereunder, as such may be amended from time to time prior to the Effective Date;

"**Applicable Laws**", in the context that refers to one or more Persons, means the Laws that apply to such Person or Persons or its or their business, activities, undertaking, property, assets or securities and emanate from a Person having jurisdiction over the Person or Persons or its or their business, activities, undertaking, property or securities;

"**Arrangement**" means the arrangement pursuant to Section 192 of the CBCA set forth in the Plan of Arrangement;

"**Arrangement Agreement**" means the arrangement agreement dated October 30, 2008 between Superior Plus and Ballard with respect to this Plan of Arrangement, and all amendments thereto;

"**Arrangement Resolution**" means the special resolution of the Securityholders approving the Plan of Arrangement to be considered at the Meeting;

"**Articles of Arrangement**" means one or more articles of arrangement in respect of the Arrangement required under Subsection 192(6) of the CBCA to be sent to the Director after the Final Order has been granted, so as to give effect to the Arrangement;

"**Ballard**" means Ballard Power Systems Inc., a corporation subsisting under the laws of Canada under corporation number 248019-01;

"**Ballard DSUs**" means the outstanding Deferred Share Units, whether or not vested, issued pursuant to the Ballard DSUP;

"**Ballard DSU Holders**" means holders of Ballard DSUs;

"**Ballard DSUP**" means the deferred share unit plans of Ballard;

"**Ballard Employees**" means the employees of Ballard or its Subsidiaries;

"**Ballard Financial Statements**" means, collectively, the audited comparative consolidated financial statements of Ballard as at and for the years ended December 31, 2007 and 2006, together with the notes thereto and the auditors' report thereon and the unaudited comparative consolidated financial statements of Ballard as at and for the nine month periods ended September 31, 2008 and 2007, together with the notes thereto;

"**Ballard Information**" means the information about Ballard and its business, operations and affairs to which must be included in the Fund Information Circular under Applicable Laws;

"**Ballard Optionholders**" means the holders of outstanding Ballard Options;

"**Ballard Option Plan**" means the stock option plans of Ballard;

"**Ballard Options**" means the outstanding stock options, whether or not vested, to acquire Ballard Shares that were issued pursuant to the Ballard Option Plan;

"**Ballard Required Approvals**" means, the third party and Governmental Entity approvals and consents listed in Appendix C to the Arrangement Agreement which are required by Ballard to be received on or prior to closing of the Arrangement in order to complete the Arrangement;

"**Ballard RSUs**" means the outstanding Restricted Share Units, whether or not vested, issued pursuant to the Ballard RSUP;

"**Ballard RSU Holders**" means holders of Ballard RSUs;

"**Ballard RSUP**" means the Restricted Share Unit Plans of Ballard;

"**Ballard Rights**" means the Ballard DSUs, Ballard RSUs or the Ballard Options;

"**Ballard Rightsholders**" means the holders of Ballard Rights;

"**Ballard SDP**" means the Share Distribution Plans of Ballard;

"**Ballard Shares**" means the common shares of Ballard;

"**Ballard Shareholders**" means the holders Ballard Shares;

"**Board of Directors**" means the board of directors of Ballard as it may be comprised from time to time;

"**CBCA**" means the Canada Business Corporations Act, as amended, including the regulations promulgated thereunder;

"**Certificate**" means the certificate or certificates or confirmation of filing which may be issued by the Director pursuant to Subsection 192(7) of the CBCA giving effect to the Arrangement;

"**Closing Time**" means 3:00 pm (Calgary time) on the Effective Date, unless otherwise agreed to by Superior Plus and Ballard;

"**Competition Act**" means the *Competition Act*, R.S. 1985, c. C-34, as amended;

"**Court**" means the Supreme Court of British Columbia;

"**Debenture Trust Indenture**" means the trust indenture between Computershare Trust Company of Canada and Superior Plus dated June 14, 2005, as supplemented by the supplemental indenture dated October 19, 2005, governing the terms of the convertible redeemable debentures issued by Superior Plus;

"**Director**" means the director duly appointed under Section 260 of the CBCA;

"**Dissenting Shareholders**" means registered Ballard Shareholders who validly exercise the rights of dissent provided to them under the Interim Order and have not, prior to the Effective Time, withdrawn their dissents;

"**Effective Date**" means the date the Arrangement becomes effective under the CBCA;

"**Effective Time**" means 11:59 pm on the Effective Date;

"**Final Order**" means the order of the Court approving the Plan of Arrangement pursuant to Subsection 192(4) of the CBCA, as such order may be affirmed, amended or modified by any court of competent jurisdiction;

"**Fund Information**" means the information about and Superior Plus' business, operations and affairs which must be included in the Fund Information Circular under Applicable Laws;

"**Fund Information Circular**" means the information circular of Superior Plus to be sent by Superior Plus to the Fund Unitholders in connection with the Fund Meeting;

"**Fund Loan**" means Superior Plus' loan of C$46,319,148 to Ballard;

"**Fund Meeting**" means the special meeting of the Fund Unitholders to be held to consider the Fund Resolution and related matters, and any adjournment(s) thereof;

"**Fund Resolution**" means the special resolution of the Fund Unitholders approving the Plan of Arrangement to be considered at the Fund Meeting;

"**Fund Required Approvals**" means the third party and Governmental Entity approvals and consents listed in Appendix C to the Arrangement Agreement which are required by the Fund to be received on or prior to closing of the Arrangement in order to complete the Arrangement;

"**Fund Rights**" means the rights to acquire trust units issued under the Superior Plus' trust unit incentive plan;

"**Fund Trustee**" means Computershare Trust Company of Canada, in its capacity as the trustee under the Fund Trust Indenture;

"**Fund Trust Indenture**" means the amended and restated declaration of trust dated September 30, 2006 between the Fund Trustee and Superior Plus Administration Inc., as such indenture may be further amended by supplemental indentures from time to time;

"**Fund Unitholders**" means the holders of issued and outstanding Trust Units;

"**Governmental Entity**" means any (a) multinational, federal, provincial, state, regional, municipal, local or other government or any governmental or public department, court, tribunal, arbitral body, commission, board, bureau or agency, (b) any subdivision, agent, commission, board or authority of any of the foregoing, or (c) any quasi-governmental or private body exercising any regulatory, expropriation or taxing authority under or for the account of any of the foregoing;

"**Information Circular**" means the management proxy circular of Ballard to be sent by Ballard to the Securityholders in connection with the Meeting;

"**Interim Order**" means an interim order of the Court concerning the Arrangement under Subsection 192(4) of the CBCA, containing declarations and directions with respect to the Arrangement and the holding of the Fund Meeting and the Meeting, as such order may be affirmed, amended or modified by any court of competent jurisdiction;

"**Laws**" means all laws, statutes, regulations, by-laws, statutory rules, orders, ordinances, protocols, codes, guidelines, notices, directions (including all Applicable Canadian Securities Laws and U.S. Securities Laws), and terms and conditions of any grant of approval, permission, authority or license of any court, Governmental Entity, statutory body or self-regulatory authority (including the TSX and the NASDAQ, as applicable);

"**Material Acquisition Proposal**" means, with respect to Superior Plus or Ballard, any inquiry or the making of any proposal to such Party or its unitholders or shareholders, as the case may be, from any Person which constitutes, or may reasonably be expected to lead to (in either case in one transaction or a series of transactions): (i) an acquisition from such Party or its unitholders or shareholders, as the case may be, or the issuance of, equity securities representing more than 35% of the outstanding securities of such Party or debt securities with a principal amount more than 35% of the book value of the assets of such Party; (ii) any acquisition of assets representing more than 35% of the book value of the assets of such Party; or (iii) an acquisition, merger, amalgamation, reorganization, arrangement or other similar transaction involving such Party which results in the unitholders or shareholders of such Party, as the case may be, holding less than 65% of the equity securities of such Party or the resulting entity on completion of the transaction; in each case the main purpose of which is not the same as the purpose of the Arrangement and which such Party can demonstrate is inconsistent with and incapable of being deferred until after completion of the Arrangement. Calculations for this definition shall be based on the values and numbers in the most recent financial statements of the applicable Party which are publicly available;

"**Meeting**" means the special meeting of Securityholders to be held to consider the Arrangement Resolution, the Option Resolution and related matters, and each adjournment thereof;

"**NASDAQ**" means The NASDAQ Global Market of The NASDAQ Stock Market, LLC;

"**Newco**" means 7076991 Canada Inc., a corporation incorporated under the CBCA;

"**Newco DSUs**" means the deferred share units to be issued pursuant to the Newco DSUP;

"**Newco DSUP**" means the deferred share unit plans to be adopted by Newco;

"**Newco Options**" means the options to be issued pursuant to the Newco Option Plan;

"**Newco Option Plan**" means the stock option plans to be adopted by Newco;

"**Newco RSUs**" means the restricted share units to be issued pursuant to the Newco RSUP;

"**Newco RSUP**" means the restricted share unit plan to be adopted by Newco;

"**Newco SDP**" means the share distribution plans to be adopted by Newco;

"**Newco Securities**" means the Newco Shares, the Newco Options, the Newco RSUs and the Newco DSUs;

"**Newco Shares**" means the common shares in the capital of Newco;

"**New Superior**" means Superior Plus Corp.;

"**New Superior Shares**" means the new class of common shares of Ballard to be created pursuant to the Arrangement;

"**Option Resolution**" means the ordinary resolution of the Ballard Shareholders approving an increase in the number of Ballard Shares reserved for issuance under the Ballard SDP and a corresponding decrease in the number of Ballard Shares reserved for issuance under the 2002 Ballard Option Plan, all as more particularly set forth and described in the Information Circular;

"**Parties**" means, collectively, the parties to the Arrangement Agreement, and "Party" means either of them;

"**Person**" means any individual, firm, partnership, joint venture, venture capital fund, association, trust, trustee, executor, administrator, legal personal representative, estate group, body corporate, corporation, unincorporated association or organization, Governmental Entity, syndicate or other entity, whether or not having legal status;

"**Plan of Arrangement**" means the plan of arrangement in the form set out in Appendix H hereto, as amended or supplemented from time to time in accordance with Article 7 thereof and Article 6 of the Arrangement Agreement;

"**PwC**" means PricewaterhouseCoopers LLP;

"**PwCCF**" means PricewaterhouseCoopers Corporate Finance Inc.;

"**Record Date**" means November 12, 2008;

"**SEC**" means the United States Securities and Exchange Commission;

"**Securityholders**" means the Ballard Shareholders and the Ballard Rightsholders;

"**Subco**" means 7076894 Canada Inc., a corporation incorporated under the CBCA;

"**Subco Shares**" means the common shares in the capital of Subco;

"**Superior Plus**" means Superior Plus Income Fund, an open-ended unincorporated investment trust established under the laws of the Province of Alberta pursuant to the Fund Trust Indenture;

"**Tax**" or "**Taxes**" means all taxes, however denominated, including any interest, penalties or other additions that may become payable in respect thereof, imposed by any federal, territorial, state, local or foreign government or any agency or political subdivision of any such government, which taxes shall include, without limiting the generality of the foregoing, all income or profits taxes (including, but not limited to, federal income taxes and provincial income taxes), payroll and employee withholding taxes, unemployment insurance, social insurance taxes, sales and use taxes, ad valorem taxes, excise taxes, franchise taxes, gross receipts taxes, business license taxes, occupation taxes, real and personal property taxes, stamp taxes, environmental taxes, transfer taxes, capital taxes, workers compensation and other governmental charges, and other obligations of the same or of a similar nature to any of the foregoing, which Superior Plus or Ballard (or any of their respective Subsidiaries), as the case may be, is required to pay, withhold, remit or collect;

"**Tax Act**" means the Income Tax Act (Canada), as amended;

"**Trust Units**" means the trust units of Superior Plus;

"**TSX**" means the Toronto Stock Exchange;

"U.S. Exchange Act" means the United States Securities Exchange Act of 1934, as amended;

"U.S. Securities Act" means the United States Securities Act of 1933, as amended; and

"**U.S. Securities Laws**" means the federal and state securities legislation of the United States and all rules, regulations and orders promulgated thereunder, as amended from time to time.

APPENDIX "B"

ARRANGEMENT RESOLUTION

SPECIAL RESOLUTION OF THE SECURITYHOLDERS OF BALLARD POWER SYSTEMS INC. (the "**Company**")

BE IT RESOLVED AS A SPECIAL RESOLUTION THAT:

1. The arrangement (as may be modified or amended, the "**Arrangement**") under section 192 of the Canada Business Corporations Act (the "**CBCA**") involving the Company and its securityholders, all as more particularly described and set forth in the plan of arrangement (as may be modified or amended, the "Plan of Arrangement") attached as Appendix H to the Management Information Circular of the Company dated November 14, 2008 (the "Information Circular"), is hereby authorized, approved and agreed.
2. The Arrangement Agreement dated October 30, 2008 between Superior Plus Income Fund and the Company, as may be amended from time to time (the "**Arrangement Agreement**"), the actions of the directors of the Company in approving the Arrangement and the Arrangement Agreement and the actions of the directors and officers of the Company in executing and delivering the Arrangement Agreement and causing the performance by the Company of its obligations thereunder be, and they are hereby confirmed, ratified, authorized and approved.
3. Notwithstanding that this resolution has been passed (and the Arrangement approved and agreed) by the securityholders of the Company or that the Arrangement has been approved by the Supreme Court of British Columbia (the "**Court**"), the directors of the Company be, and they are hereby, authorized and empowered without further approval of the shareholders of the Company (i) to amend the Arrangement Agreement or the Plan of Arrangement to the extent permitted by the Arrangement Agreement or the Plan of Arrangement, and (ii) not to proceed with the Arrangement at any time prior to the Effective Time (as defined in the Arrangement Agreement).
4. Any one director or officer of the Company be, and is hereby, authorized, empowered and instructed, acting for, in the name and on behalf of the Company, to execute and deliver for filing with the Director under the CBCA, articles of arrangement and such other documents as are necessary or desirable to give full effect to the Arrangement and related transactions in accordance with the Arrangement Agreement, such determination to be conclusively evidenced by the execution and delivery of such articles of arrangement and any such other documents.
5. Any one director or officer of the Company be, and is hereby, authorized, empowered and instructed, acting for, in the name and on behalf of the Company, to execute or cause to be executed, under the seal of the Company or otherwise, and to deliver or to cause to be delivered, all such other documents and to do or to cause to be done all such other acts and things as in such person's opinion may be necessary or desirable in order to carry out the intent of the foregoing paragraphs of these resolutions and the matters authorized thereby, such determination to be conclusively evidenced by the execution and delivery of such document or the doing of such act or thing.

APPENDIX "C"

OPTION RESOLUTION

ORDINARY RESOLUTION OF THE SHAREHOLDERS OF BALLARD POWER SYSTEMS INC. (the "**Company**")

BE IT RESOLVED AS AN ORDINARY RESOLUTION THAT:

1. The increase in the number of common shares of Ballard ("**Ballard Shares**") reserved for issuance under Ballard's 2003 Share Distribution Plan (the "**2003 Share Distribution Plan** ") by 1,250,000 Ballard Shares, such that the total number of Ballard Shares reserved for issuance under the 2003 Share Distribution Plan is 7,050,000, is hereby ratified, authorized and approved;
2. The decrease in the number of Ballard Shares reserved for issuance under Ballard's 2002 Stock Option Plan (the "**2002 Option Plan**") by 1,250,000 Ballard Shares, such that the total number of Ballard Shares reserved for issuance under the 2002 Option Plan is 2,750,000, is hereby ratified, authorized and approved; and
3. If the Arrangement is approved, the share incentive plans adopted by 7076991 Canada Inc. shall have these same changes in the number of shares reserved for issuance applied to them.

APPENDIX "D”

COURT DOCUMENTS

APPENDIX "E”

FAIRNESS OPINION OF PRICEWATERHOUSECOOPERS LLP

Please see following page.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers Place

250 Howe Street, Suite 700

Vancouver, British Columbia

Canada V6C 3S7

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Private and confidential

October 30, 2008

The Audit Committee of the Board of Directors

and the Board of Directors of

Ballard Power Systems Inc.

9000 Glenlyon Parkway

Burnaby, BC V5J 5J8

To the Audit Committee of the Board of Directors and the Board of Directors

Re: Fairness Opinion in Respect of the Proposed Corporate Reorganization Transaction

PricewaterhouseCoopers LLP (“PwC”) understands that Ballard Power Systems Inc. (“Ballard” or the “Company”) proposes to enter into a series of transactions whereby its shareholders (the “Ballard Shareholders”) will be exchanging current shareholdings into equivalent shareholdings of a newly formed entity (“Newco”) as part of a corporate reorganization. PwC understands that all of the assets and liabilities of Ballard (tangible and intangible), with the sole exception of certain tax attributes (the “Tax Pools”), will be transferred to Newco. As part of the reorganization, the Company will receive proceeds from Superior Plus Income Fund (“Superior Plus”) for the sale of Ballard (the “Proposed Transaction”), based on value being attributed by Superior Plus to the Tax Pools, being the sole remaining assets of Ballard. The Company will receive approximately C$46.3 million in gross cash proceeds (the “Proposed Consideration”) on closing, which is expected to be on December 31, 2008, but no later than January 21, 2009.

The Board of Directors of Ballard (the "Board") has appointed the Audit Committee of the Board (the "Audit Committee") to review the terms of the Proposed Transaction and to advise the Board in relation thereto.

Engagement

PwC has been engaged by the Audit Committee to provide an opinion as to the fairness of the Proposed Transaction from a financial point of view (the "Fairness Opinion") to the Ballard Shareholders. PwC understands that the Fairness Opinion will be included in an information circular or other public document (the "Information Circular") to be sent to the Ballard Shareholders and filed with Canadian securities regulators and in other jurisdictions under the Multi-Jurisdictional Disclosure System ("MJDS") rules. The Company's legal counsel indicated that there is no separate requirement to file with any US securities regulatory authority. PwC relied on this representation in providing the Fairness Opinion.

The Fairness Opinion will be for the use of the Audit Committee and the Board and will be one factor, amongst others, that the Audit Committee/Board will consider in determining whether or not to recommend the Proposed Transaction. The Fairness Opinion should not be considered or referenced in any way as a formal valuation under Multilateral Instrument 61-101.

PwC is to be paid a fixed fee by Ballard for the Fairness Opinion, the payment of which is not subject to closing of the Proposed Transaction. In addition, PwC is to be reimbursed for reasonable expenses incurred in the preparation of the Fairness Opinion and to be indemnified by Ballard in certain circumstances.

Credentials of PwC

PwC is one of the world's largest professional services organizations. Drawing on the knowledge and skills of more than 146,000 people in 150 countries, we provide clients with expertise in a wide array of services, including corporate finance, mergers and acquisitions, business valuations, tax services and auditing. In Canada, PwC and its related entities have more than 4,300 partners and staff across the country.

PwC's valuation practice has extensive experience in providing valuation and fairness opinions with respect to securities or assets. We have been involved in numerous transactions requiring fairness opinions from a financial point of view with respect to consideration offered to shareholders and/or stakeholders.

PwC has experience in completing and defending, when necessary, assignments involving fairness reviews or opinions and the valuation of companies for various purposes including transactions subject to public scrutiny, the sale or purchase of an entity or assets by related parties, assistance in resolving shareholders' disputes, tax-based corporate reorganizations and merger and acquisition activity.

PwC is not the auditor of Ballard, Newco or Superior Plus. PricewaterhouseCoopers Corporate Finance Inc. ("PwC CF"), a member firm of PwC, acted as the financial advisor to Ballard for the Proposed Transaction, and is entitled to work fees as well as contingent success fees should the Proposed Transaction close. PwC has used a separate team of qualified Chartered Business Valuators, including Partners and senior staff members (together the "PwC Fairness Committee") to prepare the Fairness Opinion. Members of the PwC Fairness Committee are separate from the PwC CF team. The PwC Fairness Committee confirms that, to the best of its knowledge, after all due and reasonable inquiry, PwC has disclosed to the Audit Committee and the Board all material facts, which could reasonably be considered to be relevant to qualifications and independence of the PwC for the purposes of this engagement.

Scope of Review

In connection with the preparation and rendering of this Fairness Opinion, PwC has reviewed and, where it considered appropriate, relied upon, among other things, the following:

- the letter of intent from Superior Plus to Ballard dated September 25, 2008;
- the draft arrangement agreement between Superior Plus and Ballard dated October 30, 2008;
- a memorandum from Stikeman Elliott LLP dated October 23, 2008 providing a summary of the Proposed Transaction;
- a letter of representation from senior management of the Company ("Management");
- the audited financial statements of the Company for each of the fiscal years ended December 31, 2003 to 2007;
- the quarterly unaudited financial statements of the Company for each of the three-month periods ended March 31, 2008 and June 30, 2008;
- a copy of the Management Information Circular of the Company dated December 13, 2007;
- corporate income tax returns of Ballard and Ballard Generation Systems Inc. as well as schedules prepared by Management summarizing the nature and estimated amount of the Tax Pools as at December 31, 2008;
- a Management prepared 20 year financial plan for Ballard for each of the years ending December 31, 2008 to 2028 (the "Financial Plan"); and

- copies of recent meeting minutes of the Board and the Audit Committee.

PwC has also done the following in relation to the preparation of the Fairness Opinion:

- held discussions with representatives of Management and its professional advisors regarding the Proposed Transaction;
- held discussions with representatives of Management with respect to the current operations and the future prospects of Ballard's existing business;
- reviewed recent comparable market transactions; and
- reviewed other publicly available information concerning the Company.

PwC has been provided with full access to all information and documents requested from Management, the Audit Committee and the Board.

Restrictions and Limitations

The Fairness Opinion has been provided for the use of the Audit Committee and the Board and should not be construed as a recommendation to vote in favour of the Proposed Transaction. The Fairness Opinion may not be used by any other person or relied upon by any other person without the express prior written consent of PwC.

PwC will not be held liable for any losses sustained by any person should this document be circulated, distributed, published, reproduced or used contrary to the provisions of this paragraph. In addition, pursuant to PwC's engagement letter dated October 14, 2008, PwC's liability is limited, and PwC will be indemnified by Ballard under certain circumstances.

PwC has relied upon the accuracy, completeness and fair presentation of all financial and other information that was obtained from public sources or that was provided by Management (collectively the "Information"). Parts of the Information were received or obtained by PwC directly or indirectly, and in various ways (oral, written, inspection), from third parties (i.e. individuals or entities other than Ballard and its directors, officers and employees). PwC has assumed that this information was complete, accurate, and not misleading and did not omit any material facts. The Fairness Opinion is conditional upon such completeness, accuracy, and fair presentation. Subject to the exercise of professional judgment and except as expressly described herein, PwC has not attempted to verify independently the completeness, accuracy or fair presentation of any of the Information.

With respect to the Financial Plan and estimates provided to PwC and used in its analyses, projecting future results is inherently subject to uncertainty. PwC assumed, however, that such budgets, forecasts, projections, and estimates have been reasonably prepared on bases reflecting the best currently available estimates and judgments of Management. By its nature, the forecast information provided by Management will likely not occur as projected and unanticipated events and circumstances may occur that may materially alter the analyses and conclusions set out herein. PwC has not undertaken any review of whether the future oriented data provided comply with existing standards, such as those issued by the Canadian Institute of Chartered Accountants ("CICA") or any other accounting body.

Although PwC's mandate includes a review of the Tax Pools, it does not constitute a formal opinion or estimate of the value of the Tax Pools, nor should it be construed as such. In addition, PwC gives no representations or assurances with respect to the following:

- the structure and mechanics of the Proposed Transaction;
- the ability of Ballard or Superior Plus to utilize the Tax Pools; and
- the income tax consequences to the Ballard Shareholders, if any, of agreeing to the Proposed Transaction.

The Fairness Opinion must be considered in its entirety, as selecting and relying on only a specific portion of the analysis or factors considered by PwC, without considering all factors and analyses together, could create a misleading view of the processes underlying the Fairness Opinion. The preparation of a Fairness Opinion is a complex process and it is not appropriate to extract partial analyses or make summary descriptions. Any attempt to do so could lead to undue and incorrect emphasis on any particular factor or analysis.

Nothing contained herein is to be construed as a tax or legal interpretation, an opinion on any contract or document, or a recommendation to invest or divest.

Senior management of Ballard represented to PwC that among other things:

- The information provided orally or in writing by, or in the presence of, an officer or employee of Ballard for purposes of preparing the Fairness Opinion was, at the date the information was provided to PwC, fairly and reasonably presented and complete, true and correct in all material respects, and did not, and does not, contain any untrue statement of material fact in respect of Ballard or the Proposed Transaction; and
- Since the dates on which the information was provided to PwC, except as disclosed in writing to PwC, there has been no material change, financial or otherwise, in the financial condition, assets, liabilities (contingent or otherwise), business, operations or prospects of Ballard and no material change has occurred in the information or any

part thereof which would have, or which could reasonably be expected to have, a material effect on the Fairness Opinion.

PwC is not commenting on, nor is in a position to comment on, the likely trading price of Ballard shares, Newco shares or the Superior Plus units as a result of entering into the Proposed Transaction.

The Fairness Opinion is limited to the fairness of the Proposed Transaction, from a financial point of view, to the Ballard Shareholders, not the strategic merits of the Proposed Transaction. The Fairness Opinion does not provide assurance that the Proposed Consideration is necessarily the maximum amount that could be received by Ballard. It represents an impartial expert judgment, not a statement of facts. In addition, the Fairness Opinion does not express an opinion about the fairness of the amount or nature of the compensation to any of the company's officers, directors or employees, or class of such persons, relative to the compensation to the Ballard Shareholders.

This Fairness Opinion is rendered as of the date of this letter, on the basis of financial, economic, market and other general business and financial conditions currently prevailing, and the conditions and prospects, financial and otherwise, of Ballard as they were reflected in the information and documents reviewed by PwC and as they were represented to PwC in discussions with Management.

PwC reserves the right to review the Fairness Opinion and, should PwC deem it necessary, to make revisions in light of any information that existed at the time, which might become known to PwC at a later date.

PwC disclaims any undertaking or obligation to advise any person of any change in any fact or matter affecting this Fairness Opinion which may come or be brought to PwC's attention after the date hereof.

Assumptions

The Fairness Opinion is based on several assumptions, including the following, any changes in which could have a significant impact on PwC's assessment of the fairness of the Proposed Transaction:

1. The Proposed Transaction will be completed as described in the draft agreements and term sheets provided to us;

2. The Financial Plan represents Management's best estimate as to the future profitability of Ballard;

3. The amount, classification and expiry dates of the various tax attributes which makeup the Tax Pools at December 31, 2008 are as provided to us by Management; and

4. A combined federal and BC tax rate of 30% for fiscal 2009 and the foreseeable future.

Approach and methodology

The assessment of fairness from a financial point of view must be determined in the context of each particular transaction. PwC has based this Fairness Opinion on methods, approaches and techniques that it considers appropriate in the circumstances.

In order to assess the fairness of the Proposed Transaction from a financial point of view to the Ballard Shareholders, PwC considered a number of matters including, but not limited to, the following:

1. A quantitative comparison of the following two scenarios:

   Scenario 1 – Acceptance of the Proposed Transaction by the Ballard Shareholders: (receipt of the Proposed Consideration at the closing date); and

   Scenario 2 – Rejection of the Proposed Transaction by the Ballard Shareholders: (assumes utilization of the Tax Pools over time by Ballard).

2. An analysis of the process undertaken by the Board and Management with respect to the Proposed Transaction; and

3. A comparison of the Proposed Transaction to recent comparable market transactions.

For the purpose of our analysis we have been guided by the concept of fair market value. Fair market value is generally defined as the highest price available in an open and unrestricted market between informed and prudent parties, acting at arm's length and under no compulsion to act, expressed in terms of money or money's worth.

Other Fairness Considerations

In assessing the fairness of the Proposed Transaction, PwC has also given consideration to the following factors:

1. The structure and terms of the Proposed Transaction as compared to recent comparable transactions;

2. Newco will carry on business as successor to Ballard;

3. The limited number of counterparties who may be willing and able to enter into a similar transaction to that of the Proposed Transaction at a level of consideration comparable to the Proposed Consideration;

4. The risk of new tax legislation being instituted which could prevent or reduce the attractiveness of transactions such as the Proposed Transaction;

5. The Proposed Transaction provides Ballard with financing, which may or may not be available in the public market, particularly given consideration to current market conditions; and

6. Other benefits to Newco resulting from the acceptance by the Ballard Shareholders of the Proposed Transaction.

Opinion

Based on our scope of review and subject to the restrictions, limitations and assumptions contained in this letter, PwC is of the opinion that the Proposed Transaction is fair from a financial point of view to the Ballard Shareholders.

Yours very truly,

PricewaterhouseCoopers LLP

APPENDIX "F"

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS OF NEWCO

PRO FORMA FINANCIAL INFORMATION

Overview

The following unaudited pro forma consolidated financial statements have been prepared on the basis of assumptions described in the notes thereto. The unaudited pro forma consolidated balance sheet was prepared as at September 30, 2008 as if the Arrangement had occurred on September 30, 2008, and the unaudited pro forma consolidated statements of operations were prepared for the year ended December 31, 2007 and the nine months ended September 30, 2008 as if the Arrangement had occurred as of January 1, 2007. As described in note 1, these pro forma consolidated financial statements have been prepared on the basis of accounting principles in effect at the date of announcement of the Arrangement. These statements are not necessarily indicative of what the financial position or results of operations would have been had the Arrangement occurred on the dates or for the periods indicated and do not purport to indicate future results of operations. In addition, they do not reflect any cost savings or other synergies that may result from the Arrangement.

The unaudited pro forma consolidated financial statements should be read in conjunction with the historical consolidated financial statements and related notes which are incorporated by reference into this Information Circular.

BALLARD POWER SYSTEMS INC.

Pro Forma Consolidated Balance Sheet

(Unaudited)

As at September 30, 2008

(In thousands of U.S. dollars)

	Newco (note 3)	Ballard Power Systems Inc.	Pro Forma Adjustments (note 2)	Newco Pro Forma Consolidated (note 1)
Assets				
Current assets:				
Cash and cash equivalents	$ -	$ 18,140	$ 33,000	$ 51,140
Short-term investments	-	38,997	-	38,997
Accounts receivable	-	12,482	-	12,842
Inventories	-	14,926	-	14,926
Prepaid expenses and other current assets	-	858	-	858
	-	85,763	33,000	118,763
Property, plant and equipment	-	39,557	-	39,557
Intangible assets	-	3,870	-	3,870
Goodwill	-	48,106	-	48,106
Investments	-	4,768	-	4,768
	$ -	$ 182,064	$ 33,000	$ 215,064
Liabilities and Shareholders' Equity				
Current liabilities:				
Accounts payable and accrued liabilities	$ -	$ 15,391	$ -	$ 15,391
Deferred revenue	-	1,342	-	1,342
Accrued warranty liabilities	-	1,748	-	1,748
	-	18,481	-	18,481
Long-term liabilities	-	18,957	-	18,957
	-	37,438	-	37,438
Shareholders' equity:				
Share capital	-	832,679	-	832,679
Contributed surplus	-	248,762	33,000	281,762
Accumulated deficit	-	(936,579)	-	(936,579)
Cumulative translation adjustment	-	(236)	-	(236)
	-	144,626	33,000	177,626
	$ -	$ 182,064	$ 33,000	$ 215,064

See accompanying notes to the unaudited pro forma consolidated financial statements.

BALLARD POWER SYSTEMS INC.

Pro Forma Consolidated Statement of Operations

(Unaudited)

For the nine months ended September 30, 2008

(In thousands of U.S. dollars, except per share amounts and number of shares)

	Newco (note 3)	Ballard Power Systems Inc	Pro Forma Adjustments (note 2)	Newco Pro Forma Consolidated (note 1)
Revenues:				
Product and service revenues	$ -	$ 35,144	$ -	$ 35,144
Engineering development revenue	-	5,535	-	5,535
Total revenues	-	40,679	-	40,679
Cost of revenues and expenses:				
Cost of product and service revenues	-	30,514	-	30,514
Research and product development	-	29,215	-	29,215
General and administrative	-	10,109	-	10,109
Marketing and business development	-	5,584	-	5,584
Depreciation and amortization	-	4,478	-	4,478
Total cost of revenues and expenses	-	79,900	-	79,900
Loss before undernoted	-	(39,221)	-	(39,221)
Investment and other income	-	2,224	-	2,224
Gain on disposal of long-lived assets	-	(18)	-	(18)
Gain on sale of assets	-	96,845	-	96,845
Equity in loss of associated companies	-	(7,707)	-	(7,707)
Income before income taxes	-	52,123	-	52,123
Income taxes	-	16	-	16
Net income for the period	$ -	$ 52,107	$ -	$ 52,107
Basic earnings per share		$ 0.61		$ 0.61
Diluted earnings per share		$ 0.60		$ 0.60
Weighted average number of common shares outstanding – Basic		85,864,530		85,864,530
Weighted average number of common shares outstanding –		86,588,462		

Diluted	86,588,462

See accompanying notes to the unaudited pro forma consolidated financial statements.

BALLARD POWER SYSTEMS INC.

Pro Forma Consolidated Statement of Operations

(Unaudited)

For the year ended December 31, 2007

(In thousands of U.S. dollars, except per share amounts and number of shares)

	Newco (note 3)	Ballard Power Systems Inc.	Pro Forma Adjustmen (note 2)
Revenues:			
Product and service revenues	$ -	$ 43,352	$
Engineering development revenue	-	22,180	
Total revenues	-	65,532	

Cost of revenues and expenses:

The following is a summary of the principal terms of the amended revolving credit facility.

Structure

The amended revolving credit facility consists of a revolving borrowing base loan of up to $100.0 million, with the ability of Unifi to request that the borrowing capacity be increased up to $150.0 million under certain circumstances. We currently do not have commitments for the additional $50.0 million of availability. Availability under the amended revolving credit facility is based on the sum of:

(a) 90% of eligible accounts receivable due from factors; plus

(b) 85% of eligible domestic and Canadian accounts receivable; plus

(c) 80% of eligible foreign accounts receivable up to a maximum amount of $10.0 million; plus

(d) the lesser of:

(i) 65% of total eligible inventory; or

(ii) 85% of net orderly liquidation value (as defined) of total eligible inventory.

Availability under the amended revolving credit facility may be further reduced under certain circumstances, including the setting of such reserves as BoA establishes in its reasonable credit judgment. Customary conditions precedent must be satisfied prior to the funding of any loan, including a condition precedent to the funding of the initial loans that we have a minimum availability of at least $35.0 million.

As of June 25, 2006, there were no amounts outstanding under our amended revolving credit facility, and based on our calculation as of that date, $94.2 million was available for borrowing under the borrowing base of this facility (net of approximately $5.8 million to support outstanding letters of credit).

Interest and Fees

Borrowings under the amended revolving credit facility bear interest at rates selected periodically by us of LIBOR plus 1.50% to 2.25% and/or prime plus 0.00% to 0.50%. The interest rate matrix is based on our excess availability under the amended revolving credit facility. The amended revolving credit facility also includes a 0.25% LIBOR margin pricing reduction if our fixed charge coverage ratio is greater than 1.5 to 1.0.

We agreed to pay certain fees and expenses and to provide certain indemnities, all of which were customary for such financings. We also agreed to pay an unused line fee at the beginning of each month equal to the amount by which the Maximum Revolver Amount (as defined in the amended revolving credit facility) exceeds the sum of the average daily outstanding amount of revolving loans and the average daily undrawn face amount of outstanding letters of credit.

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Term

The amended revolving credit facility has an initial term of five years, terminating on May 15, 2011.

Security and Guarantees

The borrowings under the amended revolving credit facility are collateralized by first-priority liens, subject to permitted liens, on substantially all of our and our subsidiary guarantors inventory, accounts receivable, general intangibles (other than uncertificated capital stock of subsidiaries and other persons), investment property (other than capital stock of subsidiaries and other persons), chattel paper, documents, instruments, supporting obligations, letter of credit rights, deposit accounts and other related personal property and all proceeds relating to the above, other than certain excluded assets. The borrowings under the amended revolving credit facility are collateralized by second-priority liens, subject to permitted liens, on our and our subsidiary guarantors assets that secure the notes and guarantees on a first-priority basis. Guarantors of the notes also act as co-borrowers under the amended revolving credit facility.

Covenants

The amended revolving credit facility contains affirmative and negative customary covenants for asset based loans that restrict future borrowings and capital spending. The covenants under the amended revolving credit facility are more restrictive than those in the indenture. The covenants include, without limitation, restrictions and limitations on:

- sales of assets,
- consolidation, merger, dissolution of us or any subsidiary guarantor and any domestic subsidiary,
- the issuance of our capital stock and that of our subsidiaries,
- encumbrances on our property and that of any subsidiary guarantor and any domestic subsidiary,
- the incurrence of indebtedness by us, any subsidiary guarantor or any domestic subsidiary,
- the making of loans or investments by us, any subsidiary guarantor or any domestic subsidiary,
- the declaration of dividends and redemptions by us or any subsidiary guarantor,
- transactions with affiliates by us or any subsidiary guarantor, and
- the repurchase by us of the notes.

Under the amended revolving credit facility, if borrowing capacity is less than $25.0 million at any time during the quarter, covenants also include a required minimum fixed charge coverage ratio of 1.1 to 1.0. In addition, maximum capital expenditures are limited to $30.0 million per fiscal year (subject to pro forma

availability greater than $25.0 million) with a 75% one-year unused carry forward. The amended revolving credit facility also permits us to make distributions, subject to standard criteria, as long as pro forma excess availability is greater than $25.0 million both before and after giving effect to such distributions, subject to certain exceptions. Under the amended revolving credit facility, acquisitions by us are subject to pro forma covenant compliance. In addition, under the amended revolving credit facility, receivables are subject to cash dominion if excess availability is below $25.0 million.

Events of Default

The amended revolving credit facility contains events of default customary for such financings, including, but not limited to, nonpayment of principal, interest, fees or other amounts when due; violation of covenants;

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failure of any representation or warranty to be true in all material respects when made or deemed made; cross default; change in control; bankruptcy events; material judgments; assignments made for the benefit of creditors; and actual asserted invalidity of the loan documents. Such events of default allow for certain grace periods and materiality concepts.

Letter of Credit Facility

The amended revolving credit facility includes a letters of credit facility arranged through, or back stopped by, BoA, of up to an aggregate amount at any time outstanding of $20.0 million. Certain reserves against the revolving loan availability are required in connection with the letters of credit.

2008 Notes

The 2008 notes mature on February 1, 2008 and bear interest at the rate of 6 1/2%.

On April 28, 2006, we commenced a tender offer for the 2008 notes in which $248.7 million of 2008 notes, representing 99.5% of the then outstanding aggregate principal amount of 2008 notes, were tendered and purchased at a purchase price of 100.0% of their principal amount plus accrued but unpaid interest to, but not including, May 26, 2006. The $1.3 million in aggregate principal amount of 2008 notes that were not tendered in the tender offer remain outstanding in accordance with their amended terms. See Prospectus Summary The Refinancing Transactions Tender Offer for 2008 Notes.

Indebtedness of Unifi do Brasil

Our subsidiary, Unifi do Brasil, receives loans from the government of the State of Minas Gerais to finance 70% of the value added taxes due by Unifi do Brasil to the State of Minas Gerais. These loans were granted as part of a 24 month tax incentive to build a manufacturing facility in the State of Minas Gerais. The loans have a 2.5% origination fee and bear an effective interest rate equal to 50% of the Brazilian inflation rate, which currently is significantly lower than the Brazilian prime interest rate. The loans are collateralized by a performance bond letter issued by a Brazilian bank, which secures the performance by Unifi do Brasil of its obligations under the loans. In return for this performance bond letter, Unifi do Brasil makes certain cash deposits with the Brazilian bank. The deposits made by Unifi do Brasil earn interest at a rate equal to approximately 100% of the Brazilian prime interest rate. These tax incentives will end in September 2008.

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THE EXCHANGE OFFER

Terms of the Exchange Offer

We are offering to exchange our exchange notes for a like aggregate principal amount of our initial notes.

The exchange notes that we propose to issue in this exchange offer will be substantially identical to our initial notes except that, unlike our initial notes, the exchange notes will have no transfer restrictions or registration rights. You should read the description of the exchange notes in the section in this prospectus entitled Description of the Notes.

We reserve the right in our sole discretion to purchase or make offers for any initial notes that remain outstanding following the expiration or termination of this exchange offer and, to the extent permitted by applicable law, to purchase initial notes in the open market or privately negotiated transactions, one or more additional tender or exchange offers or otherwise. The terms and prices of these purchases or offers could differ significantly from the terms of this exchange offer.

Expiration Date; Extensions; Amendments; Termination

This exchange offer will expire at 5:00 p.m., New York City time, on January 23, 2007, unless we extend it in our reasonable discretion. The expiration date of this exchange offer will be at least 20 business days after the commencement of the exchange offer in accordance with Rule 14e-1(a) under the Exchange Act.

We expressly reserve the right to delay acceptance of any initial notes, extend or terminate this exchange offer and not accept any initial notes that we have not previously accepted if any of the conditions described below under Conditions to the Exchange Offer have not been satisfied or waived by us. We will notify the exchange agent of any extension by oral notice promptly confirmed in writing or by written notice. We will also notify the holders of the initial notes by a press release or other public announcement communicated before 9:00 a.m., New York City time, on the next business day after the previously scheduled expiration date unless applicable laws require us to do otherwise.

We also expressly reserve the right to amend the terms of this exchange offer in any manner. If we make any material change, we will promptly disclose this change in a manner reasonably calculated to inform the holders of our initial notes of the change including providing public announcement or giving oral or written notice to these holders. A material change in the terms of this exchange offer could include a change in the timing of the exchange offer, a change in the exchange agent and other similar changes in the terms of this exchange offer. If we make any material change to this exchange offer, we will disclose this change by means of a post-effective amendment to the registration statement which includes this prospectus and will distribute an amended or supplemented prospectus to each registered holder of initial notes. In addition, we will extend this exchange offer for an additional five to ten business days as required by the Exchange Act, depending on the significance of the amendment, if the exchange offer would otherwise expire during that period. We will promptly notify the exchange agent by oral notice, promptly confirmed in writing, or written notice of any delay in acceptance, extension, termination or amendment of this exchange offer.

Procedures for Tendering Initial Notes

Proper Execution and Delivery of Letters of Transmittal

To tender your initial notes in this exchange offer, you must use one of the three alternative procedures described below:

(1) *Regular delivery procedure*: Complete, sign and date the letter of transmittal, or a facsimile of the letter of transmittal. Have the signatures on the letter of transmittal guaranteed if required by the letter of transmittal.

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Mail or otherwise deliver the letter of transmittal or the facsimile together with the certificates representing the initial notes being tendered and any other required documents to the exchange agent on or before 5:00 p.m., New York City time, on the expiration date.

(2) *Book-entry delivery procedure*: Send a timely confirmation of a book-entry transfer of your initial notes, if this procedure is available, into the exchange agent s account at The Depository Trust Company in accordance with the procedures for book-entry transfer described under Book-Entry Delivery Procedure below, on or before 5:00 p.m., New York City time, on the expiration date.

(3) *Guaranteed delivery procedure*: If time will not permit you to complete your tender by using the procedures described in (1) or (2) above before the expiration date and this procedure is available, comply with the guaranteed delivery procedures described under Guaranteed Delivery Procedure below.

The method of delivery of the initial notes, the letter of transmittal and all other required documents is at your election and risk. Instead of delivery by mail, we recommend that you use an overnight or hand-delivery service. If you choose the mail, we recommend that you use registered mail, properly insured, with return receipt requested. In all cases, you should allow sufficient time to assure timely delivery. You should not send any letters of transmittal or initial notes to us. You must deliver all documents to the exchange agent at its address provided below. You may also request your broker, dealer, commercial bank, trust company or nominee to tender your initial notes on your behalf.

Only a holder of initial notes may tender initial notes in this exchange offer. A holder is any person in whose name initial notes are registered on our books or any other person who has obtained a properly completed bond power from the registered holder.

If you are the beneficial owner of initial notes that are registered in the name of a broker, dealer, commercial bank, trust company or other nominee and you wish to tender your notes, you must contact that registered holder promptly and instruct that registered holder to tender your notes on your behalf. If you wish to tender your initial notes on your own behalf, you must, before completing and executing the letter of transmittal and delivering your initial notes, either make appropriate arrangements to register the ownership of these notes in your name or obtain a properly completed bond power from the registered holder. The transfer of registered ownership may take considerable time.

You must have any signatures on a letter of transmittal or a notice of withdrawal guaranteed by:

(1) a member firm of a registered national securities exchange or of the National Association of Securities Dealers, Inc.,

(2) a commercial bank or trust company having an office or correspondent in the United States, or

(3) an eligible guarantor institution within the meaning of Rule 17Ad-15 under the Exchange Act, unless the initial notes are tendered:

(1) by a registered holder or by a participant in The Depository Trust Company (DTC) whose name appears on a security position listing as the owner, who has not completed the box entitled Special Issuance Instructions or Special Delivery Instructions on the letter of transmittal and only if the exchange notes are being issued directly to this registered holder or deposited into this participant s account at The Depository Trust Company, or

(2) for the account of a member firm of a registered national securities exchange or of the National Association of Securities Dealers, Inc., a commercial bank or trust company having an office or correspondent in the United States or an eligible guarantor institution within the meaning of Rule 17Ad-15 under the Exchange Act.

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If the letter of transmittal or any bond powers are signed by:

(1) the recordholder(s) of the initial notes tendered: the signature must correspond with the name(s) written on the face of the initial notes without alteration, enlargement or any change whatsoever.

(2) a participant in DTC: the signature must correspond with the name as it appears on the security position listing as the holder of the initial notes.

(3) a person other than the registered holder of any initial notes: these initial notes must be endorsed or accompanied by bond powers and a proxy that authorize this person to tender the initial notes on behalf of the registered holder, in satisfactory form to us as determined in our sole discretion, in each case, as the name of the registered holder or holders appears on the initial notes.

(4) trustees, executors, administrators, guardians, attorneys-in-fact, officers of corporations or others acting in a fiduciary or representative capacity: these persons should so indicate when signing. Unless waived by us, evidence satisfactory to us of their authority to so act must also be submitted with the letter of transmittal.

To tender your initial notes in this exchange offer, you must make the following representations:

(1) you are authorized to tender, sell, assign and transfer the initial notes tendered and to acquire exchange notes issuable upon the exchange of such tendered initial notes, and we will acquire good and unencumbered title thereto, free and clear of all liens, restrictions, charges and encumbrances and not subject to any adverse claim when the same are accepted by us,

(2) any exchange notes acquired by you under the exchange offer are being acquired in the ordinary course of business, whether or not you are the holder,

(3) you or any other person who receives exchange notes, whether or not such person is the holder of the exchange notes, has an arrangement or understanding with any person to participate in a distribution of such exchange notes within the meaning of the Securities Act and is not participating in, and does not intend to participate in, the distribution of such exchange notes within the meaning of the Securities Act,

(4) you or such other person who receives exchange notes, whether or not such person is the holder of the exchange notes, is not an affiliate, as defined in Rule 405 of the Securities Act, of ours, or if you or such other person is an affiliate, you or such other person will comply with the registration and prospectus delivery requirements of the Securities Act to the extent applicable,

(5) if you are not a broker-dealer, you represent that you are not engaging in, and do not intend to engage in, a distribution of exchange notes, and

(6) if you are a broker-dealer that will receive exchange notes for your own account in exchange for initial notes, you represent that the initial notes to be exchanged for the exchange notes were acquired by you as a result of market-making or other trading activities and acknowledge that you will deliver a prospectus in connection with any resale, offer to resell or other transfer of such exchange notes.

You must also warrant that the acceptance of any tendered initial notes by the issuer and the issuance of exchange notes in exchange for the tendered initial notes shall constitute performance in full by the issuer of its obligations under the registration rights agreement relating to the initial notes.

To effectively tender notes through The Depository Trust Company, the financial institution that is a participant in The Depository Trust Company will electronically transmit its acceptance through the Automatic Tender Offer Program. The Depository Trust Company will then edit and verify the acceptance and send an agent s message to the exchange agent for its acceptance. An agent s message is a message transmitted by The

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Depository Trust Company to the exchange agent stating that The Depository Trust Company has received an express acknowledgment from the participant in The Depository Trust Company tendering the notes that this participant has received and agrees to be bound by the terms of the letter of transmittal, and that we may enforce this agreement against this participant.

Book-Entry Delivery Procedure

Any financial institution that is a participant in The Depository Trust Company s systems may make book-entry deliveries of initial notes by causing The Depository Trust Company to transfer these initial notes into the exchange agent s account at The Depository Trust Company in accordance with The Depository Trust Company s procedures for transfer. To effectively tender notes through The Depository Trust Company, the financial institution that is a participant in The Depository Trust Company will electronically transmit its acceptance through the Automatic Tender Offer Program. The Depository Trust Company will then edit and verify the acceptance and send an agent s message to the exchange agent for its acceptance. An agent s message is a message transmitted by The Depository Trust Company to the exchange agent stating that The Depository Trust Company has received an express acknowledgment from the participant in The Depository Trust Company tendering the notes that this participation has received and agrees to be bound by the terms of the letter of transmittal, and that we may enforce this agreement against this participant. The exchange agent will make a request to establish an account for the initial notes at The Depository Trust Company for purposes of the exchange offer within two business days after the date of this prospectus.

A delivery of initial notes through a book-entry transfer into the exchange agent s account at The Depository Trust Company will only be effective if an agent s message or the letter of transmittal or a facsimile of the letter of transmittal with any required signature guarantees and any other required documents is transmitted to and received by the exchange agent at the address indicated below under Exchange Agent on or before the expiration date unless the guaranteed delivery procedures described below are complied with. **Delivery of documents to The Depository Trust Company does not constitute delivery to the exchange agent.**

Guaranteed Delivery Procedure

If you are a registered holder of initial notes and desire to tender your notes, and (1) these notes are not immediately available, (2) time will not permit your notes or other required documents to reach the exchange agent before the expiration date or (3) the procedures for book-entry transfer cannot be completed on a timely basis and an agent s message delivered, you may still tender in this exchange offer if:

(1) you tender through a member firm of a registered national securities exchange or of the National Association of Securities Dealers, Inc., a commercial bank or trust company having an office or correspondent in the United States, or an eligible guarantor institution within the meaning of Rule 17Ad-15 under the Exchange Act,

(2) on or before the expiration date, the exchange agent receives a properly completed and duly executed letter of transmittal or facsimile of the letter of transmittal, and a notice of guaranteed delivery, substantially in the form provided by us, with your name and address as holder of the initial notes and the amount of notes tendered, stating that the tender is being made by that letter and notice and guaranteeing that within three New York Stock Exchange trading days after the expiration date the certificates for all the initial notes tendered, in proper form for transfer, or a book-entry confirmation with an agent s message, as the case may be, and any other documents required by the letter of transmittal will be deposited by the eligible institution with the exchange agent, and

(3) the certificates for all your tendered initial notes in proper form for transfer or a book-entry confirmation as the case may be, and all other documents required by the letter of transmittal are received by the exchange agent within three New York Stock Exchange trading days after the expiration date.

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Acceptance of Initial Notes for Exchange; Delivery of Exchange Notes

Your tender of initial notes will constitute an agreement between you and us governed by the terms and conditions provided in this prospectus and in the related letter of transmittal.

We will be deemed to have received your tender as of the date when your duly signed letter of transmittal accompanied by your initial notes tendered, or a timely confirmation of a book-entry transfer of these notes into the exchange agent s account at The Depository Trust Company with an agent s message, or a notice of guaranteed delivery from an eligible institution is received by the exchange agent.

All questions as to the validity, form, eligibility, including time of receipt, acceptance and withdrawal of tenders will be determined by us in our sole discretion. Our determination will be final and binding.

We reserve the absolute right to reject any and all initial notes not properly tendered or any initial notes which, if accepted, would, in our opinion or our counsel s opinion, be unlawful. We also reserve the absolute right to waive any conditions of this exchange offer or irregularities or defects in tender as to particular notes with the exception of conditions to this exchange offer relating to the obligations of broker dealers, which we will not waive. If we waive a condition to this exchange offer, the waiver will be applied equally to all note holders. Our interpretation of the terms and conditions of this exchange offer, including the instructions in the letter of transmittal, will be final and binding on all parties. Unless waived, any defects or irregularities in connection with tenders of initial notes must be cured within such time as we shall determine. We, the exchange agent or any other person will be under no duty to give notification of defects or irregularities with respect to tenders of initial notes. We and the exchange agent or any other person will incur no liability for any failure to give notification of these defects or irregularities. Tenders of initial notes will not be deemed to have been made until such irregularities have been cured or waived. The exchange agent will return without cost to their holders any initial notes that are not properly tendered and as to which the defects or irregularities have not been cured or waived promptly following the expiration date.

If all the conditions to the exchange offer are satisfied or waived on the expiration date, we will accept all initial notes properly tendered and will issue the exchange notes promptly thereafter. Please refer to the section of this prospectus entitled Conditions to the Exchange Offer below. For purposes of this exchange offer, initial notes will be deemed to have been accepted as validly tendered for exchange when, as and if we give oral or written notice of acceptance to the exchange agent.

We will issue the exchange notes in exchange for the initial notes tendered under a notice of guaranteed delivery by an eligible institution only against delivery to the exchange agent of the letter of transmittal, the tendered initial notes and any other required documents, or the receipt by the exchange agent of a timely confirmation of a book-entry transfer of initial notes into the exchange agent s account at The Depository Trust Company with an agent s message, in each case, in form satisfactory to us and the exchange agent.

If any tendered initial notes are not accepted for any reason provided by the terms and conditions of this exchange offer or if initial notes are submitted for a greater principal amount than the holder desires to exchange, the unaccepted or non-exchanged initial notes will be returned without expense to the tendering holder, or, in the case of initial notes tendered by book-entry transfer procedures described above, will be credited to an account maintained with the book-entry transfer facility, promptly after withdrawal, rejection of tender or the expiration or termination of the exchange offer.

By tendering into this exchange offer, you will irrevocably appoint our designees as your attorney-in-fact and proxy with full power of substitution and resubstitution to the full extent of your rights on the notes tendered. This proxy will be considered coupled with an interest in the tendered notes. This appointment will be effective only when, and to the extent that we accept your notes in this exchange offer. All prior proxies on these notes will then be revoked and you will not be entitled to give any subsequent proxy. Any proxy that you may give

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subsequently will not be deemed effective. Our designees will be empowered to exercise all voting and other rights of the holders as they may deem proper at any meeting of note holders or otherwise. The initial notes will be validly tendered only if we are able to exercise full voting rights on the notes, including voting at any meeting of the note holders, and full rights to consent to any action taken by the note holders.

Withdrawal of Tenders

Except as otherwise provided in this prospectus, you may withdraw tenders of initial notes at any time before 5:00 p.m., New York City time, on the expiration date.

For a withdrawal to be effective, you must send a written or facsimile transmission notice of withdrawal to the exchange agent before 5:00 p.m., New York City time, on the expiration date at the address provided below under Exchange Agent and before acceptance of your tendered notes for exchange by us.

Any notice of withdrawal must:

(1) specify the name of the person having tendered the initial notes to be withdrawn,

(2) identify the notes to be withdrawn, including, if applicable, the registration number or numbers and total principal amount of these notes,

(3) be signed by the person having tendered the initial notes to be withdrawn in the same manner as the original signature on the letter of transmittal by which these notes were tendered, including any required signature guarantees, or be accompanied by documents of transfer sufficient to permit the trustee for the initial notes to register the transfer of these notes into the name of the person having made the original tender and withdrawing the tender,

(4) specify the name in which any of these initial notes are to be registered, if this name is different from that of the person having tendered the initial notes to be withdrawn, and

(5) if applicable because the initial notes have been tendered through the book-entry procedure, specify the name and number of the participant s account at The Depository Trust Company to be credited, if different than that of the person having tendered the initial notes to be withdrawn.

We will determine all questions as to the validity, form and eligibility, including time of receipt, of all notices of withdrawal and our determination will be final and binding on all parties. Initial notes that are withdrawn will be deemed not to have been validly tendered for exchange in this exchange offer.

The exchange agent will return without cost to their holders all initial notes that have been tendered for exchange and are not exchanged for any reason, promptly after withdrawal, rejection of tender or expiration or termination of this exchange offer.

You may retender properly withdrawn initial notes in this exchange offer by following one of the procedures described under Procedures for Tendering Initial Notes above at any time on or before the expiration date.

Conditions to the Exchange Offer

We will complete this exchange offer only if:

(1) there is no change in the laws and regulations which would reasonably be expected to impair our ability to proceed with this exchange offer,

(2) there is no change in the current interpretation of the staff of the SEC which permits resales of the exchange notes,

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(3) there is no stop order issued by the SEC or any state securities authority suspending the effectiveness of the registration statement which includes this prospectus or the qualification of the indenture for our exchange notes under the Trust Indenture Act of 1939 and there are no proceedings initiated or, to our knowledge, threatened for that purpose,

(4) there is no action or proceeding instituted or threatened in any court or before any governmental agency or body that would reasonably be expected to prohibit, prevent or otherwise impair our ability to proceed with this exchange offer, and

(5) we obtain all governmental approvals that we deem in our sole discretion necessary to complete this exchange offer.

These conditions are for our sole benefit. We may assert any one of these conditions regardless of the circumstances giving rise to it and may also waive any one of them, in whole or in part, at any time and from time to time, if we determine in our reasonable discretion that it has not been satisfied, subject to applicable law. Notwithstanding the foregoing, all conditions to the exchange offer must be satisfied or waived before the expiration of this exchange offer. If we waive a condition to this exchange offer, the waiver will be applied equally to all note holders. We will not be deemed to have waived our rights to assert or waive these conditions if we fail at any time to exercise any of them. Each of these rights will be deemed an ongoing right which we may assert at any time and from time to time.

If we determine that we may terminate this exchange offer because any of these conditions is not satisfied, we may:

(1) refuse to accept and return to their holders any initial notes that have been tendered,

(2) extend the exchange offer and retain all notes tendered before the expiration date, subject to the rights of the holders of these notes to withdraw their tenders, or

(3) waive any condition that has not been satisfied and accept all properly tendered notes that have not been withdrawn or otherwise amend the terms of this exchange offer in any respect as provided under the section in this prospectus entitled Expiration Date; Extensions; Amendments; Termination.

Accounting Treatment

We will record the exchange notes at the same carrying value as the initial notes as reflected in our accounting records on the date of the exchange. Accordingly, we will not recognize any gain or loss for accounting purposes. We will amortize the costs of the exchange offer and the unamortized expenses related to the issuance of the exchange notes over the term of the exchange notes.

Exchange Agent

We have appointed U.S. Bank National Association as exchange agent for this exchange offer. You should direct all questions and requests for assistance on the procedures for tendering and all requests for additional copies of this prospectus or the letter of transmittal to the exchange agent as follows:

U.S. Bank National Association

EP-MN-WSZN

60 Livingston Avenue

St. Paul, MN 55107

Facsimile Transmission: U.S. Bank National Association

(651) 495-8158

Confirm by Telephone: (800) 924-6802

Attention: Specialized Finance Department

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Fees and Expenses

We will bear the expenses of soliciting tenders in this exchange offer, including fees and expenses of the exchange agent and trustee and accounting, legal, printing and related fees and expenses.

We will not make any payments to brokers, dealers or other persons soliciting acceptances of this exchange offer. However, we will pay the exchange agent reasonable and customary fees for its services and will reimburse the exchange agent for its reasonable out-of-pocket expenses in connection with this exchange offer. We will also pay brokerage houses and other custodians, nominees and fiduciaries their reasonable out-of-pocket expenses for forwarding copies of the prospectus, letters of transmittal and related documents to the beneficial owners of the initial notes and for handling or forwarding tenders for exchange to their customers.

We will pay all transfer taxes, if any, applicable to the exchange of initial notes in accordance with this exchange offer. However, tendering holders will pay the amount of any transfer taxes, whether imposed on the registered holder or any other persons, if:

(1) certificates representing exchange notes or initial notes for principal amounts not tendered or accepted for exchange are to be delivered to, or are to be registered or issued in the name of, any person other than the registered holder of the notes tendered,

(2) tendered initial notes are registered in the name of any person other than the person signing the letter of transmittal, or

(3) a transfer tax is payable for any reason other than the exchange of the initial notes in this exchange offer.

If you do not submit satisfactory evidence of the payment of any of these taxes or of any exemption from this payment with the letter of transmittal, we will bill you directly the amount of these transfer taxes.

Your Failure to Participate in the Exchange Offer Will Have Adverse Consequences

The initial notes were not registered under the Securities Act or under the securities laws of any state and you may not resell them, offer them for resale or otherwise transfer them unless they are subsequently registered or resold under an exemption from the registration requirements of the Securities Act and applicable state securities laws. If you do not exchange your initial notes for exchange notes in accordance with this exchange offer, or if you do not properly tender your initial notes in this exchange offer, you will not be able to resell, offer to resell or otherwise transfer the initial notes unless they are registered under the Securities Act or unless you resell them, offer to resell or otherwise transfer them under an exemption from the registration requirements of, or in a transaction not subject to, the Securities Act.

In addition, except as set forth in this paragraph, you will not be able to obligate us to register the initial notes under the Securities Act. You will not be able to require us to register your initial notes under the Securities Act unless you notify us prior to 20 business days following the completion of the exchange offer that:

(1) you were prohibited by law or SEC policy from participating in the exchange offer;
(2) you may not resell the exchange notes you acquired in the exchange offer to the public without delivering a prospectus and the prospectus contained in the exchange offer registration statement is not appropriate or available for such resales by you; or

(3) you are a broker-dealer and hold initial notes acquired directly from us or any of our affiliates.

In these cases, the registration rights agreement requires us to file a registration statement for a continuous offering in accordance with Rule 415 under the Securities Act for the benefit of the holders of the initial notes

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described in this sentence. We do not currently anticipate that we will register under the Securities Act any notes that remain outstanding after completion of the exchange offer.

Delivery of Prospectus

Each broker-dealer that receives exchange notes for its own account in exchange for initial notes, where such initial notes were acquired by such broker-dealer as a result of market-making activities or other trading activities, must acknowledge that it will deliver a prospectus in connection with any resale of such exchange notes. See Plan of Distribution.

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DESCRIPTION OF THE NOTES

Unifi, Inc. issued the initial notes and will issue the exchange notes under an indenture among itself, the Guarantors and U.S. Bank National Association, as trustee. You can find the definitions of certain terms used in this description below under Certain Definitions. Certain defined terms used in this description but not defined below under Certain Definitions have the meanings assigned to them in the indenture. Copies of the indenture, the registration rights agreement, the Collateral Documents and the Intercreditor Agreement are available as set forth below under Additional Information. In this description, the term Unifi refers only to Unifi, Inc. and not to any of its subsidiaries. The term notes refers to Unifi s initial notes and exchange notes. The terms of the notes will include those stated in the indenture and those made part of the indenture by reference to the Trust Indenture Act of 1939, as amended.

The following description is a summary of the material provisions of the notes, the indenture, the registration rights agreement, the Collateral Documents and the Intercreditor Agreement. It does not restate any such agreement or instrument in its entirety. We urge you to read the notes, the indenture, the registration rights agreement, the Collateral Documents and the Intercreditor Agreement because they, and not this description, define your rights as holders of the notes.

The registered holder of a note will be treated as its owner for all purposes. Only registered holders will have rights under the indenture.

Brief Description of the Notes and the Subsidiary Guarantees

The Notes. The exchange notes will be:

- senior obligations of Unifi;

- secured by first-priority Liens and security interests, subject to Permitted Liens, in substantially all of the assets (other than inventory, accounts receivable, general intangibles (other than any uncertificated securities representing Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), investment property (other than Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), chattel paper, documents, instruments, supporting obligations, letter of credit rights, deposit accounts and other personal property, and all proceeds relating to any of the above, which secure the Credit Agreement on a first-priority basis) of Unifi and the Guarantors, including, but not limited to, the real property, fixtures, equipment, general intangibles with respect to any uncertificated securities representing the Capital Stock of any Subsidiary of Unifi or the Guarantors and any Person in which Unifi or a Guarantor has a direct interest, and investment property consisting of the Capital Stock of each Subsidiary of Unifi or the Guarantors and each other Person in which Unifi or a Guarantor has a direct interest, now owned or hereafter acquired by Unifi and the Guarantors, in each case, other than Excluded Assets and as further described under Security Assets Pledged as Collateral;

- secured by second-priority Liens and security interests, subject to Permitted Liens, in the inventory, accounts receivable, general intangibles (other than any uncertificated securities representing Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), investment property (other than Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), chattel paper, documents, instruments, supporting obligations, letter of credit rights, deposit accounts and other personal property, and all proceeds relating to any of the above, which secure the Credit Agreement on a first-priority basis, now owned or hereafter acquired by Unifi and the Guarantors, in each case, other than Excluded Assets and as further described under Security Assets Pledged as Collateral;

pari passu in right of payment with all existing and future senior Indebtedness of Unifi;

senior in right of payment to any future subordinated Indebtedness of Unifi;

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effectively subordinated to Unifi s obligations under the Credit Agreement to the extent the Second Priority Collateral secures such obligations on a first-priority basis;

effectively senior to all of Unifi s existing and future Indebtedness to the extent the First Priority Collateral secures the obligations under the notes on a first-priority basis;

unconditionally guaranteed by the Guarantors on a senior secured basis; and

effectively subordinated to all Indebtedness and other liabilities, including trade payables, of Unifi s non-guarantor Subsidiaries (other than Indebtedness and other liabilities owed to Unifi or a Guarantor).

The Subsidiary Guarantees. The exchange notes will be guaranteed by each of Unifi s current and future Domestic Subsidiaries.

Each Subsidiary Guarantee will be:

the senior obligation of the Guarantor;

secured by first-priority Liens and security interests, subject to Permitted Liens, in the First Priority Collateral now owned or hereafter acquired by the Guarantor;

secured by second-priority Liens and security interests, subject to Permitted Liens, in the Second Priority Collateral now owned or hereafter acquired by the Guarantor;

pari passu in right of payment with all existing and future senior Indebtedness of such Guarantor;

senior in right of payment to any existing and future subordinated Indebtedness of such Guarantor;

effectively subordinated to the Guarantor s obligations under the Credit Agreement to the extent the Second Priority Collateral secures such obligations on a first-priority basis; and

effectively senior to all of the Guarantor s existing and future Indebtedness to the extent the First Priority Collateral secures the obligations under the Subsidiary Guarantee on a first-priority basis.

As of June 25, 2006, Unifi and the Guarantors had total indebtedness of approximately $208.4 million, including $190.0 million outstanding under the initial notes, and $1.3 million outstanding under the 2008 notes.

Subject to certain limitations, the indenture permits Unifi and its Restricted Subsidiaries to incur additional Indebtedness.

As of June 25, 2006, the notes were effectively subordinated to $19.9 million of indebtedness and other liabilities of our non-guarantor subsidiaries, and our non-guarantor subsidiaries and we had assets of $32.4 million and $190.2 million, respectively, in equity investees. See Risk Factors Risks Related to The

Notes and This Offering The notes are effectively subordinated to the liabilities and preferred stock, if any, of our non-guarantor subsidiaries and our equity investees.

In the event of a bankruptcy, liquidation or reorganization of any of the non-guarantor Subsidiaries, such non-guarantor Subsidiaries will pay the holders of their debt and their trade creditors before they will be able to distribute any of their assets to Unifi or the Guarantors. The Guarantors generated 85.7% of our consolidated revenues in fiscal year 2006. See note 21 to our audited consolidated financial statements included in this prospectus for more detail about the division of our consolidated revenues and assets between our guarantor and non-guarantor Subsidiaries.

All of our Subsidiaries are Restricted Subsidiaries. However, under the circumstances described below under the caption Certain Covenants Designation of Unrestricted Subsidiaries, we will be permitted to designate certain of our Subsidiaries as Unrestricted Subsidiaries. Our Unrestricted Subsidiaries will not be

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subject to many of the restrictive covenants set forth in the indenture. Our Unrestricted Subsidiaries will not guarantee the notes.

Principal, Maturity and Interest

Unifi issued initial notes in the aggregate principal amount of $190.0 million on the Issue Date and will issue exchange notes with an initial maximum aggregate principal amount of up to $190.0 million. Unifi may issue additional notes under the indenture from time to time after this offering; *provided*, *however*, that the net cash proceeds from any such issuance of additional notes shall be deposited into the First Priority Collateral Account and invested by Unifi in Additional Assets; provided, further, that at least 95% of such net cash proceeds shall be used to acquire or invest in Additional Assets which are assets of the type that would constitute First Priority Collateral and which upon their acquisition shall constitute First Priority Collateral in accordance with the provisions of the Intercreditor Agreement. Any issuance of additional notes is subject to all of the covenants in the indenture, including the covenant described below under the caption Certain Covenants Incurrence of Indebtedness. The notes and any additional notes subsequently issued under the indenture will have the same terms (except as to issue date, issue price and first interest payment date) and will be treated as a single class for all purposes under the indenture, including, without limitation, waivers, amendments, redemptions and offers to purchase. Unifi will issue notes in denominations of $2,000 and integral multiples of $1,000 in excess thereof. The notes will mature on May 15, 2014.

Interest on the notes accrues at the rate of 11.50% per annum and will be payable semi-annually in arrears on May 15 and November 15, commencing on November 15, 2006. Unifi will make each interest payment to the holders of record on the immediately preceding May 1 and November 1.

Interest on the notes accrues from the date of original issuance or, if interest has already been paid, from the date it was most recently paid. Interest is computed on the basis of a 360-day year comprised of twelve 30-day months.

Methods of Receiving Payments on the Notes

If a holder of notes has given wire transfer instructions to Unifi, Unifi will pay all principal, interest and premium and Additional Interest, if any, on such holder s notes in accordance with those instructions. All other payments on the notes will be made at the office or agency of the paying agent and registrar within the City and State of New York unless Unifi elects to make interest payments by check mailed to the noteholders at their address set forth in the register of holders.

Unifi will pay principal, interest and premium and Additional Interest, if any, on each note in global form registered in the name of or held by DTC or its nominee in immediately available funds to DTC or its nominee, as the case may be, as the registered holder of such global note.

Paying Agent and Registrar for the Notes

The trustee acts as paying agent and registrar. Unifi may change the paying agent or registrar without prior notice to the holders of the notes, and Unifi or any of its Subsidiaries may act as paying agent or registrar.

Transfer and Exchange

A holder may transfer or exchange notes in accordance with the provisions of the indenture. The registrar and the trustee may require a holder, among other things, to furnish appropriate endorsements and transfer documents in connection with a transfer of notes. Holders will be required to pay all taxes due on transfer. Unifi will not be required to transfer or exchange any note selected for redemption. Also, Unifi will not be required to transfer or exchange any note for a period of 15 days before a selection of notes to be redeemed.

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Subsidiary Guarantees

Unifi s obligations under the notes and the indenture are guaranteed on a senior basis by each of Unifi s current and future Domestic Subsidiaries. These Subsidiary Guarantees are joint and several obligations of the Guarantors. Each Subsidiary Guarantee is secured by the portion of the Collateral, if any, owned by such Guarantor. The obligations of each Guarantor under its Subsidiary Guarantee are limited as necessary to prevent that Subsidiary Guarantee from constituting a fraudulent conveyance or transfer under applicable law. See Risk Factors Risks Related to the Notes and This Offering We and the guarantors may be subject to laws relating to fraudulent conveyance.

A Guarantor may not sell, assign, transfer, convey, lease or otherwise dispose of all or substantially all of its properties or assets to, or consolidate or merge with or into (whether or not such Guarantor is the surviving Person) another Person, other than Unifi or another Guarantor, unless:

(1) immediately after giving effect to such transaction, no Default or Event of Default exists; and

(2) either:

(a) the Person acquiring the property in any such sale, disposition or other transfer or the Person formed by or surviving any such consolidation or merger assumes all the obligations of such Guarantor under the indenture (including its Subsidiary Guarantee), the registration rights agreement, the Collateral Documents to which such Guarantor is a party and the Intercreditor Agreement pursuant to agreements reasonably satisfactory to the trustee and the Collateral Agent; or

(b) the sale, disposition or other transfer is made in compliance with the applicable provisions of the indenture.

The Subsidiary Guarantee of a Guarantor will be automatically released:

(1) in connection with any sale, disposition or other transfer (including through merger, consolidation or spin-off) of Equity Interests of such Guarantor, following which such Guarantor is no longer a Subsidiary of Unifi, to a Person that is not (after giving effect to such transaction) Unifi or a Restricted Subsidiary of Unifi, if such sale, disposition or other transfer is not prohibited by the applicable provisions of the indenture;

(2) with respect to any Foreign Subsidiary, the Guarantee which resulted in the creation of the Subsidiary Guarantee is released or discharged, except a discharge or release by or as a result of payment by such Foreign Subsidiary under such Guarantee;

(3) if Unifi designates such Guarantor as an Unrestricted Subsidiary in accordance with the applicable provisions of the indenture; or

(4) upon the Legal Defeasance, Covenant Defeasance or satisfaction and discharge of the notes and the Subsidiary Guarantees as provided below under the captions Legal Defeasance and Covenant Defeasance and Satisfaction and Discharge.

Optional Redemption

At any time prior to May 15, 2009, Unifi may, on any one or more occasions, redeem up to 35% of the aggregate principal amount of notes (without duplication for Exchange Notes issued in exchange for other notes issued under the indenture) issued under the indenture (including additional notes) at a redemption price of 111.50% of the principal amount thereof, plus accrued and unpaid interest and Additional Interest, if any, to, but excluding, the redemption date, with the net cash proceeds of one or more Equity Offerings, *provided* that:

(1) at least 65% of the aggregate principal amount of notes (without duplication for Exchange Notes issued in exchange for other notes issued under the indenture) issued under the indenture (excluding notes held by Unifi

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and its Subsidiaries but including additional notes) remains outstanding immediately after the occurrence of such redemption; and

(2) the redemption occurs within 90 days of the date of the closing of such Equity Offering.

Except pursuant to the preceding paragraph, the notes will not be redeemable at Unifi s option prior to May 15, 2010.

On and after May 15, 2010, Unifi may redeem all or a part of the notes upon not less than 30 nor more than 60 days notice except as otherwise provided under Selection and Notice below, at the redemption prices (expressed as percentages of principal amount) set forth below, plus accrued and unpaid interest and Additional Interest, if any, on the notes redeemed, to, but excluding, the applicable redemption date, if redeemed during the twelve-month period beginning on May 15 of the years indicated below:

Year	Percentage
2010	105.750%
2011	102.875%
2012 and thereafter	100.000%

Unless Unifi defaults in the payment of the redemption price, interest will cease to accrue on the notes or portions thereof called for redemption on the applicable redemption date. If the redemption date is on or after an interest payment record date and on or before the related interest payment date, the accrued and unpaid interest and Additional Interest, if any, will be paid to the holder in whose name the note is registered at the close of business on such record date, and no additional interest or Additional Interest, if any, will be payable to holders whose notes will be subject to redemption by Unifi.

Selection and Notice

If less than all of the notes are to be redeemed at any time, the trustee will select notes for redemption as follows:

(1) if the notes are listed on any national securities exchange, in compliance with the requirements of the principal national securities exchange on which the notes are listed; or

(2) if the notes are not listed on any national securities exchange, on a pro rata basis, by lot or by such method as the trustee deems fair and appropriate.

No notes of $2,000 or less shall be redeemed in part. Notices of redemption will be mailed by first class mail at least 30 but not more than 60 days before the redemption date to each holder of notes to be redeemed at its registered address, except that redemption notices may be mailed more than 60 days prior to a redemption date if the notice is issued in connection with a defeasance of the notes or a satisfaction and discharge of the indenture. Notices of redemption may not be conditional.

If any note is to be redeemed in part only, the notice of redemption that relates to that note will state the portion of the principal amount of that note that is to be redeemed. A new note in principal amount equal to the unredeemed portion of the original note will be issued in the name of the holder thereof upon cancellation of the original note. Notes called for redemption become due on the date fixed for redemption. On and after the redemption date, interest ceases to accrue on notes or portions of notes called for redemption.

Mandatory Redemption

Unifi is not required to make mandatory redemption or sinking fund payments with respect to the notes.

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Security

Assets Pledged as Collateral

The notes and Subsidiary Guarantees and all Obligations of Unifi and the Guarantors thereunder and under the Indenture are secured by:

- first-priority Liens and security interests, subject to Permitted Liens, in substantially all of the assets (other than inventory, accounts receivable, general intangibles (other than any uncertificated securities representing Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), investment property (other than Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), chattel paper, documents, instruments, supporting obligations, letter of credit rights, deposit accounts and other personal property, and all proceeds relating to any of the above, which secure the Credit Agreement on a first-priority basis) of Unifi and the Guarantors, including, but not limited to, the real property, fixtures, equipment, general intangibles with respect to any uncertificated securities representing the Capital Stock of any Subsidiary of Unifi or the Guarantors and any Person in which Unifi or a Guarantor has a direct interest, and investment property consisting of the Capital Stock of each Subsidiary of Unifi or the Guarantors and each other Person in which Unifi or a Guarantor has a direct interest, now owned or hereafter acquired by Unifi and the Guarantors, in each case, other than Excluded Assets and as further described below; and

- second-priority Liens and security interests, subject to Permitted Liens, in the inventory, accounts receivable, general intangibles (other than any uncertificated securities representing Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), investment property (other than Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), chattel paper, documents, instruments, supporting obligations, letter of credit rights, deposit accounts and other personal property, and all proceeds relating to any of the above, which secure the Credit Agreement on a first-priority basis, now owned or hereafter acquired by Unifi and the Guarantors, in each case, other than Excluded Assets and as further described below.

The First Priority Collateral will include any improvements or additions to the real property, fixtures and equipment that currently form part of the First Priority Collateral and any additional First Priority Collateral acquired with the proceeds of any issuance of additional notes, as described in Principal, Maturity and Interest. In addition, Unifi and the Guarantors are required to pledge as First Priority Collateral any additional real property or related fixtures and equipment acquired after the date hereof, including property or related fixtures and equipment acquired with the proceeds from certain specified transactions as described below under Certain Covenants with respect to the Collateral After-acquired property, in each case, other than those assets that constitute Excluded Assets.

The lenders under our Credit Agreement have a first-priority security interest in the Second Priority Collateral and a second-priority security interest in the First-Priority Collateral. The priority of the security interests are governed by the Intercreditor Agreement, which is described below under Intercreditor Arrangements.

The Collateral will not include any of the following assets (the Excluded Assets):

(1) any property or assets owned by any Subsidiary of Unifi which is not a Guarantor,

(2) any rights or interest of Unifi or any Guarantor in, to or under any agreement, contract, license, instrument, document or other general intangible (referred to solely for purposes of this definition as a Contract) (i) to the extent that such Contract by the express terms of a valid and enforceable restriction in favor of a Person who is not Unifi or any Restricted Subsidiary, or any requirement of law, prohibits, or requires any consent or establishes any other condition for, an assignment thereof or a grant of a security interest therein by

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Unifi or a Guarantor and (ii) which, if in existence or the subject of rights in favor of Unifi or any Guarantor as of the Issue Date and with respect to which a contravention or other violation caused or arising by its inclusion as Collateral has occurred, is listed and designated as such on a schedule to any such party s perfection certificate required by the Collateral Documents or individually or collectively is not material to the conduct of the business of Unifi or such Guarantor; provided that: (i) rights to payment under any such Contract otherwise excluded from the Collateral by virtue of this definition shall be included in the Collateral to the extent permitted thereby or by Section 9-406 or Section 9-408 of the Uniform Commercial Code and (ii) all proceeds paid or payable to Unifi or any Guarantor from any sale, transfer or assignment of such Contract and all rights to receive such proceeds shall be included in the Collateral;

(3) any equipment of Unifi or any Guarantor which is subject to, or secured by, a Capital Lease Obligation or Purchase Money Indebtedness if and to the extent that (i) the express terms of a valid and enforceable restriction in favor of a Person who is not Unifi or a Restricted Subsidiary contained in the agreements or documents granting or governing such Capital Lease Obligation or Purchase Money Indebtedness prohibits, or requires any consent or establishes any other conditions for, an assignment thereof, or a grant of a security interest therein, by Unifi or any Guarantor and (ii) such restriction relates only to the asset or assets acquired by Unifi or any Guarantor with the proceeds of such Capital Lease Obligation or Purchase Money Indebtedness and attachments thereto or substitutions therefor; provided that all proceeds paid or payable to any of Unifi or any Guarantor from any sale, transfer or assignment or other voluntary or involuntary disposition of such equipment and all rights to receive such proceeds shall be included in the Collateral to the extent not otherwise required to be paid to the holder of the Capital Lease Obligation or Purchase Money Indebtedness secured by such equipment;

(4) any Voting Stock that is issued by any Person not organized under the laws of the United States or any state of the United States or the District of Columbia and owned by Unifi or any Guarantor, if and to the extent that the inclusion of such Voting Stock in the Collateral would cause the Collateral pledged by Unifi or such Guarantor, as the case may be, to include in the aggregate more than 65% of the total combined voting power of all classes of Voting Stock of such Person;

(5) any Capital Stock and other securities (Excluded Securities) of a Subsidiary to the extent that the pledge of such Capital Stock or other securities results in Unifi being required to file separate financial statements of such Subsidiary with the SEC, but only to the extent necessary to not be subject to such requirement. In addition, in the event that Rule 3-16 or Rule 3-10 of Regulation S-X under the Securities Act is amended, modified or interpreted by the SEC to require (or is replaced with another rule or regulation, or any other law, rule or regulation is adopted, which would require) the filing with the SEC (or any other governmental or other regulatory agency or stock exchange) of separate financial statements of any Subsidiary of Unifi due to the fact that such Subsidiary s Capital Stock or other securities secure the notes, then the Capital Stock and other securities of such Subsidiary shall automatically be deemed not to be part of the Collateral but only to the extent necessary to not be subject to such requirement. In such event, the Collateral Documents may be amended or modified, without the consent of any holder of notes, to the extent necessary to release the security interests in favor of the Collateral Agent on the shares of Capital Stock or other securities that are so deemed to no longer constitute part of the Collateral. In the event that Rule 3-16 and Rule 3-10 of Regulation S-X under the Securities Act are amended, modified or interpreted by the SEC to permit (or are replaced with another rule or regulation, or any other law, rule or regulation is adopted, which would permit) such Subsidiary s Capital Stock or other securities to secure the notes in excess of the amount then pledged without the filing with the SEC (or any other governmental or other regulatory agency or stock exchange) of separate financial statements of such Subsidiary, then the Capital Stock or other securities of such Subsidiary shall automatically be deemed to be a part of the Collateral but only to the extent permissible such that such subsidiary would not be subject to any such financial statement requirement; and

(6) proceeds and products from any and all of the foregoing excluded collateral described in clauses (1) through (5), unless such proceeds or products would otherwise constitute Collateral securing the notes.

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Intercreditor Arrangements

The Collateral securing the notes and the Subsidiary Guarantees also serves as collateral to secure the obligations of Unifi and the Guarantors under the Credit Agreement. Unifi, the Guarantors, the Collateral Agent, on behalf of itself and the holders of the notes, and the agent under the Credit Agreement, on behalf of itself and the lenders, have entered into the Intercreditor Agreement. The Intercreditor Agreement will provide, among other things, that (1) Liens on the Second Priority Collateral securing the notes will be lower in priority than the Liens in favor of the agent under the Credit Agreement, and consequently, the lenders under the Credit Agreement will be entitled to receive the proceeds from the foreclosure of any such assets prior to the holders of the notes, (2) Liens on the First Priority Collateral securing the notes will be higher in priority than any security interest in favor of the agent under the Credit Agreement, and consequently, the holders of the notes will be entitled to receive proceeds from the foreclosure of any such assets prior to the lenders under the Credit Agreement, (3) during any insolvency proceedings, the agent under the Credit Agreement and the Collateral Agent will be subject to provisions intended to give effect to the relative priority of their security interests in the Collateral, (4) certain procedures for enforcing the Liens on the Collateral be followed and (5) the agent under the Credit Agreement will be granted a right of access with respect to real property mortgaged to the holders of notes and use of personal property in the possession or control of the Collateral Agent. The indenture and the Collateral Agreements will be subject to the terms of the Intercreditor Agreement.

Sufficiency of Collateral

The fair market value of the Collateral is subject to fluctuations based on factors that include, among others, the condition of the textile industry, the ability to sell or otherwise dispose of the Collateral in an orderly manner, general economic conditions, applicable restrictions on the sale of the Collateral imposed by laws regarding fraudulent conveyance and transfer, the availability of buyers of the Collateral and similar factors. The amount received upon a sale of the Collateral will also be dependent on numerous factors, including, but not limited, to the actual fair market value of the Collateral at such time and the timing and the manner of the sale. By its nature, portions of the Collateral may be illiquid and may have no readily ascertainable market value. In the event of a foreclosure, liquidation, bankruptcy or similar proceeding, the Collateral may not be sold in a timely or orderly manner and the proceeds from any sale or liquidation of this Collateral may not be sufficient to pay our obligations under the notes. See Risk Factors Risks Related to the Notes and This Offering The value of the collateral securing the notes may not be sufficient to satisfy our obligations under the notes.

Certain Covenants with respect to the Collateral

The Collateral is pledged pursuant to the Collateral Documents, which contain provisions relating to the administration, preservation and disposition of the Collateral. The following is a summary of some of the covenants and provisions set forth in the Collateral Documents and the indenture as they relate to the Collateral.

Use and maintenance of Collateral. The Collateral Documents provide that Unifi and the Guarantors shall maintain the Collateral in good, safe and insurable operating order, condition and repair and do all other acts as may be reasonably necessary or appropriate to maintain and preserve the value of the Collateral. The Collateral Documents also provide that Unifi and the Guarantors shall pay all real estate and other taxes, and maintain in full force and effect all material permits and certain insurance coverages. Subject to and in accordance with the provisions of the Collateral Documents, the indenture and the Credit Agreement, so long as the Collateral Agent or other lenders have not exercised their rights with respect to the Collateral upon the occurrence and during the continuance of an Event of Default, Unifi and the Guarantors will have the right to remain in possession and retain exclusive control of the Collateral, to operate the Collateral, to alter or repair the Collateral and to collect, invest and dispose of any income therefrom.

Certain proceeds. The Collateral Documents and the indenture provide that net cash proceeds from the condemnation or destruction of the First Priority Collateral or from eminent domain proceedings relating to First

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Priority Collateral shall be deposited into the First Priority Collateral Account. Any such proceeds shall be applied in accordance with Repurchase at the Option of Holders Asset Sales below.

As described above, the net cash proceeds from any issuance of additional notes shall be deposited in the First Priority Collateral Account and used or invested as described under Principal, Maturity and Interest above.

As more fully described below under Repurchase at the Option of Holders Asset Sales, Unifi must pledge the non-cash proceeds from any sale of First Priority Collateral as First Priority Collateral for the notes and, subject to certain exceptions, use the cash proceeds from any such sale of First Priority Collateral to purchase Additional Assets.

After-acquired property. The Collateral Documents and the indenture provide that upon the acquisition by Unifi or any Guarantor after the Issue Date of (1) any assets other than Excluded Assets, including, but not limited to, any after-acquired real property with a value greater than $1.0 million or any equipment or fixtures which constitute accretions, additions or technological upgrades to the equipment or fixtures that form part of the First Priority Collateral or Second Priority Collateral, as applicable, or (2) any Additional Assets out of the net cash proceeds from any issuance of additional notes or in compliance with the covenant described under Repurchase at the Option of Holders Asset Sales, Unifi or such Guarantor shall, subject to the Intercreditor Agreement, execute and deliver such mortgages, deeds of trust, security instruments, financing statements, certificates and opinions of counsel as may be necessary to vest in the Collateral Agent a perfected security interest, subject only to Permitted Liens, in such after-acquired property and to have such after-acquired property added to the Collateral, and thereupon all provisions of the indenture and the Intercreditor Agreement relating to the Collateral shall be deemed to relate to such after-acquired property to the same extent and with the same force and effect. Notwithstanding anything herein to the contrary, if granting or perfecting any Lien to secure the notes on any Collateral that consists of rights that are licensed or leased from a third-party requires the consent of such third party pursuant to the terms of an applicable license or lease agreement, and such terms are enforceable under applicable law, Unifi or the relevant Guarantor, as the case may be, shall use all commercially reasonable efforts to obtain such consent with respect to the granting or perfecting of such Lien, but if the third party does not consent to the granting or perfecting of such Lien after the use of commercially reasonable efforts, none of Unifi or the Guarantors will be required to do so.

Further assurances. The Collateral Documents and the indenture provide that Unifi and the Guarantors shall, at their sole expense, do all acts which may be reasonably necessary to confirm that the Collateral Agent holds, for the benefit of the holders of the notes and the trustee, duly created, enforceable and perfected first- or second-priority Liens and security interests, as applicable, in the Collateral (subject to Permitted Liens).

As necessary, or upon request of the trustee, Unifi and the Guarantors shall, subject to the Intercreditor Agreement, at their sole expense, execute, acknowledge and deliver such documents and instruments and take such other actions, which may be necessary to assure, perfect, transfer and confirm the property and rights conveyed by the Collateral Documents, including with respect to after acquired Collateral, to the extent permitted by applicable law, rule or regulation.

The indenture provides that Unifi will comply with the applicable provisions of the Trust Indenture Act as they relate to the Collateral.

To the extent applicable, Unifi will cause Section 313(b) of the Trust Indenture Act, relating to reports, and Section 314(d) of the Trust Indenture Act, relating to the release of property and to the substitution therefor of any property to be pledged as collateral for the notes, to be complied with. Any certificate or opinion required by Section 314(d) of the Trust Indenture Act may be made by an Officer of Unifi except in cases where Section 314(d) requires that such certificate or opinion be made by an independent engineer, appraiser or other expert, who shall be reasonably satisfactory to the trustee. Notwithstanding anything to the contrary in this

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paragraph, Unifi will not be required to comply with all or any portion of Section 314(d) of the Trust Indenture Act if it determines, in good faith based on advice of counsel, that under the terms of Section 314(d) and/or any interpretation or guidance as to the meaning thereof of the SEC and its staff, including no action letters or exemptive orders, all or any portion of Section 314(d) is inapplicable. As described under Release, below, Collateral may be released without complying with the requirements of Section 314(d) of the Trust Indenture Act.

Impairment of security interest. The Collateral Documents provide that neither Unifi nor any of its Restricted Subsidiaries will take nor will Unifi nor any Guarantor omit to take any action which would materially adversely affect or impair the Liens in favor of the Collateral Agent and the holders of the notes with respect to the Collateral. Neither Unifi nor any of the Guarantors shall grant to any Person, or permit any Person to retain (other than the Collateral Agent), any interest whatsoever in the Collateral, other than Permitted Liens. Neither Unifi nor any of the Guarantors will enter into any agreement that requires the proceeds received from any sale of Collateral to be applied to repay, redeem, defease or otherwise acquire or retire any Indebtedness of any Person, other than as permitted by the indenture, the notes, the Collateral Documents and the Intercreditor Agreement.

Real estate mortgages and filings. With respect to any fee or ground lease interest in any real property located in the United States (individually and collectively, the Premises) owned by Unifi or a Guarantor on the Issue Date or acquired by Unifi or a Guarantor after the Issue Date (if such acquired real property exceeds $1.0 million in fair market value):

(1) Unifi shall deliver to the Collateral Agent, as mortgagee or beneficiary, as applicable, fully executed counterparts of Mortgages, each dated as of the Issue Date or the date of acquisition of such property, as the case may be, duly executed by Unifi or the applicable Guarantor, together with evidence of the completion (or satisfactory arrangements for the completion) of all recordings and filings of such Mortgages (and payment of any taxes or fees in connection therewith) as may be necessary to create a valid, perfected Lien, subject to Permitted Liens, against the properties purported to be covered thereby;

(2) the Collateral Agent shall have received mortgagee s title insurance policies in favor of the Collateral Agent, as mortgagee for the ratable benefit of itself and the holders of the notes in the amounts and in the form necessary, with respect to the property purported to be covered by such Mortgage, to ensure that title to such property is marketable and that the interests created by the Mortgage constitute valid Liens thereon free and clear of all Liens, defects and encumbrances, other than Permitted Liens, and such policies shall also include, to the extent available, such other necessary endorsements and shall be accompanied by evidence of the payment in full of all premiums thereon; provided that any such title insurance policies may be delivered up to 30 days after the date on which the surveys described in clause (3) below are delivered; and

(3) Unifi shall, or shall cause its Guarantors to, deliver to the Collateral Agent (x) with respect to each of the covered Premises owned on the Issue Date, such filings, surveys (or any updates or affidavits that the title company may reasonably require in connection therewith), local counsel opinions and fixture filings, along with such other documents, instruments, certificates and agreements, as the initial purchasers and their counsel shall reasonably request; *provided* that any survey requested on or prior to the Issue Date may be delivered up to 60 days after the Issue Date, and (y) with respect to each of the covered Premises acquired after the Issue Date, such filings, surveys, instruments, certificates, agreements and/or other documents necessary to comply with clauses (1) and (2) above and to perfect the Collateral Agent s security interest in such acquired covered Premises, together with such local counsel opinions as the Collateral Agent and its counsel shall reasonably request.

Negative pledge. The indenture provides that Unifi and its Restricted Subsidiaries will not further pledge the Collateral as security or otherwise, subject to Permitted Liens. Unifi, however, subject to compliance by Unifi with the Incurrence of Indebtedness covenant, has the ability to issue an unlimited aggregate principal amount of additional notes having identical terms and conditions as the notes, all of which may be secured by the

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Collateral; *provided, however,* that the net cash proceeds from any such issuance of additional notes shall be deposited and invested as set forth above under Principal, Maturity and Interest.

Foreclosure

Upon the occurrence and during the continuance of an Event of Default, the Collateral Documents provide for (among other available remedies) the foreclosure upon and sale of the applicable Collateral by the Collateral Agent and the distribution of the net proceeds of any such sale to the holders of the notes, subject to any prior Liens on the Collateral and the provisions of the Intercreditor Agreement and applicable laws, rules and regulations. The Intercreditor Agreement provides, among other things, that (1) Liens on Second Priority Collateral securing the notes will be junior to the Liens in favor of the agent under the Credit Agreement, and consequently, the lenders under the Credit Agreement will be entitled to receive the proceeds from the foreclosure of any such assets prior to the holders of the notes, (2) Liens on the First Priority Collateral securing the notes will be senior to any security interest in favor of the agent under the Credit Agreement, and consequently, the holders of the notes will be entitled to receive proceeds from the foreclosure of any such assets prior to the lenders under the Credit Agreement, (3) during any insolvency proceedings, the agent under the Credit Agreement and the Collateral Agent will be subject to provisions intended to give effect to the relative priority of their security interests in the Collateral, (4) certain procedures for enforcing the Liens on the Collateral be followed and (5) the agent under the Credit Agreement will be granted a right of access with respect to real property mortgaged to the holders of notes and use of personal property in possession or control of the Collateral Agent. In the event of foreclosure on the Collateral, the proceeds from the sale of the Collateral may not be sufficient to satisfy in full Unifi s obligations under the notes.

Restrictions on Enforcement of Liens on Second Priority Collateral

Whether or not an insolvency or liquidation proceeding has been commenced by or against Unifi or any Guarantor, the Collateral Agent, the trustee and the holders of notes:

- will not exercise or seek to exercise any rights or remedies with respect to any Liens on the Second Priority Collateral or institute any action or proceeding with respect to such rights or remedies (including any action of foreclosure); *provided, however,* that the Collateral Agent may exercise any or all such rights or remedies after the passage of a period of at least 180 days has elapsed since the date on which the Collateral Agent first declares the existence of an Event of Default and the agent under the Credit Agreement has received notice from the Collateral Agent of such declaration of an Event of Default (the Standstill Period); *provided, further, however,* that in no event shall the Collateral Agent or any noteholder exercise any rights or remedies with respect to the Lien on such Second Priority Collateral if, notwithstanding the expiration of the Standstill Period, any agent under the Credit Agreement shall have commenced and be diligently pursuing the exercise of their rights or remedies with respect to all or any material portion of such Second Priority Collateral (prompt notice of such exercise to be given to the Collateral Agent);

- will not contest, protest object to or hinder any foreclosure proceeding or action brought by any agent under the Credit Agreement or any other exercise by any agent under the Credit Agreement of any rights and remedies relating to such Second Priority Collateral; and

- subject to their rights under first paragraph above and except as may be otherwise permitted by the Intercreditor Agreement, will not object to the forbearance by any agent under the Credit Agreement from bringing or pursuing any enforcement;

provided, however, that, in the case of the three paragraphs above, the Liens granted to secure the notes, the Subsidiary Guarantees and the Obligations of Unifi and the Guarantors thereunder and under the Indenture shall attach to any proceeds resulting from actions taken by any agent under the Credit Agreement in accordance with the Intercreditor Agreement.

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Upon a foreclosure and sale of the interests of Unifi and the Guarantors in PAL, Parkdale Mills Incorporated, our joint venture partner, shall have the right to purchase all of Unifi and the Guarantors interest in PAL at fair market value, upon the terms and provisions set forth in the operating agreement of PAL.

Certain Bankruptcy Limitations

The right of the trustee to repossess and dispose of the Collateral upon the occurrence of an Event of Default would be significantly impaired by applicable bankruptcy law in the event that a bankruptcy case were to be commenced by or against Unifi or any Guarantor prior to the trustee having repossessed and disposed of the Collateral. Upon the commencement of a case for relief under Title 11 of the United States Code, as amended (the Bankruptcy Code), a secured creditor such as the trustee is prohibited from repossessing its security from a debtor in a bankruptcy case, or from disposing of security repossessed from the debtor, without bankruptcy court approval.

In view of the broad equitable powers of a U.S. bankruptcy court, it is impossible to predict how long payments under the notes could be delayed following commencement of a bankruptcy case, whether or when the trustee could repossess or dispose of the Collateral, the value of the Collateral at the time of the bankruptcy petition or whether or to what extent holders of the notes would be compensated for any delay in payment or loss of value of the Collateral. The Bankruptcy Code permits only the payment and/or accrual of post-petition interest, costs and attorneys fees to a secured creditor during a debtor s bankruptcy case to the extent the value of the Collateral is determined by the bankruptcy court to exceed the aggregate outstanding principal amount of the obligations secured by the Collateral.

Furthermore, in the event a bankruptcy court determines that the value of the Collateral is not sufficient to repay all amounts due on the notes, the holders of the notes would hold secured claims to the extent of the value of the Collateral to which the holders of the notes are entitled, and unsecured claims with respect to such shortfall.

In addition, because a portion of the Collateral may in the future consist of pledges of a portion of the Capital Stock of certain of our Foreign Subsidiaries, the validity of those pledges under applicable foreign law, and the ability of the holders of the notes to realize upon that Collateral under applicable foreign law, may be limited by such law, which limitations may or may not affect such Liens.

Release

The Liens on the Collateral will be released with respect to the notes:

(1) in whole, upon payment in full of the principal of, accrued and unpaid interest and premium, if any, on the notes;

(2) in whole, upon satisfaction and discharge of the indenture as set forth under the caption Satisfaction and Discharge;

(3) in whole, upon a Legal Defeasance or Covenant Defeasance as set forth under the caption Legal Defeasance and Covenant Defeasance;

(4) in part, as to any property constituting Collateral (A) that is sold or otherwise disposed of by Unifi or any of its Restricted Subsidiaries in a transaction permitted by Repurchase at the Option of Holders Asset Sales or by the Collateral Documents, to the extent of the interest sold or disposed of, (B) that is cash or Net Proceeds withdrawn from the Collateral Account for any one or more purposes permitted by subsection (a) of Repurchase at the Option of Holders Asset Sales or by the provisions under Principal, Maturity and Interest ; (C) that is of the nature described in clause (1), clause (5), clause (7), clause (8), or clauses (9) through

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(15) of the second paragraph in the definition of Asset Sale, and is subject to a disposition as therein provided, (D) that constitutes Excess Collateral Proceeds that remain unexpended after the conclusion of a Collateral Sale Offer conducted in accordance with the indenture, (E) that is owned or at any time acquired by a Subsidiary of Unifi that has been released from its Subsidiary Guarantee in accordance with the indenture, concurrently with the release thereof, (F) that is or becomes Excluded Assets or Excluded Securities, (G) that is Capital Stock, upon the dissolution of the issuer of such Capital Stock in accordance with the terms of the indenture; or (H) otherwise in accordance with, and as expressly provided for under, the indenture;

(5) with the consent of the holders of at least 75% of the aggregate principal amount of the notes affected thereby (including, without limitation, consents obtained in connection with a tender offer or exchange offer for, or purchase of, notes);

(6) on any of the Second Priority Collateral, upon any release thereof by the agent under the Credit Agreement (or the requisite lenders thereunder) or as otherwise authorized or directed by such agent or lenders (other than in connection with the expiration or termination of the Credit Agreement); *provided*, *however*, that if there is reinstated a Lien securing Credit Agreement obligation on any or all of the Second Priority Collateral upon which the Lien securing the notes has been released pursuant to this clause (6) then the Lien securing the notes on such Second Priority Collateral will also be deemed reinstated on a second priority basis;

provided, that, in the case of any release in whole pursuant to clauses (1), (2), (3), (5) and (6) above, all amounts owing to the trustee under the indenture, the notes, the Subsidiary Guarantees, the registration rights agreement, the Collateral Documents and the Intercreditor Agreement have been paid.

To the extent required, Unifi will furnish to the trustee, prior to each proposed release of Collateral pursuant to the Collateral Documents and the indenture:

an Officers Certificate and opinion of counsel and such other documentation as required by the indenture; and

all documents required by §314(d) of the Trust Indenture Act, the Collateral Documents, the Intercreditor Agreement and the indenture.

Upon compliance by Unifi or the Guarantors, as the case may be, with the conditions precedent set forth above, and upon delivery by Unifi or such Guarantor to the trustee of an Opinion of Counsel to the effect that such conditions precedent have been complied with, the trustee or the Collateral Agent shall promptly cause to be released and reconveyed to Unifi, or its Guarantors, as the case may be, the released Collateral.

Notwithstanding anything to the contrary herein, Unifi and its Subsidiaries will not be required to comply with all or any portion of Section 314(d) of the Trust Indenture Act if they determine, in good faith based on advice of counsel, that under the terms of that section and/or any interpretation or guidance as to the meaning thereof of the Commission and its staff, including no action letters or exemptive orders, all or any portion of Section 314(d) of the Trust Indenture Act is inapplicable to the released Collateral.

Without limiting the generality of the foregoing, certain no-action letters issued by the Commission have permitted an indenture qualified under the Trust Indenture Act to contain provisions permitting the release of collateral from Liens under such indenture in the ordinary course of the issuer s business without requiring the issuer to provide certificates and other documents under Section 314(d) of the Trust Indenture Act. Unifi and the Guarantors may, among other things, without any release or consent by the Trustee, conduct ordinary course activities with respect to Collateral, including, without limitation, (i) selling or otherwise disposing of, in any transaction or series of related transactions, any property subject to the Lien of the Collateral Documents which has become worn out, defective or obsolete or not used or useful in the business; (ii) abandoning, terminating, canceling, releasing or making alterations in or substitutions of any leases or contracts subject to the Lien of the Indenture or any of the Collateral Documents; (iii) surrendering or modifying any franchise, license or permit

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subject to the Lien of the Indenture or any of the Collateral Documents which it may own or under which it may be operating; altering, repairing, replacing, changing the location or position of and adding to its structures, machinery, systems, equipment, fixtures and appurtenances; (iv) granting a license of any intellectual property; (v) selling, transferring or otherwise disposing of inventory in the ordinary course of business; (vi) collecting accounts receivable in the ordinary course of business or selling, liquidating, factoring or otherwise disposing of accounts receivable in the ordinary course of business as permitted by the covenant described under Repurchase at the Option of Holders Asset Sales ; (vii) making cash payments (including for the repayment of Indebtedness or interest) from cash that is at any time part of the Collateral in the ordinary course of business that are not otherwise prohibited by the Indenture and the Collateral Documents; and (viii) abandoning any intellectual property which is no longer used or useful in Unifi s business. Unifi must deliver to the Collateral Agent, within 30 calendar days following the end of each six-month period beginning on May 15 and November 15 of any year, an officers certificate to the effect that all releases and withdrawals during the preceding six-month period (or since the Issue Date, in the case of the first such certificate) in which no release or consent of the Collateral Agent was obtained in the ordinary course of Unifi s and the Guarantors business were not prohibited by the Indenture.

Repurchase at the Option of Holders

Change of Control

If a Change of Control occurs, Unifi will be required to make an offer (a Change of Control Offer) to each holder of notes to repurchase all or any part (equal to $1,000 or an integral multiple thereof) of that holder s notes on the terms set forth in the indenture. In the Change of Control Offer, Unifi will offer a payment in cash (the Change of Control Payment) equal to 101% of the aggregate principal amount of notes repurchased, plus accrued and unpaid interest and Additional Interest, if any, on the notes repurchased, to, but excluding, the date of purchase (the Change of Control Payment Date). No later than 20 days following any Change of Control, Unifi will mail a notice to each holder describing the transaction or transactions that constitute the Change of Control and offering to repurchase notes on the Change of Control Payment Date specified in the notice, which date will be no earlier than 30 days and no later than 60 days from the date such notice is mailed, pursuant to the procedures required by the indenture and described in such notice.

Unifi will comply with the requirements of Rule 14e-1 under the Exchange Act and any other securities laws and regulations thereunder to the extent those laws and regulations are applicable in connection with the repurchase of the notes as a result of a Change of Control. To the extent that the provisions of any securities laws or regulations conflict with the Change of Control provisions of the indenture, Unifi will comply with the applicable securities laws and regulations and will not be deemed to have breached its obligations under the Change of Control provisions of the indenture by virtue of such compliance.

On the Change of Control Payment Date, Unifi will, to the extent lawful:

(1) accept for payment all notes or portions of notes properly tendered pursuant to the Change of Control Offer;

(2) deposit with the paying agent an amount equal to the Change of Control Payment in respect of all notes or portions of notes properly tendered; and

(3) deliver or cause to be delivered to the trustee the notes properly accepted together with an Officers Certificate stating the aggregate principal amount of notes or portions of notes being purchased by Unifi.

The paying agent will promptly mail to each holder of notes properly tendered the Change of Control Payment for such notes, and the trustee will promptly authenticate and mail (or cause to be transferred by book entry) to each holder a new note equal in principal amount to any unpurchased portion of the notes surrendered, if any; *provided* that each new note will be in a minimum principal amount of $2,000 or an integral multiple of

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$1,000 in excess thereof. Unifi will publicly announce the results of the Change of Control Offer on or as soon as practicable after the Change of Control Payment Date.

If the Change of Control Payment Date is on or after an interest payment record date and on or before the related interest payment date, any accrued and unpaid interest and Additional Interest, if any, will be paid to the holder in whose name a note is registered at the close of business on such record date, and no other interest or Additional Interest, if any, will be payable to holders who tender pursuant to the Change of Control Offer.

The provisions described above that require Unifi to make a Change of Control Offer following a Change of Control will be applicable whether or not any other provisions of the indenture are applicable. Except as described above with respect to a Change of Control, the indenture does not contain provisions that permit the holders of the notes to require that Unifi repurchase or redeem the notes in the event of a takeover, recapitalization or similar transaction.

Unifi will not be required to make a Change of Control Offer upon a Change of Control if (1) a third party makes the Change of Control Offer in the manner, at the times and otherwise in compliance with the requirements set forth in the indenture applicable to a Change of Control Offer made by Unifi and purchases all notes properly tendered and not withdrawn under the Change of Control Offer, or (2) notice of redemption has been given pursuant to the indenture as described above under the caption Optional Redemption, unless and until there is a default in payment of the applicable redemption price.

If a Change of Control Offer is made, there can be no assurance that Unifi will have available funds sufficient to pay the Change of Control Payment for all the notes that might be delivered by holders seeking to accept the Change of Control Offer. In the event that Unifi is required to purchase outstanding notes pursuant to a Change of Control Offer, Unifi expects it would seek third party financing to the extent it does not have available funds to meet its purchase obligations. However, there can be no assurance that Unifi would be able to obtain such financing or that the terms of the indenture would permit the incurrence of such financing.

The Change of Control provisions described above may deter certain mergers, tender offers and other takeover attempts involving Unifi by increasing the capital required to effectuate such transactions. The definition of Change of Control includes a phrase relating to the direct or indirect sale, lease, transfer, conveyance or other disposition of all or substantially all of the properties or assets of Unifi and its Restricted Subsidiaries taken as a whole. Although there is a limited body of case law interpreting the phrase substantially all, there is no precise established definition of the phrase under applicable law. Accordingly, in certain circumstances there may be a degree of uncertainty as to whether a particular transaction would involve a disposition of all or substantially all of the property or assets of Unifi and its Restricted Subsidiaries taken as a whole. As a result, it may be unclear as to whether a Change of Control has occurred and whether a holder of notes may require Unifi to make a Change of Control Offer.

Asset Sales

(a) Unifi will not, and will not permit any of the Guarantors to, consummate an Asset Sale of Collateral unless:

(1) Unifi or such Guarantor, as the case may be, receives consideration at least equal to the fair market value of the Collateral sold or otherwise disposed of (such fair market value to be determined on the date of contractually agreeing to such Asset Sale);

(2) the fair market value is determined (i) by Unifi s Chief Executive Officer or Chief Financial Officer and set forth in an Officers Certificate delivered to the trustee or (ii) for assets with a fair market value in excess of $5.0 million, by Unifi s Board of Directors and evidenced by a resolution of such Board of Directors set forth in an Officers Certificate delivered to the trustee;

(3) at least 75% of the consideration received in the Asset Sale by Unifi or such Guarantor is in the form of cash or Cash Equivalents and 100% of the Net Proceeds therefrom (other than any consideration

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that is deemed to be cash pursuant to paragraph (f)(3) below) is deposited directly by Unifi into the applicable Collateral Account, in each case, in accordance with the Intercreditor Agreement; provided that at any time prior to the termination of the Credit Agreement such Net Proceeds with respect to Second Priority Collateral shall be deposited in accordance with the provisions of the Credit Agreement and the Intercreditor Agreement; and

(4) the remaining consideration from such Asset Sale that is not in the form of cash or Cash Equivalents (including any consideration that is deemed to be cash pursuant to paragraph (f) (3) below) is thereupon with its acquisition pledged as First Priority Collateral to secure the notes, in the case of an Asset Sale of First Priority Collateral, or as Second Priority Collateral, in the case of an Asset Sale of Second Priority Collateral in accordance with the Intercreditor Agreement.

For purposes of determining whether an Asset Sale of Collateral constitutes an Asset Sale of First Priority Collateral or an Asset Sale of Second Priority Collateral, the consideration received from the sale of Equity Interests in a Guarantor shall be allocated among the assets of such Person.

In the case of an Asset Sale of Second Priority Collateral, any Net Proceeds will be deposited and applied in accordance with the Intercreditor Agreement.

Within 360 days after the deposit into the First Priority Collateral Account of any Net Proceeds from an Asset Sale of First Priority Collateral or Recovery Events (as described below) with respect to First Priority Collateral, Unifi or any of its Restricted Subsidiaries may apply such Net Proceeds to invest in Additional Assets; provided, that at least 95% of such Net Proceeds shall be used to invest in Additional Assets which are assets of the type that would constitute First Priority Collateral and which upon their acquisition shall constitute the First Priority Collateral in accordance with the provisions of the Intercreditor Agreement. Any Net Proceeds from an Asset Sale of Collateral that are deemed to be cash pursuant to paragraph (f) (3) below shall be deemed to have been invested in Additional Assets at the time of such Asset Sale of Collateral for purposes of the preceding sentence.

All of the Net Proceeds received by Unifi or the Guarantors, as the case may be, from any Recovery Event with respect to First Priority Collateral shall be deposited directly into the First Priority Collateral Account and may be withdrawn by Unifi or such Guarantor to be invested in Additional Assets (which may include performance of a Restoration of the affected First Priority Collateral) in accordance with the preceding paragraph within 360 days after the deposit into the First Priority Collateral Account of any such Net Proceeds. Any Net Proceeds from a Recovery Event with respect to Second Priority Collateral will be deposited and applied in accordance with the Intercreditor Agreement.

Any Net Proceeds from Asset Sales of Collateral or Recovery Events that are not applied or invested as provided in this subsection (a) or in accordance with the Collateral Documents will constitute Excess Collateral Proceeds. No later than the 365 day after the Asset Sale of Collateral or the deposit into the applicable Collateral Account of the Net Proceeds from a Recovery Event pursuant to this subsection (a) (or, at Unifi s option, such earlier date as it may choose), if the aggregate amount of Excess Collateral Proceeds exceeds $10.0 million, Unifi will make an offer (a Collateral Sale Offer) to all holders of notes to purchase the maximum principal amount of notes to which the Collateral Sale Offer applies that may be purchased out of the Excess Collateral Proceeds. The offer price in any Collateral Sale Offer will be equal to 100% of the principal amount of the notes, plus accrued and unpaid interest and Additional Interest, if any, to, but excluding, the date of purchase, and will be payable in cash, in each case, in integral multiples of $1,000; *provided*, *however*, that to the extent the Excess Collateral Proceeds relate to Asset Sales of Second Priority Collateral, Unifi may, prior to making a Collateral Sale Offer, make a prepayment with respect to Indebtedness that is secured by such Second Priority Collateral on a first-priority basis that may be prepaid out of such Excess Collateral Proceeds, at a price in cash in an amount equal to 100% of the principal amount of such Indebtedness, plus accrued and unpaid interest to the date of prepayment, with any Excess Collateral Proceeds not used to prepay such Indebtedness

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offered to holders of notes in accordance with this paragraph. If any Excess Collateral Proceeds remain after consummation of a Collateral Sale Offer, Unifi may use those Excess Collateral Proceeds for any purpose not otherwise prohibited by the indenture. If the aggregate principal amount of notes tendered in such Collateral Sale Offer exceeds the amount of Excess Collateral Proceeds, the portion of each note to be purchased will be determined by the trustee on a pro rata basis among the holders of such notes with appropriate adjustments such that the notes may only be purchased in integral multiples of $1,000. Upon completion of each Collateral Sale Offer or the application of Excess Collateral Proceeds pursuant to the second sentence of this paragraph, the amount of Excess Proceeds will be reset at zero.

(b) Unifi will not, and will not permit any of its Restricted Subsidiaries to, consummate an Asset Sale (other than an Asset Sale of Collateral) unless:

(1) Unifi or such Restricted Subsidiary, as the case may be, receives consideration at least equal to the fair market value of the assets or Equity Interests issued or sold or otherwise disposed of (such fair market value to be determined on the date of contractually agreeing to such Asset Sale);

(2) the fair market value is determined (i) by Unifi s Chief Executive Officer or Chief Financial Officer and set forth in an Officers Certificate delivered to the trustee or (ii) for assets with a fair market value in excess of $5.0 million, by Unifi s Board of Directors and evidenced by a resolution of such Board of Directors set forth in an Officers Certificate delivered to the trustee; and

(3) at least 75% of the consideration received in the Asset Sale by Unifi or such Restricted Subsidiary is in the form of cash or Cash Equivalents.

Within 360 days after the receipt of any Net Proceeds from an Asset Sale (other than an Asset Sale of Collateral), Unifi or any of its Restricted Subsidiaries may apply such Net Proceeds at its option to:

(A) repay, purchase or otherwise retire the notes;

(B) repay, purchase, or otherwise retire other Indebtedness of Unifi or a Guarantor (and to correspondingly reduce commitments with respect thereto) that is *pari passu* with the notes; *provided* that Unifi shall also equally and ratably reduce Obligations under the notes by making an offer (in accordance with the procedures set forth below for an Asset Sale Offer) to all holders of notes to purchase the pro rata principal amount of notes at a purchase price equal to 100% of the principal amount thereof, plus the amount of accrued but unpaid interest and Additional Interest, if any, to the repurchase date (subject to the right of the holders of record on the relevant record date to receive interest due on the relevant interest payment date);

(C) repay or repurchase Indebtedness of a Restricted Subsidiary that is not a Guarantor, other than Indebtedness owed to Unifi or another of its Restricted Subsidiaries; or

(D) acquire or invest in Additional Assets.

Any Net Proceeds from an Asset Sale that are deemed to be cash pursuant to paragraph (f) (3) below shall be deemed to have been invested in Additional Assets at the time of such Asset Sale for purposes of the preceding sentence. Pending the final application of any Net Proceeds, Unifi and its Restricted Subsidiaries may temporarily reduce revolving credit borrowings or otherwise invest the Net Proceeds in any manner that is not prohibited by the indenture.

Any Net Proceeds from Asset Sales (other than Asset Sales of Collateral) that are not applied or invested as provided in the second preceding paragraph will constitute Excess Proceeds. No later than the 365th day after the Asset Sale (or, at Unifi s option, such earlier date as it may choose), if the aggregate amount of Excess Proceeds exceeds $10.0 million, Unifi will make an offer (an Asset Sale Offer) to all holders of notes and all holders of other Indebtedness that is *pari passu* in right of payment with the notes containing provisions similar to those set forth in the indenture with respect to offers to purchase or redeem with the proceeds of sales of assets

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to purchase the maximum principal amount of notes and such other *pari passu* Indebtedness that may be purchased out of the Excess Proceeds. The offer price in any Asset Sale Offer will be equal to 100% of the principal amount (or accreted value, as applicable) of the notes and such other *pari passu* Indebtedness, plus accrued and unpaid interest and Additional Interest (or its equivalent with respect to any such *pari passu* Indebtedness), if any, to, but excluding, the date of purchase, and will be payable in cash, in each case, in integral multiples of $1,000. If any Excess Proceeds remain after consummation of an Asset Sale Offer, Unifi may use those Excess Proceeds for any purpose not otherwise prohibited by the indenture. If the aggregate principal amount of notes and other *pari passu* Indebtedness tendered in such Asset Sale Offer exceeds the amount of Excess Proceeds, the Excess Proceeds will be allocated by Unifi to the notes and such other *pari passu* Indebtedness on a pro rata basis (based upon the respective principal amounts (or accreted value, if applicable) of the notes and such other *pari passu* Indebtedness tendered in such Asset Sale Offer) and the portion of each note to be purchased will thereafter be determined by the trustee on a pro rata basis among the holders of such notes with appropriate adjustments such that the notes may only be purchased in integral multiples of $1,000. Upon completion of each Asset Sale Offer, the amount of Excess Proceeds will be reset at zero.

(c) If the Asset Sale purchase date is on or after an interest payment record date and on or before the related interest payment date, any accrued and unpaid interest and Additional Interest, if any, will be paid to the holder in whose name a note is registered at the close of business on such record date, and no interest or Additional Interest, if any, will be payable to holders who tender notes pursuant to the Collateral Sale Offer or Asset Sale Offer.

(d) Unifi will comply with the requirements of Rule 14e-1 under the Exchange Act and any other securities laws and regulations thereunder to the extent those laws and regulations are applicable in connection with each repurchase of notes pursuant to a Collateral Sale Offer or an Asset Sale Offer. To the extent that the provisions of any securities laws or regulations conflict with the Asset Sale provisions of the indenture, Unifi will comply with the applicable securities laws and regulations and will not be deemed to have breached its obligations under the Asset Sale provisions of the indenture by virtue of such compliance.

(e) For purposes of this section, Unifi, a Guarantor or a Restricted Subsidiary shall be deemed to have applied Net Proceeds within such 360-day period if, within such 360-day period, it has entered into a binding commitment or agreement to invest such Net Proceeds and continues to use all reasonable efforts to so apply such Net Proceeds as soon as practicable thereafter and that investment is substantially completed within 395 days after the date of such Asset Sale. Upon any abandonment or termination of such commitment or agreement or upon the failure to substantially complete such investment within such 395 day period, the Net Proceeds not applied will constitute Excess Collateral Proceeds or Excess Proceeds, as applicable.

(f) For purposes of this section, each of the following shall be deemed to be cash:

(1) the amount of any liabilities, as shown on Unifi s most recent consolidated balance sheet or in the notes thereto, of Unifi or such Restricted Subsidiary (other than contingent liabilities and liabilities that are by their terms subordinated in right of payment to the notes or any Subsidiary Guarantee) that are assumed by the transferee of any such assets pursuant to a customary novation agreement that releases Unifi or such Restricted Subsidiary from further liability;

(2) any securities, notes or other obligations received by Unifi or any such Restricted Subsidiary from such transferee that are within 20 Business Days following consummation of the Asset Sale, subject to normal settlement periods, converted by Unifi or such Restricted Subsidiary into cash or Cash Equivalents (to the extent of the cash or Cash Equivalents received in that conversion); and

(3) any stock or assets received as consideration for such Asset Sale that would otherwise constitute a permitted application of Net Proceeds (or other cash in such amount) under clauses (1), (2) or (4) of the definition of Additional Assets.

Unifi s Credit Agreement prohibits Unifi from purchasing any notes, and also provide that certain change of control or asset sale events with respect to Unifi would constitute a default or require repayment of the

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Indebtedness under such agreements. Any future credit agreements or other agreements relating to Indebtedness to which Unifi becomes a party may contain similar restrictions and provisions. In the event a Change of Control or Asset Sale occurs at a time when Unifi is prohibited from purchasing notes, Unifi could seek the consent of its lenders to purchase the notes or could attempt to refinance the borrowings that contain such prohibition. If Unifi does not obtain such a consent or repay such borrowings, Unifi will remain prohibited from purchasing notes. In such case, Unifi s failure to purchase tendered notes would constitute an Event of Default under the indenture, which would, in turn, constitute a default under such Indebtedness.

Certain Covenants

The indenture includes covenants including, among others, the following:

Restricted Payments

Unifi will not, and will not permit any of its Restricted Subsidiaries to, directly or indirectly:

(1) declare or pay any dividend or make any other payment or distribution on or in respect of Unifi s or any of its Restricted Subsidiaries Equity Interests (including, without limitation, any payment in connection with any merger or consolidation involving Unifi or any of its Restricted Subsidiaries) or to the direct or indirect holders of Unifi s or any of its Restricted Subsidiaries Equity Interests in their capacity as such (other than dividends or distributions payable in Equity Interests (other than Disqualified Stock) of Unifi and other than dividends or distributions payable to Unifi or a Restricted Subsidiary of Unifi);

(2) purchase, redeem or otherwise acquire or retire for value (including, without limitation, in connection with any merger or consolidation involving Unifi) any Equity Interests of Unifi or any direct or indirect parent of Unifi;

(3) make any payment on or with respect to, or purchase, redeem, defease or otherwise acquire or retire for value any Indebtedness of Unifi or any Guarantor that is contractually subordinated to the notes or to any Subsidiary Guarantee, except a payment of interest or principal at the Stated Maturity thereof or a payment of principal within 90 days of Stated Maturity thereof; or

(4) make any Restricted Investment (all such payments and other actions set forth in these clauses (1) through (4) above being collectively referred to as Restricted Payments), unless, at the time of and after giving effect to such Restricted Payment:

(1) no Default or Event of Default has occurred and is continuing or would occur as a consequence of such Restricted Payment;

(2) Unifi would, at the time of such Restricted Payment and after giving pro forma effect thereto as if such Restricted Payment had been made at the beginning of the applicable four-quarter period, have been permitted to incur at least $1.00 of additional Indebtedness pursuant to the Fixed Charge Coverage Ratio test set forth in the first paragraph of the covenant described below under the caption Incurrence of Indebtedness; and

(3) such Restricted Payment, together with the aggregate amount, without duplication, of all other Restricted Payments declared or made by Unifi and its Restricted Subsidiaries after the Issue Date (excluding Restricted Payments permitted by clauses (2), (3), (4), (6), (7), (9), (11) and (12) of the next succeeding paragraph), is less than the sum, without duplication, of:

(a) 50% of the Consolidated Net Income of Unifi for the period (taken as one accounting period) from the first fiscal quarter beginning after the Issue Date to the end of Unifi s most recently ended fiscal quarter for which internal financial statements are available at the time of such Restricted Payment (or, if such Consolidated Net Income for such period is a deficit, less 100% of such deficit), plus

(b) 100% of the aggregate net cash proceeds received by Unifi since the Issue Date as a contribution to its common equity capital or from the issue or sale of Equity Interests (other than Disqualified Stock) of

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Unifi or from the issue or sale of convertible or exchangeable Disqualified Stock or convertible or exchangeable debt securities of Unifi that have been converted into or exchanged for such Equity Interests (other than Equity Interests (or Disqualified Stock or debt securities) sold to a Subsidiary of Unifi or an employee stock ownership plan, option plan or similar trust to the extent such sale to an employee stock ownership plan or similar trust is financed by loans from or guaranteed by Unifi or any Restricted Subsidiary unless such loans have been repaid with cash on or prior to the date of determination), plus

(c) to the extent that any Restricted Investment that was made after the Issue Date is sold for cash or otherwise liquidated or repaid for cash, the lesser of (i) the cash return of capital with respect to such Restricted Investment (less the cost of disposition, if any) and (ii) the initial amount of such Restricted Investment; *provided* that no amount will be included under this clause (c) to the extent it is already included in Consolidated Net Income, *plus*

(d) to the extent that any Unrestricted Subsidiary of Unifi designated as such after the Issue Date is redesignated as a Restricted Subsidiary after the Issue Date, the lesser of (i) the fair market value of Unifi s Investment in such Subsidiary as of the date of such redesignation and (ii) such fair market value as of the date on which such Subsidiary was originally designated as an Unrestricted Subsidiary after the Issue Date; *plus*

(e) 50% of any dividends or other distributions received by Unifi or a Restricted Subsidiary of Unifi that is a Guarantor after the Issue Date from an Unrestricted Subsidiary of Unifi, to the extent that such dividends or other distributions were not otherwise included in the Consolidated Net Income of Unifi for such period.

The preceding provisions will not prohibit:

(1) the payment of any dividend or the consummation of any irrevocable redemption within 60 days after the date of declaration of the dividend or giving of the redemption notice, as the case may be, if at the date of declaration or notice the dividend or redemption payment would have been permitted by the provisions of the indenture;

(2) the making of any Restricted Payment in exchange for, or out of the net cash proceeds of the sale within 60 days of such Restricted Payment (other than to a Subsidiary of Unifi) of, Equity Interests of Unifi (other than Disqualified Stock and other than Equity Interests issued or sold to an employee stock ownership plan or similar trust to the extent such sale to an employee stock ownership plan or similar trust is financed by loans from or guaranteed by Unifi or any Restricted Subsidiary unless such loans have been repaid with cash on or prior to the date of determination) or from the contribution of common equity capital to Unifi within 60 days of such Restricted Payment; *provided* that the amount of any such net cash proceeds that are utilized for any such Restricted Payment will be excluded from clause (3)(b) of the preceding paragraph;

(3) the defeasance, satisfaction and discharge, redemption, repurchase or other acquisition or retirement for value of Indebtedness of Unifi or any Guarantor that is Subordinated Indebtedness in exchange for, or out of the net cash proceeds of the incurrence within 60 days of such defeasance, satisfaction and discharge, redemption, repurchase or other acquisition or retirement of, Permitted Refinancing Indebtedness;

(4) the payment of any dividend or distribution by a Restricted Subsidiary of Unifi to the holders of its Equity Interests on a pro rata basis;

(5) so long as no Default or Event of Default has occurred and is continuing, the repurchase, redemption or other acquisition or retirement for value of any Equity Interests of Unifi or any Restricted Subsidiary of Unifi or any direct or indirect parent of Unifi held by any current or former officer, director or employee of Unifi or any of its Restricted Subsidiaries or their estates or heirs pursuant to any equity subscription agreement, stock option agreement, shareholders agreement or similar agreement; *provided* that the aggregate price paid for all such Equity Interests repurchased, redeemed, acquired or retired pursuant to this clause may not exceed $1.0 million

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in the aggregate in any twelve month period; *provided*, *however*, that amounts available pursuant to this clause (5) to be utilized for any Restricted Payments described in this clause (5) during any twelve month period may be carried forward and utilized in any subsequent twelve month period, up to a maximum of $2.0 million in any twelve month period;

(6) repurchases of Equity Interests deemed to occur upon the exercise of stock options, warrants or other convertible securities to the extent such Equity Interests represent a portion of the exercise price thereof;

(7) the declaration and payment of regularly scheduled or accrued dividends to holders of any class or series of Disqualified Stock of Unifi or any Restricted Subsidiary of Unifi issued on or after the Issue Date in accordance with the Fixed Charge Coverage Ratio test described below under the caption Incurrence of Indebtedness;

(8) the declaration and payment of dividends by Unifi to, or the making of loans to, any direct or indirect parent in amounts required for any direct or indirect parent to pay:

(a) franchise taxes and other fees, taxes and expenses required to maintain their corporate existence,

(b) federal, state and local income taxes, to the extent such income taxes are attributable to the income of Unifi and its Restricted Subsidiaries and, to the extent of the amount actually received from its Unrestricted Subsidiaries, in amounts required to pay such taxes to the extent attributable to the income of such Unrestricted Subsidiaries,

(c) reasonable salary, bonus and other benefits payable to directors, officers and employees of any direct or indirect parent company of Unifi to the extent such salaries, bonuses and other benefits are attributable to the ownership or operation of Unifi and its Restricted Subsidiaries, and

(d) general corporate overhead expenses of any direct or indirect parent company of Unifi to the extent such expenses are attributable to the ownership or operation of Unifi and its Restricted Subsidiaries;

(9) the purchase of fractional shares by Unifi upon conversion of any securities of Unifi into Equity Interests of Unifi;

(10) the purchase, repurchase, redemption, defeasance or other acquisition or retirement for value of any Indebtedness subordinated to the notes (i) at a purchase price not greater than 101% of the principal amount of such Indebtedness in the event of a change of control as defined under such Indebtedness in accordance with provisions similar to the Change of Control covenant or (ii) at a purchase price not greater than 100% of the principal amount thereof in accordance with provisions similar to the Asset Sale covenant; *provided* that, prior to or simultaneously with such purchase, repurchase, redemption, defeasance or acquisition or retirement, Unifi has made the Change of Control Offer, Collateral Sale Offer or Asset Sale Offer, as applicable, as provided in such covenant with respect to the Sale and has completed, if applicable, the repurchase or redemption of all notes validly tendered for payment in connection with such Change of Control Offer, Collateral Sale Offer or Asset Sale Offer;

(11) payments of intercompany Subordinated Indebtedness the incurrence of which was permitted under the covenant under Incurrence of Indebtedness; and

(12) other Restricted Payments in an aggregate amount since the Issue Date not to exceed $10.0 million.

The amount of all Restricted Payments (other than cash) will be the fair market value on the date of the Restricted Payment of the asset(s) or securities proposed to be transferred or issued by Unifi or such Restricted Subsidiary, as the case may be, pursuant to the Restricted Payment. The fair market value of any non-cash Restricted Payment that is required to be valued by this covenant shall be determined by the Board of Directors of Unifi acting in good faith, whose resolution with respect thereto will be delivered to the trustee. The Board of

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Directors determination must be based upon an opinion or appraisal issued by an accounting, appraisal or investment banking firm of national standing if the fair market value exceeds $25.0 million.

For purposes of determining compliance with this covenant, in the event that a proposed Restricted Payment (or portion thereof) meets the criteria of more than one of the categories of Restricted Payments described in clauses (1) through (12) above, or is entitled to be incurred pursuant to the first paragraph of this covenant, Unifi will be entitled to classify such Restricted Payment (or portion thereof) on the date of its payment in any manner that complies with this covenant, and such Restricted Payment will be treated as having been made pursuant to only such clause or clauses or the first paragraph of this covenant.

Incurrence of Indebtedness

Unifi will not, and will not permit any of its Restricted Subsidiaries to, directly or indirectly, create, incur, issue, assume, guarantee or otherwise become directly or indirectly liable, contingently or otherwise, with respect to (collectively, incur) any Indebtedness (including Acquired Debt); *provided*, *however*, that Unifi and any Guarantor may incur Indebtedness (including Acquired Debt) if the Fixed Charge Coverage Ratio for Unifi s most recently ended four full fiscal quarters for which internal financial statements are available immediately preceding the date on which such additional Indebtedness is incurred would have been at least 2.0 to 1.0, determined on a pro forma basis (including a pro forma application of the net proceeds therefrom), as if the additional Indebtedness had been incurred at the beginning of such four-quarter period.

The first paragraph of this covenant will not prohibit:

(1) the incurrence by Unifi and any Guarantor of additional Indebtedness and letters of credit under one or more Credit Agreements in an aggregate principal amount at any one time outstanding under this clause (1) (with letters of credit being deemed to have a principal amount equal to the maximum potential liability of Unifi and its Restricted Subsidiaries thereunder) not to exceed the greater of (x) $100.0 million and (y) the Borrowing Base, *less* the aggregate amount of all Net Proceeds of Asset Sales applied by Unifi or any of its Restricted Subsidiaries since the Issue Date to repay any term Indebtedness under a Credit Agreement or to repay any revolving credit Indebtedness under a Credit Agreement and effect a corresponding commitment reduction thereunder pursuant to the covenant described above under Repurchase at the Option of Holders Asset Sales;

(2) the incurrence by Unifi and its Restricted Subsidiaries of the Existing Indebtedness;

(3) the incurrence by Unifi and the Guarantors of Indebtedness represented by the initial notes and the related Subsidiary Guarantees issued on the Issue Date and the Exchange Notes and the related Subsidiary Guarantees to be issued in exchange therefor pursuant to the registration rights agreement;

(4) the incurrence by Unifi or any of its Restricted Subsidiaries of Indebtedness represented by Capital Lease Obligations, mortgage financings, purchase money or other similar obligations with respect to assets other than Capital Stock or other Investments, in each case, incurred for the purpose of financing all or any part of the purchase price or cost of design, construction, use, installation or improvement of property, plant or equipment used in a Permitted Business, and Attributable Debt, in an aggregate principal amount not to exceed the greater of (x) $7.5 million and (y) 1.0% of Unifi s Consolidated Net Tangible Assets;

(5) the incurrence by Unifi or any of its Restricted Subsidiaries of Permitted Refinancing Indebtedness in exchange for, or the net proceeds of which are used to renew, refund, refinance, discharge, defease or replace Indebtedness (other than intercompany Indebtedness) that was permitted by the indenture to be incurred under the first paragraph of this covenant or clauses (2), (3), (4), (5) or (12) of this paragraph;

(6) the incurrence by Unifi or any of its Restricted Subsidiaries of intercompany Indebtedness between or among Unifi and any of its Restricted Subsidiaries; *provided*, *however*, that:

(a) if Unifi or any Guarantor is the obligor on such Indebtedness and the payee is not Unifi or a Guarantor, such Indebtedness must be expressly subordinated to the prior payment in full in cash of all Obligations with

respect to the notes, in the case of Unifi, or such Subsidiary Guarantee, in the case of a Guarantor; and

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(b) (i) any subsequent issuance or transfer of Equity Interests or any other event that results in any such Indebtedness being beneficially held by a Person other than Unifi or a Restricted Subsidiary of Unifi, (ii) any sale or other transfer of any such Indebtedness to a Person that is neither Unifi or a Restricted Subsidiary of Unifi or (iii) the designation of a Restricted Subsidiary which holds Indebtedness as an Unrestricted Subsidiary, will be deemed, in each case, to constitute an incurrence of such Indebtedness by Unifi or such Restricted Subsidiary, as the case may be, that was not permitted by this clause (6);

(7) the incurrence by Unifi or any of its Restricted Subsidiaries of Hedging Obligations;

(8) the Guarantee by Unifi or any of the Guarantors of Indebtedness of Unifi or a Restricted Subsidiary of Unifi that was permitted to be incurred by another provision of this covenant; *provided* that if the Indebtedness being guaranteed is (a) *pari passu* in right of payment to the notes or any Subsidiary Guarantee, then the related Guarantee shall rank equally in right of payment to the notes or such Subsidiary Guarantee, as the case may be, or (b) subordinated in right of payment to the notes or any Subsidiary Guarantee, then the related Guarantee shall be subordinated in right of payment to the same extent to the notes or such Subsidiary Guarantee, as the case may be;

(9) the incurrence of Indebtedness by Unifi or any of its Restricted Subsidiaries arising from the honoring by a bank or other financial institution of a check, draft or similar instrument (except in the case of daylight overdrafts) in the ordinary course of business inadvertently drawn against insufficient funds, *provided*, *however*, that such Indebtedness is extinguished within five Business Days after incurrence;

(10) the incurrence of Indebtedness by Unifi or any of its Restricted Subsidiaries incurred in respect of workers compensation claims, self-insurance obligations, bankers acceptances, performance, standby letters of credit, statutory clauses of lessors, licensees, contractors, franchisees or customers, surety and similar bonds and completion guarantees provided by Unifi or any of its Restricted Subsidiaries, in each case, in the ordinary course of business;

(11) the incurrence of Indebtedness by Unifi or any of its Restricted Subsidiaries arising from any agreement of Unifi or any Restricted Subsidiary providing for indemnities, guarantees, purchase price adjustments, earn-outs, letters of credit, surety bonds, performance bonds, holdbacks, contingency payment obligations based on the performance of the acquired or disposed assets or similar obligations (other than guarantees of Indebtedness) incurred by any Person in connection with the disposition of assets of Unifi or any Restricted Subsidiary, including, without limitation, any Capital Stock of any Restricted Subsidiary of Unifi;

(12) the incurrence by Unifi or any of its Restricted Subsidiaries of Acquired Debt related to the acquisition of a Permitted Business or an asset used in a Permitted Business if the Fixed Charge Coverage Ratio for Unifi s most recently ended four full fiscal quarters for which internal financial statements are available immediately preceding the date of such incurrence of Acquired Debt (the Relevant Fixed Charge Coverage Ratio) determined immediately after giving effect to such incurrence and the related acquisition (including through a merger, consolidation or otherwise) is equal to or greater than the Fixed Charge Coverage Ratio of Unifi determined immediately before giving effect to such incurrence and the related acquisition;

(13) Indebtedness of (i) Foreign Subsidiaries of Unifi incurred not to exceed at any one time outstanding and together with any other Indebtedness incurred under this clause (13) the greater of (x) $5.0 million and (y) 1.0% of the Consolidated Net Tangible Assets of Unifi and (ii) Indebtedness of Unifi do Brasil, Ltda in an aggregate principal amount at any time outstanding not to exceed $12.0 million, which Indebtedness is secured by certain cash deposits of Unifi do Brasil, Ltda with a Brazilian bank;

(14) the incurrence by Unifi or any of its Restricted Subsidiaries of Indebtedness arising in connection with endorsement of instruments for deposit in the ordinary course of business;

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(15) the incurrence by Unifi or any of its Restricted Subsidiaries of Indebtedness to the extent the net proceeds thereof are promptly deposited to defease the notes or satisfy the satisfaction and discharge of the Indenture as described below under Legal Defeasance and Covenant Defeasance and Satisfaction and Discharge; and

(16) the incurrence by Unifi or any Guarantor of additional Indebtedness, together with all other Indebtedness incurred pursuant to this clause (16) that is at the time outstanding, in an aggregate principal amount (or accreted value, as applicable) at any time outstanding not to exceed $15.0 million.

Unifi will not permit any of its Unrestricted Subsidiaries to incur any Indebtedness other than Non-Recourse Debt. If any Non-Recourse Debt of an Unrestricted Subsidiary shall at any time cease to constitute Non-Recourse Debt or such Unrestricted Subsidiary shall be redesignated a Restricted Subsidiary, such event will be deemed to constitute an incurrence of Indebtedness by a Restricted Subsidiary.

For purposes of determining compliance with this covenant:

(1) in the event that any Indebtedness meets the criteria of more than one of the categories described in clauses (1) through (16) above or is entitled to be incurred pursuant to the first paragraph of this covenant, Unifi, in its sole discretion, will be permitted to classify (or later reclassify in whole or in part) such item of Indebtedness in any manner that complies with this covenant; *provided* that Indebtedness under the Credit Agreement outstanding on the Issue Date will initially be deemed to have been incurred on such date in reliance on the exception provided by clause (1) of the second paragraph of this covenant;

(2) the accrual of interest, the accretion or amortization of original issue discount, the payment of interest on any Indebtedness in the form of additional Indebtedness with the same, or less onerous, terms, the reclassification of preferred stock of Unifi or any Guarantor as Indebtedness due to a change in accounting principles, and the payment of dividends on Disqualified Stock or preferred stock in the form of additional shares of the same class of Disqualified Stock or preferred stock, the accrual of dividends on Disqualified Stock or preferred stock and the accretion of the liquidation preference of Disqualified Stock or preferred stock will not be deemed to be an incurrence of Indebtedness for purposes of this covenant; *provided,* in each such case, that the amount thereof shall be included in the Fixed Charges of Unifi;

(3) if obligations in respect of letters of credit are incurred pursuant to a Credit Agreement and are being treated as incurred pursuant to clause (1) of the second paragraph above and the letters of credit relate to other Indebtedness, then such other Indebtedness shall not be included;

(4) Indebtedness permitted by this covenant need not be permitted solely by reference to one provision permitting such Indebtedness, but may be permitted in part by one such provision and in part by one or more other provisions of this covenant permitting such Indebtedness; and

(5) for the purposes of determining compliance with any U.S. dollar-denominated restriction on the incurrence of Indebtedness denominated in a foreign currency, the dollar-equivalent principal amount of such Indebtedness incurred pursuant thereto shall be calculated based on the relevant currency exchange rate in effect on the earlier of the date that such Indebtedness was incurred, in the case of term Indebtedness, or first committed, in the case of revolving credit Indebtedness; *provided* that if such Indebtedness is incurred to refinance other Indebtedness denominated in a foreign currency, and such refinancing would cause the applicable U.S. dollar-dominated restriction to be exceeded if calculated at the relevant currency exchange rate in effect on the date of such refinancing, such U.S. dollar-dominated restriction shall be deemed not to have been exceeded so long as the principal amount of such refinancing Indebtedness does not exceed the principal amount of such Indebtedness being refinanced. Notwithstanding any other provision of this covenant, the maximum amount of Indebtedness that Unifi or any of its Restricted Subsidiaries may incur pursuant to this covenant shall not be deemed to be exceeded solely as a result of fluctuations in the exchange rate of currencies. The principal amount

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of any Indebtedness incurred to refinance other Indebtedness, if incurred in a different currency from the Indebtedness being refinanced, shall be calculated based on the currency exchange rate applicable to the currencies in which such refinancing Indebtedness is denominated that is in effect on the date of such refinancing.

Upon any replacement or refinancing of any Credit Agreement or any portion thereof with a lender that does not become a party to the Intercreditor Agreement, the trustee shall enter into an intercreditor agreement with such lender with terms that are not materially different to the trustee or the Holders of notes than those contained in the Intercreditor Agreement.

Liens

Unifi will not and will not permit any of its Restricted Subsidiaries to, directly or indirectly, create, incur, assume or otherwise cause or suffer to exist or become effective any Lien of any kind securing Indebtedness or trade payables (other than Permitted Liens) upon any of their property or assets, now owned or hereafter acquired.

Dividend and Other Payment Restrictions Affecting Restricted Subsidiaries

Unifi will not, and will not permit any of its Restricted Subsidiaries to, directly or indirectly, create or permit to exist or become effective any consensual encumbrance or restriction on the ability of any Restricted Subsidiary to:

(1) pay dividends or make any other distributions on its Capital Stock to Unifi or any of its Restricted Subsidiaries (it being understood that the priority of any preferred stock in receiving dividends or liquidating distributions prior to dividends or liquidating distributions being paid on common stock shall not be deemed a restriction on the ability to make distributions on Capital Stock) or pay any Indebtedness owed to Unifi or any of its Restricted Subsidiaries;

(2) make loans or advances to Unifi or any of its Restricted Subsidiaries (it being understood that the subordination of loans or advances made to Unifi or any of its Restricted Subsidiaries to other Indebtedness incurred by Unifi or any of its Restricted Subsidiaries shall not be deemed a restriction on the ability to make loans or advances); or

(3) sell, lease or transfer any of its properties or assets to Unifi or any of its Restricted Subsidiaries.

However, the preceding restrictions will not apply to encumbrances or restrictions existing under or by reason of:

(1) agreements governing Existing Indebtedness and the Credit Agreement as in effect on the Issue Date and any amendments, modifications, restatements, renewals, increases, supplements, refundings, replacements or refinancings of those agreements; *provided* that the amendments, modifications, restatements, renewals, increases, supplements, refundings, replacements or refinancings are no more restrictive in any material respect, taken as a whole, with respect to such dividend and other payment restrictions than those contained in those agreements on the Issue Date as reasonably determined by Unifi;

(2) the indenture, the initial notes, the additional notes, the Exchange Notes, the related Subsidiary Guarantees, the Collateral Documents and the Intercreditor Agreement;

(3) applicable law or any applicable rule, regulation or order;

(4) any instrument governing Indebtedness or Capital Stock of a Person acquired by Unifi or any of its Restricted Subsidiaries as in effect at the time of such acquisition (except to the extent such Indebtedness or

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Capital Stock was incurred in connection with or in contemplation of such acquisition), which encumbrance or restriction is not applicable to any Person, or the properties or assets of any Person, other than the Person, or the property or assets of the Person, so acquired, including any amendments, modifications, restatements, renewals, increases, supplements, refundings, replacements or refinancings of any such agreements or instruments; *provided* that the amendments, modifications, restatements, renewals, increases, supplements, refundings, replacements or refinancings are no more restrictive in any material respect, taken as a whole, than those contained in the agreements governing such original agreement or instrument, as reasonably determined by Unifi; *provided, further,* that, in the case of Indebtedness, such Indebtedness was permitted by the terms of the indenture to be incurred;

(5) in the case of clause (3) of the first paragraph of this covenant:

(a) a lease, license or similar contract that restricts in a customary manner the subletting, assignment or transfer of any subject property or asset, or the assignment or transfer of any such lease, license or other contract;

(b) mortgages, pledges or other agreements or instruments permitted under the indenture securing Indebtedness of Unifi or any of its Restricted Subsidiaries to the extent such encumbrances or restrictions restrict the transfer of the property subject to such mortgages, pledges or other agreements or instruments; or

(c) reciprocal easement agreements of Unifi or any of its Restricted Subsidiaries containing customary provisions restricting dispositions of the subject real property interests;

(6) leases and other agreements containing net worth provisions entered into by Unifi or any Restricted Subsidiary in the ordinary course of business;

(7) purchase money obligations, mortgage financings, Capital Lease Obligations and other similar obligations permitted under the indenture that, in each case, impose restrictions on the property purchased or leased of the nature described in clause (3) of the preceding paragraph;

(8) any agreement for the sale or other disposition of assets or Capital Stock of a Restricted Subsidiary permitted under the indenture that restricts the sale of assets, distributions, loans or other activities by that Restricted Subsidiary pending the consummation of such sale or other disposition;

(9) Permitted Refinancing Indebtedness, *provided* that the dividend and other payment restrictions contained in the agreements governing such Permitted Refinancing Indebtedness are no more restrictive in any material respect, taken as a whole, than those contained in the agreements governing the Indebtedness being refinanced as reasonably determined by Unifi;

(10) agreements and other instruments evidencing Liens securing Indebtedness otherwise permitted to be incurred under the provisions of the covenant described above under the caption Liens that limit the right of the debtor to dispose of the assets subject to such Liens, including Permitted Liens;

(11) provisions with respect to the disposition or distribution of assets or property in joint venture agreements and other similar agreements permitted by the indenture; *provided* that such restrictions apply only to the assets or property subject to such agreements;

(12) other Indebtedness of Foreign Subsidiaries permitted to be incurred subsequent to the Issue Date pursuant to the provisions of the covenant described under Incurrence of Indebtedness;

(13) restrictions on cash or other deposits or net worth under contracts or leases entered into in the ordinary course of business;

(14) any instrument governing any Indebtedness or Capital Stock of a Person that is an Unrestricted Subsidiary as in effect on the date that such Person becomes a Restricted Subsidiary, which encumbrance or

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restriction is not applicable to any Person, or the properties or assets of any Person, other than the Person who became a Restricted Subsidiary, or the property or assets of the Person who became a Restricted Subsidiary, including any amendments, modifications, restatements, renewals, increases, supplements, refundings, replacements or refinancings of any such agreements or instruments; *provided* that the amendments, modifications, restatements, renewals, increases, supplements, refundings, replacements or refinancings are no more restrictive in any material respect, taken as a whole, than those contained in the agreements governing such original agreement or instrument, as reasonably determined by Unifi; *provided*, *further*, that, in the case of Indebtedness, such Indebtedness was permitted by the terms of the indenture to be incurred;

(15) encumbrances or restrictions existing pursuant to the subordination provisions of any Indebtedness that is permitted to be incurred under the Indenture; and

(16) Indebtedness permitted to be incurred under clause (15) of the second paragraph of the covenant entitled Incurrence of Indebtedness.

Merger, Consolidation or Sale of Assets

Unifi will not, directly or indirectly: (1) consolidate or merge with or into another Person (whether or not Unifi is the surviving corporation); or (2) sell, assign, transfer, convey, lease or otherwise dispose of all or substantially all of the properties or assets of Unifi and its Restricted Subsidiaries taken as a whole, in one or more related transactions, to another Person, unless:

(1) either: (a) Unifi is the surviving corporation; or (b) the Person formed by or surviving any such consolidation or merger (if other than Unifi) or to which such sale, assignment, transfer, conveyance, lease or other disposition has been made (the Successor Person) is a corporation organized or existing under the laws of the United States, any state of the United States or the District of Columbia;

(2) the Successor Person (if other than Unifi) expressly assumes all the obligations of Unifi under the notes, the indenture, the registration rights agreement, the Collateral Documents (as applicable) and the Intercreditor Agreement pursuant to agreements reasonably satisfactory to the trustee and shall cause such amendments, supplements or other instruments to be executed, filed, and recorded in such jurisdictions as may be required by applicable law to preserve and protect the Lien on the Collateral owned by or transferred to the Successor Person, together with such financing statements or comparable documents as may be required to perfect any security interests in such Collateral that may be perfected by the filing of a financing statement or a similar document under the Uniform Commercial Code or other similar statute or regulation of the relevant states or jurisdictions;

(3) immediately after such transaction, no Default or Event of Default exists;

(4) Unifi or the Successor Person (if other than Unifi) will, on the date of such transaction after giving pro forma effect thereto and any related financing transactions as if the same had occurred at the beginning of the applicable four-quarter period, be permitted to incur at least $1.00 of additional Indebtedness pursuant to the Fixed Charge Coverage Ratio test set forth in the first paragraph of the covenant described above under the caption Incurrence of Indebtedness; and

(5) Unifi shall have delivered to the trustee an Officers Certificate and an opinion of counsel, each stating that such consolidation, merger or transfer complies with the provisions of the indenture.

For purposes of this covenant, the sale, assignment, transfer, conveyance, lease or other disposition to a Person other than Unifi or another Restricted Subsidiary of all or substantially all of the properties and assets of one or more Restricted Subsidiaries of Unifi, which properties and assets, if held by Unifi instead of such Restricted Subsidiaries, would constitute all or substantially all of the properties and assets of Unifi on a consolidated basis, shall be deemed to be the transfer of all or substantially all of the properties and assets of Unifi.

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The Successor Person will succeed to, and be substituted for, and may exercise every right and power of, Unifi under the indenture and the Collateral Documents, but, in the case of a lease of all or substantially all its assets, Unifi will not be released from the obligation to pay the principal of, and interest on the notes.

Although there is a limited body of case law interpreting the phrase substantially all, there is no precise established definition of the phrase under applicable law. Accordingly, in certain circumstances there may be a degree of uncertainty as to whether a particular transaction would involve all or substantially all of the property or assets of a Person.

Without complying with the preceding clause (4), (i) any Restricted Subsidiary may consolidate with, merge into, sell, assign, convey, lease or otherwise transfer all or part of its properties and assets to Unifi or to any Guarantor, (ii) Unifi may merge with an Affiliate incorporated solely for the purpose of reincorporating Unifi in another jurisdiction and (iii) Unifi may merge with an Affiliate for the purpose of forming or collapsing a holding company structure; *provided* that any such holding company s only material asset is Equity Interests of Unifi and so long as the owners of the Voting Stock of Unifi immediately before giving effect to such transaction and the owners of the Voting Stock of such holding company immediately after giving effect to such transaction are substantially similar.

In addition, Unifi will not permit any Guarantor to consolidate with or merge with or into any Person (other than Unifi or another Guarantor) and will not permit the conveyance, transfer or lease of all or substantially all of the assets of any Guarantor unless:

(a) if such Person remains a Guarantor, the resulting, surviving or transferee Person will be a Person organized and existing under the laws of the United States, any state of the United States or the District of Columbia and such Person (if not Unifi or such Guarantor) will expressly assume, by supplemental indenture, executed and delivered to the trustee, all the obligations of such Guarantor under its Subsidiary Guarantee, the indenture, the registration rights agreement, the related Collateral Documents and the Intercreditor Agreement and shall cause such amendments, supplements or other instruments to be executed, filed, and recorded in such jurisdictions as may be required by applicable law to preserve and protect the Lien on the Collateral owned by or transferred to the surviving entity, together with such financing statements or comparable documents as may be required to perfect any security interests in such Collateral which may be perfected by the filing of a financing statement or a similar document under the Uniform Commercial Code or other similar statute or regulation of the relevant states or jurisdictions;

(b) immediately after giving effect to such transaction, no Default of Event of Default shall have occurred and be continuing; and

(c) Unifi will have delivered to the trustee an Officers Certificate and an opinion of counsel, each stating that such consolidation, merger or transfer complies with the provisions of the indenture.

Transactions with Affiliates

Unifi will not, and will not permit any of its Restricted Subsidiaries to, directly or indirectly, make any payment to, or sell, lease, transfer or otherwise dispose of any of its properties or assets to, or purchase any property or assets from, or enter into or make or amend any transaction, contract, agreement, understanding, loan, advance or guarantee with, or for the benefit of, any Affiliate of Unifi (each, an Affiliate Transaction), unless:

(1) the Affiliate Transaction is on terms that are no less favorable to Unifi or the relevant Restricted Subsidiary than those that would have been obtained in a comparable transaction in arm s-length dealings by Unifi or such Restricted Subsidiary with a Person who is not an Affiliate; and

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(2) Unifi delivers to the trustee:

(a) with respect to any Affiliate Transaction or series of related Affiliate Transactions involving aggregate consideration in excess of $5.0 million, a written resolution of the Board of Directors of Unifi set forth in an Officers Certificate certifying that a majority of the disinterested members of the Board of Directors have approved such Affiliate Transaction and determined that such Affiliate Transaction complies with this covenant; and

(b) with respect to any Affiliate Transaction or series of related Affiliate Transactions involving aggregate consideration in excess of $15.0 million, a written opinion issued by an independent accounting, appraisal or investment banking firm of national standing to the effect that (a) the financial terms of such Affiliate Transaction are fair to Unifi of such Restricted Subsidiary from a financial point of view or (b) such Affiliate Transaction is not materially less favorable to Unifi or such Restricted Subsidiary than those that might reasonably have been obtained in a comparable transaction at such time on an arm s-length basis from a Person that is not an Affiliate.

The following items will not be deemed to be Affiliate Transactions and, therefore, will not be subject to the provisions of the preceding paragraph:

(1) reasonable and customary (a) directors fees and indemnification and similar arrangements, (b) consulting fees and agreements, (c) officers and employee salaries, bonuses and employment agreements (including indemnification arrangements), and (d) compensation or employee benefit arrangements and incentive arrangements with any officer, director, employee or consultant entered into in the ordinary course of business or approved by Unifi s Board of Directors (including customary benefits thereunder) and payments pursuant thereto;

(2) transactions between or among Unifi and/or its Restricted Subsidiaries and Guarantees issued by Unifi or any of its Restricted Subsidiaries for the benefit of Unifi or any of its Restricted Subsidiaries, as the case may be, in accordance with Incurrence of Indebtedness;

(3) transactions with a Person (other than an Unrestricted Subsidiary of Unifi) that is an Affiliate of Unifi or any Restricted Subsidiary solely because Unifi or any Restricted Subsidiary owns an Equity Interest in, or controls, such Person;

(4) the pledge of Equity Interests of Unrestricted Subsidiaries to support the Indebtedness thereof;

(5) issuances and sales of Equity Interests (other than Disqualified Stock) of Unifi to Affiliates of Unifi and the granting of registration and other customary rights in connection therewith;

(6) Restricted Payments that are permitted by the provisions of the indenture described above under the caption Restricted Payments and Permitted Investments (other than pursuant to clause (1), clause (3) or clause (15) of such definition);

(7) the performance of obligations of Unifi or any of its Restricted Subsidiaries under the terms of any agreement to which Unifi or any of its Restricted Subsidiaries is a party as of or on the Issue Date and on the material terms substantially as described in the Offering Memorandum, as these agreements may be amended, modified, supplemented, extended or renewed from time to time; *provided*, *however*, that any future amendment, modification, supplement, extension or renewal entered into after the Issue Date will be permitted to the extent that its terms as a whole are not more disadvantageous to the holders of the notes than the terms of the agreements in effect on the Issue Date as reasonably determined by Unifi;

(8) transactions with customers, clients, suppliers or purchasers or sellers of goods or services in each case in the ordinary course of business and otherwise in compliance with the terms of the indenture; provided that such transaction complies with the requirements of clause (1) of the first paragraph of this covenant;

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(9) transactions pursuant to agreements or other arrangements as described in the Offering Memorandum in the section entitled Certain Relationships and Related Party Transactions; and

(10) agreements providing for the provision of administrative, treasury, accounting, management or other similar corporate services by Unifi or any Restricted Subsidiary to an Affiliate; provided that any such agreement shall comply with the requirements of clause (1) of the first paragraph of this covenant.

Designation of Unrestricted Subsidiaries

The Board of Directors of Unifi may designate any Restricted Subsidiary to be an Unrestricted Subsidiary if that designation would not cause a Default. If a Restricted Subsidiary is designated as an Unrestricted Subsidiary, the aggregate fair market value of all outstanding Investments owned by Unifi and its Restricted Subsidiaries in the Subsidiary properly designated as an Unrestricted Subsidiary will be deemed to be an Investment made as of the time of the designation and will reduce the amount available for Restricted Payments under the first paragraph (or clause (12) of the second paragraph) of the covenant described above under the caption Restricted Payments or under one or more clauses of the definition of Permitted Investments, as determined by Unifi. Such designation will only be permitted if the Investment would be permitted at that time and if the Restricted Subsidiary otherwise meets the definition of an Unrestricted Subsidiary. If immediately prior to a Person being designated as an Unrestricted Subsidiary an Investment was made in such Person which resulted in such Person becoming a Subsidiary, only the amount of such Investment will further reduce the amount available for Restricted Payments under the first paragraph (or clause (12) of the second paragraph) of the covenant described above under the caption Restricted Payments or under one or more clauses of the definition of Permitted Investments, as determined by Unifi. The Board of Directors of Unifi may redesignate any Unrestricted Subsidiary to be a Restricted Subsidiary at any time if the redesignation would not cause a Default or an Event of Default.

Any designation of a Subsidiary of Unifi as an Unrestricted Subsidiary will be evidenced to the trustee by filing with the trustee a certified copy of a resolution of the Board of Directors of Unifi giving effect to such designation and an Officers Certificate certifying that such designation complies with the preceding conditions and is permitted by the covenant described above under Restricted Payments. If, at any time, any Unrestricted Subsidiary would fail to meet the preceding requirements as an Unrestricted Subsidiary, it will thereafter cease to be an Unrestricted Subsidiary for purposes of the indenture and any Indebtedness of such Subsidiary will be deemed to be incurred by a Restricted Subsidiary of Unifi as of such date and, if such Indebtedness is not permitted to be incurred as of such date under the covenant described under Incurrence of Indebtedness, Unifi will be in default of such covenant. The Board of Directors of Unifi may at any time designate any Unrestricted Subsidiary to be a Restricted Subsidiary of Unifi; *provided* that such designation will be deemed to be an incurrence of Indebtedness by a Restricted Subsidiary of Unifi of any outstanding Indebtedness of such Unrestricted Subsidiary and such designation will only be permitted if (1) such Indebtedness is permitted under the covenant described under Incurrence of Indebtedness, calculated on a pro forma basis as if such designation had occurred at the beginning of the four-quarter reference period; and (2) no Default or Event of Default would be in existence as a result of such designation.

All Subsidiaries of Unrestricted Subsidiaries shall be automatically deemed to be Unrestricted Subsidiaries. All designations of Subsidiaries as Unrestricted Subsidiaries and revocations thereof must be evidenced by filing with the trustee resolutions of the Board of Directors of Unifi and an Officers Certificate certifying compliance with the foregoing provisions.

Additional Subsidiary Guarantees

If Unifi or any of its Restricted Subsidiaries acquires or creates another Domestic Subsidiary after the Issue Date, such Domestic Subsidiary shall on the date on which it was acquired or created become a Guarantor and execute a supplemental indenture pursuant to which such Domestic Subsidiary will guarantee, on a joint and

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several basis, the full and prompt payment of the principal of, premium, if any, and interest and Additional Interest, if any, on the notes on a senior secured basis. In addition, if any of Unifi s Foreign Subsidiaries guarantees any Indebtedness of Unifi or any Guarantor, such Foreign Subsidiary shall simultaneously become a Guarantor and execute a supplemental indenture pursuant to which such Foreign Subsidiary will guarantee, on a joint and several basis, the full and prompt payment of the principal of, premium, if any, and interest and Additional Interest, if any, on the notes on a senior secured basis. In addition, Unifi will cause such Subsidiary to become a party to the Collateral Documents and the Intercreditor Agreement and take such actions necessary or advisable (to the extent permitted by applicable law, rule or regulation) to grant to the Collateral Agent, for the benefit of itself and the holders of the notes, a perfected security interest in any Collateral (other than Excluded Assets) held by such Subsidiary, subject to Permitted Liens and the Intercreditor Agreement. The foregoing provisions shall not apply to Subsidiaries that have been properly designated as Unrestricted Subsidiaries in accordance with the indenture for so long as they continue to constitute Unrestricted Subsidiaries.

Each Subsidiary Guarantee will be limited to an amount not to exceed the maximum amount that can be guaranteed by that Restricted Subsidiary without rendering the Subsidiary Guarantee, as it relates to such Restricted Subsidiary, voidable under applicable law relating to fraudulent conveyance or fraudulent transfer or similar laws affecting the rights of creditors generally.

Business Activities

Unifi will not, and will not permit any Restricted Subsidiary to, engage in any business other than Permitted Businesses, except to such extent as would not be material to Unifi and its Subsidiaries taken as a whole.

Payments for Consent

Unifi will not, and will not permit any of its Subsidiaries to, directly or indirectly, pay or cause to be paid any consideration to or for the benefit of any holder of notes for or as an inducement to any consent, waiver or amendment of any of the terms or provisions of the indenture, the notes, the Collateral Documents or the Intercreditor Agreement unless such consideration is offered to be paid to all holders of the notes and is paid to all holders of the notes or to all holders of the notes that consent, waive or agree to amend in the time frame set forth in the solicitation documents relating to such consent, waiver or agreement.

Reports

Whether or not required by the rules and regulations of the Commission, so long as any notes are outstanding, Unifi will furnish to the holders of notes or cause the trustee to furnish to the holders of notes, within the time periods specified in the Commission s rules and regulations:

(1) all quarterly and annual reports that would be required to be filed with the Commission on Forms 10-Q and 10-K if Unifi were required to file such reports, including a Management s Discussion and Analysis of Financial Condition and Results of Operations and, with respect to the annual information only, a report on the annual financial statements by Unifi s certified independent accountants; and

(2) all current reports that would be required to be filed with the Commission on Form 8-K if Unifi were required to file such reports.

All such reports will be prepared in all material respects in accordance with the rules and regulations of the Commission applicable to such reports. Each annual report on Form 10-K will include a report on Unifi s consolidated financial statements by Unifi s registered independent accountants.

If Unifi has designated any of its Subsidiaries as Unrestricted Subsidiaries, then the quarterly and annual financial information required by the preceding paragraph will include a reasonably detailed presentation, either

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on the face of the financial statements or in the footnotes thereto, or in Management s Discussion and Analysis of Financial Condition and Results of Operations, of the financial condition and results of operations of Unifi and its Restricted Subsidiaries separate from the financial condition and results of operations of the Unrestricted Subsidiaries of Unifi.

Whether or not required by the Commission, Unifi will file a copy of each of the reports referred to in clauses (1) and (2) above with the Commission for public availability within the time periods specified in the Commission s rules and regulations applicable to such reports (unless the Commission will not accept such a filing) and make such information available to securities analysts and prospective investors upon request. Unifi s reporting obligations with respect to clauses (1) and (2) above shall be deemed satisfied in the event Unifi files such reports with the Commission on EDGAR (or any successor system) and delivers a copy of such reports to the trustee.

If, at any time after consummation of the Exchange Offer contemplated by the registration rights agreement, Unifi is no longer subject to the periodic reporting requirements of the Exchange Act for any reason, Unifi will nevertheless continue filing the reports specified in the preceding paragraphs with the Commission within the time periods specified above unless the Commission will not accept such a filing. Unifi will not take any action for the sole purpose of causing the Commission not to accept any such filings. If, notwithstanding the foregoing, the Commission will not accept Unifi s filings for any reason, Unifi will post such reports on its web site within the time periods that would apply if Unifi was required to file those reports with the Commission.

In addition, Unifi has agreed that, for so long as any notes remain outstanding, if at any time it is not required to file with the Commission the reports required by the preceding paragraphs, it will furnish to the holders of notes and to securities analysts and prospective investors, upon their request, the information required to be delivered pursuant to Rule 144A(d) (4) under the Securities Act.

If at any time the notes are Guaranteed by a direct or indirect parent of Unifi, and such company is subject to and has complied with the reporting requirements of Section 13 or 15(d) of the Exchange Act, if applicable, and has furnished the holders of notes, or filed electronically with the Commission on EDGAR (or any successor system), the reports described herein with respect to such company, as applicable (including any financial information required by Regulation S-X under the Securities Act), Unifi shall be deemed to be in compliance with the provisions of this covenant. Any information filed or furnished to the Commission via EDGAR (or any successor system) shall be deemed to have been made available to the registered holders of the notes. The subsequent filing or making available of any report required by this covenant shall be deemed automatically to cure any Default or Event of Default resulting from the failure to file or make available such report within the required time frame.

Events of Default and Remedies

Each of the following is an Event of Default :

(1) default for 30 days in the payment when due of interest on, or Additional Interest, if any, with respect to, the notes;

(2) default in the payment when due (at maturity, upon redemption or otherwise) of the principal of, or premium, if any, on, the notes;

(3) failure by Unifi or any of its Restricted Subsidiaries to comply with the provision described under the caption Certain Covenants Merger, Consolidation or Sale of Assets;

(4) failure by Unifi or any of its Restricted Subsidiaries for 30 days after notice to Unifi by the trustee or the holder of at least 25% in aggregate principal amount of the notes then outstanding to comply with (a) the

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provisions described under the caption Repurchase at the Option of Holders or any of the other provisions under the caption Certain Covenants; or (b) any of its obligations under the Collateral Documents;

(5) failure by Unifi or any of its Restricted Subsidiaries for 60 days after notice to Unifi by the trustee or the holder of at least 25% in aggregate principal amount of the notes then outstanding to comply with any of the other covenants or agreements in the indenture;

(6) default under any mortgage, indenture or instrument under which there may be issued or by which there may be secured or evidenced any Indebtedness of Unifi or any of its Restricted Subsidiaries (or the payment of which is guaranteed by Unifi or any of its Restricted Subsidiaries), whether such Indebtedness or Guarantee now exists or is created after the Issue Date, if that default:

(a) is caused by a failure to pay principal of or interest or premium, if any, on such Indebtedness prior to the expiration of the grace period provided in such Indebtedness (a Payment Default); or

(b) results in the acceleration of such Indebtedness prior to its Stated Maturity, and, in each case, the principal amount of any such Indebtedness, together with the principal amount of any other such Indebtedness under which there has been a Payment Default or the maturity of which has been so accelerated, aggregates $10.0 million or more;

(7) failure by Unifi or any of its Restricted Subsidiaries to pay final judgments entered by a court or courts of competent jurisdiction (not subject to appeal) aggregating in excess of $10.0 million (net of any amounts which are bonded or which a reputable and creditworthy insurance company has acknowledged liability for in writing), which judgments are not paid, discharged or stayed for a period of 60 days after the date on which the right to appeal has expired;

(8) except as permitted by the indenture, any Subsidiary Guarantee shall be held in any judicial proceeding before a court of competent jurisdiction to be unenforceable or invalid or shall cease for any reason to be in full force and effect, or Unifi or any Guarantor, or any Person acting on behalf of Unifi or any Guarantor, shall deny or disaffirm its obligations under its Subsidiary Guarantee to which it is a party;

(9) certain events of bankruptcy, insolvency or reorganization described in the indenture with respect to Unifi or any of its Restricted Subsidiaries that is a Significant Subsidiary or any group of Restricted Subsidiaries that, taken as a whole, would constitute a Significant Subsidiary; and

(10) with respect to any Collateral having a fair market value in excess of $10.0 million, individually or in the aggregate, (A) the security interest under the Collateral Documents, at any time, ceases to be in full force and effect for any reason other than in accordance with the terms of the indenture, the Collateral Documents or the Intercreditor Agreement, (B) any security interest created thereunder or under the indenture is declared invalid or unenforceable by a court of competent jurisdiction or (C) Unifi or any Guarantor asserts, in any pleading in any court of competent jurisdiction, that any such security interest is invalid or unenforceable.

In the case of an Event of Default arising from certain events of bankruptcy, insolvency or reorganization, with respect to Unifi or any Restricted Subsidiary of Unifi that is a Significant Subsidiary or any group of Restricted Subsidiaries that, taken as a whole, would constitute a Significant Subsidiary, all outstanding notes will become due and payable immediately without further action or notice. If any other Event of Default occurs and is continuing, the trustee or the holders of at least 25% in aggregate principal amount of the then outstanding notes, by notice in writing to the trustee and Unifi, may declare all the notes to be due and payable. Notwithstanding anything contained in the indenture or the notes to the contrary, upon such a declaration, the principal, premium, interest and Additional Interest, if any, on the notes will become immediately due and payable. In the event of a declaration of acceleration of the notes because an Event of Default described in clause (6) above has occurred and is continuing, the declaration of acceleration of the notes shall be automatically annulled if the event of default or payment default triggering such Event of Default pursuant to clause (6) shall

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be remedied or cured by Unifi or a Restricted Subsidiary of Unifi or waived by the holders of the relevant Indebtedness within 20 days after the declaration of acceleration with respect thereto and if (1) the annulment of the acceleration of the notes would not conflict with any judgment or decree of a court of competent jurisdiction and (2) all existing Events of Default, except nonpayment of principal, premium or interest on the notes that became due solely because of the acceleration of the notes, have been cured or waived.

The exercise of rights and remedies under the Indenture by the trustee and Holders of the notes may be limited or restricted by, and shall be subject to, the terms of the Collateral Documents and the Intercreditor Agreement.

Subject to the provisions of the indenture relating to the duties of the trustee or the Collateral Agent, in case an Event of Default shall occur and be continuing, the trustee or the Collateral Agent will be under no obligation to exercise any of its rights or powers under the indenture, the Collateral Documents or the Intercreditor Agreement at the request or direction of any of the holders of notes, unless such holders shall have offered to the trustee or the Collateral Agent reasonable indemnity against any loss, liability or expense. Subject to such provisions for the indemnification of the trustee, the holders of a majority in aggregate principal amount of the then outstanding notes may direct the trustee in its exercise of any trust or power. The trustee may withhold from holders of the notes notice of any continuing Default or Event of Default if it determines that withholding notice is in their interest, except a Default or Event of Default relating to the payment of principal, premium, interest or Additional Interest. Except to enforce the right to receive payment of principal, premium, if any, or interest or Additional Interest, if any, when due, no holder of a note may pursue any remedy with respect to the indenture, the notes, any Subsidiary Guarantee, the Collateral Documents or the Intercreditor Agreement unless:

(1) such holder has previously given the trustee notice that an Event of Default is continuing;

(2) holders of at least 25% in aggregate principal amount of the then outstanding notes have requested the trustee to pursue the remedy;

(3) such holders have offered the trustee reasonable security or indemnity against any loss, liability or expense;

(4) the trustee has not complied with such request within 60days after the receipt of the request and the offer of security or indemnity; and

(5) holders of a majority in aggregate principal amount of the then outstanding notes have not given the trustee a direction inconsistent with such request within such 60-day period.

The holders of a majority in aggregate principal amount of the notes then outstanding by notice to the trustee may, on behalf of the holders of all of the notes, rescind an acceleration or waive any existing Default or Event of Default and its consequences under the indenture, except a continuing Default or Event of Default in the payment of principal of, or interest or premium or Additional Interest, if any, on the notes.

Unifi is required to deliver to the trustee annually, within 90 days after the end of its fiscal year, an Officers Certificate regarding compliance by it with the indenture. Within 10 Business Days of becoming aware of any Default or Event of Default, Unifi is required to deliver to the trustee written notice specifying such Default or Event of Default, its status and what action Unifi is taking or proposing to take in respect thereof, unless such default shall have been previously cured or waived.

No Personal Liability of Directors, Officers, Employees and Stockholders

No director, officer, employee, incorporator, member, manager, general or limited partner or stockholder of Unifi or any Guarantor, as such, will have any liability for any obligations of Unifi or the Guarantors under the notes, the indenture, the Subsidiary Guarantees, the Collateral Documents, the registration rights agreement, the

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Intercreditor Agreement or for any claim based on, in respect of, or by reason of, such obligations or their creation. Each holder of notes by accepting a note waives and releases all such liability. The waiver and release are part of the consideration for issuance of the notes. The waiver may not be effective to waive liabilities under the federal securities laws.

Legal Defeasance and Covenant Defeasance

Unifi may, at its option and at any time, elect to have all of its obligations discharged with respect to the outstanding notes, the indenture, the Collateral Documents and the Intercreditor Agreement and all obligations of the Guarantors discharged with respect to their Subsidiary Guarantees, the indenture, the Collateral Documents and the Intercreditor Agreement (Legal Defeasance) except for:

(1) the rights of holders of outstanding notes to receive payments in respect of the principal of, or interest or premium and Additional Interest, if any, on such notes when such payments are due from the funds in the trust referred to below;

(2) Unifi s obligations with respect to the notes concerning issuing temporary notes, registration of notes, mutilated, destroyed, lost or stolen notes and the maintenance of an office or agency for payment and money for security payments held in trust;

(3) the rights, powers, trusts, duties and immunities of the trustee, and Unifi s and the Guarantors obligations in connection therewith; and

(4) the Legal Defeasance and Covenant Defeasance provisions of the indenture.

In addition, Unifi may, at its option and at any time, elect to have the obligations of Unifi and the Guarantors released with respect to certain covenants (including its obligation to make Change of Control Offers and Asset Sale Offers) that are described in the indenture (Covenant Defeasance) and thereafter any omission to comply with those covenants will not constitute a Default or Event of Default with respect to the notes. In the event Covenant Defeasance occurs, certain events (not including non-payment, bankruptcy, receivership, rehabilitation and insolvency events) described under Events of Default and Remedies will no longer constitute an Event of Default with respect to the notes.

In order to exercise either Legal Defeasance or Covenant Defeasance:

(1) Unifi must irrevocably deposit with the trustee, in trust, for the benefit of the holders of the notes, cash in U.S. dollars, non-callable Government Securities, or a combination of cash in U.S. dollars and non-callable Government Securities, in amounts as will be sufficient, to pay the principal of, or interest and premium and Additional Interest, if any, on, the outstanding notes on the Stated Maturity or on the applicable redemption date specified by Unifi, as the case may be, and Unifi must specify whether the notes are being defeased to maturity or to a particular redemption date;

(2) in the case of Legal Defeasance, Unifi must deliver to the trustee an opinion of counsel reasonably acceptable to the trustee confirming that:

(a) Unifi has received from, or there has been published by, the Internal Revenue Service a ruling; or

(b) since the Issue Date, there has been a change in the applicable federal income tax law, in either case to the effect that, and based thereon such opinion of counsel will confirm that, the holders of the outstanding notes will not recognize income, gain or loss for federal income tax purposes as a result of such Legal Defeasance and will be subject to federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such Legal Defeasance had not occurred;

(3) in the case of Covenant Defeasance, Unifi must deliver to the trustee an opinion of counsel reasonably acceptable to the trustee confirming that the holders of the outstanding notes will not recognize income, gain or

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loss for federal income tax purposes as a result of such Covenant Defeasance and will be subject to federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such Covenant Defeasance had not occurred;

(4) no Default or Event of Default has occurred and is continuing on the date of such deposit (other than a Default or Event of Default resulting from the borrowing of funds to be applied to such deposit);

(5) such Legal Defeasance or Covenant Defeasance will not result in a breach or violation of, or constitute a default under, any material agreement or instrument (other than the indenture) to which Unifi or any of its Restricted Subsidiaries is a party or by which Unifi or any of its Restricted Subsidiaries is bound;

(6) Unifi must deliver to the trustee an Officers Certificate stating that the deposit was not made by Unifi with the intent of preferring the holders of notes over the other creditors of Unifi with the intent of defeating, hindering, delaying or defrauding creditors of Unifi or others; and

(7) Unifi must deliver to the trustee an Officers Certificate and an opinion of counsel, each stating that all conditions precedent relating to the Legal Defeasance or the Covenant Defeasance have been complied with.

Amendment, Supplement and Waiver

Except as provided in the next four succeeding paragraphs, the indenture, the notes, the Subsidiary Guarantees, the Collateral Documents or the Intercreditor Agreement may be amended or supplemented with the consent of the holders of at least a majority in aggregate principal amount of the notes then outstanding (including, without limitation, consents obtained in connection with a purchase of, or tender offer or exchange offer for, notes), and any existing Default or Event of Default or compliance with any provision of the indenture or the notes or the Subsidiary Guarantees, the Collateral Documents or the Intercreditor Agreement may be waived with the consent of the holders of a majority in aggregate principal amount of the then outstanding notes (including, without limitation, consents obtained in connection with a purchase of, or tender offer or exchange offer for, notes).

Without the consent of each holder of notes affected, an amendment, supplement or waiver may not (with respect to any notes held by a non-consenting holder):

(1) reduce the principal amount of notes whose holders must consent to an amendment, supplement or waiver;

(2) reduce the principal of (or the premium on) or change the fixed maturity of any note or alter the provisions with respect to the redemption of the notes (other than provisions relating to the covenants described above under the caption Repurchase at the Option of Holders);

(3) reduce the rate of or change the time for payment of interest or Additional Interest on any note;

(4) waive a Default or Event of Default in the payment of principal of, or interest or premium or Additional Interest, if any, on, the notes (except a rescission of acceleration of the notes by the holders of at least a majority in aggregate principal amount of the then outstanding notes and a waiver of the payment default that resulted from such acceleration);

(5) make any note payable in a currency other than that stated in the notes;

(6) make any change in the provisions of the indenture relating to waivers of past Defaults or the rights of holders of notes to receive payments of principal of, or interest or premium or Additional Interest, if any, on, the notes or to institute suit for the enforcement of any payment on or with respect to such holder s notes;

(7) waive a redemption payment with respect to any note (other than a payment required by one of the covenants described above under the caption Repurchase at the Option of Holders);

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(8) release any Guarantor from any of its obligations under its Subsidiary Guarantee or the indenture, except in accordance with the terms of the indenture; or

(9) make any change in the preceding amendment and waiver provisions.

In addition, without the consent of at least 75% in aggregate principal amount of notes then outstanding, an amendment, supplement or waiver may not:

(1) modify any Collateral Document or the provisions in the indenture dealing with Collateral Documents or application of trust moneys in any manner adverse to the holders of the notes or otherwise release any Collateral other than in accordance with the indenture, the Collateral Documents and the Intercreditor Agreement; or

(2) modify the Intercreditor Agreement in any manner adverse to the holders of the notes in any material respect other than in accordance with the terms of the indenture, the Collateral Documents and the Intercreditor Agreement.

Notwithstanding the preceding, without the consent of any holder of notes, Unifi, the Guarantors and the trustee may amend or supplement the indenture, the notes, the Subsidiary Guarantees, the Collateral Documents or the Intercreditor Agreement to:

(1) cure any ambiguity, defect or inconsistency;

(2) provide for uncertificated notes in addition to or in place of certificated notes;

(3) provide for the assumption of Unifi s or a Guarantor s obligations to holders of notes and Subsidiary Guarantees in the case of a merger or consolidation or sale of all or substantially all of Unifi s or such Guarantor s assets, as applicable;

(4) make any change that would provide any additional rights or benefits to the holders of notes or that does not adversely affect the legal rights of any such holder under the indenture, the notes, the Subsidiary Guarantees, the Collateral Documents or the Intercreditor Agreement;

(5) provide for the issuance of additional notes and Exchange Notes in accordance with the provisions set forth in the indenture;

(6) evidence and provide for the acceptance of an appointment of a successor trustee;

(7) conform the text of the indenture, the Subsidiary Guarantees, the notes, the Collateral Documents or the Intercreditor Agreement to any provision of this Description of the Notes to the extent that such provision in this Description of the Notes was intended to be a verbatim recitation of a provision of the indenture, the Subsidiary Guarantees, the notes, the Collateral Documents or the Intercreditor Agreement;

(8) release a Guarantor from its obligations under its Subsidiary Guarantee, the notes or the indenture in accordance with the applicable provisions of the indenture;

(9) add Subsidiary Guarantees with respect to the notes;

(10) add additional Collateral to secure the notes;

(11) release Liens in favor of the Collateral Agent in the Collateral as provided under Security Release;

(12) comply with requirements of the Commission in order to effect or maintain the qualification of the indenture under the Trust Indenture Act;

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(13) to comply with the rules of any applicable securities depositary;

(14) to provide, in accordance with the provisions of the Intercreditor Agreement, for the amendment or supplement of the Collateral Documents or the Intercreditor Agreement with respect to Second Priority Collateral in order to reflect conforming amendments or supplements made to the security documents evidencing the Liens securing the Credit Agreement; or

(15) to provide for the accession or succession of any parties to the Collateral Documents or the Intercreditor Agreement (and other amendments that are administrative or ministerial in nature) in connection with an amendment, renewal, extension, substitution, refinancing, restructuring, replacement, supplementing or other modification from time to time of a Credit Agreement or any other agreement or action that is not prohibited by the Indenture.

The consent of the holders is not necessary under the Indenture to approve the particular form of any proposed amendment. It is sufficient if such consent approves the substance of the proposed amendment. A consent to any amendment or waiver under the indenture by any holder of notes given in connection with a tender of such holder s notes will not be rendered invalid by such tender. After an amendment under the indenture becomes effective, Unifi is required to mail to the holders a notice briefly describing such amendment. However, the failure to give such notice to all the holders, or any defect in the notice will not impair or affect the validity of the amendment.

In addition, without the consent of any holder of notes, any amendment, waiver or consent agreed to by the Administrative Agent in accordance with the Intercreditor Agreement under any provision of the security documents granting the first-priority lien on any Second-Priority Collateral will automatically apply to the comparable provisions of the comparable Collateral Documents entered into in connection with the notes.

Satisfaction and Discharge

The indenture will be discharged and will cease to be of further effect as to all notes issued thereunder, when:

(1) either:

(a) all notes that have been authenticated, except lost, stolen or destroyed notes that have been replaced or paid and notes for whose payment money has been deposited in trust and thereafter repaid to Unifi, have been delivered to the trustee for cancellation; or

(b) all notes that have not been delivered to the trustee for cancellation (i) have become due and payable by reason of the mailing of a notice of redemption or otherwise or (ii) will become due and payable within one year or have been or will be called for redemption and Unifi or any Guarantor has irrevocably deposited or caused to be deposited with the trustee as trust funds in trust solely for the benefit of the holders, cash in U.S. dollars, non-callable Government Securities, or a combination of cash in U.S. dollars and non-callable Government Securities, in amounts as will be sufficient without consideration of any reinvestment of interest, to pay and discharge the entire Indebtedness on the notes not delivered to the trustee for cancellation for principal, premium and Additional Interest, if any, and accrued interest to, but excluding the date of maturity or redemption;

(2) no Default or Event of Default has occurred and is continuing on the date of the deposit or will occur as a result of such deposit (other than a Default or Event of Default resulting from the borrowing of funds to be applied to such deposit) and the deposit will not result in a breach or violation of, or constitute a default under, any other material instrument to which Unifi or any Guarantor is a party or by which Unifi or any Guarantor is bound;

(3) Unifi or any Guarantor has paid or caused to be paid all sums payable by it under the indenture; and

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(4) Unifi has delivered irrevocable instructions to the trustee under the indenture to apply the deposited money toward the payment of the notes at maturity or on the redemption date, as the case may be.

In addition, Unifi must deliver an Officers Certificate and an opinion of counsel to the trustee stating that all conditions precedent to satisfaction and discharge have been satisfied.

Concerning the Trustee

If the trustee becomes a creditor of Unifi or any Guarantor, the indenture will limit the right of the trustee to obtain payment of claims in certain cases, or to realize on certain property received in respect of any such claim as security or otherwise. The trustee will be permitted to engage in other transactions; however, if it acquires any conflicting interest it must eliminate such conflict within 90 days, apply to the Commission for permission to continue as trustee (if the indenture has been qualified under the Trust Indenture Act) or resign.

The holders of a majority in aggregate principal amount of the then outstanding notes will have the right to direct the time, method and place of conducting any proceeding for exercising any remedy available to the trustee, subject to certain exceptions. The indenture will provide that in case an Event of Default occurs and is continuing, the trustee will be required, in the exercise of its power, to use the degree of care of a prudent man in the conduct of his own affairs. Subject to such provisions, the trustee will be under no obligation to exercise any of its rights or powers under the indenture at the request of any holder of notes, unless such holder has offered to the trustee security and indemnity reasonably satisfactory to it against any loss, liability or expense.

Additional Information

Anyone who receives this prospectus may obtain a copy of the indenture, the registration rights agreement, the Collateral Documents and the Intercreditor Agreement without charge by writing to Unifi, Inc., P.O. Box 19109, Greensboro, North Carolina, USA, 27419-9109, Attention: Chief Financial Officer.

Book-Entry, Delivery and Form

Except as described below, we will initially issue the exchange notes in the form of one or more registered exchange notes in global form without coupons. We will deposit each global note on the date of the closing of this exchange offer with, or on behalf of, DTC in New York, New York, and register the exchange notes in the name of DTC or its nominee, or will leave these notes in the custody of the trustee.

Depository Trust Company Procedures

For your convenience, the following description of the operations and procedures of DTC, the Euroclear System and Clearstream Banking, S.A. are provided solely as a matter of convenience. These operations and procedures are solely within the control of the respective settlement systems and are subject to changes by them. Unifi and its Restricted Subsidiaries are not responsible for these operations and procedures and urge investors to contact the system or its participants directly to discuss these matters.

DTC has advised Unifi that DTC is a limited-purpose trust company created to hold securities for its participating organizations and to facilitate the clearance and settlement of transactions in those securities between its participants through electronic book-entry changes in the accounts of these participants. These direct participants include securities brokers and dealers (including the initial purchasers), banks, trust companies, clearing corporations and certain other organizations. Access to DTC s system is also indirectly available to other entities that clear through or maintain a direct or indirect, custodial relationship with a direct participant. DTC may hold securities beneficially owned by other persons only through its participants and the ownership interests and transfers of ownership interests of these other persons will be recorded only on the records of the participants and not on the records of DTC.

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DTC has also advised Unifi that, in accordance with its procedures,

(1) upon deposit of the global notes, it will credit the accounts of the direct participants with an interest in the global notes, and

(2) it will maintain records of the ownership interests of these direct participants in the global notes and the transfer of ownership interests by and between direct participants.

DTC will not maintain records of the ownership interests of, or the transfer of ownership interests by and between, indirect participants or other owners of beneficial interests in the global notes. Both direct and indirect participants must maintain their own records of ownership interests of, and the transfer of ownership interests by and between, indirect participants and other owners of beneficial interests in the global notes.

Investors in the notes may hold their interests in the notes directly through DTC if they are direct participants in DTC or indirectly through organizations that are direct participants in DTC. Investors in the notes may also hold their interests in the notes through Euroclear and Clearstream if they are direct participants in those systems or indirectly through organizations that are participants in those systems. Euroclear and Clearstream will hold omnibus positions in the global notes on behalf of the Euroclear participants and the Clearstream participants, respectively, through customers securities accounts in Euroclear s and Clearstream s names on the books of their respective depositories, which are Morgan Guaranty Trust Company of New York, Brussels office, as operator of Euroclear, and Citibank, N.A. and The Chase Manhattan Bank, N.A., as operators of Clearstream. These depositories, in turn, will hold these positions in their names on the books of DTC. All interests in a global note, including those held through Euroclear or Clearstream, may be subject to the procedures and requirements of DTC. Those interests held through Euroclear or Clearstream may also be subject to the procedures and requirements of those systems.

The laws of some states require that some persons take physical delivery in definitive certificated form of the securities that they own. This may limit or curtail the ability to transfer beneficial interests in a global note to these persons. Because DTC can act only on behalf of direct participants, which in turn act on behalf of indirect participants and others, the ability of a person having a beneficial interest in a global note to pledge its interest to persons or entities that are not direct participants in DTC or to otherwise take actions in respect of its interest, may be affected by the lack of physical certificates evidencing the interests.

Except as described below, owners of interests in the global notes will not have notes registered in their names, will not receive physical delivery of notes in certificated form and will not be considered the registered owners or holders of these notes under the indenture for any purpose.

Payments with respect to the principal of and interest on any notes represented by a global note registered in the name of DTC or its nominee on the applicable record date will be payable by the trustee to or at the direction of DTC or its nominee in its capacity as the registered holder of the global note representing these notes under the indenture. Under the terms of the indenture, Unifi and its Restricted Subsidiaries and the trustee will treat the person in whose names the notes are registered, including notes represented by global notes, as the owners of the notes for the purpose of receiving payments and for any and all other purposes whatsoever. Payments in respect of the principal and interest on global notes registered in the name of DTC or its nominee will be payable by the trustee to DTC or its nominee as the registered holder under the indenture. Consequently, none of Unifi, any Restricted Subsidiary, the trustee or any agents of Unifi, any Restricted Subsidiary, or the trustee has or will have any responsibility or liability for:

(1) any aspect of DTC s records or any direct or indirect participant s records relating to, or payments made on account of, beneficial ownership interests in the global notes or for maintaining, supervising or reviewing any of DTC s records or any direct or indirect participant s records relating to the beneficial ownership interests in any global note; or

(2) any other matter relating to the actions and practices of DTC or any of its direct or indirect participants.

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DTC has advised Unifi that its current practice, upon receipt of any payment in respect of securities such as the notes, including principal and interest, is to credit the accounts of the relevant participants with the payment on the payment date, in amounts proportionate to their respective holdings in the principal amount of beneficial interest in the security as shown on its records, unless it has reasons to believe that it will not receive payment on the payment date. Payments by the direct and indirect participants to the beneficial owners of interests in the global note will be governed by standing instructions and customary practice and will be the responsibility of the direct or indirect participants and will not be the responsibility of DTC, the trustee, Unifi or any of its Restricted Subsidiaries.

None of Unifi, any of its Restricted Subsidiaries or the trustee will be liable for any delay by DTC or any direct or indirect participant in identifying the beneficial owners of the notes and Unifi, its Restricted Subsidiaries and the trustee may conclusively rely on, and will be protected in relying on, instructions from DTC or its nominee for all purposes, including with respect to the registration and delivery, and the respective principal amounts, of the notes.

Transfers between participants in DTC will be effected in accordance with DTC s procedures, and will be settled in same-day funds, and transfers between participants in Euroclear and Clearstream will be effected in accordance with their respective rules and operating procedures.

Cross-market transfers between the participants in DTC, on the one hand, and Euroclear or Clearstream participants, on the other hand, will be effected through DTC in accordance with DTC s rules on behalf of Euroclear or Clearstream, as the case may be, by its respective depositary; however, such cross-market transactions will require delivery of instructions to Euroclear or Clearstream, as the case may be, by the counterparty in such system in accordance with the rules and procedures and within the established deadlines (Brussels time) of such system. Euroclear or Clearstream, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to its respective depositary to take action to effect final settlement on its behalf by delivering or receiving interests in the relevant global note in DTC, and making or receiving payment in accordance with normal procedures for same-day funds settlement applicable to DTC. Euroclear participants and Clearstream participants may not deliver instructions directly to the depositories for Euroclear or Clearstream.

DTC has advised Unifi that it will take any action permitted to be taken by a holder of notes only at the direction of one or more participants to whose account DTC has credited the interests in the global notes and only in respect of the portion of the aggregate principal amount of the notes as to which the participant or participants has or have given that direction. However, if there is an event of default with respect to the notes, DTC reserves the right to exchange the global notes for legended notes in certificated form and to distribute them to its participants.

Although DTC, Euroclear and Clearstream have agreed to these procedures to facilitate transfers of interests in the global notes among participants in DTC, Euroclear and Clearstream, they are under no obligation to perform or to continue to perform these procedures and may discontinue them at any time. None of Unifi, any of its Restricted Subsidiaries, the trustee or any of their respective agents will have any responsibility for the performance by DTC, Euroclear or Clearstream or their direct or indirect participants of their respective obligations under the rules and procedures governing their operations.

Exchange of Global Notes for Certificated Notes

A global note is exchangeable for definitive notes in registered certificated form if:

(1) DTC (a) notifies Unifi that it is unwilling or unable to continue as depositary for the Global Notes or (b) has ceased to be a clearing agency registered under the Exchange Act and, in either case, Unifi fails to appoint a successor depositary;

(2) Unifi, at its option, notifies the trustee in writing that they elect to cause the issuance of the Certificated Notes; or

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(3) there has occurred and is continuing a Default or Event of Default with respect to the notes.

In addition, beneficial interests in a Global Note may be exchanged for Certificated Notes upon prior written notice given to the trustee by or on behalf of DTC in accordance with the Indenture. In all cases, Certificated Notes delivered in exchange for any Global Note or beneficial interests in Global Notes will be registered in the names, and issued in any approved denominations, requested by or on behalf of the depositary (in accordance with its customary procedures).

Exchange of Certificated Notes for Global Notes

Certificated Notes may not be exchanged for beneficial interests in any Global Note unless the transferor first delivers to the trustee a written certificate (in the form provided in the Indenture) to the effect that such transfer will comply with the appropriate transfer restrictions applicable to such notes.

Same-Day Settlement

Unifi expects that the interests in the global notes will be eligible to trade in DTC s Same-Day Funds Settlement System. As a result, secondary market trading activity in these interests will settle in immediately available funds, subject in all cases to the rules and procedures of DTC and its participants. Unifi expects that secondary trading in any certificated notes will also be settled in immediately available funds.

Because of time zone differences, the securities account of a Euroclear or Clearstream participant purchasing an interest in a global note from a participant in DTC will be credited, and any such crediting will be reported to the relevant Euroclear or Clearstream participant, during the securities settlement processing day (which must be a business day for Euroclear and Clearstream) immediately following the settlement date of DTC. DTC has advised Unifi that cash received in Euroclear or Clearstream as a result of sales of interests in a global note by or through a Euroclear or Clearstream participant to a participant in DTC will be received with value on the settlement date of DTC but will be available in the relevant Euroclear or Clearstream cash account only as of the business day for Euroclear or Clearstream following DTC s settlement date.

Certain Definitions

Set forth below are certain defined terms used in the indenture. Reference is made to the indenture for a full disclosure of all such terms, as well as any other capitalized terms used herein for which no definition is provided.

Acquired Debt means, with respect to any specified Person:

(1) Indebtedness of any other Person existing at the time such other Person is merged with or into or became a Subsidiary of such specified Person, whether or not such Indebtedness is incurred in connection with, or in contemplation of, such other Person merging with or into, or becoming a Subsidiary of, such specified Person; and

(2) Indebtedness secured by a Lien encumbering any asset acquired by such specified Person.

Additional Assets means:

(1) all or substantially all of the assets of another Permitted Business;

(2) Capital Stock of a Person engaged in a Permitted Business if such Person is or, after giving effect to such acquisition, becomes a Restricted Subsidiary of Unifi; or

(3) capital expenditures relating to an asset used or useful in a Permitted Business; or

(4) other assets that are not classified as current assets under GAAP and that are used or useful in a Permitted Business.

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Additional Interest means all additional interest then owing pursuant to the registration rights agreement.

Affiliate of any specified Person means any other Person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified Person. For purposes of this definition, control, as used with respect to any Person, means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of such Person, whether through the ownership of voting securities, by agreement or otherwise. For purposes of this definition, the terms controlling, controlled by and under common control with have correlative meanings.

Assets Held for Sale means the machinery and equipment held for sale by Unifi and its Restricted Subsidiaries as of the Issue Date, and identified on a schedule to the indenture, with an estimated appraisal value on the Issue Date not to exceed $17.0 million.

Asset Sale means:

(1) the sale, lease, conveyance or other disposition of any assets or rights; *provided* that the sale, lease, conveyance or other disposition of all or substantially all of the assets of Unifi and its Restricted Subsidiaries taken as a whole will be governed by the provisions of the indenture described above under the caption Repurchase at the Option of Holders Change of Control and/or the provisions described above under the caption Certain Covenants Merger, Consolidation or Sale of Assets and not by the provisions of the Asset Sale covenant; and

(2) the issuance of Equity Interests in any of Unifi s Restricted Subsidiaries or the sale of Equity Interests in any of its Restricted Subsidiaries.

Notwithstanding the preceding, none of the following items will be deemed to be an Asset Sale:

(1) any single transaction or series of related transactions that involves assets having a fair market value of less than $2.0 million;

(2) a transfer of assets between or among Unifi and the Guarantors; *provided* that in the case of a sale of Collateral, the transferee shall cause such amendments, supplements or other instruments to be executed, filed, and recorded in such jurisdictions as may be required by applicable law to preserve and protect the Lien on the Collateral owned by or transferred to the transferee, together with such financing statements or comparable documents as may be required to perfect any security interests in such Collateral which may be perfected by the filing of a financing statement or a similar document under the Uniform Commercial Code or other similar statute or regulation of the relevant states or jurisdictions;

(3) a transfer of assets between or among Restricted Subsidiaries that are not Guarantors or from a Restricted Subsidiary that is not a Guarantor to Unifi or a Guarantor;

(4) an issuance of Equity Interests by a Restricted Subsidiary of Unifi to Unifi or to another Restricted Subsidiary of Unifi;

(5) the sale, lease or other transfer or disposition of equipment, inventory or raw materials, products in the ordinary course of business and any sale or other disposition of damaged, worn-out or obsolete assets in the ordinary course of business;

(6) the creation of Permitted Liens and dispositions in connection with Permitted Liens;

(7) the licensing or sublicensing of intellectual property or other general intangibles and licenses, leases or subleases of other property;

(8) foreclosure on assets;

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(9) the sale or other disposition of cash or Cash Equivalents;

(10) a Restricted Payment that is permitted by the covenant described above under the caption Certain Covenants Restricted Payments or a Permitted Investment;

(11) any Recovery Event;

(12) any transfer of property or assets that is a surrender or waiver of contract rights or the settlement, release or surrender of contract, tort or other claims of any kind;

(13) a transfer or other disposition of Assets Held for Sale by Unifi and its Restricted Subsidiaries so long as such Assets Held for Sale or the proceeds therefrom are transferred to a Permitted Joint Venture or an Unrestricted Subsidiary engaged in a Permitted Business;

(14) the sale, conveyance, disposition or other transfer of Equity Interests in any Permitted Joint Venture in existence on the Issue Date, which sale, conveyance, disposition or other transfer shall comply with subclauses (1) and (2) of clause (a) of the covenant described under Repurchase at the Option of Holders Asset Sales; and

(15) any transfer or disposition of property or assets pursuant to Hedging Obligations permitted to be incurred under the Indenture.

Attributable Debt in respect of a Sale/Leaseback Transaction means, at the time of determination, the present value of the obligation of the lessee for net rental payments during the remaining term of the lease included in such Sale/Leaseback Transaction including any period for which such lease has been extended or may, at the option of the lessor, be extended. Such present value shall be calculated using a discount rate equal to the rate of interest implicit in such transaction, determined in accordance with GAAP; *provided*, *however*, that if such Sale/Leaseback Transaction results in a Capital Lease Obligation, the amount of Indebtedness represented thereby will be determined in accordance with the definition of Capital Lease Obligation.

Beneficial Owner has the meaning assigned to such term in Rule 13d-3 and Rule 13d-5 under the Exchange Act, except that in calculating the beneficial ownership of any particular person (as that term is used in Section 13(d)(3) of the Exchange Act), such person will be deemed to have beneficial ownership of all securities that such person has the right to acquire by conversion or exercise of other securities, whether such right is currently exercisable or is exercisable only upon the occurrence of a subsequent condition. The term Beneficially Own has a corresponding meaning.

Board of Directors means:

(1) with respect to a corporation, the board of directors of the corporation or any committee thereof duly authorized to act on behalf of such board;

(2) with respect to a partnership, the board of directors of the general partner of the partnership;

(3) with respect to a limited liability company, the managing member or members or any controlling committee of managing members thereof or, if managed by managers, the board of managers or any committee thereof duly authorized to act on behalf of such board; and

(4) with respect to any other Person, the board of directors or governing body of such Person serving a similar function.

Borrowing Base means, as of any date, an amount equal to the Borrowing Base as defined in the Credit Agreement as of such date.

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Business Day means each day that is not a Saturday, Sunday or other day on which banking institutions in New York, New York are authorized or required by law to close.

Capital Lease Obligation means, at the time any determination is to be made, the amount of the liability in respect of a capital lease that would at that time be required to be capitalized on a balance sheet prepared in accordance with GAAP, and the Stated Maturity thereof shall be the date of the last payment of rent or any other amount due under such lease prior to the first date upon which such lease may be prepaid by the lessee without payment of a penalty.

Capital Stock means:

(1) in the case of a corporation, common stock, preferred stock or other corporate stock;

(2) in the case of an association or business entity, any and all shares, interests, participations, rights or other equivalents (however designated) of corporate stock;

(3) in the case of a partnership or limited liability company, partnership or membership interests (whether general or limited); and

(4) any other interest or participation that confers on a Person the right to receive a share of the profits and losses of, or distributions of assets of, the issuing Person, but excluding from all of the foregoing any debt securities convertible into Capital Stock, whether or not such debt securities include any right of vote or participation with Capital Stock.

Cash Equivalents means:

(1) United States dollars and in the case of any Foreign Subsidiary, such local currencies held by them from time to time in the ordinary course of business;

(2) securities issued or directly and fully guaranteed or insured by the United States government or any agency or instrumentality of the United States government (*provided* that the full faith and credit of the United States is pledged in support of those securities) having maturities of not more than twelve months from the date of acquisition;

(3) marketable general obligations issued by any state of the United States or any political subdivision of any such state or any public instrumentality thereof maturing within one year from the date of acquisition (*provided* that the full faith and credit of the United States is pledged in support thereof) and, at the time of acquisition, having a credit rating of A or better from either S&P or Moody s;

(4) deposits, certificates of deposit and eurodollar time deposits with maturities of twelve months or less from the date of acquisition, money market deposits, bankers acceptances with maturities not exceeding twelve months and overnight bank deposits with any lender party to the Credit Agreement as of the Issue Date or any domestic commercial bank having capital and surplus in excess of $500.0 million and a Thomson Bank Watch Rating of B or better;

(5) repurchase obligations with a term of not more than seven days for underlying securities of the types described in clauses (2), (3) and (4) above entered into with any financial institution meeting the qualifications specified in clause (4) above;

(6) commercial paper having a rating of at least A-3 from Moody s or P-3 from S&P and in each case maturing within six months after the date of acquisition; and

(7) money market funds at least 95% of the assets of which constitute Cash Equivalents of the kinds described in clauses (1) through (6) of this definition.

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Change of Control means the occurrence of any of the following:

(1) the direct or indirect sale, lease, transfer, conveyance or other disposition (other than by way of merger or consolidation), in one or a series of related transactions, of all or substantially all of the properties or assets of Unifi and its Restricted Subsidiaries taken as a whole to any person (as that term is used in Section 13(d) (3) of the Exchange Act);

(2) the adoption of a plan relating to the liquidation or dissolution of Unifi;

(3) any person (as that term is used in Section 13(d)(3) of the Exchange Act) becomes the Beneficial Owner, directly or indirectly, of more than 50% of the Voting Stock of Unifi, measured by voting power rather than number of shares; or

(4) the first day on which a majority of the members of the Board of Directors of Unifi are not Continuing Directors.

Notwithstanding the foregoing, (A) a person shall not be deemed to have beneficial ownership of securities subject to a stock purchase agreement, merger agreement or similar agreement (or voting or option agreement related thereto) until the consummation of the transactions contemplated by such agreement and (B) any holding company whose only material asset is Equity Interests of Unifi or any of its direct or indirect parent companies shall not itself be considered a person for purposes of clause (3) above so long as the owners of the Voting Stock of Unifi or any of its direct or indirect parent companies immediately before giving effect to such transaction and the owners of the Voting Stock of such holding company immediately after giving effect to such transaction are substantially similar.

Collateral means all property and assets, whether now owned or hereafter acquired, in which Liens are, from time to time, purported to be granted to secure the notes pursuant to the Collateral Documents.

Collateral Account means the First Priority Collateral Account or the Second Priority Collateral Account, as applicable.

Collateral Agent means U.S. Bank National Association, acting as the Collateral Agent under the Collateral Documents.

Collateral Documents means the mortgages, deeds of trust, deeds to secure debt, security agreements, pledge agreements, agency agreements and other instruments and documents executed and delivered pursuant to the indenture or any of the foregoing, as the same may be amended, supplemented or otherwise modified from time to time and pursuant to which Collateral is pledged, assigned or granted to or on behalf of the Collateral Agent for the ratable benefit of the holders of the notes and the trustee or notice of such pledge, assignment or grant is given.

Commission means the United States Securities and Exchange Commission.

Consolidated Cash Flow means, with respect to any specified Person for any period, the Consolidated Net Income of such Person for such period, *plus* without duplication:

(1) provision for taxes based on income or profits of such Person and its Restricted Subsidiaries for such period, to the extent that such provision for taxes was deducted in computing such Consolidated Net Income; *plus*

(2) the Fixed Charges of such Person and its Restricted Subsidiaries for such period, to the extent that such Fixed Charges were deducted in computing such Consolidated Net Income; *plus*

(3) depreciation, amortization (including amortization of goodwill and other intangibles but excluding amortization of prepaid cash expenses that were paid in a prior period) and other non-cash charges (excluding

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any such non-cash charges to the extent that it represents an accrual of or reserve for cash charges in any future period or amortization of a prepaid cash charge that was paid in a prior period) of such Person and its Restricted Subsidiaries for such period to the extent that such depreciation, amortization and other non-cash charges were deducted in computing such Consolidated Net Income; *plus*

(4) restructuring and acquisition integration costs and fees, including cash severance payments made in connection with restructurings and acquisitions; *plus*

(5) without duplication, for periods prior to the Issue Date, all items added back to EBITDA for purposes of calculating Adjusted EBITDA in footnote (1) under Offering Memorandum Summary Summary Historical Financial Data in the Offering Memorandum; *minus*

(6) non-cash items increasing such Consolidated Net Income for such period, other than the accrual of revenue in the ordinary course of business, *minus*

(7) the net loss of any Person that is not a Restricted Subsidiary to the extent that such loss has been funded by an investment of cash from Unifi or a Restricted Subsidiary made for the purpose of funding such loss, in each case, on a consolidated basis and determined in accordance with GAAP.

Notwithstanding the foregoing, the provision for taxes and the depreciation, amortization and other non-cash expenses of a Restricted Subsidiary shall be added to Consolidated Net Income to compute Consolidated Cash Flow only to the extent (and in the same proportion) that the net income of such Restricted Subsidiary was included in calculating Consolidated Net Income and only if a corresponding amount would be permitted at the date of determination to be dividended to such Person by such Restricted Subsidiary without prior approval (that has not been obtained), pursuant to the terms of its charter and all agreements, instruments, judgments, decrees, orders, statutes, rules and governmental regulations applicable to such Restricted Subsidiary or its shareholders or members.

Consolidated Net Income means, with respect to any Person for any period, the aggregate of the Net Income of such Person and its Restricted Subsidiaries for such period, on a consolidated basis, determined in accordance with GAAP; *provided* that:

(1) the Net Income (but not loss) of any specified Person that is not a Restricted Subsidiary or that is accounted for by the equity method of accounting shall be included only to the extent of the amount of dividends or similar distributions paid in cash to the specified Person or a Restricted Subsidiary of such Person;

(2) the amount of Net Income of any non-Guarantor Restricted Subsidiary shall be excluded to the extent that the declaration or payment of dividends or similar distributions by that Restricted Subsidiary of that amount of Net Income is not at the date of determination permitted without any prior governmental approval (other than an approval that has already been obtained or, in the case of a Foreign Subsidiary, is reasonably likely to be obtained, in the good-faith judgment of Unifi) or, directly or indirectly, by operation of the terms of its charter or any agreement, instrument, judgment, decree, order, statute, rule or governmental regulation applicable to that Restricted Subsidiary or its shareholders or members;

(3) the cumulative effect of a change in accounting principles shall be excluded;

(4) any non-cash gains, losses, income and expenses resulting from fair value accounting with respect to Hedging Obligations required by Statements of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ;

(5) the net loss of any Person that is not a Restricted Subsidiary shall be excluded; and

(6) any charges resulting from the application of Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity to dividends paid on Equity Interests (other than Disqualified Stock) shall be excluded.

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Notwithstanding the foregoing, for the purpose of the covenant described under Certain Covenants Restricted Payments only (other than clause (3)(c) thereof), there shall be excluded from Consolidated Net Income any income arising from any sale or other disposition of Restricted Investments made by Unifi and its Restricted Subsidiaries, any repurchases and redemptions of Restricted Investments from Unifi and its Restricted Subsidiaries, any repayments of loans and advances which constitute Restricted Investments by Unifi or any of its Restricted Subsidiaries, any sale of the stock of an Unrestricted Subsidiary or any distribution or dividend from an Unrestricted Subsidiary, in each case only to the extent such amounts increase the amount of Restricted Payments permitted under such covenant pursuant to clause (3)(c) thereof.

Consolidated Net Tangible Assets means, as of any date of determination, the consolidated total assets of Unifi and its Subsidiaries determined in accordance with GAAP as of the end of Unifi s most recent fiscal quarter for which internal financial statements are available, less the sum of (1) all current liabilities and current liability items (other than liabilities under a Credit Agreement that has a Stated Maturity later than one year after such date of determination), and (2) all goodwill, trade names, trademarks, patents, organization expense, unamortized debt discount and expense and other similar intangibles properly classified as intangibles in accordance with GAAP.

Continuing Directors means, as of any date of determination, any member of the Board of Directors of Unifi who:

(1) was a member of such Board of Directors on the Issue Date; or

(2) was nominated for election or elected to such Board of Directors with the approval of a majority of the Continuing Directors who were members of such Board of Directors at the time of such nomination or election.

Credit Agreement means that certain Amended and Restated Credit Agreement, dated as of May 26, 2006, among Unifi, certain of its Subsidiaries, Bank of America, N.A., as agent, and the lenders parties thereto, including any related notes, guarantees, collateral documents, instruments and agreements executed in connection therewith, and in each case as amended, restated, modified, extended, renewed, refunded, replaced (whether upon or after termination or otherwise) or refinanced (including by means of sales of debt securities to institutional investors) in whole or in part from time to time and, with respect to Unifi or any Guarantor, one or more debt facilities, commercial paper facilities, in each case, with banks or other institutional lenders providing for revolving credit loans, term loans, receivables financing (including through the sale of receivables to such lenders or to special purpose entities formed to borrow from (or sell such receivables to) such lenders against such receivables), letters of credit, bankers acceptances, or other borrowings, in each case, as amended, restated, modified, extended, renewed, refunded, replaced (whether upon or after termination or otherwise) or refinanced in whole or in part from time to time, in each case, whether or not such amendment, restatement, modification, extension, renewal, refunding, replacement or refinancing occurs (i) with the original parties thereto, (ii) on one or more separate occasions or (iii) simultaneously or not with the termination or repayment of a prior Credit Agreement.

Default means any event that is, or with the passage of time or the giving of notice or both would be, an Event of Default.

Disqualified Stock means any Capital Stock that, by its terms (or by the terms of any security into which it is convertible, or for which it is exchangeable, in each case at the option of the holder of the Capital Stock), or upon the happening of any event, matures or is mandatorily redeemable, pursuant to a sinking fund obligation or otherwise, or redeemable at the option of the holder of the Capital Stock, in whole or in part, on or prior to the date that is 91 days after the date on which the notes are scheduled to mature. Notwithstanding the preceding sentence, any Capital Stock that would constitute Disqualified Stock solely because the holders of the Capital Stock have the right to require Unifi to repurchase such Capital Stock upon the occurrence of a change of control or an asset sale will not constitute Disqualified Stock if the terms of such Capital Stock provide that Unifi may

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not repurchase or redeem any such Capital Stock pursuant to such provisions unless such repurchase or redemption complies with the covenant described above under the caption Certain Covenants Restricted Payments. Any class of Capital Stock of Unifi that, by its terms, authorizes Unifi to satisfy in full its obligations with respect to the payment of dividends or upon maturity, redemption (pursuant to a sinking fund or otherwise) or repurchase thereof or otherwise by the delivery of Capital Stock (other than Disqualified Stock) and that is not convertible into, puttable or exchangeable for Disqualified Stock, will not be deemed to be Disqualified Stock so long as Unifi satisfies its obligations with respect thereto solely by the delivery of Capital Stock (other than Disqualified Stock).

Domestic Subsidiary means any Restricted Subsidiary of Unifi that was formed under the laws of the United States or any state of the United States or the District of Columbia.

Equity Interests means Capital Stock and all warrants, options or other rights to acquire Capital Stock (but excluding any debt security that is convertible into, or exchangeable for, Capital Stock).

Equity Offering means any offer and sale for cash by Unifi (or any direct or indirect parent of Unifi to the extent the net proceeds therefrom are contributed to the equity capital of Unifi) of Capital Stock (other than Disqualified Stock) after the Issue Date, other than (a) any issuance pursuant to employee benefit plans or otherwise in compensation to officers, directors or employees or (b) any offering of Capital Stock issued in connection with a transaction that constitutes a Change of Control.

Exchange Notes means the notes issued in the Exchange Offer pursuant to the indenture.

Exchange Offer has the meaning set forth for such term in the registration rights agreement.

Exchange Offer Registration Statement has the meaning set forth for such term in the registration rights agreement.

Existing Indebtedness means Indebtedness of Unifi and its Restricted Subsidiaries (other than Indebtedness under the Credit Agreement) in existence on the Issue Date.

First Priority Collateral means substantially all of the assets (other than the Second Priority Collateral and other than Excluded Assets) of Unifi and the Guarantors, including, but not limited to, the real property, fixtures, equipment, general intangibles with respect to any uncertificated securities representing the Capital Stock of any Subsidiary of Unifi or the Guarantors and any Person in which Unifi or a Guarantor has a direct interest, and investment property consisting of the Capital Stock of each Subsidiary of Unifi or the Guarantors and each other Person in which Unifi or a Guarantor has a direct interest, now owned or hereafter acquired by Unifi and the Guarantors, as to which the notes have a first-priority Lien.

First Priority Collateral Account means any segregated account under the sole control of the Collateral Agent that is free from all other Liens (other than Liens securing obligations under the Credit Agreement) and includes all cash and Cash Equivalents received by the Collateral Agent from Asset Sales of First Priority Collateral, Recovery Events of First Priority Collateral, foreclosures on or sales of First Priority Collateral, any issuance of additional notes or any other awards or proceeds related to First Priority Collateral pursuant to the Collateral Documents.

Fixed Charge Coverage Ratio means with respect to any specified Person, the ratio of the Consolidated Cash Flow of such Person for the most recently ended four full fiscal quarters for which financial statements are available to the Fixed Charges of such Person for such period. In the event that the specified Person or any of its Restricted Subsidiaries incurs, assumes, Guarantees, repays, repurchases, redeems, defeases or otherwise discharges any Indebtedness (other than ordinary working capital borrowings) or issues, repurchases or redeems preferred stock subsequent to the commencement of the period for which the Fixed Charge Coverage Ratio is

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being calculated and on or prior to the date on which the event for which the calculation of the Fixed Charge Coverage Ratio is made (the Calculation Date), then the Fixed Charge Coverage Ratio shall be calculated giving pro forma effect to such incurrence, assumption, Guarantee, repayment, repurchase, redemption, defeasance or other discharge of Indebtedness, or such issuance, repurchase or redemption of preferred stock, and the use of the proceeds therefrom as if the same had occurred at the beginning of the applicable four-quarter reference period.

In addition, for purposes of calculating the Fixed Charge Coverage Ratio:

(1) acquisitions that have been made by the specified Person or any of its Restricted Subsidiaries, including through mergers or consolidations, or any Person or any of its Restricted Subsidiaries acquired by the specified Person or any of its Restricted Subsidiaries, and including any related financing transactions and including increases in ownership of Restricted Subsidiaries, Investments by the specified Person or any of its Restricted Subsidiaries in any Person if as a result of such Investment such Person becomes a Restricted Subsidiary of the specified Person and any redesignation of an Unrestricted Subsidiary to a Restricted Subsidiary or a designation of a Restricted Subsidiary to an Unrestricted Subsidiary, during the four-quarter reference period or subsequent to such reference period and on or prior to the Calculation Date will be given pro forma effect as if they had occurred on the first day of the four-quarter reference period; *provided* that such pro forma calculations shall be determined in good faith by the Chief Financial Officer of Unifi and shall be set forth in an Officer s Certificate signed by Unifi s Chief Financial Officer which states (i) the amount of such adjustment or adjustments, (ii) that such adjustment or adjustments are based on the reasonable good faith belief of Unifi at the time of such execution, and (iii) that the steps necessary for the realization of such adjustments have been taken or are reasonably expected to be taken within 12 months following such transaction;

(2) the Consolidated Cash Flow attributable to discontinued operations, as determined in accordance with GAAP, and operations or businesses (and ownership interests therein) disposed of prior to the Calculation Date, shall be excluded;

(3) the Fixed Charges attributable to discontinued operations, as determined in accordance with GAAP, and operations or businesses (and ownership interests therein) disposed of prior to the Calculation Date, shall be excluded, but only to the extent that the obligations giving rise to such Fixed Charges will not be obligations of the specified Person or any of its Restricted Subsidiaries following the Calculation Date;

(4) if any Indebtedness bears a floating rate of interest, the interest expense on such Indebtedness shall be calculated as if the rate in effect on the Calculation Date had been the applicable rate for the entire four-quarter reference period (taking into account any Hedging Obligation applicable to such Indebtedness if such Hedging Obligation has a remaining term as at the Calculation Date in excess of 12 months); and

(5) if any arrangement, instrument or agreement that does not constitute Indebtedness yet results in the incurrence of Fixed Charges is repaid, eliminated, reversed or discharged during such four-quarter reference period, such arrangement, instrument or agreement shall be deemed to have been repaid, eliminated, reversed or discharged as of the first day of such four-quarter reference period.

Fixed Charges means, with respect to any specified Person for any period, the sum, without duplication, of:

(1) the consolidated interest expense (net of interest income) of such Person and its Restricted Subsidiaries for such period, whether paid or accrued (including, without limitation, amortization of debt issuance costs and original issue discount, non-cash interest payments, the interest component of any deferred payment obligations, the interest component of all payments associated with Capital Lease Obligations, imputed interest with respect to Attributable Debt, commissions, discounts and other fees and charges incurred in respect of letter of credit or bankers acceptance financings, and net of the effect of all payments made or received pursuant to Hedging Obligations) in respect of interest rates; *plus*

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(2) the consolidated interest expense of such Person and its Restricted Subsidiaries that was capitalized during such period; *plus*

(3) any interest expense on Indebtedness of another Person that is guaranteed by such Person or one of its Restricted Subsidiaries or secured by a Lien on assets of such Person or one of its Restricted Subsidiaries (whether or not such Guarantee or Lien is called upon); *plus*

(4) the product of (a) all dividends, whether paid or accrued and (whether or not in cash) on any series of preferred stock or Disqualified Stock of such Person or any of its Restricted Subsidiaries, other than dividends on Equity Interests payable solely in Equity Interests of such Person (other than Disqualified Stock) or to such Person or a Restricted Subsidiary of such Person, times (b) a fraction, the numerator of which is one and the denominator of which is one minus the then current combined federal, state and local statutory tax rate of such Person, expressed as a decimal, in each case, determined on a consolidated basis and in accordance with GAAP.

For purposes of the foregoing, total Fixed Charges will be determined by excluding any charges resulting from the application of Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity with respect to payments made on Equity Interests other than Disqualified Stock.

Foreign Subsidiary means any Restricted Subsidiary of Unifi that is not a Domestic Subsidiary.

GAAP means generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or the Public Company Accounting Oversight Board or in such other statements by such other entity as have been approved by a significant segment of the accounting profession, which are in effect on the Issue Date.

Guarantee means a guarantee other than by endorsement of negotiable instruments for collection in the ordinary course of business, direct or indirect, in any manner including, without limitation, by way of a pledge of assets or through letters of credit or reimbursement agreements in respect thereof, of all or any part of any Indebtedness (whether arising by virtue of partnership arrangements, or by agreements to keep-well, to purchase assets, goods, securities or services, to take or pay or to maintain financial statement conditions or otherwise).

Guarantor means any Person that guarantees the notes; *provided* that upon the release or discharge of such Person from its Subsidiary Guarantee in accordance with the provisions of the indenture, such Person shall cease to be a Guarantor.

Hedging Obligations means, with respect to any specified Person, the obligations of such Person incurred in connection with the ordinary course of business not for speculative purposes under:

(1) interest rate swap agreements (whether from fixed to floating or from floating to fixed), interest rate cap agreements and interest rate collar agreements;

(2) foreign exchange contracts and currency protection agreements entered into with one of more financial institutions and designed to protect the person or entity entering into the agreement against fluctuations in currency exchange rates; and

(3) other agreements or arrangements designed to manage fluctuations in interest rates, currency exchange rates or commodity prices.

Indebtedness means (without duplication), with respect to any specified Person, any indebtedness of such Person (excluding accrued expenses and trade payables), whether or not contingent:

(1) in respect of borrowed money;

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(2) evidenced by bonds, notes, debentures or similar instruments or letters of credit (or reimbursement agreements in respect thereof);

(3) in respect of letters of credit, banker s acceptances or other similar instruments;

(4) representing the portion of Capital Lease Obligations (that does not constitute interest expense) and Attributable Debt;

(5) representing the balance deferred and unpaid of the purchase price of any property or services due more than six months after such property is acquired or such services are completed;

(6) all obligations of such Person with respect to the redemption, repayment or other repurchase of any Disqualified Stock or, with respect to any Subsidiary that is not a Guarantor, any preferred stock (but excluding, in each case, any accrued dividends); or

(7) representing any Hedging Obligations; if and to the extent any of the preceding items (other than letters of credit and Hedging Obligations) would appear as a liability on a balance sheet prepared in accordance with GAAP. For the avoidance of doubt, trade payables, accrued liabilities arising in the ordinary course of business, obligations of a Person other than principal and any liability for federal, state or local taxes or other taxes shall not be deemed to be Indebtedness.

In addition, the term Indebtedness includes all Indebtedness of others secured by a Lien on any asset of the specified Person (whether or not such Indebtedness is assumed by the specified Person) and, to the extent not otherwise included, the Guarantee by the specified Person of any Indebtedness of any other Person.

The amount of any Indebtedness outstanding as of any date will be:

(1) the accreted value of the Indebtedness, in the case of any Indebtedness issued with original issue discount;

(2) in the case of any Disqualified Stock of the specified Person or any Guarantor or preferred stock of a Restricted Subsidiary that is not a Guarantor, the repurchase price calculated in accordance with the terms of such Disqualified Stock or preferred stock as if such Disqualified Stock or preferred stock were repurchased on the date on which Indebtedness is required to be determined pursuant to the indenture; *provided* that if such Disqualified Stock or preferred stock is not then permitted to be repurchased, the greater of the liquidation preference and the book value of such Disqualified Stock or preferred stock;

(3) in the case of Indebtedness of others secured by a Lien on any asset of the specified Person, the lesser of (A) the fair market value of such asset on the date on which Indebtedness is required to be determined pursuant to the indenture and (B) the amount of the Indebtedness so secured;

(4) in the case of the Guarantee by the specified Person of any Indebtedness of any other Person, the maximum liability to which the specified Person may be subject upon the occurrence of the contingency giving rise to the obligation;

(5) in the case of any Hedging Obligations, the net amount payable if such Hedging Obligations were terminated at that time by such Person (after giving effect to any contractually permitted set-off); and

(6) the principal amount of the Indebtedness, together with any interest on the Indebtedness that is more than 30 days past due, in the case of any other Indebtedness.

Intercreditor Agreement means the Intercreditor Agreement entered into among Unifi, the Guarantors, the Collateral Agent, on behalf of itself, the trustee and the holders of the notes, and the agent under the Credit

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Agreement, on behalf of itself and the lenders, as the same may be amended, supplemented or otherwise modified from time to time.

Investments means, with respect to any Person, all direct or indirect investments by such Person in other Persons (including Affiliates) in the forms of loans (including Guarantees or other obligations), advances or capital contributions (excluding commission, travel and similar advances to officers and employees made in the ordinary course of business), purchases or other acquisitions, including purchases or acquisitions of Equity Interests, for consideration of cash, Cash Equivalents, Indebtedness, Equity Interests or other securities, together with all items that are or would be classified as investments on a balance sheet prepared in accordance with GAAP. If Unifi or any Restricted Subsidiary of Unifi sells or otherwise disposes of any Equity Interests of any direct or indirect Restricted Subsidiary of Unifi such that, after giving effect to any such sale or disposition, such Person is no longer a Restricted Subsidiary of Unifi, Unifi will be deemed, without duplication, to have made an Investment on the date of any such sale or disposition in an amount equal to the fair market value of the Equity Interests of such Subsidiary not sold or disposed of in an amount determined as provided in the final paragraph of the covenant described above under the caption Certain Covenants Restricted Payments. The acquisition by Unifi or any Restricted Subsidiary of Unifi of a Person that holds an Investment in a third Person will be deemed, without duplication, to be an Investment made by Unifi or such Restricted Subsidiary in such third Person in an amount equal to the fair market value of the Investment held by the acquired Person in such third Person on the date of any such acquisition in an amount determined as provided in the final paragraph of the covenant described above under the caption Certain Covenants Restricted Payments. Except as otherwise provided in the indenture, the amount of an Investment will be determined at the time the Investment is made and without giving effect to subsequent changes in value.

Issue Date means the date on which the initial notes were first issued.

Lien means, with respect to any asset, any mortgage, lien, pledge, charge, security interest or encumbrance of any kind in respect of such asset, whether or not filed, recorded or otherwise perfected under applicable law, including any conditional sale or other title retention agreement, any lease in the nature thereof, any option or other agreement to sell or give a security interest in and any filing of or agreement to give any financing statement under the Uniform Commercial Code (or equivalent statutes) of any jurisdiction.

Moody s means Moody s Investors Service, Inc. or any successor to the rating agency business thereof.

Mortgages means the mortgages, deeds of trust, deeds to secure debt or other similar documents securing Liens on the Premises, as well as the other Collateral secured by and described in the mortgages, deeds of trust, deeds to secure debt or other similar documents.

Net Award means any awards or proceeds in respect of any condemnation or other eminent domain proceeding relating to any Collateral, net of any cash amounts expended by Unifi or its Restricted Subsidiaries to obtain such awards or proceeds or defend against such condemnation or eminent domain proceedings.

Net Insurance Proceeds means any awards or proceeds in respect of any casualty insurance or title insurance claim relating to any Collateral, net of any cash amounts expended by Unifi or its Restricted Subsidiaries to obtain such awards or proceeds.

Net Income means, with respect to any specified Person and its Restricted Subsidiaries, the net income (loss) of such Person, determined in accordance with GAAP and before any reduction in respect of preferred stock dividends, excluding, however:

(1) any gain (or loss), together with any related provision for taxes on such gain (or loss), realized in connection with (a) any Asset Sale (including, without limitation, dispositions pursuant to Sale/Leaseback

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Transactions) or (b) the disposition of any securities by such Person or any of its Restricted Subsidiaries or the extinguishment of any Indebtedness of such Person or any of its Restricted Subsidiaries;

(2) any extraordinary gain (or loss), together with any related provision for taxes on such extraordinary gain (or loss);

(3) any after-tax effect of income (or loss) from the early extinguishment of Indebtedness or from Hedging Obligations or other derivative instruments;

(4) any impairment charge or asset write-off, in each case, pursuant to GAAP and the amortization of intangibles arising pursuant to GAAP; and

(5) any non-cash compensation expense recorded from grants of stock appreciation or similar rights, stock options, restricted stock, equity-based awards or other rights shall be excluded.

Net Proceeds means the aggregate cash proceeds received by Unifi or any of its Restricted Subsidiaries in respect of any Asset Sale (including, without limitation, any cash received upon the sale or other disposition of any non-cash consideration received in any Asset Sale), net of (i) the direct costs relating to such Asset Sale, including, without limitation, legal, accounting, consulting and investment banking fees, and sales commissions, and any relocation expenses incurred as a result of the Asset Sale, (ii) taxes paid or payable as a result of the Asset Sale, in each case, after taking into account any available tax credits or deductions and any tax sharing arrangements, (iii) amounts required to be applied to the repayment of Indebtedness plus any accrued interest, fees, expenses, premiums, consent payments or liquidated damages in connection therewith, (iv) any reserve for adjustment in respect of the sale price of such asset or assets established in accordance with GAAP, (v) payments of unassumed liabilities (not constituting Indebtedness) relating to the assets and (vi) amounts required to be paid to any Person (other than Unifi or any Restricted Subsidiary) owning a beneficial interest in the assets subject to the Asset Sale or having a Lien thereon. With respect to a Recovery Event, Net Proceeds shall mean the Net Award or Net Insurance Proceeds, as applicable, in respect of such Recovery Event, net of (i) taxes paid or payable as a result of the Recovery Event, in each case, after taking into account any available tax credits or deductions and any tax sharing arrangements, (ii) amounts required to be applied to the repayment of Indebtedness plus any accrued interest, fees, expenses, premiums, consent payments or liquidated damages in connection therewith, (iii) any reserve for adjustment in respect of the recovery amounts in respect of such asset or assets established in accordance with GAAP, and (iv) amounts required to be paid to any Person (other than Unifi or any Restricted Subsidiary) owning a beneficial interest in the assets subject to the Recovery Event or having a Lien thereon.

Non-Recourse Debt means Indebtedness:

(1) as to which neither Unifi nor any of its Restricted Subsidiaries (a) provides credit support of any kind (including any undertaking, agreement or instrument that would constitute Indebtedness), (b) is directly or indirectly liable as a guarantor or otherwise, or (c) is the lender (other than by a pledge of the Capital Stock or other securities of the Person incurring such Non-Recourse Debt);

(2) no default with respect to which (including any rights that the holders of the Indebtedness may have to take enforcement action against an Unrestricted Subsidiary) would permit upon notice, lapse of time or both any holder of any other Indebtedness of Unifi or any of its Restricted Subsidiaries to declare a default on such other Indebtedness or cause the payment of such other Indebtedness to be accelerated or payable prior to its Stated Maturity; and

(3) as to which the lenders have been notified in writing that they will not have any recourse to the stock or assets of Unifi or any stock or assets of its Restricted Subsidiaries or the assets of Unifi (other than a pledge of the Capital Stock or other securities of the entity incurring the Non-Recourse Debt).

Obligations means any principal, premium, if any, interest (including interest accruing on or after the filing of any petition in bankruptcy or for reorganization, whether or not a claim for post-filing interest is allowed

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in such proceeding), penalties, fees, charges, expenses, indemnifications, reimbursement obligations, damages, guarantees, and other liabilities or amounts payable under the documentation governing any Indebtedness or in respect thereto.

Offering Memorandum means the final Offering Memorandum relating to the issuance of the initial notes, dated May 26, 2006.

Officers Certificate means a certificate signed by an Officer which complies with the provisions of the indenture.

Permitted Business means the lines of business conducted by Unifi and its Restricted Subsidiaries on the Issue Date and any business incidental or reasonably related thereto or which is a reasonable extension thereof as determined in good faith by Unifi s Board of Directors (including, without limitation, the design, development, production, distribution and sale of yarns, fibers, textiles, fabrics and other related goods).

Permitted Investments means:

(1) any Investment in Unifi or in a Restricted Subsidiary of Unifi;

(2) any Investment in cash and Cash Equivalents;

(3) any Investment by Unifi or any Restricted Subsidiary of Unifi in a Person, if as a result of such Investment:

(a) such Person becomes a Restricted Subsidiary of Unifi; or

(b) such Person is merged, consolidated or amalgamated with or into, or transfers or conveys substantially all of its assets to, or is liquidated into, Unifi or a Restricted Subsidiary of Unifi;

(4) any Investment made as a result of the receipt of non-cash consideration from an Asset Sale that was made pursuant to and in compliance with the covenant described above under the caption Repurchase at the Option of Holders Asset Sales or any non-cash consideration received in connection with a disposition of assets excluded from the definition of Asset Sales;

(5) workers compensation, utility, performance, lease and similar deposits and prepaid expenses in the ordinary course of business and endorsements of negotiable instruments and documents in the ordinary course of business;

(6) loans or advances to employees (other than executive officers) made in the ordinary course of business of Unifi or such Restricted Subsidiary in an aggregate amount not to exceed $1.0 million at any one time outstanding; *provided, however,* that Unifi and its Subsidiaries shall comply in all material respects with the provisions of the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated in connection therewith relating to such loans and advances;

(7) any Investments received in compromise or resolution of (A) obligations of trade creditors or customers that were incurred in the ordinary course of business of Unifi or any of its Restricted Subsidiaries, including pursuant to any plan of reorganization or similar arrangement upon the bankruptcy or insolvency of any trade creditor or customer, or (B) litigation, arbitration or other disputes with Persons who are not Affiliates;

(8) Hedging Obligations;

(9) repurchase of the notes or Exchange Notes and related Subsidiary Guarantees;

(10) advances or extensions of credit on terms customary in the industry in the form of accounts or other receivables incurred (provided that such terms may include such concessionary trade terms as Unifi or its

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Restricted Subsidiary deems reasonable under the circumstances), and loans and advances made in settlement of such accounts receivable, all in the ordinary course of business;

(11) Investments existing on the Issue Date and Investments consisting of Equity Interests of Yihua Unifi Fibre Industry Company Limited received in exchange for the Indebtedness of Yihua Unifi Fibre Industry Company Limited owing to Unifi or any subsidiary in an amount not to exceed the aggregate principal amount outstanding on the Issue Date;

(12) guarantees issued in accordance with the covenant set forth under the caption Certain Covenants Incurrence of Indebtedness;

(13) advances, loans or extensions of credit to suppliers and vendors in the ordinary course of business;

(14) Investments in Permitted Joint Ventures in an aggregate amount, together with all other Investments made pursuant to this clause (14), not to exceed 5.0% of Consolidated Net Tangible Assets (with the fair market value of such Investment being measured at the time made and without giving effect to subsequent changes in value); *provided*, *however*, that if any Investment pursuant to this clause (14) is made in a Person that is not a Restricted Subsidiary of Unifi at the date of the making of such Investment and such Person becomes a Restricted Subsidiary of Unifi after such date, such Investment shall thereafter be deemed to have been made pursuant to clause (1) above (to the extent the Investment is permitted under such clause) and shall cease to have been made pursuant to this clause (14).

(15) payroll, travel and similar advances to cover matters that are expected at the time of such advances ultimately to be treated as expenses for accounting purposes and that are made in the ordinary course of business;

(16) Investments consisting of the licensing or sublicensing of intellectual property;

(17) Investments in Permitted Joint Ventures or Unrestricted Subsidiaries engaged in a Permitted Business made with the net proceeds from the sale or other disposition of Equity Interests in any Permitted Joint Venture in existence on the Issue Date, less the amount of any Investment made in such Permitted Joint Venture after the Issue Date; *provided*, *however*, that, in the case of sales of Equity Interests in a Permitted Joint Venture directly held on the Issue Date by Unifi or a Guarantor, (i) up to $15.0 million of the proceeds from such sales in the aggregate since the Issue Date may be used to make Investments pursuant to this clause (17) in any Permitted Joint Venture or Unrestricted Subsidiary engaged in a Permitted Business, and (ii) otherwise, the proceeds from such sales used to make Investments pursuant to this clause (17) shall be used to make Investments in a Permitted Joint Venture or Unrestricted Subsidiary that is engaged in a Permitted Business and is directly held by Unifi or a Guarantor (and such Equity Interests in such Permitted Joint Venture or Unrestricted Subsidiary shall be included in the First Priority Collateral in accordance with the terms, provisions and exclusions of the Collateral Documents);

(18) transfers of Assets Held for Sale or Investments made with the proceeds from the sale of such Assets Held for Sale by Unifi and its Restricted Subsidiaries to Permitted Joint Ventures or Unrestricted Subsidiaries engaged in a Permitted Business;

(19) contributions of assets or other property to a Permitted Joint Venture or an Unrestricted Subsidiary consisting of assets or other property received by Unifi in connection with a contribution to Unifi s common equity capital or a purchase or issuance of Unifi s Equity Interests (other than Disqualified Stock of Unifi); provided that such real property or other property is specifically identified in an Officer s Certificate delivered to the trustee; and

(20) other Investments in any Person having an aggregate fair market value (measured on the date each such Investment was made and without giving effect to subsequent changes in value), when taken together with all

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other Investments made pursuant to this clause (20) that are at the time outstanding, not to exceed $12.5 million; *provided*, *however*, that if any Investment pursuant to this clause (20) is made in a Person that is not a Restricted Subsidiary of Unifi at the date of the making of such Investment and such Person becomes a Restricted Subsidiary of Unifi after such date, such Investment shall thereafter be deemed to have been made pursuant to clause (1) above (to the extent the Investment is permitted under such clause) and shall cease to have been made pursuant to this clause (20).

Permitted Joint Ventures means any Person which is, directly or indirectly, through its Subsidiaries or otherwise, engaged principally in a Permitted Business, and the Capital Stock (or securities convertible into Capital Stock) of which is owned, directly or indirectly, by Unifi or one or more of its Restricted Subsidiaries and one or more other Person other than Unifi or any of its Subsidiaries or Affiliates; provided that such other Person or Persons shall own Capital Stock constituting (1) at least 25% of the Capital Stock and (2) at least 25% of the Voting Stock of such Permitted Joint Venture.

Permitted Liens means:

(1) Liens to secure Indebtedness and other Obligations under any Credit Agreement permitted by clause (1) of the second paragraph of the covenant entitled Certain Covenants Incurrence of Indebtedness (and related Hedging Obligations); provided that any such Liens on First Priority Collateral shall be subject to the terms of the Intercreditor Agreement;

(2) Liens in favor of Unifi or any Guarantor;

(3) Liens on property of a Person existing at the time such Person is merged with or into or consolidated with Unifi or any Restricted Subsidiary of Unifi or becomes a Restricted Subsidiary of Unifi; *provided* that such Liens were in existence prior to and not incurred in connection with the contemplation of such merger or consolidation and do not extend to any assets other than those of the Person merged into or consolidated with Unifi or the Restricted Subsidiary;

(4) Liens on property (including Capital Stock) existing at the time of acquisition of the property by Unifi or any Restricted Subsidiary of Unifi, *provided* that such Liens were in existence prior to such acquisition and not incurred in contemplation of such acquisition;

(5) Liens to secure the performance of statutory obligations, surety or appeal bonds, performance bonds or other obligations of a like nature incurred in the ordinary course of business;

(6) Liens existing on the Issue Date;

(7) Liens securing Hedging Obligations so long as the related Indebtedness is, and is permitted to be under the indenture, secured by a Lien on the same property securing such Hedging Obligation;

(8) Liens to secure Indebtedness and other obligations (including Capital Lease Obligations) permitted by clause (4) of the second paragraph of the covenant entitled Certain Covenants Incurrence of Indebtedness covering only the assets acquired with or financed by such Indebtedness;

(9) statutory Liens or landlords and carriers , warehouseman s, mechanics , suppliers , materialmen s, repairmen s or other like Liens arising in the ordinary course of business;

(10) Liens for taxes, assessments or governmental charges or claims that are not yet delinquent or that are being contested in good faith by appropriate proceedings promptly instituted and diligently conducted and if a reserve or other appropriate provision, if any, as shall be required in conformity with GAAP shall have been made therefor;

(11) Liens incurred or deposits made in the ordinary course of business in connection with workers compensation, unemployment insurance and other types of social security;

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(12) survey exceptions, easements or reservations of, or rights of others for, licenses, rights-of-way, sewers, electric lines, telegraph and telephone lines and other similar purposes, or zoning or other restrictions as to the use of real property that were not incurred in connection with Indebtedness and that do not in the aggregate materially adversely affect the value of said properties or materially impair their use in the operation of the business of such Person and minor defects in title or Liens or other exception to title that appear on a policy of title insurance, or a commitment to issue such a policy, with respect to any Collateral in favor of the trustee on the Issue Date;

(13) Liens created for the benefit of (or to secure) the notes, the additional notes, the Exchange Notes or the related Subsidiary Guarantees or any Obligations owing to the trustee or the Collateral Agent under the indenture, the Collateral Documents or the Intercreditor Agreement;

(14) rights of banks to set off deposits against debts owed to said bank;

(15) Liens upon specific items of inventory or other goods and proceeds of Unifi or its Subsidiaries securing Unifi s or any Restricted Subsidiary s Obligations in respect of bankers acceptances issued or created for the account of any such Person to facilitate the purchase, shipment or storage of such inventory or other goods;

(16) Liens securing reimbursement obligations with respect to letters of credit which encumber documents and other property relating to such letters of credit and the products and proceeds thereof;

(17) Liens in favor of customs, revenue or other similar authorities arising as a matter of law to secure payment of customs duties in connection with the importation of goods;

(18) Liens to secure any Permitted Refinancing Indebtedness permitted to be incurred under the indenture; *provided, however,* that:

(a) the new Lien shall be limited to all or part of the same property and assets that secured or, under the written agreements pursuant to which the original Lien arose, could secure the original Lien (plus improvements and accessions to, such property or proceeds or distributions thereof); and

(b) the Indebtedness secured by the new Lien is not increased to any amount greater than the sum of (x) the outstanding principal amount, or, if greater, committed amount, of the Permitted Refinancing Indebtedness, (y) accrued interest and (z) an amount necessary to pay any fees and expenses, including premiums, consent payments or liquidated damages, related to such renewal, refunding, refinancing, replacement, defeasance or discharge; and

(19) Liens with respect to obligations that do not exceed $5.0 million at any one time outstanding;

(20) Liens under licensing or sublicensing agreements for use of intellectual property;

(21) Leases or subleases to third parties;

(22) Liens securing Indebtedness permitted by clauses (9), (10), (11), (13), (14) or (15) of the second paragraph of the covenant entitled Certain Covenants Incurrence of Indebtedness;

(23) Liens encumbering deposits made to secure obligations arising from statutory, regulatory or contractual requirements of Unifi or a Restricted Subsidiary, including rights of offset and set-off;

(24) Liens on materials, inventory or consumables and the proceeds therefrom securing trade payables relating to such materials, inventory or consumables;

(25) Factoring Liens relating to Indebtedness permitted to be incurred pursuant to the indenture; and

(26) any extension, renewal or replacement, in whole or in part, of any Lien described in the foregoing clauses (1) through (25) provided that the Lien so extended, renewed or replaced does not extend to any additional property or assets.

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Permitted Refinancing Indebtedness means any Indebtedness of Unifi or any of its Restricted Subsidiaries issued in exchange for, or the net proceeds of which are used to extend, refinance, renew, replace, defease, refund or discharge other Indebtedness of Unifi or any of its Subsidiaries (other than intercompany Indebtedness); *provided* that:

(1) the principal amount (or accreted value, if applicable) of such Permitted Refinancing Indebtedness does not exceed the principal amount (or accreted value, if applicable) of the Indebtedness extended, refinanced, renewed, replaced, defeased, refunded or discharged (plus all accrued interest on the Indebtedness and the amount of all fees, expenses, premiums, consent payments or liquidated damages incurred in connection therewith);

(2) (a) if the Stated Maturity of the Indebtedness being refinanced is the same as or earlier than the Stated Maturity of the notes, such Permitted Refinancing Indebtedness has a Stated Maturity no earlier than the Stated Maturity of the Indebtedness being refinanced or (b) if the Stated Maturity of the Indebtedness being refinanced is later than the Stated Maturity of the notes, such Permitted Refinancing Indebtedness has a Stated Maturity at least 91 days later than the Stated Maturity of the notes;

(3) such Permitted Refinancing Indebtedness has a Weighted Average Life to Maturity equal to or greater than the Weighted Average Life to Maturity of, the Indebtedness being extended, refinanced, renewed, replaced, defeased, refunded or discharged;

(4) if the Indebtedness being extended, refinanced, renewed, replaced, defeased, refunded or discharged is subordinated in right of payment to the notes or any Subsidiary Guarantee, such Permitted Refinancing Indebtedness is subordinated in right of payment to the notes or the Subsidiary Guarantees, as the case may be, on terms at least as favorable to the holders of the notes as those contained in the documentation governing the Indebtedness being extended, refinanced, renewed, replaced, defeased, refunded or discharged; and

(5) if the obligor on the Indebtedness being extended, refinanced, renewed, replaced, defeased, refunded or discharged is Unifi or any Guarantor, such refinancing Indebtedness is incurred either by Unifi or by another Guarantor.

Person means any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, limited liability company or government or other entity.

Recovery Event means any event, occurrence, claim or proceeding that results in any Net Award or Net Insurance Proceeds.

Restoration has the meaning ascribed to it in the applicable Collateral Document.

Restricted Investment means an Investment other than a Permitted Investment.

Restricted Subsidiary of a Person means any Subsidiary of the referent Person that is not an Unrestricted Subsidiary.

S&P means Standard & Poor s Ratings Group, Inc., or any successor to the rating agency business thereof.

Sale/Leaseback Transaction means an arrangement relating to property or assets owned by Unifi or a Subsidiary on the Issue Date or thereafter acquired by Unifi or a Subsidiary whereby Unifi or a Subsidiary transfers such property or assets to a Person (other than Unifi or a Restricted Subsidiary of Unifi) and Unifi or a Subsidiary leases such property or assets from such Person.

Second Priority Collateral means the inventory, accounts receivable, general intangibles (other than any uncertificated securities representing Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person

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in which Unifi or a Guarantor has a direct interest), investment property (other than Capital Stock of any Subsidiary of Unifi or the Guarantors and each Person in which Unifi or a Guarantor has a direct interest), chattel paper, documents, instruments, supporting obligations, letter of credit rights, deposit accounts and other personal property, and all proceeds relating to any of the above, which secure the Credit Agreement on a first-priority basis, now owned or hereafter acquired by Unifi and the Guarantors and other than Excluded Assets, as to which the notes have a second-priority Lien.

Second Priority Collateral Account means any segregated account under the sole control of the Collateral Agent that is free from all other Liens (other than Liens securing the notes) and includes all cash and Cash Equivalents received by the Collateral Agent from Asset Sales of Second Priority Collateral, Recovery Events of Second Priority Collateral, foreclosures on or sales of Second Priority Collateral or any other awards or proceeds related to Second Priority Collateral pursuant to the Collateral Documents.

Shelf Registration Statement has the meaning set forth for such term in the registration rights agreement.

Significant Subsidiary means any Restricted Subsidiary that would be a significant subsidiary of Unifi as defined in Article 1, Rule 1-02 of Regulation S-X, promulgated pursuant to the Securities Act, as such Regulation is in effect on the Issue Date.

Stated Maturity means, with respect to any installment of interest or principal on any series of Indebtedness, the date on which the payment of interest or principal was scheduled to be paid in the documentation governing such Indebtedness as of the Issue Date, and will not include any contingent obligations to repay, redeem or repurchase any such interest or principal prior to the date originally scheduled for the payment thereof.

Subordinated Indebtedness of a Person means any Indebtedness of such Person (whether outstanding on the Issue Date or thereafter incurred) which is subordinate or junior in right of payment to the notes pursuant to a written agreement. For purposes of the foregoing, for the avoidance of doubt, no Indebtedness shall be deemed to be subordinated in right of payment to any other Indebtedness solely by virtue of being unsecured or secured by a lower priority Lien or by virtue of the fact that the holders of such Indebtedness have entered into intercreditor agreements or other arrangements giving one or more of such holders priority over the other holders in the collateral held by them.

Subsidiary means, with respect to any specified Person:

(1) any corporation, association or other business entity of which more than 50% of the total voting power of shares of Capital Stock entitled (without regard to the occurrence of any contingency and after giving effect to any voting agreement or stockholders agreement that effectively transfers voting power) to vote in the election of the Board of Directors thereof is at the time owned or controlled, directly or indirectly, by that Person or one or more of the other Subsidiaries of that Person (or a combination thereof); and

(2) any partnership (or any comparable foreign entity) (a) the sole general partner (or functional equivalent thereof) or the managing general partner of which is such Person or a Subsidiary of such Person or (b) the only general partners (or functional equivalents thereof) of which are that Person or one or more Subsidiaries of that Person (or any combination thereof).

Subsidiary Guarantee means any guarantee by a Guarantor of Unifi s payment Obligations pursuant to the terms of the indenture and on the notes.

Unrestricted Subsidiary means any Subsidiary of Unifi that is designated by the Board of Directors of Unifi as an Unrestricted Subsidiary pursuant to a resolution of the Board of Directors, but only to the extent that such Subsidiary:

(1) has no Indebtedness other than Non-Recourse Debt;

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(2) except as permitted by the covenant described above under the caption Certain Covenants Transactions with Affiliates, is not party to any agreement, contract, arrangement or understanding with Unifi or any Restricted Subsidiary of Unifi unless the terms of any such agreement, contract, arrangement or understanding are no less favorable to Unifi or such Restricted Subsidiary than those that might be obtained at the time from Persons who are not Affiliates of Unifi;

(3) is a Person with respect to which neither Unifi nor any of its Restricted Subsidiaries has any direct or indirect obligation (a) to subscribe for additional Equity Interests or (b) to maintain or preserve such Person s financial condition or to cause such Person to achieve any specified levels of operating results; and

(4) has not guaranteed or otherwise directly or indirectly provided credit support for any Indebtedness of Unifi or any of its Restricted Subsidiaries (other than in the form of a pledge of its Capital Stock or other securities or a Guarantee of the notes, additional notes, the Exchange Notes, the Subsidiary Guarantees or Obligations thereunder).

Voting Stock of any specified Person as of any date means (i) in the case of a corporation (or other similar entity), the Capital Stock of such Person that is at the time entitled to vote in the election of the Board of Directors of such Person, (ii) in the case of a partnership, partnership interests entitled to elect or replace the general partner (or equivalent person) thereof, (iii) in the case of a limited liability company, membership interests entitled, by contract or otherwise, to manage, or to elect to appoint the Persons that will manage the operations or business of the limited liability company.

Weighted Average Life to Maturity means, when applied to any Indebtedness at any date, the number of years obtained by dividing:

(1) the sum of the products obtained by multiplying (a) the amount of each then remaining installment, sinking fund, serial maturity or other required payments of principal, including payment at final maturity, in respect of the Indebtedness, by (b) the number of years (calculated to the nearest one-twelfth) that will elapse between such date and the making of such payment; by

(2) the then outstanding principal amount of such Indebtedness.

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CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following is a general summary of certain material anticipated U.S. federal income tax consequences to a U.S. Holder and to a Non-U.S. Holder, each as defined below, and of certain material anticipated U.S. federal estate tax consequences to a Non-U.S. Holder, of an exchange of initial notes for exchange notes in this offering and of the ownership and disposition of exchange notes. In the opinion of Paul, Weiss, Rifkind, Wharton & Garrison LLP, our special tax counsel, subject to the exceptions, assumptions, and qualifications set forth below, the discussion accurately describes the material U.S. federal income tax consequences to a U.S. Holder and the material U.S. federal income and estate tax consequences to a Non-U.S. Holder of the consummation of the exchange offer and of the ownership and disposition of exchange notes. This discussion is based on the U.S. Internal Revenue Code of 1986, as amended (the Code), Treasury regulations promulgated under the Code, administrative pronouncements or practices, and judicial decisions, all as of the date hereof. Future legislative, judicial, or administrative modifications, revocations, or interpretations, which may or may not be retroactive, may result in U.S. federal tax consequences significantly different from those discussed herein. This discussion is not binding on the U.S. Internal Revenue Service (the IRS). No ruling has been or will be sought or obtained from the IRS with respect to the classification of the initial notes or exchange notes for U.S. federal income tax purposes or any of the U.S. federal tax consequences discussed herein. There can be no assurance that the IRS will not challenge any of the conclusions discussed herein or that a U.S. court will not sustain such a challenge.

This discussion does not address any U.S. federal alternative minimum tax; U.S. federal estate, gift, or other non-income tax except as expressly provided below; or any state, local, or non-U.S. tax consequences of an exchange of initial notes for exchange notes or of the ownership or disposition of exchange notes. In addition, this discussion does not address the U.S. federal income tax consequences to beneficial owners of initial notes or exchange notes subject to special rules, including, for example, beneficial owners that:

(i) are banks, financial institutions, or insurance companies,

(ii) are regulated investment companies or real estate investment trusts,

(iii) are brokers, dealers, or traders in securities or currencies,

(iv) are tax-exempt organizations,

(v) hold initial notes or exchange notes as part of hedges, straddles, constructive sales, conversion transactions, or other integrated investments,

(vi) acquire initial notes or exchange notes as compensation for services,

(vii) have a functional currency other than the U.S. dollar,

(viii) use the mark-to-market method of accounting, or

(ix) are U.S. expatriates.

As used herein, a Holder means a beneficial owner of an exchange note. A U.S. Holder means a Holder that is:

(i) an individual citizen or resident of the U.S. for U.S. federal income tax purposes,

(ii) a corporation or any other entity taxable as a corporation for U.S. federal income tax purposes organized under the laws of the U.S. or any political subdivision thereof, including any State and the District of Columbia,

(iii) an estate the income of which is subject to U.S. federal income tax regardless of its source, or

(iv) a trust that:

(a) is subject to the primary jurisdiction of a court within the U.S. and for which one or more U.S. persons have authority to control all substantial decisions, or

(b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

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If a Holder is a partnership or any other entity taxable as a partnership for U.S. federal income tax purposes (a Partnership), the U.S. federal income tax consequences to an owner or partner in such Partnership generally will depend on the status of such owner or partner and on the activities of such Partnership. A Holder that is a Partnership or an owner or partner in a Partnership is urged to consult its own tax advisor regarding the U.S. federal income tax consequences of an exchange of initial notes for exchange notes in this offering and of the ownership or disposition of exchange notes. As used herein, a Non-U.S. Holder means a Holder that is neither a U.S. Holder nor a Partnership or an owner or partner in a Partnership.

This discussion assumes that initial notes were, and exchange notes will be, capital assets, within the meaning of the Code, in the hands of a Holder at all relevant times.

A HOLDER IS URGED TO CONSULT ITS OWN TAX ADVISOR REGARDING THE APPLICATION OF U.S. FEDERAL TAX LAWS TO ITS PARTICULAR CIRCUMSTANCES AND ANY TAX CONSEQUENCES ARISING UNDER THE LAWS OF ANY STATE, LOCAL, NON-U.S., OR OTHER TAXING JURISDICTION OR UNDER ANY APPLICABLE TAX TREATY.

Exchange of an Initial Note for an Exchange Note

An exchange of an initial note for an exchange note in this offering will not be a taxable exchange for U.S. federal income tax purposes, and a Holder will not recognize any gain or loss on such exchange. Following an exchange of an initial note for an exchange note in this offering, a Holder s holding period in its exchange notes will include its holding period in the initial notes exchanged therefor, and a Holder s tax basis in its exchange notes will equal its adjusted tax basis in the initial notes exchanged therefor immediately before such exchange.

Tax Considerations for a U.S. Holder

Payments of Interest

Stated interest on an exchange note generally will be taxable to a U.S. Holder as ordinary income at the time it accrues or is received in accordance with such U.S. Holder s method of accounting for U.S. federal income tax purposes.

Payments on Early Redemptions or Other Circumstances

In certain circumstances (see Description of the Notes Optional Redemption and Description of the Notes Repurchase at the Option of Holders Change of Control), the Company may be obligated or entitled to redeem exchange notes before their stated maturity date, possibly for amounts in excess of the stated principal thereof. According to Treasury regulations, the possibility that any such redemption might occur will not affect the amount, timing, or character of interest income to be currently recognized by a U.S. Holder if there was only a remote chance as of the date the initial notes were issued that any of the circumstances that would give rise to any such redemption (considered individually and in the aggregate) will occur. Because the Company believed as of the date the initial notes were issued that there was only a remote chance that any such redemption would occur the Company does not intend to treat such potential redemptions as part of or affecting the yield to maturity of an exchange note. In the event that such a contingency does occur, it would affect the amount and timing of the income that a U.S. Holder will recognize. The Company s determination that these contingencies are remote is binding on a U.S. Holder unless such U.S. Holder discloses a contrary position in the manner required by applicable Treasury regulations. The Company s determination is not binding on the IRS, and if the IRS were to challenge this determination, a U.S. Holder might be required to accrue income on an exchange note at a higher yield and to treat as ordinary income (rather than as capital gain) any income realized on the taxable disposition of an exchange note before the resolution of such contingencies.

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Sale, Exchange, or Retirement of an Exchange Note

A U.S. Holder generally will recognize gain or loss on the sale, exchange, retirement, or other taxable disposition of an exchange note in an amount equal to the difference between:

(i) the amount of U.S. dollars plus the fair market value of any other property received (other than any amount received in respect of accrued but unpaid interest not included previously in income, which will be taxable as ordinary income if not included previously in such U.S. Holder s gross income), and

(ii) the U.S. Holder s adjusted tax basis in the exchange note.

A U.S. Holder s adjusted tax basis in an exchange note generally will be the U.S. Holder s adjusted tax basis in the initial note exchanged therefor decreased by any payment from the Company to the U.S. Holder on such exchange note (other than a payment of qualified stated interest). Gain or loss recognized on the sale, exchange, retirement, or other taxable disposition of an exchange note generally will be capital gain or loss, and will be long-term capital gain or loss if the U.S. Holder s holding period in such exchange note exceeds one year. Long-term capital gain is subject to U.S. federal income tax at a reduced rate to a non-corporate U.S. Holder. The deductibility of capital losses is subject to limitations.

Tax Considerations for a Non-U.S. Holder

The rules governing the U.S. federal income taxation of a Non-U.S. Holder are complex. A Non-U.S. Holder is urged to consult its own tax advisor regarding the application of U.S. federal tax laws, including any information reporting requirements, to its particular circumstances and any tax consequences arising under the laws of any state, local, non-U.S., or other taxing jurisdiction.

U.S. Federal Income Tax

Payments of interest on exchange notes by the Company or the Company s paying agent to a Non-U.S. Holder generally will not be subject to withholding of U.S. federal income tax if such interest will qualify as portfolio interest. Interest on exchange notes paid to a Non-U.S. Holder will qualify as portfolio interest if:

- for U.S. federal income tax purposes, such Non-U.S. Holder does not own directly or indirectly, actually or constructively, 10% or more of the total combined voting power of all classes of Company stock entitled to vote;
- for U.S. federal income tax purposes, such Non-U.S. Holder is not a controlled foreign corporation related directly or indirectly to the Company through stock ownership;
- such Non-U.S. Holder is not a bank receiving interest described in Section 881(c)(3)(A) of the Code; and
- the certification requirement, described below, has been fulfilled with respect to such Non-U.S. Holder.

The certification requirement will be fulfilled if either:

(i) the Non-U.S. Holder provides to the Company or the Company s paying agent an IRS Form W-8BEN (or successor form), signed under penalty of perjury, that includes such Non-U.S. Holder s name, address, and a certification as to its non-U.S. status, or

(ii) a securities clearing organization, bank, or other financial institution that holds customers securities in the ordinary course of its trade or business holds the exchange notes on behalf of such Non-U.S. Holder, and provides to the Company or the Company s paying agent a statement, signed under penalty of perjury, in which such organization, bank, or other financial institution certifies that it has received an IRS Form W-8BEN (or successor form) from such Non-U.S. Holder or from another financial institution acting on behalf of such Non-U.S. Holder and provides to the Company or the Company s paying agent a copy thereof.

Other methods might be available to satisfy the certification requirement depending on a Non-U.S. Holder s particular circumstances.

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The gross amount of any payment of interest on a Non-U.S. Holder s exchange notes that does not qualify for the portfolio interest exception will be subject to withholding of U.S. federal income tax at the statutory rate of 30% unless:

(i) such Non-U.S. Holder provides a properly completed IRS Form W-8BEN (or successor form) claiming an exemption from or reduction in withholding of U.S. federal income tax under an applicable tax treaty, or

(ii) such interest is effectively connected with the conduct of a U.S. trade or business by such Non-U.S. Holder and such Non-U.S. Holder provides a properly completed IRS Form W-8ECI (or successor form).

Subject to the discussion below concerning backup withholding, a Non-U.S. Holder generally will not be subject to U.S. federal income tax or to withholding of U.S. federal income tax on any gain realized on the sale, exchange, redemption, retirement, or other disposition of an exchange note unless:

(i) such Non-U.S. Holder is an individual present in the United States for 183 days or more in the taxable year of such disposition and other applicable conditions are met, or

(ii) such gain is effectively connected with the conduct of a U.S. trade or business by such Non-U.S. Holder and, if required by an applicable income tax treaty, is attributable to a U.S. permanent establishment maintained by such Non-U.S. Holder.

If a Non-U.S. Holder is engaged in a U.S. trade or business and interest on an exchange note or gain realized on the disposition of an exchange note is effectively connected with the conduct of such U.S. trade or business, such Non-U.S. Holder generally will be subject to regular U.S. federal income tax on such interest and gain on a net basis in the same manner as if such Non-U.S. Holder were a U.S. Holder, unless an applicable tax treaty provides otherwise. In addition, if such Non-U.S. Holder is a non-U.S. corporation:

(i) such interest and gain will be included in the non-U.S. corporation s earnings and profits, and

(ii) such non-U.S. corporation may be subject to the branch profits tax on its effectively connected earnings and profits for the taxable year, subject to certain adjustments, at the statutory rate of 30% unless such rate is reduced or the branch profit tax is eliminated by an applicable tax treaty.

Although such effectively connected income will be subject to U.S. federal income tax, and may be subject to the branch profits tax, it generally will not be subject to withholding of U.S. federal income tax if a Non-U.S. Holder provides a properly completed IRS Form W-8ECI (or successor form).

In certain circumstances (see Description of the Notes Optional Redemption and Description of the Notes Repurchase at the Option of Holders Change of Control), the Company may be entitled or obligated to redeem exchange notes before their stated maturity date, possibly for amounts in excess of the stated principal thereof. Although the Company believes that as of the date the initial notes were issued there was only a remote chance that any such contingent payment would be made, a contingent payment actually made and treated as in the nature of interest for U.S. federal income tax purposes should be subject to U.S. federal income tax, including possible withholding tax, generally in the same manner as stated interest. A Non-U.S. Holder is urged to consult its own tax advisor regarding the U.S. federal income tax consequences of any such contingent payment.

U.S. Federal Estate Tax

An exchange note held or treated as held by an individual who is a non-resident of the U.S. (as specially defined for U.S. federal estate tax purposes) at the time of his or her death will not be subject to U.S. federal estate tax, provided that:

(i) the interest on the exchange note is exempt from withholding of U.S. federal income tax under the portfolio interest exemption discussed above (without regard to the certification requirement), and

(ii) interest on the exchange note will not be effectively connected with the conduct of a U.S. trade or business by such individual.

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An individual may be a Non-U.S. Holder but not a non-resident of the U.S. for U.S. federal estate tax purposes. A Non-U.S. Holder that is an individual is urged to consult its own tax advisor regarding the possible application of the U.S. federal estate tax to its particular circumstances, including the effect of any applicable treaty.

Information Reporting and Backup Withholding

A Holder may be subject, under certain circumstances, to information reporting and/or backup withholding at the applicable rate (currently 28%) with respect to certain payments of principal of, and interest on, an exchange note, and the proceeds of a disposition of an exchange note before maturity. Backup withholding may apply to a U.S. Holder that:

(i) fails to furnish its taxpayer identification number, or TIN, which for an individual is his or her Social Security number, within a reasonable time after a request therefor,

(ii) furnishes an incorrect TIN,

(iii) is notified by the IRS that it failed to report properly certain interest or dividends, or

(iv) fails, under certain circumstances, to provide a certified statement, signed under penalty of perjury, that it is a U.S. person, that the TIN provided is correct, and that it has not been notified by the IRS that it is subject to backup withholding.

The application for exemption is available by providing a properly completed IRS Form W-9 (or successor form). These requirements generally do not apply with respect to certain U.S. Holders, including corporations, tax-exempt organizations, qualified pension and profit sharing trusts, certain financial institutions and individual retirement accounts.

The Company generally must report to the IRS and to a Non-U.S. Holder the amount of interest on exchange notes paid to such Non-U.S. Holder and the amount of any tax withheld in respect of such interest payments. Copies of information returns that report such interest payments and any withholding of U.S. federal income tax may be made available to tax authorities in a country in which a Non-U.S. Holder is a resident under the provisions of an applicable income tax treaty.

Backup withholding is not an additional tax. Any amount withheld from a payment to a U.S. Holder under the backup withholding rules will be allowed as credit against such U.S. Holder s U.S. federal income tax liability and may entitle such U.S. Holder to a refund, provided that the required information is timely furnished to the IRS. A U.S. Holder is urged to consult its own tax advisor regarding the application of information reporting and backup withholding in its particular circumstances, the availability of an exemption from backup withholding, and the procedure for obtaining any such available exemption.

If a Non-U.S. Holder provides the applicable IRS Form W-8BEN or other applicable form (together with all appropriate attachments, signed under penalties of perjury, and identifying such Non-U.S. Holder and stating that it is not a U.S. person), and the Company or the Company s paying agent, as the case may be, has neither actual knowledge nor reason to know that such Non-U.S. Holder is a U.S. person, then such Non-U.S. Holder will not be subject to U.S. backup withholding with respect to payments of principal or interest on exchange notes made by the Company or the Company s paying agent. Special rules apply to pass-through entities and this certification requirement may also apply to beneficial owners of pass-through entities.

Payment of the proceeds of a disposition of an exchange note by a Non-U.S. Holder made to or through a U.S. office of a broker generally will be subject to information reporting and backup withholding unless such Non-U.S. Holder:

(i) certifies its non-U.S. status on IRS Form W-8BEN (or successor form) signed under penalty of perjury, or

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(ii) otherwise establishes an exemption.

Payment of the proceeds of a disposition of an exchange note by a Non-U.S. Holder made to or through a non-U.S. office of a non-U.S. broker generally will not be subject to information reporting or backup withholding unless such non-U.S. broker is a U.S. Related Person (as defined below). Payment of the proceeds of a disposition of an exchange note by a Non-U.S. Holder made to or through a non-U.S. office of a U.S. broker or a U.S. Related Person generally will not be subject to backup withholding, but will be subject to information reporting, unless:

(i) such Non-U.S. Holder certifies its non-U.S. status on IRS Form W-8BEN (or successor form) signed under penalty of perjury, or

(ii) such U.S. broker or U.S. Related Person has documentary evidence in its records as to the non-U.S. status of such Non-U.S. Holder and has neither actual knowledge nor reason to know that such Non-U.S. Holder is a U.S. person.

For this purpose, a U.S. Related Person is:

(i) a controlled foreign corporation for U.S. federal income tax purposes,

(ii) a non-U.S. person 50% or more of whose gross income from all sources for the three-year period ending with the close of its taxable year preceding the payment (or for such part of the period that the broker has been in existence) is derived from activities that are effectively connected with the conduct of a U.S. trade or business, or

(iii) a non-U.S. partnership if at any time during its taxable year one or more of its partners are U.S. persons who, in the aggregate, hold more than 50% of the income or capital interest of the partnership or if, at any time during its taxable year, the partnership is engaged in the conduct of a U.S. trade or business.

Backup withholding is not an additional tax. Any amount withheld from a payment to a Non-U.S. Holder under the backup withholding rules will be allowed as a credit against such Non-U.S. Holder s U.S. federal income tax liability and may entitle such Non-U.S. Holder to a refund, provided that certain required information is timely furnished to the IRS. A Non-U.S. Holder is urged to consult its own tax advisor regarding the application of information reporting and backup withholding in its particular circumstances, the availability of an exemption from backup withholding, and the procedure for obtaining any such available exemption.

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CERTAIN ERISA CONSIDERATIONS

IRS Circular 230 disclosure: To ensure compliance with Internal Revenue Service Circular 230, you are hereby notified that: (a) any discussion of U.S. federal tax issues in this document is not intended or written to be relied upon, and cannot be relied upon by Holders, for the purpose of avoiding penalties that may be imposed on them under the U.S. Internal Revenue Code; (b) such discussion is written in connection with the promotion or marketing of the transactions or matters addressed herein; and (c) each Holder should seek advice based on its particular circumstances from an independent tax advisor.

The following is a summary of certain considerations associated with the purchase of the notes by employee benefit plans that are subject to Title I of the U.S. Employee Retirement Income Security Act of 1974, as amended, or ERISA, plans, individual retirement accounts and other arrangements that are subject to Section 4975 of the Code or provisions under any federal, state, local, non-U.S. or other laws or regulations that are similar to such provisions of ERISA or the Code, which we refer to collectively as Similar Laws, and entities whose underlying assets are considered to include plan assets of any such plan, account or arrangement, each of which we refer to as a Plan.

General Fiduciary Matters

ERISA and the Code impose certain duties on persons who are fiduciaries of a Plan subject to Title I of ERISA or Section 4975 of the Code, or an ERISA Plan, and prohibit certain transactions involving the assets of an ERISA Plan and its fiduciaries or other interested parties. Under ERISA and the Code, any person who exercises any discretionary authority or control over the administration of such an ERISA Plan or the management or disposition of the assets of such an ERISA Plan, or who renders investment advice for a fee or other compensation to such an ERISA Plan, is generally considered to be a fiduciary of the ERISA Plan.

In considering an investment in the notes of a portion of the assets of any Plan, a fiduciary should determine whether the investment is in accordance with the documents and instruments governing the Plan and the applicable provisions of ERISA, the Code or any Similar Law relating to a fiduciary s duties to the Plan including, without limitation, the prudence, diversification, delegation of control and prohibited transaction provisions of ERISA, the Code and any other applicable Similar Laws.

Certain plans that are not subject to ERISA, including plans maintained by state and local governmental entities, are nonetheless subject to investment restrictions under the terms of applicable local law. Such restrictions may preclude the purchase of the notes and any such plan purchasing the notes will be deemed to have represented that its purchasing, holding and disposition of the notes will not violate any applicable law.

Prohibited Transaction Issues

Section 406 of ERISA and Section 4975 of the Code prohibit ERISA Plans from engaging in specified transactions involving plan assets with persons or entities who are parties in interest , within the meaning of ERISA, or disqualified persons , within the meaning of Section 4975 of the Code, unless an exemption is available. A party in interest or disqualified person who engaged in a non-exempt prohibited transaction may be subject to excise taxes and other penalties and liabilities under ERISA and the Code. In addition, the fiduciary of the ERISA Plan that engaged in such a non-exempt prohibited transaction may be subject to penalties and liabilities under ERISA and the Code. The acquisition and/or holding of notes (or exchange notes) by an ERISA Plan with respect to which the issuer, the initial purchasers, or the guarantor subsidiaries are considered a party in interest or a disqualified person may constitute or result in a direct or indirect prohibited transaction under Section 406 of ERISA and/or Section 4975 of the Code, unless the investment is acquired and is held in accordance with an applicable statutory, class or individual prohibited transaction exemption. In this regard, the U.S. Department of Labor (the DOL) has issued prohibited transaction class exemptions, or PTCEs, that may apply to the acquisition and holding of the notes. These class exemptions include, without limitation, PTCE

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84-14 respecting transactions determined by independent qualified professional asset managers, PTCE 90-1 respecting insurance company pooled separate accounts, PTCE 91-38 respecting bank collective investment funds, PTCE 95-60 respecting life insurance company general accounts and PTCE 96-23 respecting transactions determined by in-house asset managers, although there can be no assurance that all of the conditions of any such exemptions will be satisfied.

Because of the foregoing, the notes should not be purchased or held by any person investing plan assets of any Plan, unless such purchase and holding will not constitute a non-exempt prohibited transaction under ERISA and the Code or violation of any applicable Similar Laws.

Representation

Accordingly, by acceptance of a note (and an exchange note), each purchaser and subsequent transferee of a note (and an exchange note) will be deemed to have represented and warranted that either (i) no portion of the assets used by such purchaser or transferee to acquire or hold the notes constitutes assets of any Plan or (ii) the purchase and holding of the notes by such purchaser or transferee will not constitute a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violation under any applicable Similar Laws.

The foregoing discussion is general in nature and is not intended to be all inclusive. Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries, or other persons considering purchasing the notes on behalf of, or with the assets of, any Plan, consult with their counsel regarding the potential applicability of ERISA, Section 4975 of the Code and any Similar Laws to such investment and whether an exemption would be applicable to the purchase and holding of the notes (and the exchange notes).

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PLAN OF DISTRIBUTION

Each broker-dealer who holds initial notes that are transfer restricted securities that were acquired for its own account as a result of market-making activities or other trading activities (other than transfer restricted securities acquired directly from us or any of our affiliates), may exchange such transfer restricted securities in the exchange offer.

Each broker-dealer that receives exchange notes for its own account in the exchange offer in exchange for initial notes acquired by such broker-dealer as a result of market-making or other trading activities may be deemed to be an underwriter within the meaning of the Securities Act and, therefore, must deliver a prospectus meeting the requirements of the Securities Act in connection with any resales, offers to resell or other transfers of the exchange notes received by it in connection with the exchange offer. Accordingly, each such broker-dealer must acknowledge that it will deliver a prospectus meeting the requirements of the Securities Act in connection with any resale of such exchange notes. The letter of transmittal states that by acknowledging that it will deliver and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of exchange notes received in exchange for initial notes where such initial notes were acquired as a result of market-making activities or other trading activities. We have agreed that, for a period of one year after the completion of this exchange offer, we will make this prospectus, as amended or supplemented, available to any broker-dealer for use in connection with any such resale. In addition, until March 20, 2007, all dealers effecting transactions in the exchange notes may be required to deliver a prospectus.

We will not receive any proceeds from any sale of exchange notes by broker-dealers. Exchange notes received by broker-dealers for their own account in the exchange offer may be sold from time to time in one or more transactions in the over-the-counter market, in negotiated transactions, through the writing of options on the exchange notes or a combination of such methods of resale, at market prices prevailing at the time of resale, at prices related to such prevailing market prices or negotiated prices. Any such resale may be made directly to purchasers or to or through brokers or dealers who may receive compensation in the form of commissions or concessions from any such broker-dealer and/or the purchasers of any such exchange notes. Any broker-dealer that resells exchange notes that were received by it for its own account in the exchange offer and any broker or dealer that participates in a distribution of such exchange notes may be deemed to be an underwriter within the meaning of the Securities Act and any profit of any such resale of exchange notes and any commissions or concessions received by any such persons may be deemed to be underwriting compensation under the Securities Act. The letter of transmittal states that by acknowledging that it will deliver and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act.

LEGAL MATTERS

Paul, Weiss, Rifkind, Wharton & Garrison LLP, New York, New York, will opine that the exchange notes are binding obligations of the registrant and will pass on the validity of the guarantees offered hereby. Moore & Van Allen PLLC will pass on certain legal matters of North Carolina law relating to the guarantors. Paul, Weiss, Rifkind, Wharton & Garrison LLP has relied upon the opinion of this firm as to matters of state law in the indicated jurisdiction.

EXPERTS

Ernst & Young LLP, independent registered public accounting firm, has audited our consolidated financial statements and schedule included in our Annual Report on Form 10-K for the year ended June 25, 2006, and management s assessment of the effectiveness of our internal control over financial reporting as of June 25, 2006, as set forth in their reports, which are incorporated by reference in this prospectus and elsewhere in the

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registration statement. We have included our financial statements at June 25, 2006 and June 26, 2005 and for each of the three years in the period ended June 25, 2006 in the prospectus and elsewhere in the registration statement and our financial statements and schedule and management s assessment are incorporated by reference in reliance on Ernst & Young LLP s reports, given on their authority as experts in accounting and auditing.

The financial statements of Yihua Unifi Fibre Industry Company Limited at May 30, 2006 and for the period from August 4, 2005 (date of inception) to May 30, 2006, appearing in this prospectus and registration statement have been audited by Ernst & Young Hua Ming, Shanghai Branch, The People s Republic of China, independent registered public accounting firm, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

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WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Form S-4 to register the exchange notes. We are subject to the informational requirements of the Exchange Act, and file reports, proxy statements and other information with the SEC. This prospectus, which forms part of the registration statement, does not contain all of the information included in that registration statement. For further information about us and the exchange notes offered in this prospectus, you should refer to the registration statement and its exhibits. You may read and copy any document we file with the SEC at the SEC s Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549. Copies of these reports, proxy statements and information may be obtained at prescribed rates from the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. In addition, the SEC maintains a web site that contains reports, proxy statements and other information regarding registrants, such as us, that file electronically with the SEC. The address of this web site is http://www.sec.gov.

Anyone who receives a copy of this prospectus may obtain a copy of the indenture without charge by writing to

Mr. William Lowe, Jr.

Unifi, Inc.

P.O. Box 19109

Greensboro, NC 27419-9109

(336) 294-4410

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Unifi, Inc.

We have audited the accompanying consolidated balance sheets of Unifi, Inc. as of June 25, 2006, and June 26, 2005, and the related consolidated statements of operations, changes in shareholders equity and comprehensive income (loss), and cash flows for each of the three years in the period ended June 25, 2006. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Unifi, Inc. at June 25, 2006 and June 26, 2005 and the consolidated results of its operations and its cash flows for each of the three years in the period ended June 25, 2006, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Greensboro, North Carolina

August 30, 2006

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UNIFI, INC.

CONSOLIDATED BALANCE SHEETS

	June 25, 2006	June 26, 2005
	(Amounts in thousands, except per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 35,317	$ 105,621
Receivables, net	93,236	106,437
Inventories	116,018	110,827
Deferred income taxes	11,739	14,578
Assets held for sale	15,419	32,536
Restricted cash		2,766
Other current assets	9,229	15,590
Total current assets	280,958	388,355
Property, plant and equipment:		
Land	3,628	3,979
Buildings and improvements	170,377	166,504
Machinery and equipment	642,192	664,228
Other	100,140	120,748
	916,337	955,459
Less accumulated depreciation	(676,641)	(675,727)
	239,696	279,732
Investments in unconsolidated affiliates	190,217	160,675
Other noncurrent assets	21,766	16,613
	$ 732,637	$ 845,375
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 68,593	$ 62,666
Accrued expenses	23,869	45,618
Deferred gain	323	
Income taxes payable	2,303	2,292
Current maturities of long-term debt and other current liabilities	6,330	35,339
Total current liabilities	101,418	145,915
Long-term debt and other liabilities	202,110	259,790
Deferred gain	295	
Deferred income taxes	45,861	55,913
Minority interests		182
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.10 par (500,000 shares authorized, 52,208 and 52,145 shares outstanding)	5,220	5,215
Capital in excess of par value	929	208

Retained earnings	382,082	396,448
Unearned compensation		(128)
Accumulated other comprehensive loss	(5,278)	(18,168)
	382,953	383,575
	$ 732,637	$ 845,375

The accompanying notes are an integral part of the financial statements.

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UNIFI, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Fiscal Years Ended		
	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands, except per share data)		
Summary of Operations:			
Net sales	$ 738,825	$ 793,796	$ 666,383
Cost of sales	696,055	762,717	625,983
Selling, general and administrative expenses	41,534	42,211	45,963
Provision for bad debts	1,256	13,172	2,389
Interest expense	19,247	20,575	18,698
Interest income	(4,489)	(2,152)	(2,152)
Other (income) expense, net	(3,118)	(2,300)	(2,590)
Equity in (earnings) losses of unconsolidated affiliates	(825)	(6,938)	6,877
Minority interest income		(530)	(6,430)
Restructuring charges (recovery)	(254)	(341)	8,229
Arbitration costs and expenses			182
Alliance plant closure recovery			(206)
Write down of long-lived assets	2,366	603	25,241
Goodwill impairment			13,461
Loss from early extinguishment of debt	2,949		
Loss from continuing operations before income taxes and extraordinary item	(15,896)	(33,221)	(69,262)
Benefit for income taxes	(1,170)	(13,483)	(25,113)
Loss from continuing operations before extraordinary item	(14,726)	(19,738)	(44,149)
Income (loss) from discontinued operations, net of tax	360	(22,644)	(25,644)
Loss before extraordinary item	(14,366)	(42,382)	(69,793)
Extraordinary gain net of taxes of $0		1,157	
Net loss	$ (14,366)	$ (41,225)	$ (69,793)
Income (losses) per common share (basic and diluted):			
Loss from continuing operations before extraordinary item	$ (.28)	$ (.38)	$ (.85)
Income (loss) from discontinued operations, net of tax		(.43)	(.49)
Extraordinary gain net of taxes of $0		.02	
Net loss per common share	$ (.28)	$ (.79)	$ (1.34)

The accompanying notes are an integral part of the financial statements.

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UNIFI, INC.

CONSOLIDATED STATEMENTS OF CHANGES

IN SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME (LOSS)

	Shares Outstanding	Common Stock	Capital in Excess of Par Value	Retained Earnings	Unearned Compensation	Other Comprehensive Income (Loss)	Total Shareholders Equity	Comprehensive Income (Loss) Note 1
				(Amounts in thousands)				
Balance June 29, 2003	53,399	$ 5,340	$	$ 515,572	$ (302)	$ (40,862)	$ 479,748	
Purchase of stock	(1,304)	(131)	(7)	(8,242)			(8,380)	
Cancellation of unvested restricted stock	(2)			(18)	18			
Issuance of restricted stock	22	2	134		(136)			
Amortization of restricted stock					192		192	
Currency translation adjustments						134	134	$ 134
Net loss				(69,793)			(69,793)	(69,793)
Balance June 27, 2004	52,115	5,211	127	437,519	(228)	(40,728)	401,901	$ (69,659)
Purchase of stock	(1)		(2)				(2)	
Options exercised	33	4	101				105	
Cancellation of unvested restricted stock	(2)		(18)		15		(3)	
Amortization of restricted stock					85		85	
Currency translation adjustments						19,580	19,580	$ 19,580
Liquidation of foreign subsidiaries				154		2,980	3,134	2,980
Net loss				(41,225)			(41,225)	(41,225)
Balance June 26, 2005	52,145	5,215	208	396,448	(128)	(18,168)	383,575	$ (18,665)
Reclassification upon adoption of SFAS 123R		(1)	27		128		154	
Options exercised	63	6	168				174	
Stock option tax benefit			1				1	
Stock option expense			394				394	
Cancellation of unvested restricted stock			131				131	
Currency translation adjustments						5,550	5,550	$ 5,550
						7,340	7,340	7,340

Liquidation of foreign subsidiaries								
Net loss				(14,366)			(14,366)	(14,366)
Balance June 25, 2006	52,208	$ 5,220	$ 929	$ 382,082	$	$ (5,278)	$ 382,953	$ (1,476)

The accompanying notes are an integral part of the financial statements.

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UNIFI, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Years Ended		
	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Cash and cash equivalents at beginning of year	$ 105,621	$ 65,221	$ 76,801
Operating activities:			
Net loss	(14,366)	(41,225)	(69,793)
Adjustments to reconcile net loss to net cash provided by continuing operating activities:			
Extraordinary gain		(1,157)	
(Income) loss from discontinued operations	(360)	22,644	25,644
Net (income) loss of unconsolidated equity affiliates, net of distributions	1,945	(2,302)	8,695
Depreciation	48,669	51,542	56,226
Amortization	1,276	1,350	1,377
Net (gain) loss on asset sales	(1,755)	(1,770)	(3,227)
Non-cash portion of loss on extinguishment of debt	1,793		
Non-cash portion of restructuring charges (recovery)	(254)	(341)	7,155
Non-cash write down of long-lived assets	2,366	603	25,241
Non-cash effect of goodwill impairment			13,461
Deferred income taxes	(7,776)	(19,057)	(28,201)
Provision for bad debts	1,256	13,172	2,389
Change in cash surrender value of life insurance	1,643	(1,077)	3,107
Minority interest		(551)	(6,148)
Other	148	(461)	(731)
Changes in assets and liabilities, excluding effects of acquisitions and foreign currency adjustments:			
Receivables	10,592	(1,504)	(8,954)
Inventories	(5,844)	20,574	(813)
Other current assets	(1,278)	(901)	(668)
Accounts payable and accrued expenses	(8,504)	(10,933)	(13,539)
Income taxes	542	179	159
Net cash provided by continuing operating activities	30,093	28,785	11,380
Investing activities:			
Capital expenditures	(11,988)	(9,422)	(11,124)
Acquisition	(30,634)	(1,358)	(83)
Return of capital from equity affiliates		6,138	1,665
Investment of foreign restricted assets	171	388	(323)
Collection of notes receivable	404	520	581
Increase in notes receivable		(139)	(711)
Proceeds from sale of capital assets	10,093	2,290	4,242
Restricted cash	2,766	(2,766)	
Other	(42)	(342)	(24)
Net cash used in investing activities	(29,230)	(4,691)	(5,777)
Financing activities:			
Payment of long term debt	(273,134)		
Borrowing of long term debt	190,000		
Debt issuance costs	(8,041)		
Issuance of Company stock	176	104	
Purchase and retirement of Company stock		(2)	(8,390)
Other	825	(20)	(77)
Net cash provided by (used in) financing activities	(90,174)	82	(8,467)

Cash flows of discontinued operations (Revised See Note 18)			
Operating cash flow	(3,342)	(6,273)	(8,358)
Investing cash flow	22,028	13,902	(427)
Financing cash flow			10
Net cash provided by (used in) discontinued operations	18,686	7,629	(8,775)
Effect of exchange rate changes on cash and cash equivalents	321	8,595	59
Net increase (decrease) in cash and cash equivalents	(70,304)	40,400	(11,580)
Cash and cash equivalents at end of year	$ 35,317	$ 105,621	$ 65,221

The accompanying notes are an integral part of the financial statements.

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies and Financial Statement Information

Principles of Consolidation. The Consolidated Financial Statements include the accounts of the Company and all majority-owned subsidiaries. The portion of the income applicable to non-controlling interests in the majority-owned operations is reflected as minority interests in the Consolidated Statements of Operations. The accounts of all foreign subsidiaries have been included on the basis of fiscal periods ended three months or less prior to the dates of the Consolidated Balance Sheets. All significant intercompany accounts and transactions have been eliminated. Investments in 20% to 50% owned companies and partnerships where the Company is able to exercise significant influence, but not control, are accounted for by the equity method and, accordingly, consolidated income includes the Company s share of the investees income or losses.

Fiscal Year. The Company s fiscal year is the 52 or 53 weeks ending in the last Sunday in June. Fiscal years 2006, 2005 and 2004 were comprised of 52 weeks.

Reclassification. The Company has reclassified the presentation of certain prior year information to conform with the current year presentation.

Restatements. In July 2004, the Company announced the closing of its European manufacturing operations and associated sales offices. Unifi ceased operating its dyed facility in Manchester, England, in June 2004 and ceased its manufacturing operations in Ireland in October 2004. The Company ceased all other European operations by June 2005 and sold the real property, plant and equipment of its European division in fiscal years 2005 and 2006. In July 2005, the Company announced that it had decided to exit the sourcing business and, as of the end of the third quarter of fiscal year 2006, it had substantially liquidated the business. Accordingly, the consolidated financial statements have been restated to present these results as discontinued operations for all periods presented.

Revenue Recognition. Revenues from sales are recognized at the time shipments are made and include amounts billed to customers for shipping and handling. Costs associated with shipping and handling are included in cost of sales in the Consolidated Statements of Operations. Freight paid by customers is included in net sales in the Consolidated Statements of Operations.

Foreign Currency Translation. Assets and liabilities of foreign subsidiaries are translated at year-end rates of exchange and revenues and expenses are translated at the average rates of exchange for the year. Gains and losses resulting from translation are accumulated in a separate component of shareholders equity and included in comprehensive income (loss). Gains and losses resulting from foreign currency transactions (transactions denominated in a currency other than the subsidiary s functional currency) are included in other income or expense in the Consolidated Statements of Operations.

Cash and Cash Equivalents. Cash equivalents are defined as short-term investments having an original maturity of three months or less.

Restricted Cash. Cash deposits held for a specific purpose or held as security for contractual obligations are classified as restricted cash.

Receivables. The Company extends unsecured credit to its customers as part of its normal business practices. An allowance for losses is provided for known and potential losses arising from yarn quality claims and for amounts owed by customers. Reserves for yarn quality claims are based on historical experience and known pending claims. The ability to collect accounts receivable is based on a combination of factors including the aging of accounts receivable, write-off experience and the financial condition of specific customers. Accounts

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

are written off when they are no longer deemed to be collectible. General reserves are established based on the percentages applied to accounts receivables aged for certain periods of time and are supplemented by specific reserves for certain customer accounts where collection is no longer certain. Establishing reserves for yarn claims and bad debts requires management judgment and estimates, which may impact the ending accounts receivable valuation, gross margins (for yarn claims) and the provision for bad debts. The reserve for such losses was $5.1 million at June 25, 2006 and $14.0 million at June 26, 2005.

Inventories. The Company utilizes the last-in, first-out (LIFO) method for valuing certain inventories representing 38.2% and 40.2% of all inventories at June 25, 2006, and June 26, 2005, respectively, and the first-in, first-out (FIFO) method for all other inventories. Inventories are valued at lower of cost or market including a provision for slow moving and obsolete items. Market is considered net realizable value. Inventories valued at current or replacement cost would have been approximately $7.3 million and $3.5 million in excess of the LIFO valuation at June 25, 2006, and June 26, 2005, respectively. The Company did not have LIFO liquidations during fiscal year 2006 but experienced LIFO liquidations of $0.3 million pre-tax loss during fiscal year 2005. The Company maintains reserves for inventories valued utilizing the FIFO method and may provide for additional reserves over and above the LIFO reserve for inventories valued at LIFO. Such reserves for both FIFO and LIFO valued inventories can be specific to certain inventory or general based on judgments about the overall condition of the inventory. General reserves are established based on percentage markdowns applied to inventories aged for certain time periods. Specific reserves are established based on a determination of the obsolescence of the inventory and whether the inventory value exceeds amounts to be recovered through expected sales prices, less selling costs; and, for inventory subject to LIFO, the amount of existing LIFO reserves. Estimating sales prices, establishing markdown percentages and evaluating the condition of the inventories require judgments and estimates, which may impact the ending inventory valuation and gross margins. The total inventory reserves on the Company s books, including LIFO reserves, at June 25, 2006 and June 26, 2005 were $10.7 million and $7.9 million, respectively. The following table reflects the composition of the Company s inventory as of June 25, 2006 and June 26, 2005:

	June 25, 2006	June 26, 2005
	(Amounts in thousands)	
Raw materials and supplies	$ 48,594	$ 47,441
Work in process	10,144	8,497
Finished goods	57,280	54,889
	$ 116,018	$ 110,827

Other Current Assets. Other current assets consist of government tax deposits ($4.3 million and $8.9 million), prepaid insurance ($2.5 million and $2.8 million), unrealized gains on hedging contracts ($0.0 million and $1.6 million), prepaid VAT taxes ($1.4 million and $1.0 million), deposits of ($0.7 million and $0.7 million) and other assets ($0.3 million and $0.6 million) as of June 25, 2006 and June 26, 2005, respectively.

Property, Plant and Equipment. Property, plant and equipment are stated at cost. Depreciation is computed for asset groups primarily utilizing the straight-line method for financial reporting and accelerated methods for tax reporting. For financial reporting purposes, asset lives have been assigned to asset categories over periods ranging between three and forty years. Amortization of assets recorded under capital leases is included with depreciation expense.

Goodwill and Other Intangible Assets. The Company accounts for goodwill and other intangibles under the provisions of Statements of Financial Accounting Standard No. 142, Goodwill and Other Intangible Assets

(SFAS 142). SFAS 142 requires that these assets be reviewed for impairment annually, unless specific

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circumstances indicate that a more timely review is warranted. This impairment test involves estimates and judgments that are critical in determining whether any impairment charge should be recorded and the amount of such charge if an impairment loss is deemed to be necessary. In addition, future events impacting cash flows for existing assets could render a write down necessary that previously required no such write down.

Other Noncurrent Assets. Other noncurrent assets at June 25, 2006, and June 26, 2005, consist primarily of the cash surrender value of key executive life insurance policies ($4.6 million and $6.1 million), unamortized bond issue costs and debt origination fees ($7.9 million and $2.5 million), restricted cash investments in Brazil ($6.2 million and $4.1 million), strategic investment assets ($1.0 million and $1.4 million), other miscellaneous assets ($1.8 million and $0.7 million), and various notes receivable due from both affiliated and non-affiliated parties ($0.3 million and $1.8 million), respectively. On April 28, 2006 the Company commenced a tender offer to purchase the outstanding $250 million of 2008 senior, unsecured debt securities (the 2008 notes). The offer expired on May 25, 2006. On May 26, 2006, the Company issued $190 million in senior, secured notes (the 2014 notes) that expire in 2014, incurring $6.8 million in related issuance costs. As a result, $1.3 million of the remaining 2008 note issue costs were expensed. The Company simultaneously on May 26, 2006 amended its Revolving Credit Facility (amended revolving credit facility) to extend its maturity from 2006 to 2011 and increase its borrowing capacity. The Company incurred $1.2 million in origination fees related to the new facility. The debt origination fees relating to the old facility of $0.2 million were expensed in the fourth quarter fiscal 2006. All debt related origination costs have been amortized on the straight-line method over the life of the corresponding debt, which approximates the effective interest method. Accumulated amortization at June 25, 2006 for unamortized debt origination costs attributable to the 2014 notes and 2011 amended credit facility was $0.1 million. Accumulated amortization at June 26, 2005 attributable to the 2008 notes and 2006 Revolving Credit Facility was $7.3 million.

Long-Lived Assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For assets held and used, impairment may occur if projected undiscounted cash flows are not adequate to cover the carrying value of the assets. In such cases, additional analysis is conducted to determine the amount of loss to be recognized. The impairment loss is determined by the difference between the carrying amount of the asset and the fair value measured by future discounted cash flows. The analysis requires estimates of the amount and timing of projected cash flows and, where applicable, judgments associated with, among other factors, the appropriate discount rate. Such estimates are critical in determining whether any impairment charge should be recorded and the amount of such charge if an impairment loss is deemed to be necessary. In addition, future events impacting cash flows for existing assets could render a write down necessary that previously required no such write down.

For assets held for disposal, an impairment charge is recognized if the carrying value of the assets exceeds the fair value less costs to sell. Estimates are required of fair value, disposal costs and the time period to dispose of the assets. Such estimates are critical in determining whether any impairment charge should be recorded and the amount of such charge if an impairment loss is deemed to be necessary. Actual cash flows received or paid could differ from those used in estimating the impairment loss, which would impact the impairment charge ultimately recognized and the Company s cash flows.

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Accrued Expenses. The following table reflects the composition of the Company s accrued expenses as of June 25, 2006 and June 26, 2005:

	June 25, 2006	June 26, 2005
	(Amounts in thousands)	
Payroll and fringe benefits	$ 11,112	$ 14,309
Severance	576	5,252
Interest	1,984	7,325
Pension		6,141
Other	10,197	12,591
	$ 23,869	$ 45,618

Income Taxes. The Company and its domestic subsidiaries file a consolidated federal income tax return. Income tax expense is computed on the basis of transactions entering into pre-tax operating results. Deferred income taxes have been provided for the tax effect of temporary differences between financial statement carrying amounts and the tax basis of existing assets and liabilities. Otherwise, income taxes have not been provided for the undistributed earnings of certain foreign subsidiaries as such earnings are deemed to be permanently invested.

Losses Per Share. The following table details the computation of basic and diluted losses per share:

	Fiscal Year Ended		
	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Numerator:			
Loss from continuing operations before discontinued operations	$ (14,726)	$ (19,738)	$ (44,149)
Income (loss) from discontinued operations, net of tax	360	(22,644)	(25,644)
Extraordinary gain, net of taxes of $0		1,157	
Net loss	$ (14,366)	$ (41,225)	$ (69,793)
Denominator:			
Denominator for basic losses per share weighted average shares	52,155	52,106	52,249
Effect of dilutive securities:			
Stock options			
Restricted stock awards			
Diluted potential common shares denominator for diluted losses per share adjusted weighted average shares and assumed conversions	52,155	52,106	52,249

In fiscal years 2006, 2005, and 2004, options and unvested restricted stock awards had the potential effect of diluting basic earnings per share, and if the Company had net earnings in these years, diluted weighted average shares would have been higher than basic weighted average shares by 232,986 shares, 199,207 shares, and 1,507 shares, respectively.

Stock-Based Compensation. With the adoption of SFAS 123, the Company elected for fiscal years 2005 and 2004 to continue to measure compensation expense for its stock-based employee compensation plans using the intrinsic value method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees. Had the fair value-based method under SFAS 148 been applied, compensation expense would have been recorded for the options outstanding in fiscal years 2005 and 2004 based on their respective vesting schedules.

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Net loss in fiscal years 2005 and 2004 on a pro forma basis assuming SFAS 123 had been applied would have been as follows:

	June 25, 2006	June 26, 2005
	(Amounts in thousands, except per share amounts)	
Net loss as reported	$ (41,225)	$ (69,793)
Adjustment: Impact of stock options, net of tax	(3,321)	(1,656)
Adjusted net loss	$ (44,546)	$ (71,449)
Basic and diluted net loss per share:		
As reported	$ (.79)	$ (1.34)
Adjusted for stock option expense	(.85)	(1.37)

Stock options were granted during fiscal years 2006, 2005, and 2004. The fair value and related compensation expense of fiscal years 2006, 2005, and 2004 options were calculated as of the issuance date using the Black-Scholes model with the following assumptions:

Options Granted	2006	2005	2004
Expected term (years)	6.1	7.0	7.0
Interest rate	4.9%	4.4%	2.5%
Volatility	57.2%	57.0%	51.0%
Dividend yield			

On December 16, 2004, the Financial Accounting Standards Board (FASB) finalized Statement of Financial Accounting Standards (SFAS) No. 123(R) Shared-Based Payment (SFAS No. 123R) which, after the Securities and Exchange Commission (SEC) amended the compliance dates on April 15, 2005, was effective for the Company s fiscal year beginning June 27, 2005. The new standard required the Company to record compensation expense for stock options using a fair value method. On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB No. 107), which provides the Staff s views regarding interactions between SFAS No. 123R and certain SEC rules and regulations and provides interpretation of the valuation of share-based payments for public companies.

Effective June 27, 2005, the Company adopted SFAS 123R and elected the Modified Prospective Transition Method whereby compensation cost is recognized for share-based payments based on the grant date fair value from the beginning of the fiscal period in which the recognition provisions are first applied (see Note 4, Common Stock, Stock Option Plan and Restricted Stock Plan).

Comprehensive Income. Comprehensive income includes net income and other changes in net assets of a business during a period from non-owner sources, which are not included in net income. Such non-owner changes may include, for example, available-for-sale securities and foreign currency translation adjustments. Other than net income, foreign currency translation adjustments presently represent the only component of comprehensive income for the Company. The Company does not provide income taxes on the impact of currency translations as earnings from foreign subsidiaries are deemed to be permanently invested.

Recent Accounting Pronouncements. In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). This is an interpretation of SFAS No. 143,

Accounting for Asset Retirement Obligations (SFAS No. 143) which applies to all entities and addresses accounting and reporting for legal obligations associated with the retirement of tangible long-lived

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assets that result from the acquisition, construction, development or normal operation of a long-lived asset. The SFAS requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. FIN 47 further clarifies what conditional asset retirement obligation means with respect to recording the asset retirement obligation discussed in SFAS No. 143. The effective date is for fiscal years ending after December 15, 2005. During fiscal year 2006, the Company performed a formal review of its asset retirement obligations in accordance with FIN 47. With respect to assets for which the retirement obligation was measurable, the impact on the Company s financial position and results of operations was immaterial.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) which is an interpretation of SFAS No. 109. The pronouncement creates a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of the first day of fiscal year 2008 and it does not expect that the adoption of this interpretation will have a significant impact on its financial position and results of operations.

Use of Estimates. The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

2. Long-Term Debt and Other Liabilities

A summary of long-term debt and other liabilities follows:

	June 25, 2006	June 26, 2005
	(Amounts in thousands)	
Senior secured notes due 2014	$ 190,000	$
Senior unsecured notes due 2008	1,273	249,473
Note payable		24,407
Brazilian government loans	10,499	12,912
Other obligations	6,668	8,337
Total debt and other obligations	208,440	295,129
Current maturities	(6,330)	(35,339)
Total long-term debt and other liabilities	$ 202,110	$ 259,790

Long-Term Debt

On February 5, 1998, the Company issued $250 million of senior, unsecured debt securities which bore a coupon rate of 6.5% and were scheduled to mature in February 2008. On April 28, 2006, the Company commenced a tender offer for all of its outstanding 2008 notes. As of June 25, 2006 $1.3 million in aggregate principal amount of 2008 notes had not been tendered and remain outstanding in accordance with their amended terms. As a result of the tender offer, the Company incurred $1.1 million in related fees and wrote off the remaining $1.3 million of unamortized issuance costs and $0.3 million of unamortized bond discounts as

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

expense. The estimated fair value of the 2008 notes, based on quoted market prices as of June 25, 2006, and June 26, 2005, was approximately $1.3 million and $210.0 million, respectively.

On May 26, 2006 the Company issued $190 million of 11.5% senior secured notes due May 15, 2014. Interest is payable on the notes on May 15 and November 15 of each year, beginning on November 15, 2006. The 2014 notes and guarantees are secured by first-priority liens, subject to permitted liens, on substantially all of the Company s and the Company s subsidiary guarantors assets (other than the assets securing the Company s obligations under the Company s amended revolving credit facility on a first-priority basis, which consist primarily of accounts receivable and inventory), including, but not limited to, property, plant and equipment, the capital stock of the Company s domestic subsidiaries and certain of the Company s joint ventures and up to 65% of the voting stock of the Company s first-tier foreign subsidiaries, whether now owned or hereafter acquired, except for certain excluded assets. The 2014 notes are unconditionally guaranteed on a senior, secured basis by each of the Company s existing and future restricted domestic subsidiaries. The 2014 notes and guarantees are secured by second-priority liens, subject to permitted liens, on the Company and its subsidiary guarantors assets that will secure the notes and guarantees on a first-priority basis. The Company may redeem some or all of the 2014 notes on or after May 15, 2010. In addition, prior to May 15, 2009, the Company may redeem up to 35% of the principal amount of the 2014 notes with the proceeds of certain equity offerings. In connection with the issuance, the Company incurred $6.8 million in professional fees and other expenses which will be amortized to expense over the life of the 2014 notes. The estimated fair value of the 2014 notes, based on quoted market prices, at June 25, 2006 was approximately $182.4 million.

Concurrently with the closing of this offering, the Company amended its senior secured asset-based revolving credit facility to provide a $100 million revolving borrowing base (with an option to increase borrowing capacity up to $150 million), to extend its maturity to 2011, and revise some of its other terms and covenants. The amended revolving credit facility is secured by first-priority liens on the Company s and it s subsidiary guarantors inventory, accounts receivable, general intangibles (other than uncertificated capital stock of subsidiaries and other persons), investment property (other than capital stock of subsidiaries and other persons), chattel paper, documents, instruments, supporting obligations, letter of credit rights, deposit accounts and other related personal property and all proceeds relating to any of the above, and by second-priority liens, subject to permitted liens, on the Company s and its subsidiary guarantors assets securing the notes and guarantees on a first-priority basis, in each case other than certain excluded assets. The Company s ability to borrow under the Company s amended revolving credit facility is limited to a borrowing base equal to specified percentages of eligible accounts receivable and inventory and is subject to other conditions and limitations.

Borrowings under the amended revolving credit facility bear interest at rates of LIBOR plus 1.50% to 2.25% and/or prime plus 0.00% to 0.50%. The interest rate matrix is based on the Company s excess availability under the amended revolving credit facility. The amended revolving credit facility also includes a 0.25% LIBOR margin pricing reduction if the Company s fixed charge coverage ratio is greater than 1.5 to 1.0. The unused line fee under the amended revolving credit facility is 0.25% to 0.35% of the borrowing base. In connection with the refinancing, the Company incurred fees and expenses aggregating $1.2 million, which are being amortized over the term of the amended revolving credit facility. As of June 25, 2006, the Company had no outstanding borrowings and availability of $94.2 million under the terms of the amended credit facility.

The amended credit facility replaces the December 7, 2001 $100 million revolving bank credit facility (the Credit Agreement), as amended, which would have terminated on December 7, 2006. The Credit Agreement was secured by substantially all U.S. assets excluding manufacturing facilities and manufacturing equipment. Borrowing availability was based on eligible domestic accounts receivable and inventory. Borrowings under the Credit Agreement bore interest at rates selected periodically by the Company of LIBOR plus 1.75% to 3.00%

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and/or prime plus 0.25% to 1.50%. The interest rate matrix was based on the Company s leverage ratio of funded debt to EBITDA, as defined by the Credit Agreement. Under the Credit Agreement, the Company paid unused line fees ranging from 0.25% to 0.50% per annum on the unused portion of the commitment which is included in interest expense. In connection with the refinancing, the Company incurred fees and expenses aggregating $2.0 million, which were being amortized over the term of the Credit Agreement with the balance of $0.2 million expensed upon the May 26, 2006 refinancing.

The amended revolving credit facility contains affirmative and negative customary covenants for asset based loans that restrict future borrowings and capital spending. The covenants under the amended revolving credit facility are more restrictive than those in the indenture. Such covenants include, without limitation, restrictions and limitations on (i) sales of assets, consolidation, merger, dissolution and the issuance of our capital stock, each subsidiary guarantor and any domestic subsidiary thereof, (ii) permitted encumbrances on our property, each subsidiary guarantor and any domestic subsidiary thereof, (iii) the incurrence of indebtedness by the Company, any subsidiary guarantor or any domestic subsidiary thereof, (iv) the making of loans or investments by the Company, any subsidiary guarantor or any domestic subsidiary thereof, (v) the declaration of dividends and redemptions by the Company or any subsidiary guarantor and (vi) transactions with affiliates by the Company or any subsidiary guarantor.

Under the amended revolving credit facility, if borrowing capacity is less than $25 million at any time during the quarter, covenants will include a required minimum fixed charge coverage ratio of 1.1 to 1.0. In addition, the maximum capital expenditures are limited to $30 million per fiscal year (subject to pro forma availability greater than $25 million) with a 75% one-year unused carry forward. The amended revolving credit facility permits the Company to make distributions, subject to standard criteria, as long as pro forma excess availability is greater than $25 million both before and after giving effect to such distributions, subject to certain exceptions. Under the amended revolving credit facility, acquisitions by the Company are subject to pro forma covenant compliance. In addition, the amended revolving credit facility receivables are subject to cash dominion if excess availability is below $25 million.

On September 30, 2004, the Company completed its acquisition of the polyester filament manufacturing assets located in Kinston, North Carolina from INVISTA S.a.r.l. (INVISTA), a subsidiary of Koch Industries, Inc. (Koch). As part of the acquisition of the Kinston facility from INVISTA and upon finalizing the quantities and value of the acquired inventory, the Company entered into a $24.4 million five-year Loan Agreement. The note, which called for interest only payments for the first two years, bore interest at 10% per annum. The note was secured by all of the business assets held by Unifi Kinston, LLC. On July 25, 2005 the Company paid off the $24.4 million note payable and the related accrued interest.

Unifi do Brasil, receives loans from the government of the State of Minas Gerais to finance 70% of the value added taxes due by Unifi do Brasil to the State of Minas Gerais. These loans were granted as part of a 24 month tax incentive to build a manufacturing facility in the State of Minas Gerais. The loans have a 2.5% origination fee and bear an effective interest rate equal to 50% of the Brazilian inflation rate, which currently is significantly lower than the Brazilian prime interest rate. The loans are collateralized by a performance bond letter issued by a Brazilian bank, which secures the performance by Unifi do Brasil of its obligations under the loans. In return for this performance bond letter, Unifi do Brasil makes certain cash deposits with the Brazilian bank. The deposits made by Unifi do Brasil earn interest at a rate equal to approximately 100% of the Brazilian prime interest rate. These tax incentives will end in September 2008.

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The following summarizes the maturities of the Company s long-term debt on a fiscal year basis:

		Aggregate Debt Maturities (Amounts in thousands)			
Description of Commitment	**Total**	**2007**	**2008**	**2009-2011**	**Thereafter**
Long-term debt	$ 201,772	$ 4,335	$ 7,437	$	$ 190,000

Other Obligations

On May 20, 1997, the Company entered into a sale-leaseback agreement with a financial institution whereby land, buildings and associated real and personal property improvements of certain manufacturing facilities were sold to the financial institution and will be leased by the Company over a sixteen-year period. This transaction has been recorded as a direct financing arrangement. As of June 25, 2006 the balance of the note was $2.3 million and the net book value of the related assets was $6.6 million. Payments for the remaining balance of the sale-leaseback agreement are due semi-annually and are in varying amounts, in accordance with the agreement. Average annual principal payments over the next six years are approximately $0.3 million. The interest rate implicit in the agreement is 7.84%.

Other obligations also includes operating lease accruals associated with the Altamahaw, North Carolina plant closure in the amount of $2.7 million and $1.7 million of liquidation accruals associated with the closure of a dye operation in England in June 2004.

3. Income Taxes

Income from continuing operations before income taxes is as follows:

	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Income (loss) from continuing operations before income taxes:			
United States	$ (15,256)	$ (40,838)	$ (80,399)
Foreign	(640)	7,617	11,137
	$ (15,896)	$ (33,221)	$ (69,262)

The provision for (benefit from) income taxes applicable to continuing operations for fiscal years 2006, 2005, and 2004 consists of the following:

	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Currently payable (recoverable):			
Federal	$ (29)	$ 2,729	$ 669
Repatriation of foreign earnings	2,125		
State	21	203	(675)

Foreign	2,221	2,073	2,734
Total current	4,338	5,005	2,728
Deferred:			
Federal	(4,956)	(18,096)	(28,637)
Repatriation of foreign earnings	(1,122)	1,122	
State	290	(908)	433
Foreign	280	(606)	363
Total deferred	(5,508)	(18,488)	(27,841)
Income tax benefits	$ (1,170)	$ (13,483)	$ (25,113)

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Income tax benefits were 7.4%, 40.6%, and 36.3% of pre-tax losses in fiscal 2006, 2005, and 2004, respectively. A reconciliation of the provision for income tax benefits with the amounts obtained by applying the federal statutory tax rate is as follows:

	June 25, 2006	June 26, 2005	June 27, 2004
Federal statutory tax rate	(35.0)%	(35.0)%	(35.0)%
State income taxes net of federal tax benefit	(10.4)	(4.2)	(4.4)
Foreign taxes less than domestic rate	17.3	(0.7)	(1.1)
Foreign tax adjustment		(3.0)	
Repatriation of foreign earnings	6.3	3.4	
Change in valuation allowance	11.9	2.5	5.7
Change in tax status of subsidiary		(3.9)	
Nondeductible expenses and other	2.5	0.3	(1.5)
Effective tax rate	(7.4)%	(40.6)%	(36.3)%

During fiscal year 2006, the Company repatriated approximately $31.0 million of dividends from foreign subsidiaries which qualified for the temporary dividends-received-deduction available under the American Jobs Creation Act. The associated net tax cost of approximately $1.1 million was not fully provided for in fiscal year 2005 due to management s decision during fiscal year 2006 to increase the original repatriation plan from $15.0 million to $40.0 million.

During fiscal year 2005, the Company determined that it had not properly recorded deferred tax assets of a foreign subsidiary that should have been previously recognized. The Company recorded a deferred tax asset of $1.2 million in the fourth quarter of fiscal year 2005. The Company evaluated the effect of the adjustment and determined that the differences were not material for any of the periods presented in the Consolidated Financial Statements.

The deferred income taxes reflect the net tax effects of temporary differences between the basis of assets and liabilities for financial reporting purposes and their basis for income tax purposes. Significant components of the Company s deferred tax liabilities and assets as of June 25, 2006 and June 26, 2005 were as follows:

	June 25, 2006	June 26, 2005
	(Amounts in thousands)	
Deferred tax liabilities:		
Property, plant and equipment	$ 50,044	$ 60,859
Investments in equity affiliates	11,251	14,821
Unremitted foreign earnings		1,122
Other	42	2
Total deferred tax liabilities	61,337	76,804
Deferred tax assets:		
State tax credits	10,597	13,085
Accrued liabilities and valuation reserves	11,783	15,748

Net operating loss carryforwards	7,799	10,529
Intangible assets	4,278	4,914
Charitable contributions	876	1,022
Other items	1,114	1,101
Total gross deferred tax assets	36,447	46,399
Valuation allowance	(9,232)	(10,930)
Net deferred tax assets	27,215	35,469
Net deferred tax liability	$ 34,122	$ 41,335

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As of June 25, 2006, the Company has available for income tax purposes approximately $21.0 million in federal net operating loss carryforwards that may be used to offset future taxable income. The carryforwards expire as set forth in the table below:

	2023	2024	2025
	(Amounts in thousands)		
Expiration amount	$ 1,373	$ 11,989	$ 7,618

The Company also has available for state income tax purposes approximately $16.3 million in North Carolina investment tax credits, for which the Company has established a valuation allowance in the amount of $9.2 million. The credits expire as set forth in the table below:

	2007	2008	2009	2010	2011	Thereafter
	(Amounts in thousands)					
Expiration amount	$ 3,861	$ 3,760	$ 3,689	$ 3,204	$ 1,229	$ 562

The Company also has charitable contribution carryforwards of $2.5 million expiring in fiscal year 2007 through fiscal year 2010 that also may be used to offset future taxable income.

For the years ended June 25, 2006 and June 26, 2005, the valuation allowance decreased $1.7 million and $2.2 million, respectively. In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, available taxes in the carryback periods, projected future taxable income and tax planning strategies in making this assessment.

4. Common Stock, Stock Option Plans and Restricted Stock Plan

Common shares authorized were 500 million in 2006 and 2005. Common shares outstanding at June 25, 2006 and June 26, 2005 were 52,208,467 and 52,145,434, respectively.

At its meeting on April 24, 2003, the Company s Board of Directors reinstituted the Company s previously authorized stock repurchase plan. During fiscal year 2004, the Company repurchased approximately 1.3 million shares. At June 25, 2006, there was remaining authority for the Company to repurchase approximately 6.8 million shares of its common stock under the repurchase plan. The repurchase program was suspended in November 2003 and the Company has no immediate plans to reinstitute the program.

In December 2004, the FASB issued SFAS No. 123R as a replacement to SFAS No. 123 Accounting for Stock-Based Compensation . SFAS No. 123R supersedes APB No. 25 which allowed companies to use the intrinsic method of valuing share-based payment transactions. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on the fair-value method as defined in SFAS No. 123. On March 29, 2005, the SEC issued SAB No. 107 to provide guidance regarding the adoption of SFAS No. 123R and disclosures in Management s Discussion and Analysis. The effective date of SFAS No. 123R was modified by SAB No. 107 to begin with the first annual reporting period of the registrant s first fiscal year beginning on or after June 15, 2005. Accordingly, the Company implemented SFAS No. 123R effective June 27, 2005.

Previously the Company measured compensation expense for its stock-based employee compensation plans using the intrinsic value method prescribed by APB Opinion No. 25, Accounting for Stock Issued to

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Employees as permitted by SFAS No. 123 and SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure . Had the fair value-based method under SFAS No. 123 been applied, compensation expense would have been recorded for the options outstanding based on their respective vesting schedules.

The Company currently has only one share-based compensation plan which had unvested stock options as of June 25, 2006. The compensation cost that was charged against income for this plan was $0.7 million and $0 for the fiscal years ended June 25, 2006 and June 26, 2005, respectively. The total income tax benefit recognized for share-based compensation in the Consolidated Statements of Operations was not material for the fiscal years 2006, 2005 and 2004.

During the fourth quarter of fiscal year 2006, the Board authorized the issuance of 150 thousand options from the 1999 Long-Term Incentive Plan to two newly promoted officers of the Company. During the first half of fiscal year 2005, the Board authorized the issuance of approximately 2.1 million stock options from the 1999 Long-Term Incentive Plan to certain key employees. The stock options granted in fiscal years 2006 and 2005 vest in three equal installments: the first one-third at the time of grant, the next one-third on the first anniversary of the grant and the final one-third on the second anniversary of the grant.

On April 20, 2005, the Board of Director s approved a resolution to vest all stock options, in which the exercise price exceeded the closing price of the Company s common stock on April 20, 2005, granted prior to June 26, 2005. The Board decided to fully vest these specific underwater options, as there was no perceived value in these options to the employee, little retention ramifications, and to minimize the expense to the Company s consolidated financial statements upon adoption of SFAS No. 123R. No other modifications were made to the stock option plan except for the accelerated vesting. This acceleration of the original vesting schedules affected 0.3 million unvested stock options.

SFAS No. 123R requires the Company to record compensation expense for stock options using the fair value method. The Company decided to adopt SFAS No. 123R using the Modified Prospective Transition Method in which compensation cost is recognized for share-based payments based on the grant date fair value from the beginning of the fiscal period in which the recognition provisions are first applied. The effect of the change from applying the intrinsic method of accounting for stock options under APB 25, previously permitted by SFAS No. 123 as an alternative to the fair value recognition method, to the fair value recognition provisions of SFAS No. 123 on income from continuing operations before income taxes, income from continuing operations and net income for the fiscal year 2006 was $0.7 million, $0.7 million and $0.7 million, respectively. There was no material change from applying the original provisions of SFAS No. 123 on cash flow from continuing operations, cash flow from financing activities, and basic and diluted earnings per share.

The fair value of each option award is estimated on the date of grant using the Black-Scholes model. The Company uses historical data to estimate the expected life, volatility, and estimated forfeitures of an option. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant.

On October 21, 1999, the shareholders of the Company approved the 1999 Unifi, Inc. Long-Term Incentive Plan (1999 Long-Term Incentive Plan). The plan authorized the issuance of up to 6,000,000 shares of Common Stock under the grant or exercise of stock options, including Incentive Stock Options (ISO), Non-Qualified Stock Options (NQSO) and restricted stock, but not more than 3,000,000 shares may be issued as restricted stock. Option awards are granted with an exercise price equal to the market price of the Company s stock at the date of grant.

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Stock options granted under the plan have vesting periods of three to five years based on continuous service by the employee. All stock options have a 10 year contractual term. In addition to the 3,672,174 common shares reserved for the options that remain outstanding under grants from the 1999 Long-Term Incentive Plan, the Company has previous ISO plans with 57,500 common shares reserved and previous NQSO plans with 216,667 common shares reserved at June 25, 2006. No additional options will be issued under any previous ISO or NQSO plan. The stock option activity for fiscal years 2006, 2005 and 2004 of all three plans was as follows:

	ISO		NQSO	
	Options Outstanding	Weighted Avg. $/Share	Options Outstanding	Weighted Avg. $/Share
Fiscal year 2004:				
Shares under option beginning of year	3,880,772	$ 10.81	583,175	$ 24.67
Granted	20,000	6.85		
Expired	(294,252)	12.89	(50,000)	26.66
Forfeited	(71,693)	8.79		
Shares under option end of year	3,534,827	10.66	533,175	24.48
Fiscal year 2005:				
Granted	2,101,788	2.84		
Exercised	(33,330)	2.76		
Expired	(1,227,591)	12.76	(191,508)	25.82
Forfeited	(102,691)	4.91		
Shares under option end of year	4,273,003	6.41	341,667	23.72
Fiscal year 2006:				
Granted	150,000	3.40		
Exercised	(63,333)	2.76		
Expired	(581,667)	9.32	(125,000)	26.00
Forfeited	(48,329)	2.76		
Shares under option end of year	3,729,674	5.94	216,667	22.41

The following table sets forth the exercise prices, the number of options outstanding and exercisable and the remaining contractual lives of the Company s stock options as of June 25, 2006:

	Options Outstanding			Options Exercisable	
Exercise Price	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Contractual Life Remaining (Years)	Number of Options Exercisable	Weighted Average Exercise Price

$2.76	$ 3.78	1,910,001	$ 2.82	8.2	1,226,735	$ 2.79
5.29	7.64	959,949	7.28	5.5	959,949	7.28
8.10	11.99	604,626	10.54	3.9	604,626	10.54
12.53	16.31	340,098	14.16	2.9	340,098	14.16
18.75	31.00	131,667	26.35	1.5	131,667	26.35

The total intrinsic value of options exercised was $22 thousand in fiscal year 2006 and $2 thousand in fiscal year 2005. The amount of cash received from exercise of options was $174 thousand in fiscal year 2006 and $92 thousand in fiscal year 2005.

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The following table sets forth certain required stock option information for the ISO and NQSO plans as of and for the year ended June 25, 2006:

	ISO	NQSO
Number of options expected to vest	3,720,674	216,667
Weighted-average price of options expected to vest	$ 5.95	$ 22.41
Intrinsic value of options expected to vest	$ 332,500	$
Weighted-average remaining contractual term of options expected to vest	6.50	1.82
Number of options exercisable as of June 25, 2006	3,046,408	216,667
Option price range	$ 2.76 $16.31	$ 16.31 $31.00
Weighted-average exercise price for options currently exercisable	$ 6.64	$ 22.41
Intrinsic value of options currently exercisable	$ 332,500	$
Weighted-average remaining contractual term of options currently exercisable	6.44	1.82
Weighted-average fair value of options granted	$ 1.98	N/A

The Company has a policy of issuing new shares to satisfy share option exercises. The Company has elected an accounting policy of accelerated attribution for graded vesting.

As of June 25, 2006, unrecognized compensation costs related to unvested share based compensation arrangements granted under the 1999 Long-Term Incentive Plan was $0.2 million. The costs are estimated to be recognized over a period of 2.0 years.

The restricted stock activity for fiscal years 2006, 2005 and 2004 was as follows:

	Shares	Weighted Average Grant-Date Fair Value
Fiscal year 2004:		
Unvested shares beginning of year	20,900	$ 8.90
Granted	21,500	6.36
Vested	(9,100)	7.80
Forfeited	(2,100)	9.03
Unvested shares end of year	31,200	7.46
Fiscal year 2005:		
Vested	(10,400)	7.98
Forfeited	(1,500)	7.89
Unvested shares end of year	19,300	7.15
Fiscal year 2006:		
Vested	(8,600)	7.67
Forfeited	(300)	9.95

Unvested shares end of year	10,400	6.63

5. Retirement Plans

Defined Contribution Plan. The Company matches employee contributions made to the Unifi, Inc. Retirement Savings Plan (the DC Plan), an existing 401(k) defined contribution plan, which covers eligible salaried and hourly employees. Under the terms of the Plan, the Company matches 100% of the first three percent of eligible employee contributions and 50% of the next two percent of eligible contributions. For fiscal

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years ended June 25, 2006, June 26, 2005 and June 27, 2004, the Company incurred $2.4 million, $2.5 million and $2.5 million, respectively, of expense for its obligations under the matching provisions of the DC Plan.

Defined Benefit Plan. The Company s subsidiary in Ireland maintained a defined benefit plan (DB Plan) that covered substantially all of its employees and was funded by both employer and employee contributions. The plan provided defined retirement benefits based on years of service and the highest three year average of earnings over the ten year period preceding retirement. During the first quarter of fiscal year 2005, the Company announced plans to close its European Division, and as a result, recognized the previously unrecognized net actuarial loss of $9.4 million. As of June 26, 2005, the subsidiary had terminated substantially all of its employees.

During fiscal year 2006 the Company s Irish subsidiary made its final contribution of $6.1 million and the remaining accumulated benefit obligation of $32.5 million was paid in full through the purchase of annuity contracts for all participants in the DB Plan. In fiscal years 2005 and 2004, the Company recorded pension (income) expense of $11.1 million and $(2.4) million, respectively, which was recorded on the Loss from discontinued operations, net of tax line item of the Consolidated Statements of Operations.

Obligations and funded status related to the DB Plan is presented below:

	June 25, 2006	June 26, 2005
	(Amounts in thousands)	
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 32,511	$ 30,937
Service cost		255
Interest cost	852	1,783
Plan participants contributions		127
Actuarial gain		(891)
Benefits paid	(33,736)	(509)
Curtailments		509
Translation adjustment	373	300
Benefit obligation at end of year	$	$ 32,511
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 26,370	$ 25,620
Actual return on plan assets	852	1,019
Employer contributions	6,212	255
Plan participants contributions		127
Benefits paid	(33,736)	(509)
Translation adjustment	302	(142)
Fair value of plan assets at end of year		26,370
Funded status		(6,141)
Unrecognized net actuarial loss		
Net amount recognized	$	$ (6,141)

The accumulated benefit obligation was $0 million at June 25, 2006 and $32.5 million at June 26, 2005.

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Amount recognized in the Consolidated Balance Sheet consists of:

	June 25, 2006	June 26, 2005
	(Amount in thousands)	
Accrued benefit cost	$	$ 6,141

Components of Net Periodic Benefit Cost/(Income):

	June 25, 2006	June 26, 2005	June 27, 2004
		(Amounts in thousands)	
Service cost	$	$ 382	$ 1,074
Interest cost	853	1,783	1,789
Expected return on plan assets	(853)	(1,910)	(1,670)
Amortization of net loss		9,935	477
Cost of termination events		1,019	477
Net periodic benefit cost		11,209	2,147
Less plan participants contributions		(127)	(477)
Sub-total		11,082	1,670
Correction of error			(4,109)
Company s net periodic benefit cost (income)	$	$ 11,082	$ (2,439)

During the fourth quarter of fiscal year 2004, the Company determined that it had not properly recorded or disclosed the DB Plan and a pension asset should have been previously recognized. The Company corrected the error in the fourth quarter of fiscal year 2004 by recording a pension asset of $4.1 million.

Assumptions:

Weighted-average assumption used to determine benefit obligations as of:

	June 25, 2006	June 26, 2005	June 27, 2004
Discount rate	N/A	N/A	5.60%
Rate of compensation increase	N/A	N/A	3.75%

Weighted-average assumption used to determine net periodic benefit cost for fiscal years ended:

	June 25, 2006	June 26, 2005	June 27, 2004
Discount rate	N/A	N/A	5.60%
Expected long-term return on plan assets	N/A	N/A	6.93%

Rate of compensation increase	N/A	N/A	3.75%

Plan Assets:

The DB Plan s weighted-average asset allocations at June 26, 2005, by asset category was as follows:

	June 26, 2005
Equity securities	
Debt securities	100.0%
Real estate	
Total	100.0%

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6. Leases and Commitments

In addition to the direct financing sale-leaseback obligation described in Note 2, Long-Term Debt and Other Liabilities, the Company is obligated under operating leases relating primarily to real estate and equipment. Future obligations for minimum rentals under the leases during fiscal years after June 25, 2006 are $3.6 million in 2007, $4.9 million in 2008, $1.3 million in 2009, $0.4 million in 2010, and $0.0 million in aggregate thereafter. Rental expense was $3.6 million, $6.8 million, and $7.8 million for the fiscal years 2006, 2005, and 2004, respectively. The Company had no significant binding commitments for capital expenditures at June 25, 2006.

The Company s nylon segment has a supply agreement with UNF which expires in April 2008. The Company is obligated to purchase certain to be agreed upon quantities of yarn production from UNF. The actual purchases under this agreement for fiscal years 2006, 2005, and 2004 were $24.3 million, $30.2 million and $29.3 million. The agreement does not provide for a fixed or minimum amount of yarn purchases, therefore there is a degree of uncertainty associated with the obligation.

7. Business Segments, Foreign Operations and Concentrations of Credit Risk

The Company and its subsidiaries are engaged predominantly in the processing of yarns by texturing of synthetic filament polyester and nylon fiber with sales domestically and internationally, mostly to knitters and weavers for the apparel, industrial, hosiery, home furnishing, automotive upholstery and other end-use markets. The Company also maintains investments in several minority-owned and jointly owned affiliates.

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In accordance with Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information, segmented financial information of the polyester, nylon and sourcing operating segments, as regularly reported to management for the purpose of assessing performance and allocating resources, is detailed below.

	Polyester	Nylon	Total
	(Amounts in thousands)		
Fiscal year 2006:			
Net sales to external customers	$ 566,367	$ 172,458	$ 738,825
Inter-segment net sales	5,525	6,022	11,547
Depreciation and amortization	30,412	14,576	44,988
Restructuring charges (recovery)	533	(787)	(254)
Write down of long-lived assets	51	2,315	2,366
Segment operating profit (loss)	5,658	(6,534)	(876)
Total assets	361,206	128,165	489,371
Fiscal year 2005:			
Net sales to external customers	$ 587,008	$ 206,788	$ 793,796
Inter-segment net sales	5,858	5,758	11,616
Depreciation and amortization	32,714	14,870	47,584
Restructuring charges (recoveries)	(212)	(129)	(341)
Write down of long-lived assets		603	603
Segment operating loss	(1,569)	(9,825)	(11,394)
Total assets	432,231	156,936	589,167
Fiscal year 2004:			
Net sales to external customers	$ 481,847	$ 184,536	$ 666,383
Inter-segment net sales	4,567	6,721	11,288
Depreciation and amortization	35,768	15,654	51,422
Restructuring charges	7,591	638	8,229
Arbitration costs and expenses	182		182
Alliance plant closure costs (recovery)	(206)		(206)
Write downs of long-lived assets	25,241		25,241
Goodwill impairment	13,461		13,461
Segment operating loss	(48,378)	(4,092)	(52,470)
Total assets	459,724	182,108	641,832

For purposes of internal management reporting, segment operating income (loss) represents net sales less cost of sales and allocated selling, general and administrative expenses. Certain indirect manufacturing and selling, general and administrative costs are allocated to the operating segments on activity drivers relevant to the respective costs. Intersegment sales of the Company s polyester POY business are recorded at market whereas all other intersegment sales are recorded at cost.

Domestic operating divisions fiber costs are valued on a standard cost basis, which approximates first-in, first-out accounting. For those components of inventory valued utilizing the last-in, first-out method (see Note 1, Significant Accounting Polices and Financial Statement Information), an adjustment is made at the segment level to record the difference between standard cost and LIFO. Segment operating income (loss) excludes the provision for bad debts of $1.3 million, $13.2 million, and $2.4 million for fiscal years 2006, 2005, and 2004, respectively. For significant capital projects, capitalization is delayed for management segment reporting until the facility is substantially complete. However, for consolidated financial reporting, assets are capitalized into construction in progress as costs are incurred or carried as unallocated corporate fixed assets if they have been placed in service but have not as yet been moved for management segment reporting.

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The net decrease of $71.0 million in the polyester segment total assets between fiscal year end 2005 and 2006 primarily reflects decreases in cash of $34.3 million, fixed assets of $21.0 million, assets held for sale of $14.3 million, accounts receivable of $13.2 million, other current assets of $3.4 million, and deferred taxes of $0.9 million offset by an increase in inventory of $13.2 million and other assets of $2.9 million. The fixed asset reduction is primarily associated with current year depreciation. The net decrease of $28.8 million in the nylon segment total assets between fiscal year end 2005 and 2006 is primarily a result of a decrease in fixed assets of $16.2 million, inventories of $5.6 million, accounts receivable of $4.3 million, assets held for sale of $2.9 million, cash of $2.0 million and other assets of $0.2 million, offset by an increase in deferred taxes of $2.4 million. The reduction in property and equipment is primarily associated with current year depreciation and an impairment charge of $2.3 million.

The following tables present reconciliations from segment data to consolidated reporting data:

	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Depreciation and amortization:			
Depreciation and amortization of specific reportable segment assets	$ 44,988	$ 47,584	$ 51,422
Depreciation of allocated assets	3,682	3,958	4,804
Amortization of allocated assets	1,275	1,350	1,377
Consolidated depreciation and amortization	$ 49,945	$ 52,892	$ 57,603
Operating income (loss):			
Reportable segments loss	$ (876)	$ (11,394)	$ (52,470)
Provision for bad debts	1,256	13,172	2,389
Interest expense	19,247	20,575	18,698
Interest income	(4,489)	(2,152)	(2,152)
Other (income) expense, net	(3,118)	(2,300)	(2,590)
Equity in losses (earnings) of unconsolidated affiliates	(825)	(6,938)	6,877
Loss on early extinguishment of debt	2,949		
Minority interests (income) expense		(530)	(6,430)
Loss from continuing operations before income taxes and extraordinary item	$ (15,896)	$ (33,221)	$ (69,262)

	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Total assets:			
Reportable segments total assets	$ 489,371	$ 589,167	$ 641,832
Sourcing segment total assets	21	4,365	1,369
Corporate current assets	24,828	60,764	34,092
Unallocated corporate fixed assets	15,976	18,931	22,586
Other non-current corporate assets	13,616	12,797	9,609
Investments in unconsolidated affiliates	190,217	160,675	164,286
Intersegment eliminations	(1,392)	(1,324)	(1,239)

Consolidated assets	$ 732,637	$ 845,375	$ 872,535

Capital expenditures for long-lived assets totaled $12.0 million of which $8.4 million related to the Company s polyester segment and $2.8 million related to the Company s nylon segment.

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The Company s domestic operations serve customers principally located in the United States as well as international customers located primarily in Canada, Mexico and Israel and various countries in Europe, Central America, South America and South Africa. Export sales from its U.S. operations aggregated $78.9 million in 2006, $94.7 million in 2005, and $112.4 million in 2004. In fiscal year 2006, the Company had nylon segment net sales to one customer of $76.4 million which is in excess of 10% of consolidated net sales, whereas in fiscal years 2005 and 2004, the Company did not have sales to any one customer in excess of 10% of consolidated revenues. The concentration of credit risk for the Company with respect to trade receivables is mitigated due to the large number of customers and dispersion across different end-uses and geographic regions.

The Company s foreign operations primarily consist of manufacturing operations in Brazil and Colombia. On March 2, 2004, the Company announced its plan to close its dyed facility in Manchester, England. The facility ceased all operations in early June 2004. During the first quarter of fiscal year 2005, the Company announced a plan to close its entire European Division which included a manufacturing facility in Letterkenny, Ireland and the associated European sales offices. The facility s manufacturing operations ceased in October 2004. On July 28, 2005, the Company announced that management had decided to discontinue the operations of the Company s external sourcing business, Unimatrix Americas. Management s exit plan was completed as of the end of the third quarter fiscal 2006, and accordingly, the segment s results of operations have been accounted for as a discontinued operation in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Net sales and total assets of the Company s continuing foreign and domestic operations are as follows:

	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Foreign operations:			
Net sales	$ 105,311	$ 93,420	$ 82,977
Total assets	123,179	151,447	150,013
Domestic operations:			
Net sales	$ 633,514	$ 700,376	$ 583,406
Total assets	609,458	693,928	722,522

8. Derivative Financial Instruments and Fair Value of Financial Instruments

The Company accounts for derivative contracts and hedging activities under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities which requires all derivatives to be recorded on the balance sheet at fair value. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or are recorded in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative s change in fair value is immediately recognized in earnings. The Company does not enter into derivative financial instruments for trading purposes nor is it a party to any leveraged financial instruments.

The Company conducts its business in various foreign currencies. As a result, it is subject to the transaction exposure that arises from foreign exchange rate movements between the dates that foreign currency transactions are recorded (export sales and purchases commitments) and the dates they are consummated (cash receipts and cash disbursements in foreign currencies). The Company utilizes some natural hedging to mitigate these transaction exposures. The Company also enters into foreign currency forward contracts for the purchase and sale of European and North American currencies to hedge balance sheet and income statement currency exposures. These contracts are principally entered into for the purchase of inventory and equipment and the sale of Company products into export markets. Counter-parties for these instruments are major financial

institutions.

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Currency forward contracts are used to hedge exposure for sales in foreign currencies based on specific sales orders with customers or for anticipated sales activity for a future time period. Generally, 60-80% of the sales value of these orders is covered by forward contracts. Maturity dates of the forward contracts are intended to match anticipated receivable collections. The Company marks the outstanding accounts receivable and forward contracts to market at month end and any realized and unrealized gains or losses are recorded as other income and expense. The Company also enters currency forward contracts for committed or anticipated equipment and inventory purchases. Generally 50-75% of the asset cost is covered by forward contracts although 100% of the asset cost may be covered by contracts in certain instances. Effective February 14, 2005, the Company entered into a contract to sell the European facility in Ireland and received a $2.8 million non-refundable deposit from the purchaser. In addition to the deposit, the contract called for a partial payment of 16.0 million Euros on June 30, 2005 and a final payment of 2.1 million Euros on September 30, 2005. On February 22, 2005, the Company entered into a forward exchange contract for 15.0 million Euros. The Company was required by the financial institution to deposit $2.8 million in an interest bearing collateral account to secure the financial institution s exposure on the hedge contract. This cash deposit is classified as Restricted cash and is included in current assets on the fiscal year 2005 balance sheet. On July 15, 2005, the Company settled the forward exchange contract for 15.0 million Euros. Forward contracts are matched with the anticipated date of delivery of the assets and gains and losses are recorded as a component of the asset cost for purchase transactions when the Company is firmly committed. The latest maturity for all outstanding purchase and sales foreign currency forward contracts are July 2006 and October 2006, respectively.

The dollar equivalent of these forward currency contracts and their related fair values are detailed below:

	June 25, 2006	June 26, 2005	June 27, 2004
		(Amounts in thousands)	
Foreign currency purchase contracts:			
Notional amount	$ 526	$ 168	$ 3,660
Fair value	535	159	3,642
Net (gain) loss	$ (9)	$ 9	$ 18
Foreign currency sales contracts:			
Notional amount	$ 833	$ 24,414	$ 18,833
Fair value	878	22,687	19,389
Net (gain) loss	$ 45	$ (1,727)	$ 556

The fair values of the foreign exchange forward contracts at the respective year-end dates are based on discounted year-end forward currency rates. The total impact of foreign currency related items that are reported on the line item other (income) expense, net in the Consolidated Statements of Operations, including transactions that were hedged and those that were not hedged, was a pre-tax loss of $0.7 million for the fiscal year ended June 25, 2006, a pre-tax loss of $0.5 million for the fiscal year ended June 27, 2004, and a pre-tax gain of $1.1 million for the fiscal year ended June 26, 2005.

The Company uses the following methods in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents, trade receivables and trade payables. The carrying amounts approximate fair value because of the short maturity of these instruments.

Long-term debt. The fair value of the Company s borrowings is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities (see Note 2, Long-Term Debt and Other Liabilities).

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Foreign currency contracts. The fair value is based on quotes obtained from brokers or reference to publicly available market information.

9. Investments in Unconsolidated Affiliates

The Company and SANS Fibres of South Africa formed a 50/50 joint venture (UNIFI-SANS Technical Fibers, LLC or USTF) to produce low-shrinkage high tenacity nylon 6.6 light denier industrial (LDI) yarns in North Carolina. The business is operated in a plant in Stoneville, North Carolina which is owned by the Company. The Company receives annual rental income of $0.3 million from USTF for the use of the facility. The Company also received from USTF during fiscal 2006 payments totaling $1.7 million which consisted of reimbursements for rendering general and administrative services and purchasing various manufacturing related items for the operations. Unifi manages the day-to-day production and shipping of the LDI produced in North Carolina and SANS Fibres handles technical support and sales. Sales from this entity are primarily to customers in the Americas.

Unifi and Nilit Ltd., located in Israel, formed a 50/50 joint venture named U.N.F. Industries Ltd. (UNF). The joint venture produces nylon POY at Nilit s manufacturing facility in Migdal Ha Emek, Israel. The nylon POY is utilized in the Company s nylon texturing and covering operations. The nylon segment has a supply agreement with UNF which expires in April 2008. Unifi is obligated to purchase certain to be agreed upon quantities of yarn production from UNF. The agreement does not provide for a fixed or minimum amount of yarn purchases, therefore there is a degree of uncertainty associated with the obligation. Accordingly, the Company has estimated its obligation under the agreement based on past history and internal projections.

The Company and Parkdale Mills, Inc. entered into a contribution agreement whereby both companies contributed all of the assets of their spun cotton yarn operations utilizing open-end and air jet spinning technologies to create Parkdale America, LLC (PAL). In exchange for its contributions, the Company received a 34% ownership interest in the joint venture. PAL is a producer of cotton and synthetic yarns for sale to the textile and apparel industries primarily within North America. PAL has 14 manufacturing facilities primarily located in central and western North Carolina.

The Company s investment in PAL at June 25, 2006 was $140.9 million and the underlying equity in the net assets of PAL at June 25, 2006 is $130.3 million or a difference of $10.6 million, which is accounted for as goodwill and is included in the Company s investment in PAL disclosures. The Company s view is that the entire carrying value of the investment in PAL is recoverable from its share of future cash distributions from the venture plus a terminal exit value.

On October 21, 2004, the Company announced that Unifi and Sinopec Yizheng Chemical Fiber Co., Ltd. (YCFC) signed a non-binding letter of intent to form a joint venture to manufacture, process and market polyester filament yarn in YCFC s facilities in Yizheng, Jiangsu Province, Peoples Republic of China. On June 10, 2005, Unifi and YCFC entered into an Equity Joint Venture Contract (the JV Contract), to form Yihua Unifi Fibre Company Limited (YUFI). Under the terms of the JV Contract, each company owns a 50% equity interest in the joint venture. The joint venture transaction closed on August 3, 2005, and accordingly, the Company contributed to YUFI its initial capital contribution of $15.0 million in cash on August 4, 2005. YCFC s facilities were already producing product at a steady state. On October 12, 2005, the Company transferred an additional $15.0 million to YUFI to complete the capitalization of the joint venture. The Company records revenues from the joint venture under a licensing agreement for certain proprietary information including technical knowledge, manufacturing processes, trade secrets, commercial information and other information relating to the design, manufacture, application testing, maintenance and sale of products. During fiscal year 2006, payments received under this agreement were $2.0 million.

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Condensed balance sheet information as of June 25, 2006 and June 26, 2005, and income statement information for fiscal years 2006, 2005 and 2004, of combined unconsolidated equity affiliates were as follows (in thousands):

	June 25, 2006	June 26, 2005
	(Amounts in thousands)	
Current assets	$ 149,278	$ 127,188
Noncurrent assets	217,955	176,265
Current liabilities	48,334	28,235
Noncurrent liabilities	44,460	18,840
Shareholders equity and capital accounts	274,439	256,378

	Fiscal Years Ended		
	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Net sales	$ 567,223	$ 471,786	$ 469,512
Gross profit	31,853	40,312	7,880
Income (loss) from operations	8,435	16,991	(15,928)
Net income (loss)	6,279	14,003	(20,183)

USTF and PAL are organized as partnerships for U.S. tax purposes. Taxable income and losses are passed through USTF and PAL to the members in accordance with the Operating Agreements of USTF and PAL. For the fiscal years ended June 25, 2006, June 26, 2005, and June 27, 2004, distributions received by the Company from its equity affiliates amounted to $2.8 million, $11.1 million, and $3.1 million, respectively. The total undistributed earnings of unconsolidated equity affiliates were $1.8 million as of June 26, 2006. Included in the above net sales amounts for the 2006, 2005, and 2004 fiscal years are sales to Unifi of approximately $24.0 million, $29.6 million, and $27.5 million, respectively. These amounts represent sales of nylon POY from UNF for use in the production of textured nylon yarn in the ordinary course of business.

10. Supplemental Cash Flow Information

Supplemental cash flow information is summarized below:

	Fiscal Years Ended		
	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Cash payments for:			
Interest	$ 18,153	$ 16,536	$ 16,842
Income taxes, net of refunds	3,164	5,012	2,437

11. Minority Interest

Effective May 29, 1998, the Company formed Unifi Textured Polyester, LLC (UTP) with Burlington Industries, LLC, now known as International Textile Group, LLC (ITG), to manufacture and market natural textured polyester yarns. The Company had an 85.42% interest in UTP and ITG had 14.58%. For the first five years, ITG was entitled to the first $9.4 million of annual net earnings and the first $12.0 million of UTP s cash flows on an annual basis, less the amount of UTP net earnings. Subsequent to this five-year period, earnings and cash flows were allocated based on ownership percentages. UTP s assets, liabilities and earnings are

consolidated with those of the Company and ITG s interest in the UTP is included in the Company s financial statements as minority interest (income) expense. In April 2005, the Company purchased ITG s ownership interest of 14.58%

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

for $0.9 million in cash which resulted in a net write down of UTP s assets of $2.9 million, as a result of applying purchase accounting to the acquisition of minority interest. Minority interest (income) expense for ITG s share of UTP in fiscal years 2006, 2005, and 2004 was $0.0 million, $(0.5) million, and $(6.5) million, respectively.

12. Fiscal Year 1999 Early Retirement and Termination Charge

During the third quarter of fiscal 1999, the Company recognized a $14.8 million charge associated with the early retirement and termination of 114 salaried employees. As of June 25, 2006, the remaining financial obligation is to provide health and dental coverage to each early retiree until they reach 65 years of age. An adjustment to the reserve was recorded in fiscal years 2006, 2005 and 2004 to replenish the reserve for the difference between the actual cash payments and the present value of the liability originally recorded, which represented interest expense. At June 25, 2006, a reserve of $2.0 million remained on the Consolidated Balance Sheet that is expected to equal the present value of future cash payments for remaining medical and dental expenses associated with these terminated employees. The table below summarizes the activity associated with this charge for fiscal years 2006, 2005, and 2004:

	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Balance at beginning of fiscal year	$ 2,931	$ 3,418	$ 3,860
Change in estimate for original charges	(673)	(308)	314
Present value adjustment	217	243	327
Cash payments	(444)	(422)	(1,083)
Balance at end of fiscal year	$ 2,031	$ 2,931	$ 3,418

13. Severance and Restructuring Charges

In fiscal year 2004, the Company recorded restructuring charges of $27.7 million, which consisted of $12.1 million of fixed asset write downs associated with the closure of a dye facility in Manchester, England and the consolidation of the Company s polyester operations in Ireland, $7.8 million of employee severance for approximately 280 management and production level employees, $5.7 million in lease related costs associated with the closure of the facility in Altamahaw, NC and other restructuring costs of $2.1 million primarily related to the various plant closures. Of the $27.7 million recorded in fiscal year 2004 as a restructuring charge to continuing operations, $19.6 million has been reclassified to the line item Loss from discontinued operations, net of tax in the Consolidated Statements of Operations. Severance payments were made in accordance with various plan terms and were completed by July 2005. The lease obligation consists of rental payments of $1.0 million in fiscal year 2007 and $3.0 million in fiscal year 2008.

On October 19, 2004, the Company announced that it planned to curtail two production lines and downsize its recently acquired facility in Kinston, North Carolina. During the second quarter of fiscal year 2005, the Company recorded a severance reserve of $10.7 million for approximately 500 production level employees and a restructuring reserve of $0.4 million for the cancellation of certain warehouse leases. The entire restructuring reserve was recorded as assumed liabilities in purchase accounting; and accordingly, was not recorded as a restructuring expense in the Consolidated Statements of Operations. During the third quarter of fiscal year 2005, management completed the curtailment of both production lines as scheduled which resulted in an actual reduction of 388 production level employees and a reduction to the initial restructuring reserve. Since no long-term assets or intangible assets were recorded in purchase accounting, the net reduction of $1.2

million was recorded as an extraordinary gain in the accompanying Consolidated Statements of Operations in fiscal year 2005.

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

On April 20, 2006, the Company re-organized its domestic business operations, and as a result, recorded a restructuring charge for severance of approximately $0.8 million in the fourth quarter of fiscal year 2006. Approximately 45 management level salaried employees were affected by the plan of reorganization.

The table below summarizes changes to the accrued severance and accrued restructuring accounts for the fiscal years ended June 26, 2005 and June 25, 2006:

	Balance at June 26, 2005	Additional Charges	Adjustments	Amount Used	Balance at June 25, 2006
			(Amounts in thousands)		
Accrued severance	$ 5,252	$ 812	$ 44	$ (5,532)	$ 576
Accrued restructuring	5,053		(195)	(1,308)	3,550

	Balance at June 27, 2004	Additional Charges	Adjustments	Amount Used	Balance at June 26, 2005
			(Amounts in thousands)		
Accrued severance	$ 2,949	$ 10,701	$ (834)	$ (7,564)	$ 5,252
Accrued restructuring	6,654	391	(695)	(1,297)	5,053

14. Impairment Charges

During the third quarter of fiscal year 2004, management performed impairment testing for the domestic textured polyester business due to the continued challenging business conditions and reduction in volume and gross profit in the preceding quarter. As a result, management determined the fair value of the plant, property and equipment at $73.7 million using market prices of the assets. Management determined that the assets were in fact impaired because the carrying value was $98.9 million. This resulted in a $25.2 million write down of the assets, which is included in the Write down of long-lived assets line item in the Consolidated Statements of Operations. Subsequent to performing the impairment test for the property, plant and equipment, the entire domestic polyester segment was tested for impairment as of February 29, 2004. As a result of the testing, the Company recorded a goodwill impairment charge of $13.5 million in the third quarter of fiscal year 2004 to reduce the segment s goodwill to $0. The Company used the income approach and market approach to determine the fair value.

In June 2005 the Company entered into a contract to sell 166 machines held by the nylon division. As a result, a $0.6 million charge was recorded to write the assets down from a net book value of $1.5 million to their fair value less cost to sell. This charge is recorded on the Write down of long-lived assets line item in the Consolidated Statements of Operations.

On August 29, 2005, the Company announced an initiative to improve the efficiency of its nylon business unit which included the closing of Plant one in Mayodan, North Carolina and moving its operations and offices to Plant three in nearby Madison, North Carolina which is the Nylon division s largest facility with over one million square feet of production space. In connection with this initiative, the Company decided to offer for sale a plant, a warehouse and a central distribution center (CDC), all of which are located in Mayodan, North Carolina. Based on appraisals received in September 2005, the Company determined that the warehouse was impaired and recorded an impairment charge of $1.5 million, which included $0.2 million in estimated selling

costs. On March 13, 2006, the Company entered into a contract to sell the CDC and related land located in Mayodan, North Carolina. The terms of the contract call for a sale price of $2.7 million, which was approximately $0.7 million below the property s carrying value. In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS No. 144) the Company recorded an impairment charge of

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

approximately $0.8 million during the third quarter of fiscal year 2006 which included selling costs of $0.1 million. The sale of the CDC closed in the fourth quarter of fiscal year 2006 with no further expense to the Company.

15. Assets Held for Sale

On July 28, 2004, the Company announced its decision to close its European Division and associated sales offices throughout Europe. The manufacturing facilities in Ireland ceased operations on October 31, 2004. On February 24, 2005, the Company announced that it had entered into three separate contracts to sell the property, plant and equipment of the European Division for approximately $38.0 million. The European Division s assets held for sale were separately stated in the June 26, 2005 Consolidated Balance Sheet and were reported in the Company s polyester segment.

The Company announced in the first quarter of fiscal year 2006 that the nylon division decided to consolidate its operating facilities in Mayodan and Madison, North Carolina. As a result, Plant 1, Plant 5, Plant 7, and the CDC were completely vacated as of March 2006 and listed for sale. In addition, unrelated to the Nylon restructuring plan, the Company decided to market other properties in Yadkinville, North Carolina and Staunton, Virginia as well as related idle machinery and equipment. The listing contract for real property was signed in December 2005. The sale of the CDC and the Staunton, Virginia properties were closed in the fourth quarter of fiscal year 2006.

The following table summarizes by category assets held for sale:

	June 25, 2006	June 26, 2005
	(Amounts in thousands)	
Land	$ 612	$ 1,588
Building	10,052	24,831
Machinery and equipment	4,238	5,985
Leasehold improvements	517	132
	$ 15,419	$ 32,536

16. Alliance

Effective June 1, 2000, the Company and E.I. DuPont De Nemours and Company (DuPont) initiated a manufacturing alliance (the Alliance). The intent of the Alliance was to optimize the Company s and DuPont s POY manufacturing facilities by increasing manufacturing efficiency and improving product quality. Under the terms of the Alliance, DuPont and the Company ran their polyester POY manufacturing facilities as a single operating unit. The companies split equally the costs to complete the necessary plant consolidation and the benefits gained through asset optimization.

DuPont s subsidiary, Invista, Inc., held DuPont s textiles and interiors assets and businesses which included the Alliance assets. Such assets and businesses were subsequently sold to subsidiaries of Koch. INVISTA continued to operate the DuPont site through September 29, 2004.

Effective September 30, 2004, the Company completed the acquisition of the INVISTA polyester POY manufacturing assets from INVISTA. See Note 17, Asset Acquisition .

The Company recognized, as a reduction of cost of sales, cost savings and other benefits from the Alliance of $0, $8.4 million and $38.2 million for fiscal years 2006, 2005 and 2004, respectively.

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

17. Asset Acquisition

As discussed in Note 16, Alliance , the Company completed its acquisition of the INVISTA polyester POY manufacturing assets located in Kinston, North Carolina, including inventories, valued at $24.4 million which was seller financed. See Note 2, Long-Term Debt and Other Liabilities for details of the financing agreement. On October 19, 2004, the Company announced its plans to curtail two production lines and downsize the workforce at its newly acquired manufacturing facility in Kinston, North Carolina. At that time the Company recorded a reserve of $10.7 million in related severance costs and $0.4 million in restructuring costs which were recorded as assumed liabilities in purchase accounting; and therefore, had no impact on the Consolidated Statements of Operations. As of March 27, 2005, both lines were successfully shut down which resulted in a reduction in the original restructuring estimate for severance. As a result of the reduction to the restructuring reserve, a $1.2 million extraordinary gain, net of tax, was recorded in fiscal year 2005.

18. Discontinued Operations

On July 28, 2005, the Company announced that it would discontinue the operations of the Company s external sourcing business, Unimatrix Americas. As of March 26, 2006, management s plan to exit the business was successfully completed resulting in the reclassification of the segment s losses as discontinued operations for all periods presented. See Note 20, Quarterly Results (Unaudited) for restatements of the fiscal 2006 first and second quarters and fiscal 2005 quarters.

On July 28, 2004, the Company announced its decision to close its European manufacturing operations and associated sales offices throughout Europe (the European Division). The manufacturing facilities in Ireland ceased operations on October 31, 2004. On February 24, 2005, the Company announced that it had entered into three separate contracts to sell the property, plant and equipment of the European Division for approximately $37.0 million. As of June 26, 2005, the Company has received approximately $9.9 million in proceeds from the sales contracts and recognized a gain of $10.4 million on the sales of capital assets. The Company received the remaining proceeds of $28.1 million during the first quarter fiscal year 2006 which resulted in a net gain of $4.6 million. The gains on the sales of capital assets are included in the line item Income (loss) from discontinued operations net of tax in the Consolidated Statements of Operations.

The Company s dyed facility in Manchester, England was closed in June 2004 and the physical assets were abandoned in June 2005. In accordance with SFAS No. 144, the complete abandonment of the business which occurred in June 2005 required the Company to include the operating results for this facility as discontinued operations for all periods presented.

Beginning with the third quarter of fiscal year 2006, the Company separately disclosed the operating, investing and financing portions of the cash flows attributable to all discontinued operations in the Consolidated Statements of Cash Flows. All prior periods have been restated to conform with the current presentation.

Results of operations for the sourcing segment, European Division and the dyed facility in England for fiscal years 2006, 2005, and 2004 are as follows:

	Fiscal Years Ended		
	June 25, 2006	June 26, 2005	June 27, 2004
	(Amounts in thousands)		
Net sales	$ 3,967	$ 30,261	$ 80,087

Restructuring charges		14,873	19,487
Loss from discontinued operations before income taxes	$ (784)	$ (22,073)	$ (25,867)
Income tax (benefit) expense	(1,144)	571	(223)
Net (income) loss from discontinued operations net of taxes	$ 360	$ (22,644)	$ (25,644)

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

19. Contingencies

The land with the Kinston Site is leased under a 99 year ground lease (Ground Lease) with DuPont. Since 1993, DuPont has been investigating and cleaning up the Kinston Site under the supervision of the United States Environmental Protection Agency (EPA) and the North Carolina Department of Environment and Natural Resources under the Resource Conservation and Recovery Act Corrective Action program. The Corrective Action Program requires DuPont to identify all potential areas of environmental concern (AOCs), assess the extent of contamination at the identified AOCs and clean them up to applicable regulatory standards. Under the terms of the Ground Lease, upon completion by DuPont of required remedial action, ownership of the Kinston Site will pass to the Company. Thereafter, the Company will have responsibility for future remediation requirements, if any, at the AOCs previously addressed by DuPont. At this time the Company has no basis to determine if and when it will have any responsibility or obligation with respect to the AOCs or the extent of any potential liability for the same.

20. Quarterly Results (Unaudited)

Quarterly financial data for the fiscal years ended June 26, 2005 and June 25, 2006 is presented below:

	First Quarter (13 Weeks)	Second Quarter (13 Weeks)	Third Quarter (13 Weeks)	Fourth Quarter (13 Weeks)
	(Amounts in thousands, except per share data)			
2006:				
Net sales(a)	$ 183,102	$ 191,117	$ 181,398	$ 183,208
Gross profit(a)(b)	8,403	9,370	13,137	11,860
Income (loss) from discontinued operations, net of tax	1,929	(583)	(790)	(196)
Loss before extraordinary item	(2,878)	(3,976)	(2,117)	(5,395)
Extraordinary gain (loss) net of tax of $0(c)	(208)	208		
Net loss	(3,086)	(3,768)	(2,117)	(5,395)
Per Share of Common Stock (basic and diluted):				
Net loss before extraordinary item	$ (.06)	$ (.07)	$ (.04)	$ (.10)
Extraordinary gain net of taxes of $0				
Net loss	$ (.06)	$ (.07)	$ (.04)	$ (.10)
2005:				
Net sales(a)	$ 178,993	$ 206,687	$ 207,688	$ 200,428
Gross profit(a)(b)	10,840	9,817	9,332	1,090
Income (loss) from discontinued operations, net of tax	(21,650)	(2,941)	(1,659)	3,606
Loss before extraordinary item	(22,555)	(7,746)	(3,272)	(8,809)
Extraordinary gain (loss) net of tax of $0(c)			1,342	(185)
Net loss	(22,555)	(7,746)	(1,930)	(8,994)

Per Share of Common Stock (basic and diluted):				
Net loss before extraordinary item	$ (.43)	$ (.15)	$ (.06)	$ (.17)
Extraordinary gain net of taxes of $0			.02	
Net loss	$ (.43)	$ (.15)	$ (.04)	$ (.17)

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(a) As discussed further in Note 18, Discontinued Operations the Company decided to close its dye operation in England in June 2004 and the closure was substantially completed in June 2005, which required the Company to include the operating results for this facility as discontinued operations. As a result, net sales, gross profit and income (loss) from discontinued operations for the first three quarters of fiscal year 2005 have been restated. In July 2005, the Company announced its decision to exit the sourcing business and management s plan to exit the business was successfully completed on March 26, 2006, resulting in the reclassification of the segment s losses as discontinued operations. As a result, net sales, gross profit and income (loss) from discontinued operations for the first and second quarters of the fiscal year 2006 and in each of the quarters in fiscal year 2005 have been restated. There was no effect on previously reported net income. Below is a reconciliation of the net sales, gross profit and income (loss) from discontinued operations amounts as previously reported in the Company s quarterly reports on Form 10-Q to the restated amounts reported above:

	Fiscal 2006		Fiscal 2005			
	First Quarter	Second Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(13 Weeks)	(13 Weeks)	(13 Weeks)	(13 Weeks)	(13 Weeks)	(13 Weeks)
	(Amounts in thousands)					
Net sales as previously reported	$ 185,441	$ 192,300	$ 180,155	$ 208,473	$ 208,318	$ 203,151
Less sales of discontinued operations	2,339	1,183	1,162	1,786	630	2,723
Net sales as restated	$ 183,102	$ 191,117	$ 178,993	$ 206,687	$ 207,688	$ 200,428
Gross profit as previously reported	$ 7,522	$ 9,093	$ 10,560	$ 9,686	$ 9,107	$ 1,189
Less gross profit (loss) of discontinued operations	(881)	(277)	(280)	(131)	(225)	99
Gross profit as restated	$ 8,403	$ 9,370	$ 10,840	$ 9,817	$ 9,332	$ 1,090
Income (loss) from discontinued operations as previously reported	$ 2,781	$ (270)	$ (21,299)	$ (3,051)	$ (1,429)	$ 3,681
Plus income (loss) of discontinued operations	(852)	(313)	(351)	110	(230)	(75)
Income (loss) from discontinued operations as restated	$ 1,929	$ (583)	$ (21,650)	$ (2,941)	$ (1,659)	$ 3,606

(b) The lower gross profit amount for the fourth quarter of fiscal year 2005 is primarily attributable to the Company selling off aged inventory in order to improve its working capital position.

(c) As discussed further in Note 17, Asset Acquisition the Company acquired a manufacturing facility at the beginning of its fiscal year 2005 second quarter and, as a result of purchase accounting, was required to record an extraordinary gain.

21. Condensed Consolidating Financial Statements

The guarantor subsidiaries presented below represent the Company s subsidiaries that are subject to the terms and conditions outlined in the indenture governing the Company s issuance of senior secured notes and guarantees the notes, jointly and severally, on a senior unsecured basis. The non-guarantor subsidiaries presented below represent the foreign subsidiaries which do not guarantee the notes. Each subsidiary guarantor is 100% owned by Unifi, Inc. and all guarantees are full and unconditional.

Supplemental financial information for the Company and its guarantor subsidiaries and non-guarantor subsidiaries for the notes is presented below.

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Balance Sheet Information as of June 25, 2006 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 22,992	$ 1,392	$ 10,933	$	$ 35,317
Receivables, net	1	72,332	20,903		93,236
Inventories		91,840	24,178		116,018
Deferred income taxes		10,473	1,266		11,739
Assets held for sale		15,419			15,419
Other current assets		2,558	6,671		9,229
Total current assets	22,993	194,014	63,951		280,958
Property, plant and equipment	11,806	848,068	56,463		916,337
Less accumulated depreciation	(1,553)	(637,487)	(37,601)		(676,641)
	10,253	210,581	18,862		239,696
Investments in unconsolidated affiliates		157,741	32,476		190,217
Investments in consolidated subsidiaries	450,655			(450,655)	
Other noncurrent assets	65,713	8,116	8,223	(60,286)	21,766
	$ 549,614	$ 570,452	$ 123,512	$ (510,941)	$ 732,637
LIABILITIES AND SHAREHOLDERS EQUITY					
Current liabilities:					
Accounts payable and other	$ 1,698	$ 57,315	$ 9,903	$	$ 68,916
Accrued expenses	2,202	18,011	3,656		23,869
Income taxes payable (receivable)	(10,046)	11,004	1,345		2,303
Current maturities of long-term debt and other current liabilities		290	6,040		6,330
Total current liabilities	(6,146)	86,620	20,944		101,418
Long-term debt and other liabilities	191,273	57,557	13,861	(60,286)	202,405
Deferred income taxes	(18,466)	63,380	947		45,861
Shareholders / invested equity	382,953	362,895	87,760	(450,655)	382,953
	$ 549,614	$ 570,452	$ 123,512	$ (510,941)	$ 732,637

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Balance Sheet Information as of June 26, 2005 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 35,868	$ 25,272	$ 44,481	$	$ 105,621
Receivables, net		85,073	21,364		106,437
Inventories		86,039	24,788		110,827
Deferred income taxes	(1,122)	14,527	1,173		14,578
Assets held for sale		21,843	10,693		32,536
Restricted cash			2,766		2,766
Other current assets		3,344	12,246		15,590
Total current assets	34,746	236,098	117,511		388,355
Property, plant and equipment	11,805	890,488	53,166		955,459
Less accumulated depreciation	(1,265)	(642,538)	(31,924)		(675,727)
	10,540	247,950	21,242		279,732
Investments in unconsolidated affiliates		152,918	7,757		160,675
Investments in consolidated subsidiaries	481,888			(481,888)	
Other noncurrent assets	86,441	13,456	5,163	(88,447)	16,613
	$ 613,615	$ 650,422	$ 151,673	$ (570,335)	$ 845,375
LIABILITIES AND SHAREHOLDERS EQUITY					
Current liabilities:					
Accounts payable	$ 1,417	$ 49,719	$ 11,530	$	$ 62,666
Accrued expenses	7,201	27,592	10,825		45,618
Income taxes payable (receivable)	(7,481)	8,715	1,058		2,292
Current maturities of long-term debt and other current Liabilities		30,950	15,573	(11,184)	35,339
Total current liabilities	1,137	116,976	38,986	(11,184)	145,915
Long-term debt and other liabilities	249,473	5,884	4,685	(252)	259,790
Deferred income taxes	(20,570)	75,348	1,135		55,913
Other non-current liabilities		77,011		(77,011)	
Minority interests			182		182
Shareholders / invested equity	383,575	375,203	106,685	(481,888)	383,575
	$ 613,615	$ 650,422	$ 151,673	$ (570,335)	$ 845,375

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UNIFI, INC.

NOTES CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Statement of Operations Information for the Fiscal Year Ended June 25, 2006 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Summary of Operations:					
Net sales	$	$ 633,514	$ 108,584	$ (3,273)	$ 738,825
Cost of sales		597,807	101,267	(3,019)	696,055
Selling, general and administrative expenses	146	35,654	6,138	(404)	41,534
Provision for bad debts		1,004	252		1,256
Interest expense	18,558	558	131		19,247
Interest income	(1,888)	(129)	(2,472)		(4,489)
Other (income) expense, net	(17,413)	14,650	(355)		(3,118)
Equity in (earnings) losses of unconsolidated affiliates		(5,216)	4,643	(252)	(825)
Equity in subsidiaries	12,969		(402)	(12,567)	
Restructuring charges (recovery)		(226)	(28)		(254)
Write down of long-lived assets		2,315	51		2,366
Loss from early extinguishment of debt	2,949				2,949
Income (loss) from continuing operations before income taxes	(15,321)	(12,903)	(641)	12,969	(15,896)
Provision (benefit) for income taxes	(955)	(2,717)	2,502		(1,170)
Income (loss) from continuing operations	(14,366)	(10,186)	(3,143)	12,969	(14,726)
Income (loss) from discontinued operations, net of tax		(2,123)	2,483		360
Net income (loss)	$ (14,366)	$ (12,309)	$ (660)	$ 12,969	$ (14,366)

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UNIFI, INC.

NOTES CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Statement of Operations Information for the Fiscal Year Ended June 26, 2005 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Summary of Operations:					
Net sales	$	$ 700,374	$ 98,462	$ (5,040)	$ 793,796
Cost of sales		678,808	88,298	(4,389)	762,717
Selling, general and administrative expenses	201	36,964	5,982	(936)	42,211
Provision for bad debts		12,886	467	(181)	13,172
Interest expense	18,167	2,408			20,575
Interest income	(518)	(116)	(1,518)		(2,152)
Other (income) expense, net	(17,802)	16,934	(1,581)	149	(2,300)
Equity in (earnings) losses of unconsolidated affiliates		(6,410)	(749)	221	(6,938)
Equity in subsidiaries	43,847			(43,847)	
Minority interest (income) expense		(539)	9		(530)
Restructuring charges (recovery)		(374)	33		(341)
Write down of long-lived assets		603			603
Income (loss) from continuing operations before income taxes and extraordinary item	(43,895)	(40,790)	7,521	43,943	(33,221)
Provision (benefit) for income taxes	(2,670)	(12,225)	1,412		(13,483)
Income (loss) from continuing operations before extraordinary item	(41,225)	(28,565)	6,109	43,943	(19,738)
Loss from discontinued operations, net of tax		(1,012)	(20,364)	(1,268)	(22,644)
Net income (loss) before extraordinary item	(41,225)	(29,577)	(14,255)	42,675	(42,382)
Extraordinary gain net of taxes of $0		1,157			1,157
Net income (loss)	$ (41,225)	$ (28,420)	$ (14,255)	$ 42,675	$ (41,225)

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Statement of Operations Information for the Fiscal Year Ended June 27, 2004 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Summary of Operations:					
Net sales	$	$ 583,405	$ 89,381	$ (6,403)	$ 666,383
Cost of sales		555,500	75,266	(4,783)	625,983
Selling, general and administrative expenses		42,223	5,382	(1,642)	45,963
Provision for bad debts		2,399	(10)		2,389
Interest expense	18,141	520	37		18,698
Interest income	(294)	(219)	(1,639)		(2,152)
Other (income) expense, net	(20,161)	17,352	(171)	390	(2,590)
Equity in (earnings) losses of unconsolidated affiliates		7,956	(1,079)		6,877
Equity in subsidiaries	71,392			(71,392)	
Minority interest (income) expense		(6,521)	91		(6,430)
Restructuring charges		8,229			8,229
Arbitration costs and expenses		182			182
Alliance plant closure costs(recovery)		(206)			(206)
Write down of long-lived assets		25,241			25,241
Goodwill impairment	13,461				13,461
Income (loss) from continuing operations before income taxes	(82,539)	(69,251)	11,504	71,024	(69,262)
Provision (benefit) for income taxes	(12,746)	(15,466)	3,099		(25,113)
Income (loss) from continuing operations	(69,793)	(53,785)	8,405	71,024	(44,149)
Loss from discontinued operations, net of tax		(512)	(25,116)	(16)	(25,644)
Net income (loss)	$ (69,793)	$ (54,297)	$ (16,711)	$ 71,008	$ (69,793)

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Statements of Cash Flows Information for the Fiscal Year Ended June 25, 2006 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating activities:					
Net cash provided by continuing operating activities	$ 22,061	$ (1,740)	$ 9,622	$ 150	$ 30,093
Investing activities:					
Capital expenditures		(10,400)	(1,588)		(11,988)
Acquisition		(634)	(30,000)		(30,634)
Investment of foreign restricted assets			171		171
Collection of notes receivable	564	(160)			404
Proceeds from sale of capital assets		10,026	67		10,093
Increase in restricted cash			2,766		2,766
Other		32	(74)		(42)
Net cash provided by (used in) investing activities	564	(1,136)	(28,658)		(29,230)
Financing activities:					
Payment of long term debt	(248,727)	(24,407)			(273,134)
Borrowing of long term debt	190,000				190,000
Debt issuance costs	(8,041)				(8,041)
Issuance of Company stock	176				176
Cash dividend paid	31,091		(31,091)		
Purchase and retirement of Company stock		358	467		825
Other		(10)	10		
Net cash used in financing activities	(35,501)	(24,059)	(30,614)		(90,174)
Cash flows of discontinued operations:					
Operating cash flow		4,025	(7,367)		(3,342)
Investing cash flow		(970)	22,998		22,028
Net cash provided by (used in) discontinued operations		3,055	15,631		18,686
Effect of exchange rate changes on cash and cash equivalents			471	(150)	321
	(12,876)	(23,880)	(33,548)		(70,304)

Net decrease in cash and cash equivalents					
Cash and cash equivalents at beginning of year	35,868	25,272	44,481		105,621
Cash and cash equivalents at end of year	$ 22,992	$ 1,392	$ 10,933	$	$ 35,317

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Statements of Cash Flows Information for the Fiscal Year Ended June 26, 2005 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating activities:					
Net cash provided by (used in) continuing operating activities	$ 4,222	$ 23,518	$ (3,827)	$ 4,872	$ 28,785
Investing activities:					
Capital expenditures		(5,548)	(4,498)	624	(9,422)
Acquisition		(1,358)			(1,358)
Return of capital from equity affiliates		6,138			6,138
Investment of foreign restricted assets			388		388
Collection of notes receivable	543	(206)	252	(69)	520
Increase in notes receivable		(139)			(139)
Proceeds from sale of capital assets		2,259	492	(461)	2,290
Increase in restricted cash		(2,766)			(2,766)
Other		(884)	(206)	748	(342)
Net cash provided by (used in) investing activities	543	(2,504)	(3,572)	842	(4,691)
Financing activities:					
Issuance of Company stock	104				104
Purchase and retirement of Company stock	(2)				(2)
Other		(530)	510		(20)
Net cash provided by (used in) financing activities	102	(530)	510		82
Cash flows of discontinued operations:					
Operating cash flow		12	(3,045)	(3,240)	(6,273)
Investing cash flow			13,902		13,902
Net cash provided by (used in) discontinued operations		12	10,857	(3,240)	7,629
Effect of exchange rate changes on cash and cash equivalents			11,069	(2,474)	8,595
Net increase in cash and cash equivalents	4,867	20,496	15,037		40,400
	31,001	4,776	29,444		65,221

Cash and cash equivalents at beginning of year					
Cash and cash equivalents at end of year	$ 35,868	$ 25,272	$ 44,481	$	$ 105,621

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UNIFI, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Statements of Cash Flows Information for the Fiscal Year Ended June 27, 2004 (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating activities:					
Net cash provided by (used in) continuing operating activities	$ (8,361)	$ 6,106	$ 11,589	$ 2,046	$ 11,380
Investing activities:					
Capital expenditures	(378)	(10,310)	(821)	385	(11,124)
Acquisition		(83)			(83)
Return of capital from equity affiliates		1,665			1,665
Investment of foreign restricted assets		(202)	(323)	202	(323)
Change in notes receivable	1,905	(702)	(1,333)		(130)
Proceeds from sale of capital assets	4,048	194			4,242
Other		(24)			(24)
Net cash provided by (used in) investing activities	5,575	(9,462)	(2,477)	587	(5,777)
Financing activities:					
Issuance of Company stock					
Purchase and retirement of Company stock	(8,390)				(8,390)
Other		(186)	109		(77)
Net cash provided by (used in) financing activities	(8,390)	(186)	109		(8,467)
Cash flows of discontinued operations:					
Operating cash flow		(10)	(6,765)	(1,583)	(8,358)
Investing cash flow			(427)		(427)
Financing cash flow		10			10
Net cash used in discontinued operations			(7,192)	(1,583)	(8,775)
Effect of exchange rate changes on cash and cash equivalents			1,109	(1,050)	59
Net increase (decrease) in cash and cash equivalents	(11,176)	(3,542)	3,138		(11,580)
	42,177	8,318	26,306		76,801

Cash and cash equivalents at beginning of year					
Cash and cash equivalents at end of year	$ 31,001	$ 4,776	$ 29,444	$	$ 65,221

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Unifi, Inc.

Exchange Offer for

$190,000,000

11 ½ Senior Secured Notes due 2014

PROSPECTUS

December 20, 2006

No person has been authorized to give any information or to make any representation other than those contained in this prospectus, and, if given or made, any information or representations must not be relied upon as having been authorized. This prospectus does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which it relates or an offer to sell or the solicitation of an offer to buy these securities in any circumstances in which this offer or solicitation is unlawful. Neither the delivery of this prospectus nor any sale made under this prospectus shall, under any circumstances, create any implication that there has been no change in the affairs of Unifi, Inc. since the date of this prospectus.

Until March 20, 2007, broker dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the broker dealers obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.