



Chesswood  
Group Limited

**2013**

ANNUAL REPORT

## CONTENTS

<a href="#"><u>PRESIDENT'S MESSAGE</u></a>	<a href="#"><u>1</u></a>
<a href="#"><u>COMPANY PROFILE</u></a>	<a href="#"><u>1</u></a>
<a href="#"><u>PAWNEE LEASING CORPORATION</u></a>	<a href="#"><u>2</u></a>
<a href="#"><u>CASE FUNDING INC.</u></a>	<a href="#"><u>3</u></a>
<a href="#"><u>WINDSET CAPITAL CORPORATION</u></a>	<a href="#"><u>5</u></a>
<a href="#"><u>SHERWAY LP</u></a>	<a href="#"><u>6</u></a>
<a href="#"><u>NORTHSTAR LEASING CORPORATION</u></a>	<a href="#"><u>6</u></a>
<a href="#"><u>MANAGEMENT'S DISCUSSION AND ANALYSIS</u></a>	<a href="#"><u>6</u></a>
<a href="#"><u>FORWARD-LOOKING STATEMENTS</u></a>	<a href="#"><u>6</u></a>
<a href="#"><u>KEY PERFORMANCE INDICATORS</u></a>	<a href="#"><u>7</u></a>
<a href="#"><u>NON-GAAP MEASURES</u></a>	<a href="#"><u>10</u></a>
<a href="#"><u>ADJUSTED EBITDA</u></a>	<a href="#"><u>11</u></a>
<a href="#"><u>SELECTED FINANCIAL INFORMATION</u></a>	<a href="#"><u>11</u></a>
<a href="#"><u>RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2013 AND 2012</u></a>	<a href="#"><u>12</u></a>
<a href="#"><u>RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012</u></a>	<a href="#"><u>15</u></a>
<a href="#"><u>STATEMENT OF FINANCIAL POSITION</u></a>	<a href="#"><u>15</u></a>
<a href="#"><u>LIQUIDITY AND CAPITAL RESOURCES OVERVIEW</u></a>	<a href="#"><u>20</u></a>
<a href="#"><u>OUTLOOK</u></a>	<a href="#"><u>24</u></a>
<a href="#"><u>CRITICAL ACCOUNTING POLICIES AND ESTIMATES</u></a>	<a href="#"><u>25</u></a>
<a href="#"><u>FUTURE ACCOUNTING POLICIES</u></a>	<a href="#"><u>28</u></a>
<a href="#"><u>RISK FACTORS</u></a>	<a href="#"><u>28</u></a>
<a href="#"><u>RELATED PARTY TRANSACTIONS</u></a>	<a href="#"><u>38</u></a>
<a href="#"><u>CONTROLS &amp; PROCEDURES</u></a>	<a href="#"><u>39</u></a>
<a href="#"><u>MARKET FOR SECURITIES</u></a>	<a href="#"><u>40</u></a>
<a href="#"><u>ADDITIONAL INFORMATION</u></a>	<a href="#"><u>41</u></a>
<a href="#"><u>REPORTS AND CONSOLIDATED FINANCIAL STATEMENTS</u></a>	
<a href="#"><u>MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING</u></a>	<a href="#"><u>42</u></a>
<a href="#"><u>REPORT OF INDEPENDENT AUDITOR</u></a>	<a href="#"><u>43</u></a>
<a href="#"><u>CONSOLIDATED STATEMENTS OF FINANCIAL POSITION</u></a>	<a href="#"><u>44</u></a>
<a href="#"><u>CONSOLIDATED STATEMENTS OF INCOME</u></a>	<a href="#"><u>45</u></a>
<a href="#"><u>CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME</u></a>	<a href="#"><u>46</u></a>
<a href="#"><u>CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY</u></a>	<a href="#"><u>47</u></a>
<a href="#"><u>CONSOLIDATED STATEMENTS OF CASH FLOWS</u></a>	<a href="#"><u>48</u></a>
<a href="#"><u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS</u></a>	<a href="#"><u>49</u></a>
<a href="#"><u>DIRECTORS, OFFICERS AND OTHER INFORMATION</u></a>	<a href="#"><u>91</u></a>

**TO OUR SHAREHOLDERS**

This year marked Chesswood's seventh year in a row of earnings growth over the prior year, a record we are all extremely proud of. These results reflect the consistent hard work, dedication and commitment of our operating teams in Fort Collins, New York City, Reno, Salt Lake City and Toronto.

Our business has grown and changed considerably over this seven-year period. Pawnee Leasing has almost doubled the size of its portfolio and earnings; Acura Sherway has posted remarkably consistent results; we launched Case Funding from a start-up to profitability in a fairly short period of time; we wound down our Canadian vehicle leasing business (which was the genesis of Chesswood); we launched our new working capital loan business - Windset Capital; and most recently, we added Northstar Leasing as our Canadian leasing arm, to complement Pawnee, in the North American small ticket non-prime equipment finance market.

Pawnee Leasing certainly continues to be Chesswood's largest business and contributes to our overall profitability just as significantly. Our outstanding management team at Pawnee continues to execute effectively, year after year. We are fortunate to have three other avenues for growth which we believe will, over time, continue to add growth and value for our stakeholders. While very early on in its life, the traction we are achieving in originations at Windset Capital is particularly encouraging and we have injected capital several times since its launch in late September, in support of the growth.

All of our finance businesses have a commonality to them that we find attractive - effective management of risk offers us the opportunity to enjoy generous risk-adjusted returns, as evidenced by Chesswood's after-tax return on equity this year of 16%.

This space affords me the opportunity to publicly express thanks to our operating teams in all of Chesswood's businesses. We are truly fortunate to have excellent teams in place at every one of our businesses and I am very thankful to be able to work with such quality people, every day.



Barry Shafran  
President & CEO

**COMPANY PROFILE**

Chesswood Group Limited ("Chesswood" or the "Company"), is an Ontario corporation and is the successor to Chesswood Income Fund (the "Fund") following the "conversion" of the Fund under a plan of arrangement which became effective on January 1, 2011.

Through its interest in Pawnee Leasing Corporation ("Pawnee"), Chesswood is involved in the business of micro and small-ticket equipment finance to small businesses in the start-up and "B" credit market in the lower 48 states of the United States. Through its interest in Windset Capital Corporation ("Windset"), Chesswood is in the business of providing working capital loans to small businesses in the United States. Through its interest in Case Funding Inc. ("Case Funding"), Chesswood is involved in the business of providing financing to plaintiffs and attorneys and the purchase of medical liens that form part of litigation throughout the United States. Through its interest in Sherway LP ("Sherway"), Chesswood is involved in selling, servicing and leasing Acura automobiles in the Province of Ontario. Through its interest in Lease-Win Limited ("Lease-Win"), Chesswood owned and operated cars4U.com. In addition, on January 31, 2014, the Company acquired Northstar Leasing Corporation ("Northstar"), which is a non-prime commercial equipment finance company in Ontario, Canada.

The Company's annual report and annual information form for the year-ended December 31, 2013 are available on SEDAR at [www.sedar.com](http://www.sedar.com), and provide additional information on Chesswood and its operating companies.

The Company's common shares are listed on the Toronto Stock Exchange under the symbol CHW. The Company's debentures issued on December 16, 2013 are listed on the Toronto Stock Exchange under the symbol CHW.DB.

**PAWNEE LEASING CORPORATION**

Pawnee is an equipment finance company that provides financing on micro and small-ticket business equipment. Pawnee focuses on small businesses (with a particular focus in the start-up and “B” credit segment of the U.S. equipment finance market), servicing the lower 48 states through a network of approximately 550 independent brokers. As of December 31, 2013, Pawnee administered 9,761 leases and loans in its portfolio, with remaining scheduled payments of approximately U.S.\$174.5 million over the next five years.

Pawnee finances equipment where generally:

- (i) the equipment is fundamental to the core operations of the lessee/borrower’s business;
- (ii) the cost of the equipment usually does not exceed U.S.\$75,000;
- (iii) a personal guarantee of at least the major shareholder/owner is obtained; and
- (iv) all scheduled payments are required to be paid by direct debit out of the lessee’s/borrower’s account.

Pawnee’s business does not involve financing of consumer goods. Pawnee funds only commercial equipment.

A key aspect of Pawnee’s business is managing potential risks in order to limit defaults to the greatest extent possible. Pawnee has developed a number of risk management tools and processes which it continually monitors and improves to address changes in its market and in the equipment finance industry.

Management believes that Pawnee is a leading micro and small-ticket funding source available to equipment financing brokers in the start-up equipment finance market in the U.S. and is a well-recognized player in the “B” credit market. Pawnee’s success in these higher risk niche markets is due to Pawnee’s ability to select creditworthy businesses through its proprietary credit analysis matrix and process, to price for higher risk, and its efficient servicing and collection processes.

Pawnee has traditionally provided funding to two very similar micro and small-ticket commercial financing markets - the start-up market and the “B” credit market. The creditworthiness of start-up businesses does not fall into traditional credit categories because of their lack of business credit history. Pawnee defines “start-up” businesses to be those businesses with less than two years of operating history. “B” credit businesses are those that have two or more years of operating history and have some unique aspect to their overall credit profile such that they are not afforded an “A” rated credit score and/or that the business owner(s) do not have an “A” rated personal credit history.

The start-up and “B” credit segments of the micro and small-ticket equipment finance market have historically been, and continue to be, more sensitive to monthly lease/loan payment amounts than to the effective rates of interest charged.

Pawnee added a new product offering to its broker network in late 2008. This additional “B” market product, now offered to all of Pawnee’s brokers, referred to as “B+”, complements Pawnee’s long standing core “B” product, by offering funding to lessees that have stronger credit profiles than Pawnee had considered in the past.

Assessed as lower risk business than Pawnee’s traditional “B” business, “B+” borrowers receive funding based on rates that typically range from 14-30%. At December 31, 2013, approximately 65% of Pawnee’s lease and loan receivables consisted of the “B+” product.

Pawnee’s business model is different from many other leasing, equipment finance, consumer, sub-prime mortgage and finance companies in a number of important respects, including the following:

- Pawnee does not sell its leases and loans, but rather retains its leases and loans for their full term,
- Pawnee’s revenues are derived directly from its leases and loans, and are not derived from (and therefore, and more importantly, Pawnee’s revenues are not dependent upon) fees from the sale of its portfolio of leases and loans, and
- not only is there significant geographic diversification (within the United States) within Pawnee’s portfolio of leases and loans, there is also significant diversification in terms of the equipment funded and the industries in which Pawnee’s lessees and borrowers operate. At December 31, 2013:
  - no state represented more than 11.0% of the number of Pawnee’s total active leases and loans, with the exception of California which represented 12.4%;



- Pawnee financed over 70 equipment categories, with its five largest categories by volume being restaurant, auto repair, titled trucks and trailers, medical and computer equipment, which combined accounted for 52.7% of the number of active leases and loans;
- its lessees and borrowers operated in over 85 different industry segments, with no industry concentration accounting for more than 16.1% of its number of active leases and loans;
- no lessee/borrower accounted for more than 0.01% of its total lease and loan portfolio; and
- its largest source of originations accounted for 5.2% of its gross lease and loan receivable, and its ten largest origination sources accounted for 31.6% of its gross lease and loan receivable.

Pawnee's revenues and fundings are not dependent upon continuously finding third party buyers for its lease and loan portfolio (where demand is driven by factors such as prevailing interest rates and the quality of other available portfolios and other available investments). Rather, Pawnee has a continuing lending facility.

As of December 31, 2013, Pawnee employed approximately 41 full-time equivalent employees, over one-third of whom are dedicated to collection and default remediation.

### **CASE FUNDING INC.**

On June 10, 2011, Chesswood acquired the shares of Case Funding, a newly incorporated and organized corporation which acquired the tangible and intangible assets required to carry on the going forward business of Quick Cash Inc. ("Quick Cash"), a provider of legal financing to plaintiffs and attorneys throughout the United States from offices in New York and Reno.

The entire team of Quick Cash joined Case Funding, combining their legal finance experience with Chesswood's specialty finance expertise and financial resources to build a growth-oriented legal finance business.

#### *The Legal Funding Market - Overview*

The legal finance market is a large underserved market that has been growing rapidly over the last decade. Case Funding provides litigators with loans based on their credit profile and a percentage of the value of their contingent fees (as determined by Case Funding) and provides legal funding for plaintiffs based on Case Funding's views of the strength of their lawsuits. Quick Cash has been in the legal finance business since 2003.

Management believes that Case Funding provides Chesswood with the ability to expand its specialty finance business by generating superior risk adjusted returns, through an existing infrastructure with market position, and in so doing provides opportunities for significant long-term growth.

Legal funding provides contingency fee based law firms with working capital for operations and case costs and to supplement their uneven cash flow, and individual plaintiffs with funds for living and lawsuit related medical expenses while they pursue the case. Conventional lenders such as banks and commercial lenders generally avoid these markets due to its relative complexity, leaving law firms and plaintiffs at a disadvantage when seeking a fair settlement against deep pocketed defendants and insurance companies.

In the United States, legal funding improves fairness in the legal process by permitting a person lacking the required funds to continue pursuing a claim against a defendant. Legal funding provides an alternative funding option for plaintiffs who are in financial need (due to inability to work, medical issues or otherwise), while their case is being litigated.

Many plaintiffs are unable to afford fee-based attorneys and are forced to seek out contingency attorneys who are willing to represent them on a percentage-of-settlement basis. Contingency based attorneys typically only pursue cases they feel have merit and can generate significant fees. Because of the delays in the litigation process, however, plaintiffs and their law firms still have a strong need for funds to see them through until the full settlement of their cases.

Before legal funding, plaintiffs suffered a distinct disadvantage as they often had to wait years for their cases to be resolved. This delay caused many plaintiffs to prematurely settle potentially valuable claims at a substantial discount to their true value. The industry does not generally provide funding, unless an action has already commenced.

While legal funding markets in the U.K. and Australia are quite mature, legal funding is an emerging industry in the U.S., and is highly fragmented.

There are significant variations amongst funders in the structure of loans and advances, especially to law firms, and in the fees and rates that are charged to plaintiffs and law firms. The attorney/law firm funding business is growing in the United States, as numerous but poorly capitalized legal funding companies have emerged. In the United States, it is estimated that 10,000 to 20,000 plaintiff funding applications per month are presented to leading legal funding companies.

Internationally there are several firms engaged exclusively in legal financing that are publicly listed in foreign markets. These listed firms are primarily centered on corporate litigation with a focus on insolvency or commercial litigation.

In most states throughout the United States, it is illegal for lawyers to share contingency fees with non-lawyers, thereby prohibiting non-lawyers from becoming equity investors in law firms. To add to the difficulties presented to lawyers when financing their practices, banks in the United States do not generally lend to professional service businesses that do not have significant balance sheets. This situation leads to a fragmented, capital-hungry industry where no one law firm owns a significant percentage of the market for any type of tort claim in their primary state of practice.

Lawyers in the United States are limited in the way they can leverage their businesses. Larger, fee-based law firms doing corporate and defense work have long been able to obtain bank financing by pledging their receivables. However, subrogation and other contingency fee-based law firms have limited ability to access working capital financing from traditional banks. These firms are often forced to refer their cases out to larger trial firms and accept relatively small referral fees for their origination services because of their limited capital.

#### *Attorney Loans*

Like all specialty finance businesses, Case Funding's attorney loans are structured and administered with a focus on risk management.

In order to mitigate the potential for loss, an attorney loan made by Case Funding will always be in an amount significantly less than the contingency fees that Case Funding expects, after its own independent evaluation, the attorney is likely to earn from the basket of existing cases against which the advance is made. Case Funding's advance rate is a maximum of 15% of the expected total fees. Only cases already in progress are eligible for inclusion in a basket of collateral.

Repayment of Case Funding's attorney loans is required by contract to be made on a priority basis, meaning that a significant portion of attorney fees resulting from settlements of cases from the basket are usually required to be used first to repay the loan, further reducing the potential for loan losses. In cases where Case Funding deems the law firm to be creditworthy, revolving arrangements can be negotiated where such law firms pay on each recovery from an identified case and Case Funding re-advances funds against new cases in an amount that fits within its risk and "loan-to-value" guidelines. This generates additional income opportunities from known clients.

In the case of attorney loans, lending terms generally include; guarantees of the law firm, guarantees of the partners (often joint and several), registered liens against all of the firm's assets, a direction that requires the trust accounts to repay Case Funding upon receipt of proceeds and that all proceeds are to be held in escrow when received; generous effective annual rates of interest (18% - 40%) of which a portion is paid monthly, and the balance is paid upon receipt of legal fees; underwriting and origination fees; requirement to report on an ongoing basis the status of cases in the basket; provision of the firm's monthly bank statements; and notice provisions for all settled cases including copies of all remittance cheques and periodic on-site audits.

Case Funding primarily uses in-house lawyers to evaluate new applications for loans and advances. Case Funding's lawyers review the case files of cases being offered by the attorneys, and arrive at their own assessment of expected fees for the entire basket. These lawyers also assist in our ongoing administration as it relates to the assessment of changes to any significant cases in each basket, including a formal review three times a year.

Case Funding's staff visits the office of all attorneys requesting a loan in excess of \$100,000 as a key part of the due diligence in assessing an application. While the visit includes the examination of case files, it also includes an assessment of the firm itself

and the partners, including confirming that information regarding the firm matches up with an onsite visit, such as staffing, number of partners, etc. The standing and license of each partner is verified with the state's bar association.

Because these loans often function as lines of credit for the attorneys, where amounts are repaid and then advanced again, against additional (and collateralized) cases, cash flow with respect to principal repayment is "lumpy" and the term is generally longer.

#### *Plaintiff Advances*

Plaintiff advances are made based on the timing and probability of success, and potential claim size, not the plaintiff's credit score. The standard for this industry is that advances are made on a non-recourse, at-risk basis where the funder forfeits its entire advance and any related fees if the plaintiff is not successful in the lawsuit. Inherent to the underwriting process is the approval for funding of cases that have a high probability of success, to be achieved either in pre-trial settlement or as a result of a judgment by a court.

Commercial banks in the United States have traditionally been unwilling to advance funding to plaintiffs or lawyers based on a contingent recovery, and lawyers are generally prohibited under state law from providing financial assistance to their clients. While the United States landscape is open to the use of plaintiff legal funding, the key issues of acceptability include rights of access to justice, lending and usury laws, legal ethics, champerty and maintenance restrictions, public policy and perception issues.

Plaintiff advances are made in smaller amounts and can therefore provide Case Funding with "smoother" cash flow and a diversification of risk.

As of December 31, 2013, Case Funding employed 11 full-time equivalent employees.

#### **WINDSET CAPITAL CORPORATION**

Chesswood launched Windset, its new working capital loan business, in late September 2013. Windset provides working capital loans up to \$250,000 to tenured small businesses throughout the United States.

More than ever before, small business owners in the United States find that banks either will not consider them for working capital loans or the process of applying for a bank loan may take too long and the outcome is less than certain. Many U.S. banks can no longer afford to consider loans under \$250,000 due to their high internal administration and regulatory costs. While the working capital loan market is a newer market that sprung primarily from the financial crisis, the significant demand for this product has been clearly demonstrated, as billions of dollars of loans have been originated since 2008. Payments are processed automatically and deducted every business day from the borrowers' bank account. The terms of these loans can range from 3 months to 18 months but are typically 9-10 months on average, and extensions are common for those borrowers that have been in good standing during the initial term of the loan.

Windset leverages off of the equipment finance business expertise of Pawnee, and uses Pawnee's experience, processes and broker channel to offer this new product to small businesses throughout the U.S. Windset also is assisted by Pawnee's documentation, collection and administrative departments that provide "back-office" support to Windset, under the terms of a managed services agreement between the two businesses.

Capital for Windset's initial portfolio growth has been provided by making use of a modest portion of Pawnee's unused credit facility, allocated to Windset by agreement with Pawnee's lenders. Notwithstanding the \$250,000 limit on Windset loans, initial expectations are for loans that average \$30,000 to \$40,000.

Management believes that Windset provides Chesswood with the ability to expand its specialty finance business by generating superior risk adjusted returns, utilizing some of Pawnee's existing infrastructure and providing equipment finance brokers and independent sales organizations (generally, these are brokers of financial products other than equipment finance) with a working capital funder that understands their unique marketplace and needs.

At December 31, 2013, Windset had approximately U.S.\$2.6 million in gross loan receivables outstanding.

**SHERWAY LP**

Sherway, through its Acura Sherway dealership, sells new Acura brand vehicles and related automobile services and products, and also sells used vehicles of various brands. Sherway had 47 employees at December 31, 2013.

**NORTHSTAR LEASING CORPORATION**

On January 31, 2014, subsequent to year end, Chesswood purchased all of the outstanding shares of Northstar, a long-standing non-prime commercial equipment finance company, located in Barrie, Ontario. Chesswood now has a North-American small ticket platform and can offer its products and services to brokers and their customers, regardless of which country they operate in. Northstar has decades of experience and management believes that this experience coupled with Pawnee's expertise, will allow the businesses to leverage the strengths of one another. See Note 36(a) - *Subsequent Events* for more details about the business acquisition. At January 31, 2014, Northstar had 7 employees.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following management's discussion and analysis ("MD&A") is a review of the financial condition and financial performance of Chesswood Group Limited ("Chesswood" or the "Company") for the three months and year ended December 31, 2013. This discussion should be read in conjunction with the audited consolidated financial statements and accompanying notes of the Company for the year ended December 31, 2013 set forth in the Company's 2013 Annual Report. The fiscal year of the Company ends on December 31. The date of this MD&A is March 7, 2014. All dollar amounts in this MD&A are Canadian dollars, unless otherwise indicated.

Through its interest in Pawnee Leasing Corporation ("Pawnee"), Chesswood is involved in the business of micro and small-ticket equipment finance to small businesses in the start-up and "B" credit market in the lower 48 states of the United States. Through its interest in Windset Capital Corporation ("Windset"), Chesswood is in the business of providing working capital loans to small businesses in the United States. Through its interest in Case Funding Inc. ("Case Funding"), Chesswood is involved in the business of legal financing to plaintiffs and attorneys and the purchase of medical liens that form part of litigation throughout the United States. Through its interest in Sherway LP ("Sherway"), Chesswood is involved in selling, servicing and leasing Acura automobiles in the Province of Ontario. Through its interest in Lease-Win Limited ("Lease-Win"), Chesswood owned and operated cars4U.com. In addition, on January 31, 2014, the Company acquired Northstar Leasing Corporation ("Northstar"), which is a non-prime commercial equipment finance company in Ontario, Canada.

The Company prepares its financial statements in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") as set out in The Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011.

This discussion contains forward-looking statements. Please see "Forward-Looking Statements" for a discussion of the risks, uncertainties and assumptions relating to these statements. This discussion makes reference to certain non-GAAP measures to assist in assessing the Company's financial performance. Non-GAAP measures do not have any standard meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. See "Non-GAAP Measures" for the definition of and reconciliation to GAAP measures of EBITDA and Adjusted EBITDA.

Our annual information form in respect of the fiscal year ended December 31, 2013 is available on SEDAR at [www.sedar.com](http://www.sedar.com), and provides additional information and should be read in conjunction with this report, management's discussion and analysis, consolidated financial statements and notes thereto.

**FORWARD-LOOKING STATEMENTS**

In this report, management makes statements that are considered forward-looking statements. Forward-looking information consists of disclosure regarding possible events, conditions or results that is based on assumptions about future economic conditions and courses of action. Wherever used, the words "may", "could", "should", "will", "anticipate", "intend", "expect", "plan", "predict", "believe", and similar expressions identify forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management, but indicate management's expectations of future growth, results of operations, business performance, and business prospects and opportunities.



Forward-looking statements should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether, or the times at which, such performance or results will be achieved. Forward-looking statements are based on information available at the time they are made, assumptions made by management, and management's good faith belief with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in forward-looking statements, historical results or current expectations. The Company assumes no obligation to publicly update or revise its forward-looking statements even if experience or future changes make it clear that any projected results expressed or implied therein will not be realized.

The Company operates in a dynamic environment that involves various risks and uncertainties, many of which are beyond the Company's control and which could have an effect on the Company's business, revenues, operating results, cash flow and financial condition, including without limitation:

- continuing access to required financing;
- continuing access to products to allow us to hedge our exposure to changes in interest rates;
- risks of increasing default rates on leases, loans and advances;
- our provision for credit losses;
- increasing competition (including without limitation, more aggressive risk pricing by competitors);
- increased governmental regulation of the rates and methods we use in financing and collecting on our equipment leases or loans, on the legal funding business generally and on our working capital loans;
- dependence on key personnel; and
- general economic and business conditions.

Readers should also carefully review the risk factors described under "Risk Factors" below and the risk factors described in the Company's annual information form filed with various Canadian securities regulatory authorities through SEDAR (the System for Electronic Document Analysis and Retrieval) at [www.sedar.com](http://www.sedar.com).

### KEY PERFORMANCE INDICATORS – PAWNEE

Management regularly evaluates and analyzes key performance indicators, including the following, to more effectively operate Pawnee's business:

#### Pawnee Portfolio Statistics (in U.S.\$ thousands except # of leases/loans and %'s)

	Mar 31 2012	June 30 2012	Sep 30 2012	Dec 31 2012	Mar 31 2013	June 30 2013	Sep 30 2013	Dec 31 2013
Number of leases and loans outstanding (#)	8,401	8,625	8,701	9,009	9,348	9,670	9,753	9,761
Gross lease and loan receivable ("GLR") <sup>(1)</sup>	\$134,613	\$140,605	\$141,971	\$150,125	\$163,311	\$173,092	\$175,208	\$174,491
Residual receivable	\$16,754	\$17,258	\$17,546	\$18,015	\$18,552	\$18,646	\$18,379	\$18,013
Net investment in leases and loans receivable, before allowance <sup>(4)</sup>	\$109,832	\$115,074	\$117,121	\$123,497	\$133,212	\$140,510	\$141,150	\$141,670
Security deposits (nominal value) <sup>(4)</sup>	\$11,478	\$11,854	\$12,074	\$12,378	\$12,669	\$12,770	\$12,635	\$12,321
Allowance for doubtful accounts – IFRS	\$1,990	\$2,259	\$2,629	\$2,950	\$3,098	\$3,128	\$3,522	\$3,450
Over 31 days delinquency (% of GLR) <sup>(2)</sup>	1.54%	1.64%	1.98%	2.23%	1.99%	1.99%	2.12%	2.05%
Net charge-offs for the three-months ended <sup>(3)</sup>	\$1,097	\$945	\$1,017	\$1,295	\$1,287	\$1,079	\$1,553	\$1,610
Provision for credit losses for the three-months ended – previous method	\$788	\$760	\$924	\$1,448	\$1,472	\$1,602	\$1,703	\$1,916
Provision for credit losses for the three-months ended – IFRS	\$968	\$1,238	\$1,431	\$1,635	\$1,515	\$1,370	\$1,832	\$1,578

Notes:

(1) Excludes residual receivable.

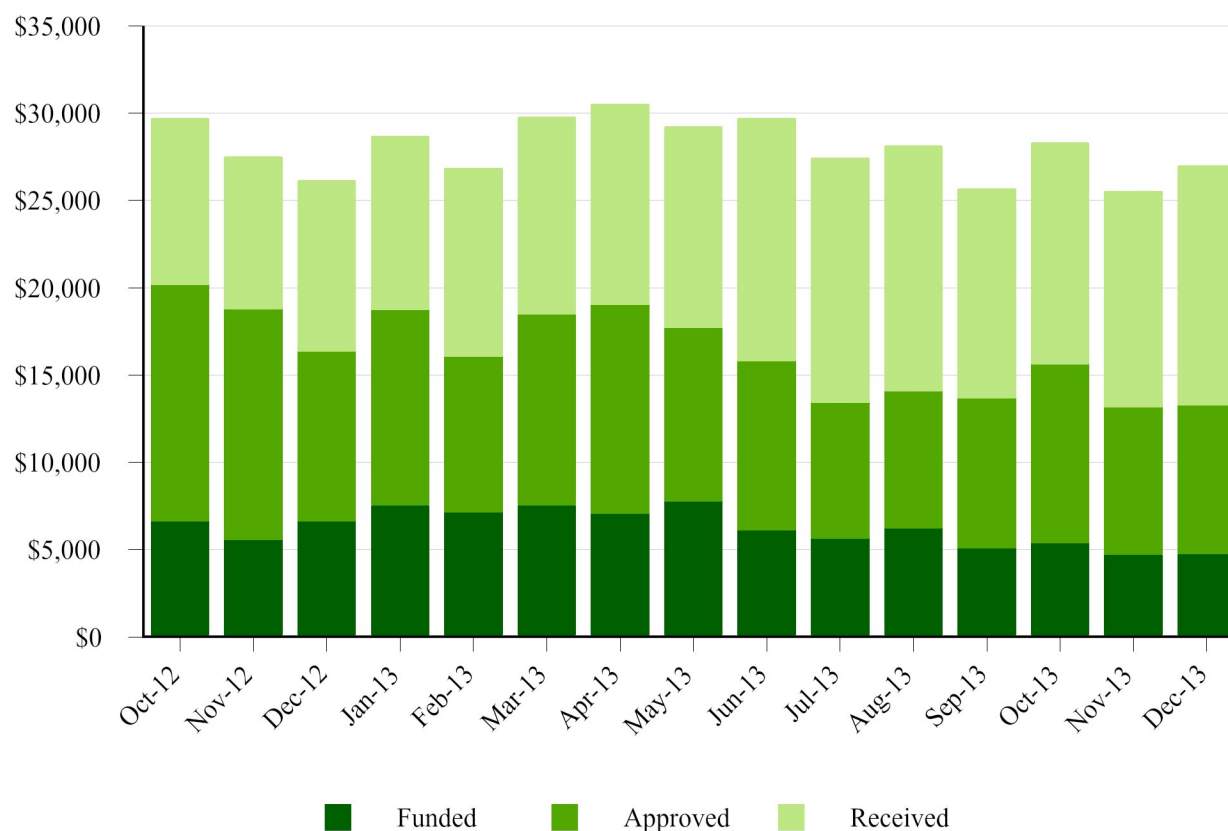
- (2) Over 31-days delinquency includes non-accrual gross lease and loan receivables. Pawnee ceases to accrue interest income on leases and loans after they become 94 days contractually past due unless information indicates that an earlier cessation of income is warranted and charges-off leases and loans when they become 154 days contractually past due, unless information indicates that an earlier charge-off is warranted.
- (3) Excludes the "charge-offs" of interest revenue on finance leases and loans on non-accrual leases recognized under IFRS.
- (4) Excludes adjustment for discounting security deposits and increasing unearned income for interest savings on security deposits.

### *Lease and Loan Application, Approval and Origination Volume*

Management regularly reviews lease and loan application, approval and origination volumes, for trends that may indicate changes in the economic or competitive landscape and that may necessitate adjustments in Pawnee's approach to doing business in its market segments. Pawnee also uses this data in its forecasting and budgeting process. Management reviews application approval data to analyze and predict shifts in the credit quality of Pawnee's applicants, and looks at individual broker approval rates to determine whether a broker is submitting applications that meet Pawnee's credit criteria. Pawnee refers to total originations as a percentage of leases and loans funded as the "closing ratio". Pawnee tracks and reviews the closing ratio to aid management in determining the efficiency and effectiveness of Pawnee's origination processes. Significant changes in any of these key metrics, as well as other less significant metrics, usually results in a more detailed review, which may include, amongst other things, a review of broker, industry or equipment type, equipment cost, or geographic areas for specific results.

Pawnee's lease and loan originations in the fourth quarter of 2013 were down from the fourth quarter of the prior year as competition has begun to aggressively price risk at levels below the risk-adjusted price levels Pawnee believes are appropriate for its lessees/borrowers. This competitive behavior has been demonstrated in the past as the cycle of the leasing industry enters a time of increasing capital availability, as it is today. Please see the "Outlook" section for a further discussion on this matter.

### **Lease and Loan Application, Approval and Origination Volume (in U.S.\$ thousands)**



*Asset Quality*

Pawnee is a niche specialty finance company that is focused on doing business with commercial enterprises that are not usually considered by conventional financing sources and that generally have a higher risk profile. This exposes the firm to a greater risk level; however management has built an operating model that is based on managing this risk. As a result, Pawnee has been able to generate greater margins with lower volume than many typical finance companies.

Risk management begins with carefully selecting which independent brokers Pawnee does business with. Brokers must have personal credit profiles acceptable to Pawnee, industry references and preferably have been active in the equipment finance industry for a minimum of one year. Regional marketing managers are responsible for training and for developing a knowledge base with new and existing brokers regarding Pawnee's underwriting policies and procedures. This training process is very important in ensuring that neither the broker nor Pawnee spend extraordinary time in reviewing and handling applicants that can't meet Pawnee's basic qualifications. The managers are also responsible for monitoring the brokers for credit application review and closing efficiencies, including applications submitted, approved and ultimately funded.

The Pawnee credit process is not the automated scoring procedure typical of high volume equipment finance companies. A credit analyst reviews each application and manually completes a proprietary credit matrix which is used as a guide for reaching a prudent credit decision. The matrix is designed to ensure that all of Pawnee's analysts are consistent in their review of applications. Analysts are available to directly assist brokers submitting applications and communicate credit decisions, including what would make an applicant more likely to be approved. Pawnee applies several basic principles for all credit decisions on new leases and loans, including the requirement that all business owners personally guarantee the lease/loan and must therefore submit their personal credit information for consideration, and all scheduled payments must be paid through direct debit. All leases and loans assigned to Pawnee, must be approved by Pawnee in accordance with the same criteria used in originating its own leases and loans.

Pawnee's credit matrix undergoes continual review by management, in addition to periodic assessment by outside professionals with statistical expertise.

*Operating Efficiency*

Pawnee manages operating performance using, in addition to other tools, a comprehensive budgetary review process. Included in this review are line-item-level comparisons of revenues and expenses to budget and trend data for the period then ended. If management finds there is a significant or unusual variance from budget or expectations, management will review the variance in detail and take corrective action, if necessary. Management focuses its attention on significant changes from projections and takes appropriate action, as necessary.

Pawnee's static pool loss analysis measures lease/loan loss performance by identifying a finite pool of lease/loan originations and segmenting this pool into quarterly or annual vintages according to when the leases and loans were originated. Poorly performing brokers, geographic areas, equipment types and industries are reviewed in more detail to determine if there is a systematic or other identifiable cause on which corrective action can be taken. For example, if management determines that Pawnee has unusually high losses on leases/loans for a particular type of equipment, management may raise the minimum required credit matrix score for those leases/loans to be approved or stop originating leases/loans of that equipment type altogether.

*Collections*

The ability to efficiently service and collect on leases and loans is critical in achieving appropriate profit margins and stable cash flows. Management of Pawnee recognizes the importance of the ability to collect on leases/loans and, as such, a great deal of emphasis is placed on the employment and retention of experienced collection personnel. Over one-third of Pawnee's personnel dedicate their activities to the collections process. Pawnee's collections department is structured to systematically and quickly resolve delinquent leases and loans whenever possible, mitigate losses and collect post-default recovery dollars.

Pawnee's collections activities begin when a lease/loan initially becomes delinquent. An account is recognized as troubled if for any reason the direct debit payment is not successfully received on the required due date - the account is immediately considered delinquent. When the lease/loan becomes 31 days past due, or earlier if the collector recognizes that the problem is something more significant than a past due payment, the lease/loan is referred to the appropriate negotiation, repossession/remarketing, bankruptcy or legal specialist on the Advanced Collection team. Pawnee regularly remediates a high percentage of leases/loans that go initially past due.

The Advanced Collection team's objective is to minimize Pawnee's loss through a combination of collecting payments, writing forbearances, repossessing and selling financed equipment, initiating lawsuits and, most importantly, negotiating settlements. After 154 days of delinquency, or earlier if the Advanced Collection team determines the account is uncollectible, the lease/loan is charged off.

After an account is charged off, it may continue to be handled internally when collection prospects for recovery through a personal guarantor or other remedy are considered good. If not, it is normally assigned to an independent collection agency for additional collection efforts. At this stage in the collections process, the primary sources of recovery are payments on restructured accounts, settlements with guarantors, equipment sales, litigation and bankruptcy court distributions.

Throughout the collections process, Pawnee's repossession/remarketing specialists perform a wide variety of functions, including acting on repossession requests from any collector, managing third-party vendors that perform repossession activities, working with remarketers to establish and approve the selling price on all repossessed equipment, and selling equipment on behalf of Pawnee.

#### **KEY PERFORMANCE INDICATORS – WINDSET**

Given the very recent launch of this business in late 2013, Windset currently relies on just a few markers to assess portfolio performance and composition, including delinquency, loan size, credit profiles and proprietary matrix scores.

#### **KEY PERFORMANCE INDICATORS – CASE FUNDING**

As a specialty finance business that began operations without a portfolio, management initially monitored Case Funding's overhead expenses as they compared to budget, on an ongoing basis, as well as tracking and measuring originations by product type, for volume, pricing and in the case of attorney loans, credit quality.

As Case Funding has grown since June 2011, its portfolio, processes and systems are subject to ongoing enhancement and change, in monitoring, measurement and analyses.

Most attorney loans are subject to conditional approval of a credit committee after having first been evaluated by Case Funding's credit underwriting. That conditional approval most often reflects the fact that a prospective attorney borrower's basket of cases must still meet Case Funding's legal underwriting criteria. Legal underwriting generally commences after a borrower's credit profile has been determined to meet Case Funding's standards.

Operationally, Case Funding monitors the collection of attorney interest payments (generally made monthly by ACH) and activity in the borrower's trust accounts, as two key steps out of a number of control measures, that provide effective monitoring tools of the borrower's payment history and settlement activity. There are a variety of other controls and processes in place to monitor these loans, including regularly scheduled updates from the borrowers, on the status of their cases.

Plaintiff advances are also subject to regularly scheduled updates from the plaintiff's attorney as to the status of the case and any changes that may have taken place since the last update. The plaintiff portfolio is also periodically examined for the aging of the advances and concentration by case types, amongst other metrics.

#### **KEY PERFORMANCE INDICATORS – SHERWAY**

Management monitors and analyzes a number of key indicators of the Sherway dealership's operations, by profit centre/department. One key indicator for each department is the level of gross margins being generated - on a per unit and total volume basis. This measure, along with other metrics that may vary amongst departments, as applicable, is monitored daily, weekly and monthly. The analyses of these various metrics allows management to react quickly to trends, concerns and opportunities in each department, on a daily, weekly and/or monthly basis.

#### **NON-GAAP MEASURES**

The Company provides non-GAAP measures as supplementary information. Management believes EBITDA and Adjusted EBITDA are useful measures in evaluating the performance of the Company and in determining whether to invest in Common Shares. EBITDA and Adjusted EBITDA are not earnings measures recognized by GAAP and do not have standardized meanings prescribed by GAAP. Therefore, EBITDA and Adjusted EBITDA may not be comparable to similarly titled measures presented by other

issuers. Investors are cautioned that EBITDA and Adjusted EBITDA should not be construed as an alternative to net income (loss) determined in accordance with GAAP as indicators of performance or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows.

#### Definitions of EBITDA and Adjusted EBITDA

“EBITDA” is defined as net income (loss) adjusted to exclude interest, income taxes, depreciation and amortization.

“Adjusted EBITDA” is defined as EBITDA adjusted for (i) interest on leasing and vehicle credit lines, (ii) non-cash gain (loss) on interest rate swaps and convertible debentures, (iii) non-cash unrealized gain (loss) on foreign exchange, (iv) non-cash share-based compensation expenses, (v) non-cash fair value adjustments on other liabilities, (vi) the non-cash loss on sale of property and equipment, and (vii) any unusual and material one-time expenses (such as the convertible debenture issue costs in December 2013).

Management references to operating income in the MD&A means income before undernoted items as presented on the consolidated statement of income.

#### ADJUSTED EBITDA <sup>(1)</sup>

For the quarter-ended (\$ thousands)	2012				2013			
	Q1	Q2	Q3	Q4 <sup>(4)</sup>	Q1	Q2	Q3	Q4 <sup>(6)</sup>
Net income	\$ 1,901	\$ 2,307	\$ 1,558	\$ 3,223	\$ 2,994	\$ 3,329	\$ 2,872	\$ 1,710
Interest expense	901	928	918	906	929	1,046	1,076	1,127
Provision for taxes	1,998	1,863	1,677	2,100	2,146	2,577	2,146	1,963
Amortization	183	172	164	160	165	89	47	61
EBITDA <sup>(1)</sup>	<b>\$ 4,983</b>	<b>\$ 5,270</b>	<b>\$ 4,317</b>	<b>\$ 6,389</b>	<b>\$ 6,234</b>	<b>\$ 7,041</b>	<b>\$ 6,141</b>	<b>\$ 4,861</b>
Interest expense	(901)	(928)	(918)	(906)	(929)	(1,046)	(1,076)	(1,127)
Share-based compensation expense	427	329	334	346	365	416	289	275
Contingent consideration <sup>(4)</sup>	43	47	48	(863)	—	—	—	—
Financing costs - conv deb <sup>(6)</sup>	—	—	—	—	—	—	—	2,035
Foreign exchange loss (gain)	53	(240)	338	(208)	(204)	166	22	(462)
Unrealized loss (gain) – interest rate swaps	(161)	203	169	(218)	(260)	(730)	(47)	(376)
Adjusted EBITDA <sup>(1)</sup>	<b>\$ 4,444</b>	<b>\$ 4,681</b>	<b>\$ 4,288</b>	<b>\$ 4,540</b>	<b>\$ 5,206</b>	<b>\$ 5,847</b>	<b>\$ 5,329</b>	<b>\$ 5,206</b>

#### SELECTED FINANCIAL INFORMATION

(\$ thousands, except per share figures)

	For the years ended December 31,		
	2011	2012	2013
Revenue <sup>(5)</sup>	\$ 77,864	\$ 86,596	\$ 94,739
Gross margin before expenses <sup>(5)</sup>	\$ 30,296	\$ 33,236	\$ 39,080
Basic earnings per share <sup>(2)(3)</sup>	\$ 0.59	\$ 0.80	\$ 0.96
Diluted earnings per share <sup>(2)(3)</sup>	\$ 0.56	\$ 0.77	\$ 0.89
Total assets	\$ 147,366	\$ 161,395	\$ 216,521
Long-term financial liabilities	\$ 77,428	\$ 86,381	\$ 134,899
Adjusted EBITDA <sup>(1)</sup>	\$ 15,632	\$ 17,953	\$ 21,588
Dividends declared <sup>(3)</sup>	\$ 6,673	\$ 7,239	\$ 8,262
Dividends declared per share <sup>(2)(3)</sup>	\$ 0.600	\$ 0.640	\$ 0.725



As at and for the quarter-ended (\$ thousands, except per share figures)	2012				2013			
	Q1	Q2	Q3	Q4 <sup>(4)</sup>	Q1	Q2	Q3	Q4 <sup>(6)</sup>
Revenue <sup>(5)</sup>	\$19,174	\$23,142	\$21,474	\$22,806	\$19,778	\$24,354	\$24,935	\$25,672
Gross margin before expenses <sup>(5)</sup>	8,017	8,633	8,228	8,358	8,980	10,138	9,766	10,196
Income before tax, and gain (loss) on interest rate swaps, conv deb and fx	3,834	4,180	3,790	4,034	4,676	5,342	4,993	4,870
Income before tax	3,899	4,170	3,235	5,323	5,140	5,906	5,018	3,673
Provision for taxes	1,998	1,863	1,677	2,100	2,146	2,577	2,146	1,963
Net income	\$1,901	\$2,307	\$1,558	\$3,223	\$2,994	\$3,329	\$2,872	\$1,710
Basic earnings per share <sup>(2)(3)</sup>	\$0.17	\$0.20	\$0.14	\$0.29	\$0.26	\$0.30	\$0.25	\$0.15
Diluted earnings per share <sup>(2)(3)</sup>	\$0.16	\$0.20	\$0.13	\$0.28	\$0.25	\$0.28	\$0.23	\$0.13
Total assets	149,431	163,214	153,742	161,395	174,446	190,371	187,782	216,521
Long-term financial liabilities	77,007	89,302	83,220	86,381	96,170	112,170	107,335	134,899
<b>Other Data</b>								
Adjusted EBITDA <sup>(1)</sup>	\$4,444	\$4,681	\$4,288	\$4,540	\$5,206	\$5,847	\$5,329	\$5,206
Dividends declared <sup>(3)</sup>	1,694	1,809	1,867	1,869	1,983	2,047	2,057	2,175
Dividends declared per share <sup>(2)(3)</sup>	\$0.15	\$0.16	\$0.165	\$0.165	\$0.175	\$0.18	\$0.18	\$0.19

- (1) Adjusted EBITDA and EBITDA are non-GAAP measures. See "Non-GAAP Measures" for the definition of Adjusted EBITDA and EBITDA.
- (2) Based on weighted average shares outstanding during period.
- (3) Includes dividends on Exchangeable Securities (non-controlling interest as described below under "Statement of Financial Position").
- (4) While Case Funding continued to grow and show promise, the projected results were less than the original forecasts used as a basis for the contingent consideration. It was determined that the estimated probability that Chesswood would have to pay the contingent consideration and bonus in June 2014 is extremely low. The \$850,000 accrual at September 30, 2012, relating to the contingent consideration (\$680,000) and bonus (\$170,000) was reversed in Q4 2012. While management believes the \$399,000 deferred tax asset at Case Funding will be realized, given the uncertainty of forecasting the growth of Case Funding, the timing of the utilization of the tax losses was not certain and thus the deferred tax asset established in Q4 2011 was reversed in Q4 2012. Previously disclosed quarterly Adjusted EBITDA amounts did not consider contingent consideration and bonus, the calculation of quarterly Adjusted EBITDA was updated in Q4 2012.
- (5) The Canadian automotive business represents approximately 55% of the Company's total revenue, however only represents approximately 18% of the Company's gross margin before expenses. The automotive revenue can significantly fluctuate throughout the year and year-to-year based on seasonality, sales volumes and market conditions with little effect to the Company's gross margin before expenses.
- (6) During Q4 2013, the Company issued \$20.0 million of convertible debentures. Management has elected under IAS 39.11A to designate the entire convertible debenture (and all the embedded derivatives) as a combined financial liability and for accounting purposes value it at fair value, with changes in fair value recorded through profit or loss. The fair value of the convertible debentures is based on their trading price on the Toronto Stock Exchange every reporting period, as a result, there may be increased volatility in the reported net income. At December 31, 2013, the fair value adjustment resulted in a loss of \$680,000 in financing costs on the Statement of Income. As a result of this election, the \$1.4 million expenses related to issuing the convertible debenture were expensed in Q4 2013 and not over the life of the debentures.

## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2013 AND 2012

The U.S. dollar results for the three months ended December 31, 2013 were converted at approximately 1.0494, which was the average exchange rate for the three month period. The U.S. dollar results for the three months ended December 31, 2012 were converted at approximately 0.9913, which was the average exchange rate for the corresponding period.

	Three months ended December 31, 2013				
	(\$ thousands)				
	Equipment Financing – U.S. (**)	Legal Financing – U.S.	Automotive operations – Canada	Corporate overhead – Canada	Total
Interest revenue on leases and loans	\$ 8,952	\$ 751	\$ —	\$ —	\$ 9,703
Ancillary finance and other fee income	1,297	52	—	—	1,349
Interest expense	(1,089)	—	—	—	(1,089)
Provision for credit losses	(1,656)	—	—	—	(1,656)
<b>Finance margin</b>	<b>7,504</b>	<b>803</b>	<b>—</b>	<b>—</b>	<b>8,307</b>
Revenue - automotive operations	—	—	14,620	—	14,620
Cost of sales - automotive operations	—	—	(12,731)	—	(12,731)
<b>Gross margin before expenses</b>	<b>7,504</b>	<b>803</b>	<b>1,889</b>	<b>—</b>	<b>10,196</b>
Personnel expense	1,226	248	830	253	2,557
Share-based compensation expense	36	17	7	215	275
Other expenses	925	421	598	489	2,433
Amortization	29	6	26	0	61
<b>Income before undernoted items</b>	<b>5,288</b>	<b>111</b>	<b>428</b>	<b>(957)</b>	<b>4,870</b>
Financing costs - convertible debentures	—	—	—	(2,035)	(2,035)
Unrealized gain on interest rate swaps	376	—	—	—	376
Unrealized gain on foreign exchange	—	—	—	462	462
<b>Income before taxes</b>	<b>5,664</b>	<b>111</b>	<b>428</b>	<b>(2,530)</b>	<b>3,673</b>
Provision for (recovery of) taxes	2,301	—	(39)	(299)	1,963
<b>Net income</b>	<b>\$ 3,363</b>	<b>\$ 111</b>	<b>\$ 467</b>	<b>\$ (2,231)</b>	<b>\$ 1,710</b>

(\*\*) Windset information is aggregated with Equipment Financing segment as it did not meet the quantitative requirements for its own segment.

For the three months ended December 31, 2013, the Company reported consolidated net income of \$1.7 million compared to \$3.2 million in the same period in the prior year, a decrease of \$1.5 million year-over-year.

The accounting treatment elected for the newly issued \$20.0 million of convertible debentures resulted in a decrease of \$1.6 million in net income for the three months ended December 31, 2013. The \$1.6 million is comprised of the expensing of all costs associated with issuing the debentures which total \$1.36 million, a fair value adjustment of \$680,000 less \$453,000 in future tax asset due to timing differences.

In 2012, there were two significant adjustments to Case Funding's results, the net impact of which increased net income by \$464,000 for the three months ended December 31, 2012. The reversal of contingent consideration and bonus for Case Funding led to an increase in net income for the three months ended December 31, 2012 by \$863,000. It has been determined that the estimated probability that Chesswood will have to pay the contingent consideration and bonus in June 2014 is extremely low. The \$850,000 total accrued balance at September 30, 2012, relating to the contingent consideration (\$680,000) and bonus (\$170,000) was reversed in Q4 2012, along with \$13,000 in foreign exchange impact. While management believes the \$399,000 deferred tax asset at Case Funding will be realized, given the uncertainty of forecasting the growth of Case Funding, the timing of the utilization of the tax losses was not certain and thus the \$395,000 deferred tax asset was reversed in Q4 2012.

In total, these specific items resulted in a \$2.0 million decrease in net income in the three month period year-over-year.

	Three months ended December 31, 2012				
	(\$ thousands)				
	Equipment Financing – U.S.	Legal Financing – U.S.	Automotive operations – Canada	Corporate overhead – Canada	Total
Interest revenue on leases and loans	\$ 7,535	\$ 454	\$ 1	\$ —	\$ 7,990
Ancillary finance and other fee income	1,236	63	—	—	1,299
Interest expense	(847)	—	—	—	(847)
Provision for credit losses	(1,635)	3	23	—	(1,609)
<b>Finance margin</b>	<b>6,289</b>	<b>520</b>	<b>24</b>	<b>—</b>	<b>6,833</b>
Revenue - automotive operations	—	—	13,517	—	13,517
Cost of sales - automotive operations	—	—	(11,992)	—	(11,992)
<b>Gross margin before expenses</b>	<b>6,289</b>	<b>520</b>	<b>1,549</b>	<b>—</b>	<b>8,358</b>
Personnel expense	883	246	686	290	2,105
Share-based compensation expense	87	41	25	193	346
Other expenses	838	123	515	237	1,713
Amortization	145	(1)	15	1	160
<b>Income before undernoted items</b>	<b>4,336</b>	<b>111</b>	<b>308</b>	<b>(721)</b>	<b>4,034</b>
Contingent consideration and bonus	—	863	—	—	863
Unrealized gain on interest rate swaps	218	—	—	—	218
Unrealized gain on foreign exchange	—	—	—	208	208
<b>Income before taxes</b>	<b>4,554</b>	<b>974</b>	<b>308</b>	<b>(513)</b>	<b>5,323</b>
Provision for taxes	1,594	399	—	107	2,100
<b>Net income</b>	<b>\$ 2,960</b>	<b>\$ 575</b>	<b>\$ 308</b>	<b>\$ (620)</b>	<b>\$ 3,223</b>

For the three months ended December 31, 2013, the Company reported consolidated operating income (“income before undernoted items”) of \$4.9 million compared to \$4.0 million in the prior year, an increase of \$836,000 year-over-year.

The \$836,000 increase in operating income for the three month period year-over-year was the result of:

- An increase in Pawnee’s operating income by \$952,000 in the three month period compared to the prior year, predominantly from a \$1.2 million increase in finance income due to a larger portfolio offset by a \$21,000 increase in provision for credit losses and a \$379,000 increase in personnel and other expenses compared to the prior year. Pawnee’s amortization expense decreased \$116,000 year-over-year in the three month period as its broker network intangible asset was fully depreciated by the end of April 2013, seven years after the acquisition of Pawnee. In the three month period, Pawnee’s actual net charge-offs increased by U.S.\$315,000 year-over-year consistent with the growth in the portfolio.
- Case Funding’s operating income for the three month period was relatively unchanged year-over-year and totaled \$111,000. The increase in finance revenue of \$283,000 in the three month period year-over-year reflects the growth in the portfolio year-over-year.
- Automotive operations income increased \$120,000 year-over-year reflecting an increase in income from Sherway of approximately \$183,100 offset by \$63,100 in net expenses for Lease-Win predominantly relating to severance payments to cars4U.com staff. On December 31, 2013, the Company ceased operations of cars4U.com; cars4U.com did not contribute materially to the results or assets of the Company. While new vehicle sales at Sherway decreased by 6 vehicles in Q4 2013 compared to Q4 2012, the gross profit per vehicle was up year-over-year and contributed to the increase in Sherway’s operating income.
- Corporate overhead before foreign exchange increased by \$236,000 year-over-year, predominantly from a \$252,000 increase in general and administrative expenses and a \$22,000 increase in share-based compensation expense, offset by a reduction in personnel expenses of \$37,000 due to timing of bonus accruals in the prior year. General and administrative expenses include \$88,000 of costs incurred relating to the acquisition of Northstar.

The provision for taxes for the three months ended December 31, 2013 totaled \$2.0 million compared to \$2.1 million in the same period of the prior year. The \$2.0 million provision for taxes for the three months ended December 31, 2013 is comprised of \$1.81 million in current tax expense, \$104,500 in withholding tax on inter-company dividends and future tax expense of \$47,000.

## **RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

The U.S. dollar results for the year ended December 31, 2013 were converted at approximately 1.0299, which was the average exchange rate for 2013. The U.S. dollar results for the year ended December 31, 2012 were converted at approximately 0.9996, which was the average exchange rate for such year.

Please see Note 35 - *Segment Information* in the notes to the Company's consolidated financial statements for a breakdown of operating results and other information by industry segment and/or geographic location.

For the year ended December 31, 2013, the Company reported consolidated net income of \$10.9 million compared to \$9.0 million in the prior year, an increase of \$1.9 million year-over-year.

Financing costs relating to the convertible debentures in 2013 and the reversal of contingent consideration in 2012 resulted in a \$2.0 million decrease in net income year-over-year (as discussed above in the three month analysis); offsetting these decreases the unrealized gains on interest rate swaps and foreign exchange increased net income year-over-year by \$1.9 million.

For the year ended December 31, 2013, the Company reported consolidated operating income ("income before undernoted items") of \$19.9 million, compared to \$15.8 million in the prior year, an increase of \$4.1 million year-over-year or an increase of almost 26%.

The \$4.1 million increase in operating income year-over-year was the result of:

- An increase in Pawnee's operating income by \$3.0 million compared to the prior year, predominantly from a \$4.8 million increase in finance income due to a larger portfolio offset by a \$1.2 million increase in provision for credit losses and an \$883,000 increase in personnel and other expenses compared to the prior year. In 2013, Pawnee's actual net charge-offs increased by U.S.\$1.2 million year-over-year, predominantly from the increase in leases outstanding year-over-year, approximately 4.27% of average investment in loans and leases (net of security deposits), relatively unchanged from the prior year.
- Case Funding's operating income for 2013 increased by \$886,000 year-over-year and totaled \$683,000 compared to a loss of \$203,000 in the prior year. Case Funding was acquired on June 10, 2011, however Chesswood did not acquire Case Funding's existing loan portfolio. Case Funding has been gradually building its own legal finance receivables portfolio since June 2011. The increase in finance revenue of \$1.5 million year-over-year reflects the growth in the portfolio.
- Automotive operations income increased \$715,000 year-over-year reflecting an increase in income from Sherway of approximately \$534,000, and the absence of \$181,000 in net expenses for Lease-Win. New vehicle sales increased by 37 vehicles in 2013, due in part to the introduction of new models. Automotive revenue from Lease-Win was down \$509,000 in 2013 compared to the prior year, and gross profit from Lease-Win was down \$185,000 which reflects the wind-down and eventual sale of its remaining automotive leases in August 2012.
- Corporate overhead before foreign exchange increased by \$598,000 year-over-year, predominantly from a \$431,000 increase in general and administrative expenses and \$148,000 increase in share-based compensation expense.

The provision for taxes for the year ended December 31, 2013 totaled \$8.8 million compared to \$7.6 million in the prior year. The \$8.8 million provision for taxes for the year ended December 31, 2013 is comprised of \$11.8 million in current tax expense, \$543,000 in withholding tax on inter-company dividends and a reduction in future taxes payable of \$3.6 million.

## **STATEMENT OF FINANCIAL POSITION**

Total consolidated assets of the Company at December 31, 2013 were \$216.5 million, an increase of \$55.1 million from December 31, 2012. The exchange rate on December 31, 2013 was 1.0636 compared to 0.9949 at December 31, 2012. The change in the foreign exchange rate increased assets by \$10.1 million, thus total assets excluding the foreign exchange impact increased by \$45.0 million from December 31, 2012. The \$45.0 million increase in net assets before the foreign impact was predominantly the result of a \$26.5 million increase in finance receivables and the \$18.6 million in net funds raised from the issuance of the convertible debentures on December 16, 2013.

Cash totaled \$22.7 million at December 31, 2013 compared to \$5.6 million at December 31, 2012, an increase of approximately \$17.1 million. The \$18.6 million in net funds raised from the issuance of the convertible debentures on December 16, 2013 accounted for the majority of the increase in cash. At December 31, 2013, approximately U.S.\$7.9 million (December 31, 2012 - U.S.\$8.1 million) that could have been sent up to Chesswood was still at Pawnee, being utilized to fund portfolio growth and to lower interest costs. This is one of Chesswood's best avenues for deploying cash resources.

Accounts receivable totaled \$1.2 million at December 31, 2013 compared to \$771,000 at December 31, 2012. The accounts receivable balance principally relates to Sherway includes amounts due from the manufacturer for financing contracts in transit, which are typically collected within seven to ten days, and are usually at their highest levels at month end. Vehicle receivable balances fluctuate throughout the year based on seasonality, and sales volumes of the industry.

Inventory totaled \$7.8 million at December 31, 2013 compared to \$7.9 million at December 31, 2012, relatively unchanged from the prior year. Vehicle inventory balances at dealerships fluctuate throughout the year based on seasonality, sales volumes and market conditions.

Prepaid expenses and other assets totaled \$1.8 million at December 31, 2013, an increase of \$815,000 from December 31, 2012. Tax receivable increased \$703,000 year-over-year and accounted for the majority of the increase in prepaid expenses and other assets.

Finance receivables consist of the following:

	<b>December 31, 2013</b>	June 30, 2013	December 31, 2012
		<i>(\$ thousands)</i>	
Net investment in leases	<b>\$ 127,145</b>	\$ 128,739	\$ 111,905
Equipment financing agreements and working capital loans ("loans")	<b>21,195</b>	14,275	6,700
Legal finance receivables	<b>10,961</b>	8,175	5,645
	<b><u>\$ 159,301</u></b>	<u>\$ 151,189</u>	<u>\$ 124,250</u>

The change in the foreign exchange rate increased finance receivables by \$8.6 million from December 31, 2012 [and \$5.2 million from June 30, 2013], thus the finance receivables excluding the foreign exchange impact increased \$26.5 million from December 31, 2012 [and \$2.9 million from June 30, 2013]. Pawnee's lease and loan originations in the fourth quarter of 2013 were down from the fourth quarter of the prior year as competition has begun to aggressively price risk at levels below the risk-adjusted price levels Pawnee believes are appropriate for its lessees/borrowers. This competitive behavior has been regularly demonstrated in the past as the cycle of the leasing industry enters a time of increasing capital availability, just as it is today, once again. Please see the "Outlook" section for a further discussion on this matter.

The \$148.3 million in net investment in leases and loans is net of \$3.7 million in allowance for doubtful accounts compared to \$2.9 million in allowance for doubtful accounts at December 31, 2012. Under IFRS, an allowance can only be set up if there is objective evidence that the impairment has already occurred; potential losses expected as a result of future events, no matter how likely based on past historical evidence, are not allowed to be recognized. Pawnee charges-off leases and loans when they become 154 days contractually past due, unless information indicates that an earlier charge-off is warranted. A high percentage of the charge-offs are made before the subject leases/loans reach 154 days contractually past due. As only a small percentage of the total lease and loan receivable portfolio have monthly payments that are past due at any one reporting date, the portion of the receivables that shows observable objective evidence of impairment at any one reporting date is quite small, despite long-term historical experience that indicates that future charge-offs with respect to the current lease and loan receivable will typically exceed the level of observable impairment, in a matter of months. Windset had no delinquent loans at December 31, 2013 and thus no allowance for doubtful accounts was recorded.

Unlike certain other equipment finance companies, Pawnee does not sell any of its lease or loan receivables. All receivables originated by Pawnee and Windset are retained for their full term. Pawnee and Windset funds their leases and loans through a floating rate facility offered by a banking syndicate, as discussed below.



Legal finance receivables consist of funds advanced to plaintiffs, attorneys, and for the purchase of medical liens relating to plaintiff cases. At December 31, 2013, there were 605 advances and loans outstanding (December 31, 2012 - 366 advances and loans). The advances and loans are due when the underlying cases are settled; however, attorney borrowers do make partial monthly interest payments that are generally equal to at least half of the interest accruing on the loan. These payments are collected through automatic monthly debits to the borrowers' bank accounts.

Interest income is recognized for accounting purposes by estimating the collection date and thus total funds to be collected, from which income can be determined on an effective interest basis.

# of days outstanding (**)	1day -> 90 days	91 days -> 180 days	181 days -> 365 days	366 days ->	Total
# of loans & advances	134	89	138	244	605
\$ thousands	\$2,061	\$1,754	\$2,656	\$4,490	\$10,961

*(\*\*)The advances and loans are due when the underlying cases are settled; the number of days the receivable is outstanding does not necessarily indicate the likelihood of impairment. It is normal for receivables in this industry to be outstanding anywhere from 6 months to 48 months.*

Under IFRS, an allowance for the collectability of the legal finance receivables can only be set up if there is objective evidence that the impairment has already occurred; potential losses expected as a result of future events, no matter how likely based on past historical evidence or known uncertainties with this type of receivable, are not allowed to be recognized.

The collectability of loans and/or advances made by Case Funding depends on litigation outcomes in the form of judgments and/or settlements. Once an advance/loan is made, the timing of the collection cycle is out of Case Funding's control. Therefore, the timing of actual collections will be irregular. At December 31, 2013, Case Funding was not aware of any situation where the collection of a receivable was doubtful and thus there was no observable objective evidence of impairment and therefore no basis for establishing an allowance for doubtful accounts under IFRS; however historical experience and the uncertainties involved would indicate that Case Funding will not collect 100% of the loans and advances. Case Funding's pricing to the markets it serves reflects this fact.

Net additions to property and equipment totaled \$510,000 for the year ended December 31, 2013. Approximately \$342,000 was spent on computer hardware and systems, the majority of which was spent at Pawnee and Windset. Approximately \$151,000 of the property and equipment additions in 2013 (and \$204,700 in total) relates to architect and other preliminary costs associated with Sherway's re-imaging upgrade of the dealership. The current estimate of costs for the project is between \$2.5 million and \$3.0 million. Initial funding for the re-imaging upgrade will be funded by Sherway's bank facility and/or Chesswood's excess capital. Once complete, a large portion of the costs will be reimbursed by Acura Canada. The construction began in March 2014. At December 31, 2013, approximately \$204,700 of the property and equipment was not being amortized as it relates to renovation costs still in progress.

Intangible assets totaled \$7.0 million at December 31, 2013 compared to \$6.8 million at December 31, 2012. The net change in intangible assets is comprised of \$169,300 in amortization of broker relationships and a \$400,000 increase as the result of the change in foreign exchange rates. The significant intangible assets of broker relationships and trade names do not require any outlay of cash to be maintained, as the creation of lease and loan receivables does not require an outlay of cash, other than commissions, which are separately expensed over the term of the lease and loan receivable.

Goodwill totaled \$14.7 million at December 31, 2013 compared to \$13.9 million at December 31, 2012. The movement in the foreign exchange rate resulted in an increase of \$783,000 in goodwill during the year ended December 31, 2013. Goodwill is typically tested annually for impairment unless certain circumstances arise that would require an assessment prior to an annual review. The Company completed its annual goodwill impairment test as at December 31, 2013 and 2012 and determined that no impairment had occurred.

Accounts payable and other liabilities totaled \$7.1 million at December 31, 2013 compared to \$8.3 million at December 31, 2012, a decrease of \$1.2 million. Current taxes paid at Pawnee represented the majority of the decrease. See Note 17 - *Accounts payable and other liabilities*, for more detail on the balances that comprise accounts payable and other liabilities.

Vehicle inventory is financed through vehicle financing credit facilities, of which \$6.4 million was outstanding at December 31, 2013 compared to \$6.2 million at December 31, 2012, leaving \$1.5 million of inventory that was self-financed as at December 31, 2013 compared to \$1.7 million self-financed at December 31, 2012. Vehicle inventory balances at dealerships fluctuate throughout the year based on seasonality, sales volumes and market conditions.

Pawnee enters into interest rate swap agreements with its principal lender under its banking facility that provides for payment of an annual fixed rate, in exchange for a LIBOR based floating rate amount. Pawnee's bank has the option to terminate the swaps typically one year prior to the maturity date. The interest rate swaps are intended to offset a portion of the variable interest rate risk on the credit facility. At December 31, 2013, the mark-to-market adjustment is a cumulative loss of approximately \$1.2 million compared to a loss of approximately \$2.5 million at December 31, 2012 and is shown as a liability on the statement of financial position.

The following interest rate swaps were outstanding at December 31, 2013:

<b>Effective Date</b>	<b>Notional Amount U.S.\$</b>	<b>Annual Fixed Rate</b>	<b>Maturity date</b>
March 2011	\$15 million	3.12%	March 2014
March 2012	\$15 million	4.00%	March 2015
April 2013	\$15 million	0.96%	April 2016
March 2014	\$15 million	1.33%	March 2017
March 2015	\$15 million	1.56%	March 2017
April 2015	\$15 million	2.12%	March 2019
April 2016	\$15 million	2.11%	March 2018

The following interest rate swap agreements were entered into after December 31, 2013:

<b>Effective Date</b>	<b>Notional Amount U.S.\$</b>	<b>Annual Fixed Rate</b>	<b>Maturity date</b>
March 2017	\$15 million	2.88%	March 2018
March 2017	\$15 million	3.23%	March 2019

Pawnee's interest rate swaps are not considered trading instruments as it intends to hold them until maturity. Nonetheless, the interest rate swaps do not qualify as a hedge for accounting purposes, and are therefore recorded as a separate derivative financial instrument. Accordingly, the estimated fair value of the interest rate swaps is recorded as a liability on the accompanying consolidated statement of financial position. Payments made and received pursuant to the terms of the interest rate swaps and adjustments to the fair value of the interest rate swaps are recorded as gain or loss on interest rate swaps. The fair value of interest rate swaps is based upon the estimated net present value of cash flows.

Borrowings totaled \$77.3 million at December 31, 2013 compared to \$47.6 million at December 31, 2012. Pawnee was utilizing U.S.\$73.2 million of its credit facility at December 31, 2013 compared to U.S.\$48.3 million at December 31, 2012. The increase in the borrowings reflects the final 2012 dividend payment to Chesswood which must be taken by the end of April of the following year, and tax payments for 2012 and 2013. At December 31, 2013, approximately U.S.\$7.9 million (December 31, 2012 - U.S.\$8.1 million) that could have been sent up to Chesswood was still at Pawnee, being utilized to fund portfolio growth and to lower interest costs.

In July 2012, Pawnee renewed and expanded its credit facility. The credit facility limit was increased by U.S.\$30.0 million to U.S.\$85.0 million, while the accordion feature of the loan agreement has been increased to U.S.\$115.0 million from U.S.\$85.0 million. Pawnee's borrowings under the credit facility are subject to, among other things, adhering to certain percentages of eligible gross lease/loan receivables, and the maintenance of a minimum debt to tangible net worth ratio. This credit facility is secured by substantially all of Pawnee's assets, contains negative covenants including the maintaining of leverage and interest coverage ratios, requires Pawnee to mitigate its interest rate risk by entering interest rate swaps for a notional amount not less than 50% of the outstanding amount, and matures on July 24, 2016. Pawnee was in full compliance with all its bank covenants during the period.

In November 2013, Pawnee's syndicate of lenders approved amendments to Pawnee's credit facility so as to provide Windset with access to a maximum of US\$5.0 million of capital from Pawnee's credit facility. No significant changes were made to Pawnee's covenants under the credit facility as a result of this new availability.

In early 2014, Pawnee's syndicate of lenders approved amendments to Pawnee's credit facility so as to provide Windset with access to another U.S.\$5.0 million in capital to a maximum of U.S.\$10.0 million of capital from Pawnee's credit facility. In conjunction with this amendment, Chesswood contributed U.S.\$1.75 million of additional capital to Windset to support its growth.

The \$11.8 million (December 31, 2012 - \$11.0 million) in customer security deposits relates to security deposits held by Pawnee. Pawnee's primary contracts requires that the lessee/borrower provide two payments as security deposit (not advance payments), which are held for the full term of the lease and then returned or applied to the purchase option of the equipment at the lessee's request, unless the lessee has previously defaulted (in which case the deposit is applied against the lease receivable). Historically, a very high percentage of lessees' deposits are either applied to the purchase option of the leased equipment at the end of the lease term or used to offset charge-offs. Approximately \$759,200 of the increase is the result of the change in the foreign exchange rate.

On December 16, 2013, the Company issued a total of \$20.0 million of convertible debentures. The debentures mature on December 31, 2018, and bear interest at a rate of 6.5% per annum, payable semi-annually. The outstanding principal under the debentures may, at the option of the holders, be converted into common shares of the Company at a conversion price of \$21.25 per share at any time. Upon a holder's election to convert its debentures, in lieu of delivering shares, the Company may elect to pay the holder cash. The Company also has the right to satisfy its payment obligations under the debentures (subject to obtaining any required regulatory approvals) by issuing common shares (based on a deemed issue price of 95% of the current market value).

The Company has the following options to redeem the convertible debentures before the maturity:

- After December 31, 2016 and prior to December 31, 2017, the Company has the option to redeem the debentures provided the current market price, as defined for purposes of the debentures, is at least 125% of the conversion price of \$21.25.
- Subsequent to December 31, 2017 and prior to December 31, 2018, the Company has the option to redeem the debentures provided the redemption price at a price equal to the principal amount including accrued and unpaid interest.

The convertible debentures have several embedded derivative features which were determined to not meet the criteria for treatment as equity components and would otherwise be required to be recognized as separate financial instruments, measured at fair value through profit or loss. The Company has elected under IAS 39.11A to designate the entire convertible debentures (and all the embedded derivatives) as a combined financial liability at fair value through profit or loss. The fair value of the convertible debentures is based on its trading price on the Toronto Stock Exchange every reporting period; as a result, there may be increased volatility in the reported net income. At December 31, 2013, the fair value adjustment resulted in a loss of \$680,000 in financing costs on the Statement of Income. As a result of this election, the \$1.4 million costs related to the issuance of the convertible debentures were expensed when incurred; thus no transaction costs are capitalized in the fair value of the convertible debentures.

Future taxes payable at December 31, 2013 totaled \$23.9 million compared to \$25.3 million at December 31, 2012, a decrease of \$1.4 million. The decrease in future taxes payable is the result of a future tax reduction of approximately \$3.0 million and a \$1.65 million increase as a result of the change in the foreign exchange rate. Pawnee has benefited from the accelerated bonus depreciation rules introduced in 2007 as part of the U.S. Economic Stimulus Act and has therefore been able to utilize a portion of operating cash flows normally used to pay taxes, to fund portfolio growth. While the "fiscal cliff" legislation, passed in early January 2013, extended bonus depreciation until the end of 2013, Pawnee was in a tax payable position, after having taken full advantage of available bonus depreciation. Pawnee expects to make tax installment payments throughout 2014. The actual taxes payable for

2014 will be dependent on the growth of its lease portfolio in 2014 and is inherently difficult to predict. Pawnee has sufficient capital resources, including its line of credit, through which to satisfy its taxation obligations and fund its portfolio growth. Tax at Pawnee is provided for using the asset and liability method of accounting. This method recognizes future tax assets and liabilities that arise from differences between the accounting basis of the subsidiary's assets and liabilities and their corresponding tax basis.

At December 31, 2013, there were 9,969,882 Common Shares outstanding (excluding the shares issuable in exchange for the Exchangeable Securities, as defined below) with a book value of \$45.2 million. Including the Exchangeable Securities, Chesswood would have had 11,448,419 Common Shares outstanding.

In August 2012, the Board of Directors approved the repurchase and cancellation of up to 658,943 of the Company's outstanding Common Shares for the period commencing August 25, 2012 and ending on August 24, 2013. From January 2013 to August 24, 2013, no Common Shares had been repurchased under this normal course issuer bid. In August 2013, the Board of Directors approved the repurchase and cancellation of up to 688,614 of the Company's outstanding Common Shares for the period commencing August 25, 2013 and ending on August 24, 2014. During the period ended December 31, 2013, no Common Shares had been repurchased under the renewed normal course issuer bid. Decisions regarding the timing of purchases are based on market conditions and other factors.

Non-controlling interest is comprised of the 1,274,601 Class B common shares and 203,936 Class C common shares ("the Exchangeable Securities") of Chesswood U.S. Acquisitionco Ltd. ("U.S. Acquisitionco"), which were issued as partial consideration for the acquisition of Pawnee and are fully exchangeable at any time for Common Shares, on a one-for-one basis, through a series of steps. Attached to the Exchangeable Securities are Special Voting Shares of the Company which provide the holders of the Exchangeable Securities voting equivalency to holders of Common Shares. Under IAS 27, the Exchangeable Securities must be shown as non-controlling interest because they are equity in a subsidiary not attributable, directly or indirectly, to the parent (even though they have no voting powers in the subsidiary only in the parent company and are fully exchangeable into the equity of the parent for no additional consideration and receive the same dividends as the common shares of the parent company). When the non-controlling interest was moved from Other liabilities back to the shareholders' equity section on January 1, 2011 (the date the Fund converted to a corporation), per IFRS, the value attributed to the non-controlling interest was just the fair value of the equivalent Common Shares (closing value of Fund Units on the Toronto Stock Exchange on December 31, 2010) as the Exchangeable Securities are fully exchangeable into Common Shares. Their portion of the cumulative income and dividends from May 2006 to January 1, 2011 was not allocated to non-controlling interest; however, their portion of income and dividends has since been allocated to non-controlling interest.

Reserve represent the accumulated share-based compensation expensed over the vesting term for options and restricted share units unexercised at December 31, 2013.

Accumulated other comprehensive loss is the cumulative translation difference between the exchange rate on January 1, 2010, the IFRS adoption date and the exchange rate on December 31, 2013 of self-sustaining foreign operations net assets.

## **LIQUIDITY AND CAPITAL RESOURCES OVERVIEW**

The primary sources of cash for the Company and its subsidiaries have been cash flows from operating activities, and borrowings under its various subsidiaries' credit facilities. The primary uses of cash for the Company and its subsidiaries are to fund equipment leases and loans, long-term debt principal repayments and dividends.

The Company raised net funds of \$18.6 million through the issuance of convertible debentures in December 2013 to fund acquisitions and growth of existing operating subsidiaries. In January 2014, the Company used a portion of those funds to acquire Northstar for approximately \$10.6 million, including costs. See Note 36(a) - *Subsequent Events* for more details about the business acquisition.

The Company's subsidiaries' objective is to maintain low cash balances, investing any free cash in their operations as needed and using any excess to pay down debt on various financing facilities. The subsidiaries fund working capital needs, lease and loan originations and growth using advances under credit facilities available when operating cash flow is not sufficient. At December 31, 2013, the Company's operating units had \$13.5 million in additional borrowings available under various credit facilities to fund business operations; however, Chesswood anticipates injecting at least U.S.\$3.5 million of additional equity into Windset during 2014 to support its growth.

The Company itself does not have any credit facility. The subsidiaries' respective credit facilities are used to provide funding for the subject subsidiary's operations (i.e. to provide financing for the purchase of assets which are to be the subject of leases and loans or to acquire vehicle inventory and support working capital), other than Case Funding which is in the process of seeking a banking partner. The credit facilities are not intended to directly fund dividends by the Company (and these facilities generally limit the amount which can be distributed to the Company to the net income of the subject subsidiary).

Sherway has finalized its plans for a re-imaging upgrade of its dealership. The current estimated costs for the project are between \$2.5 million and \$3.0 million. Initial funding for the re-imaging upgrade will be funded by Sherway's bank facility or through the use of Chesswood's excess cash resources. Once complete, a large portion of the costs will be reimbursed by Acura Canada. The construction began in March 2014.

Pawnee has benefited from the accelerated bonus depreciation rules introduced in 2007 as part of the U.S. Economic Stimulus Act and has therefore been able to utilize a portion of operating cash flows normally used to pay taxes, to fund portfolio growth. While the "fiscal cliff" legislation, passed in early January 2013, extended bonus depreciation until the end of 2013, Pawnee was in a tax paying position in 2013, after having taken full advantage of available bonus depreciation. Pawnee expects to make tax installment payments throughout 2014. The actual taxes payable for 2014 will be dependent on the growth of its lease portfolio in 2014 and is inherently difficult to predict. Pawnee has sufficient capital resources, including its line of credit, through which to satisfy its taxation obligations and fund its portfolio growth.

The following are the contractual principal payments and maturities of financial liabilities and other commitments:

(\$ thousands)	2014	2015	2016	2017	2018 +	Total
Accounts payable and other liabilities	\$ 7,021	\$ 29	\$ 31	\$ 15	\$ —	<b>\$7,096</b>
Vehicle financing	6,368	—	—	—	—	<b>6,368</b>
Interest rate swaps	115	752	186	274	(126)	<b>1,201</b>
Borrowings (a)	—	—	77,305	—	—	<b>77,305</b>
Customer security deposits (b)	3,483	3,188	2,825	1,601	733	<b>11,830</b>
Convertible debentures	—	—	—	—	20,000	<b>20,000</b>
	<b>\$16,987</b>	<b>\$3,969</b>	<b>\$80,347</b>	<b>\$1,890</b>	<b>\$20,607</b>	<b>\$123,800</b>
Other financial commitments (c)	901	783	596	278	119	<b>2,677</b>
Total commitments	<b>\$17,888</b>	<b>\$4,752</b>	<b>\$80,943</b>	<b>\$2,168</b>	<b>\$20,726</b>	<b>\$126,477</b>

- Pawnee's financing credit facility is a line-of-credit; as such the balance can fluctuate. The credit facility matures in 2016. The interest rate has a floating component, thus the interest payments are dependent on the balance of the line of credit and the interest rate at any point of time.
- The Company's experience has shown that the actual contractual payment streams will vary depending on a number of variables including: prepayment rates, charge-offs and modifications. Accordingly, the scheduled contractual payments of customer security deposits shown in the table above are not to be regarded as a forecast of future cash payments.
- The Company and its subsidiaries are committed to future minimum rental payments under existing leases for premises, excluding occupancy costs and property tax, expiring in 2015 and 2018.

The Company has no material "off-balance sheet" financing obligations, except for long-term premises lease agreements. Other commitments are disclosed in Note 30 - *Contingent liabilities and other financial commitments*, of the annual consolidated financial statements.

### Cash Sources and Uses

The statement of cash flows, which is compiled using the indirect method, shows cash flows from operating, investing, and financing activities, and the Company's cash at the beginning and end of the year. Cash flows in foreign currencies have been translated at the average rate for the period. Cash flow from operating activities comprises net income (loss) adjusted for non-cash items, changes in working capital and operational net assets. Receipts and payments with respect to tax are included in cash from operating activities. The Company considers net investment in leases, legal finance receivables, vehicle financing, borrowings,



and customer security deposits as operational assets and liabilities as they directly relate to our core business. The changes in these operational assets and liabilities are shown in cash flows from operating activities and the associated interest revenue and interest expenses are included in operating activities and not investing or financing activities. Cash flow from investing activities comprises payments relating to the acquisition of companies and property and equipment. Cash flow from financing activities comprises payment of dividends, proceeds from stock issues, and the purchase and sale of treasury stock.

For the year ended December 31, 2013

The Company's operations generated cash flow from operations before the changes in operating assets and liabilities of \$31.1 million during the year ended December 31, 2013 compared to \$25.4 million in the prior year, an increase of \$5.7 million due to improved earnings year-over-year.

The Company's operations generated cash flow from operations of \$6.9 million during the year ended December 31, 2013 compared to \$6.6 million in the year ended December 31, 2012, an increase of \$335,000. The amount of cash utilized to fund the growth in finance receivables increased \$11.4 million year-over-year which was funded by the increase in cash from net earnings and increase in borrowings. Chesswood had net tax payments of \$15.1 million in the year ended December 31, 2013 compared to \$2.6 million in the prior year, an increase of \$12.5 million in net tax payment year-over-year, which was the predominant reason for the \$18.6 million increase in funds from borrowings year-over-year.

Capital expenditures totaled \$510,000 (2012 - \$261,000) during the year ended December 31, 2013.

The Company paid dividends to the holders of Common Shares and Exchangeable Securities in the amount of \$8.1 million during the year ended December 31, 2013 compared to \$7.2 million in the prior year; an increase of \$959,000 due to a higher number of shares outstanding and higher dividend per share amounts year-over-year.

On December 16, 2013, the Company raised net proceeds of \$18.6 million through the issuance of convertible debentures. A portion of the funds were used to acquire Northstar in January 2014. See Note 36(a) - *Subsequent Events* for more details about the business acquisition.

Excluding the net proceeds of \$18.6 million raised through the convertible debenture offering in the year ended December 31, 2013, there was a decrease in cash of \$1.6 million compared to a decrease of \$1.7 million in the prior year. Pawnee could have utilized its credit facility to fund more of its portfolio growth and tax payments; however, as Chesswood had sufficient funds, Pawnee retained the funds that would otherwise be paid out in dividends to Chesswood. At December 31, 2013, approximately U.S.\$7.9 million (2012 - U.S.\$8.1 million) that is permitted to be sent up to Chesswood was still at Pawnee, being utilized to fund portfolio growth and lower interest costs.

For the three-months ended December 31, 2013

The Company's operations generated cash flow from operations before the changes in operating assets and liabilities of \$7.7 million during the three-months ended December 31, 2013 compared to \$6.7 million in the three months ended December 31, 2012, an increase of \$1.0 million.

The amount of cash utilized to fund the growth in finance receivables in Q4 2013 was \$6.0 million compared to \$8.7 million in Q4 of 2012, a decrease of \$2.8 million year-over-year. Chesswood had net tax payments of \$4.1 million in the three months ended December 31, 2013 compared to \$703,000 in the same period in the prior year, an increase of \$3.4 million. As a result of these main sources and uses of cash, the borrowings in the three months ended December 31, 2013 totaled \$3.4 million compared to \$4.5 million in the same period in the prior year.

The Company's operations generated cash flow of \$1.1 million during the three-months ended December 31, 2013 compared to \$1.5 million in the three months ended December 31, 2012, a decrease of \$425,000 compared to the same period in the prior year.

Capital expenditures totaled \$43,000 (2012 - \$71,000) during the three-months ended December 31, 2013.

The Company paid dividends to the holders of Common Shares and Exchangeable Securities in the amount of \$2.1 million during the three-months ended December 31, 2013 compared to \$1.9 million in the same period in the prior year; an increase of \$246,000 due to a higher number of shares outstanding and higher dividend per share amounts year-over-year.

On December 16, 2013, the Company raised net proceeds of \$18.6 million through the issuance of convertible debentures. A portion of the funds were used to acquire Northstar in January 2014. See Note 36(a) - *Subsequent Events* for more details about the business acquisition.

Excluding the net proceeds of \$18.6 million raised through the convertible debenture offering in the three-months ended December 31, 2013, there was a decrease in cash of \$1.2 million compared to \$918,000 in the same period in the prior year. At December 31, 2013, approximately U.S.\$7.9 million (2012 - U.S.\$8.1 million) that is permitted to be sent up to Chesswood was still at Pawnee, being utilized to fund portfolio growth and lower interest costs.

Chesswood's directors will continue to review cash flow and cash position, to determine appropriate changes, if any, to the dividend policy going forward. Chesswood's cash flow may or may not attain the levels necessary to generate the funds required to meet the current level of dividends.

Chesswood expects that current operations and planned capital expenditures for the foreseeable future of its subsidiaries will be financed using funds generated from operations, existing cash, and funds available under existing and/or new credit facilities. Chesswood may require additional funds to finance future acquisitions and support significant internal growth initiatives such as Case Funding's operations and originations and Pawnee's portfolio growth. It will seek such additional funds, if necessary, through public or private equity or debt financings from time to time, as market conditions permit.

#### **Financial Covenants, Restrictions and Events of Default**

The Company's operating subsidiaries are subject to bank and/or manufacturer covenants relative to leverage and/or working capital, other than Case Funding and Lease-Win, which either have no banking facility or no longer has or needs a banking facility.

Pawnee funds its business primarily through variable rate borrowings and has a revolving credit facility for up to U.S.\$85.0 million which can, subject to certain conditions, be extended to U.S.\$115.0 million. As of December 31, 2013, Pawnee had used approximately U.S.\$73.2 million of its available borrowing under this facility (U.S.\$48.3 million as of December 31, 2012). Pawnee's ability to access funding at competitive rates through various economic cycles enables it to maintain the liquidity necessary to manage its business, and its ability to continue to access funding is an important condition to its future success. Pawnee is required to purchase fixed interest rate hedges for at least 50% of the outstanding balance under its credit facility, and as of December 31, 2013, Pawnee has hedged U.S.\$45.0 million, representing approximately 61.5% of the U.S.\$73.2 million outstanding under the credit facility.

In November 2013, Pawnee's syndicate of lenders approved amendments to the current banking agreement that provide Windset with access to a maximum of US\$5.0 million of capital from Pawnee's credit facility. No significant changes were made to Pawnee's covenants under the credit facility, as a result of this new availability.

In early 2014, Pawnee's syndicate of lenders approved amendments to the current banking agreement that provide Windset with access to another U.S.\$5.0 million in capital to a maximum of U.S.\$10.0 million of capital from Pawnee's credit facility. In conjunction with this amendment, Chesswood contributed U.S.\$1.75 million of additional capital to Windset to support its growth.

Pawnee's secured borrowing agreement has financial covenants and other restrictions with which Pawnee and U.S. Acquisitionco must comply in order to obtain continued funding and avoid default. Events of default under these arrangements include a change in control without lender-approval.

Advances on the revolving facility may be drawn at any time, subject to compliance with borrowing base calculations and compliance with the covenants set out therein. As of December 31, 2013, U.S.\$73.2 million was outstanding under the facility and Pawnee had capacity to draw up to and in excess of the U.S.\$85.0 million commitment and remain within the borrowing base under the facility.

Pawnee is restricted in its ability to merge, acquire companies or be acquired, or incur additional debt without lender approval. Furthermore, dividends are limited to compliance with all bank covenants and may not exceed 95% of U.S. Acquisitionco's consolidated net income, as determined in accordance with U.S. GAAP, with a few adjustments, including mark-to-market adjustments for interest rate swaps.

Pawnee is subject to the risk of increases in interest rates as the credit facility used to fund the business operations has a variable interest rate component, while the yields on its equipment leases and loans are fixed. Pawnee seeks to mitigate that risk through the use of swap agreements that effectively convert floating rate debt to fixed rates.

Pawnee's current funding agreement expires on July 24, 2016. Pawnee has successfully renewed its funding facility on numerous occasions.

### Dividends to Shareholders

The Company declared cash dividends during the year ended December 31, 2013 as follows:

<u>Shareholder Record Date</u>	<u>Per Share</u>
January 31, 2013	\$ 0.055
February 28, 2013	\$ 0.060
March 31, 2013	\$ 0.060
April 30, 2013	\$ 0.060
May 31, 2013	\$ 0.060
June 30, 2013	\$ 0.060
July 31, 2013	\$ 0.060
August 31, 2013	\$ 0.060
September 30, 2013	\$ 0.060
October 31, 2013	\$ 0.060
November 30, 2013	\$ 0.065
December 31, 2013	\$ 0.065
	<u>\$ 0.725</u>

### Dividend Policy

The Company's policy is to pay monthly dividends to shareholders of record on the last business day of each month by the 15<sup>th</sup> of the following month (or the next business day thereafter if the 15<sup>th</sup> is not a business day).

The amount of any dividends payable by Chesswood is at the discretion of its board of directors, is evaluated on an ongoing basis, and may be revised subject to business circumstances and expected capital requirements depending on, among other things, Chesswood's earnings, financial requirements for its operating entities, growth opportunities, the satisfaction of applicable solvency tests for the declaration and payment of dividends and other conditions existing from time to time.

### OUTLOOK

As always, we continue to focus on the growth opportunities presented to each of our operating businesses, and each one faces its own unique opportunities and market conditions.

We expect to see the strong growth we have experienced early in the launch of Windset, continue, while Case Funding continues its growth trajectory as well. Northstar is expected to begin to grow toward the end of 2014. We also expect to continue to see origination pressure in Pawnee's main market, as heightened competition continues to offer underwriting terms which we do not believe are consistent with sustainable risk adjusted returns.

Sherway has begun its renovation. GAAP requires us to expense the entire cost of the temporary sales facility we have constructed on site, despite the fact the need for the facility is wholly attributable to the renovation, the cost of which is a capital item. The cost of the temporary facility is estimated to be approximately \$300,000. We will receive Acura's long-awaited primary luxury sedan, the new TLX, in late spring or early summer.

We have a strong balance sheet, buttressed by almost \$20.0 million from the issue of our convertible debenture at the end of 2013, and \$68 million of equity. This strength along with the growth opportunities described above, present Chesswood with many avenues by which we expect to continue to enhance shareholder value.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Understanding the Company's accounting policies is essential to understanding the results of the Company's operations and financial condition. The Company's significant accounting policies are described in Note 3 - *Significant Accounting Policies*, to the Company's consolidated financial statements for the year ended December 31, 2013. The preparation of these financial statements requires us to make estimates and judgments that affect reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties and the most significant of which are described below.

### ***Net Investment in Leases***

The leases entered into by the Company are considered to be finance leases in nature, based on an evaluation of all the terms and conditions and the determination that the Company has transferred substantially all the risks and rewards of legal ownership of the asset to the lessee. Interest revenue on finance leases is recognized under the effective interest method. The effective interest method of income recognition applies a constant rate of interest equal to the internal rate of return on the lease.

### ***Allowance for Doubtful Accounts***

The carrying value of net investment in leases and loans is net of allowance for doubtful accounts. Quantifying the impairment is based on the estimates of the carrying value that will ultimately not be collected where there is objective evidence of impairment.

Pawnee's lease receivables and EFAs are each composed of a large number of homogenous leases and loans (EFAs are classified as loans for accounting purposes), with relatively small balances made to inherently risky borrowers. Pawnee charges-off leases and EFAs when they become 154 days contractually past due, unless information indicates that an earlier charge-off is warranted. A high percentage of charge-offs are made before the subject leases and loans reach 154 days contractually past due.

Pawnee's allowance for doubtful accounts on Chesswood's consolidated financial statements is comprised of the net investment in leases and EFAs value that is over 30 days delinquent, plus any leases or loans identified as impaired less than 30 days delinquent and approximately 10% of the 1-30 day delinquent leases (those considered most likely to fall into the over 30 days delinquent category by the next month).

Under IFRS, an allowance can only be set up if there is objective evidence that the impairment has already occurred; potential losses expected as a result of future events, no matter how likely based on past historical evidence, are not allowed to be recognized. As only a small percentage of the total lease and loan receivable portfolio have monthly payments that are past due at any one reporting date, the portion of the lease and loan receivables that shows observable objective evidence of impairment at any one reporting date is quite small, despite long-term historical experience that indicates that future charge-offs with respect to the current lease and loan receivable will typically exceed the level of observable impairment, in a matter of months.

Projections of Pawnee's probable net credit losses are inherently uncertain, and as a result we cannot predict with certainty the amount of such losses. Changes in economic conditions, the risk characteristics and composition of the portfolio, bankruptcy laws, and other factors could impact Pawnee's actual and projected net credit losses and the related allowance for doubtful accounts.

### ***Legal Finance Receivables***

Attorney loans and medical lien financing are deemed to be a financial asset as they are a contractual right to receive cash from another entity and are considered to be loans and receivables for accounting purposes, based on an evaluation of all the terms and conditions of the contracts. The contracts are deemed to have fixed or determinable payments, in that the payments are due when the underlying cases are settled however the date as to which that will happen is not known and is estimated. Loans and receivables

are accounted for at amortized cost using the effective interest method; however the effective interest rate is calculated using estimated cash flows based on an estimated settlement dated.

Plaintiff advances are deemed to be a financial asset as they are a contractual right to receive cash from another entity and are considered to be available-for-sale financial assets for accounting purposes, based on an evaluation of all the terms and conditions of the contracts. The terms of the plaintiff advances are on a non-recourse basis, and payment depends on the success and potential claim size. Thus, the terms may limit the expected cash flows and other than for credit deterioration, they are deemed not to be loans and receivables. Available-for-sale financial assets are valued at fair value, the accretion in value is recognized based on the effective interest method and recognized into finance income, any changes in fair value are recorded in other comprehensive income until realized.

Under IFRS, an allowance for the collectability of the legal finance receivables can only be set up if there is objective evidence that the impairment has already occurred; potential losses expected as a result of future events, no matter how likely based on past historical evidence or known uncertainties with this type of receivable, are not allowed to be recognized. The collectability of loans and/or advances made by Case Funding depends on litigation outcomes in the form of judgments and/or settlements. Once an advance/loan is made, the timing of the collection cycle is out of Case Funding's control. Therefore, the timing of actual collections will be irregular. At December 31, 2013, Case Funding is not aware of any situation where the collection of a receivable is doubtful and thus there is no observable objective evidence of impairment and therefore no basis for establishing an allowance for doubtful accounts under IFRS; however historical experience and the uncertainties involved would indicate that Case Funding will not collect 100% of the loans and advances.

#### ***Impairment of Goodwill***

Goodwill is evaluated for impairment on an annual basis, or more frequently if certain events or circumstances exist. The Company's impairment test of goodwill is based on the value-in-use which is estimated using a discounted cash flow model. The cash flows are derived from budgets for the next five years, excluding restructuring activities and future investments. Impairment testing is applied on an individual asset basis unless an asset does not generate cash inflows that are largely independent of the cash inflows generated by other assets or groups of assets. None of the Company's non-financial assets generate independent cash inflows and therefore all non-financial assets are allocated to cash generating units ("CGU") for purposes of assessing impairment.

CGUs are defined as the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Impairment losses are recognized when the carrying amount of a CGU exceeds the recoverable amount, which is the greater of the CGU's fair value less cost to sell and its value in use. Value-in-use is the present value of the estimated future cash flows from the CGU discounted using a pre-tax rate that reflects current market rates and the risks inherent in the business of each CGU. If the recoverable amount of the CGU is less than its carrying amount, the CGU is considered impaired and is written down to its recoverable amount. The impairment loss is allocated to reduce the carrying amount of the assets of the CGU, first to reduce the carrying amount of the CGU's goodwill and then to the other assets of the CGU allocated pro-rata on the basis of the carrying amount of each asset. Other than the cash flow estimates, the value-in-use is most sensitive to the discount rate used and the growth rate applied beyond the five year estimate. Changes in these estimates and assumptions could have a significant impact on the value-in-use and/or goodwill impairment.

#### ***Contingent Consideration and Bonus***

Contingent consideration and bonus relates to the Incentive Payment Amount (as defined below) on the acquisition of Case Funding. The consideration is payable in the event that Case Funding's normalized net income ("NNI") for the 25th through 36th months following the Acquisition Date (June 10, 2011) achieves the targeted amount of approximately U.S.\$4.7 million (the "Targeted Amount"), whereby an amount of U.S.\$1.4 million (the "Incentive Payment Amount") (or an identical percentage adjusted portion of the Incentive Payment Amount if NNI is less than, but at least 90% of, the Targeted Amount) will be paid no later than the 38th month. It was determined at December 31, 2013 that the probability that the Targeted Amount would be reached was minimal.

The estimate of the fair value of contingent consideration and bonus payable requires very subjective assumptions to be made of various potential operating result scenarios and discount rates. Although the Company believes that there will be no Incentive Payment Amount due in June 2014, it will continue to periodically review NNI results and an updated assessment of various probability weighted projected NNI scenarios. If circumstances change and the Company determines that an earn-out payment



may be due, such future revisions may materially change the estimate of the fair value of contingent consideration and therefore materially affect the Company's future financial results.

### ***Convertible Debentures***

The convertible debentures have several embedded derivative features which were determined to not meet the criteria for treatment as equity components and would otherwise be required as separate financial instruments, measured at fair value through the profit or loss. The Company has elected under IAS 39.11A to designate the entire convertible debentures (and all the embedded derivatives) as a combined financial liability at fair value through profit or loss. As the convertible debentures will be fair valued based on its trading price on the Toronto Stock Exchange every reporting period, there may be increased volatility in our reported net income. As result of the election to value the convertible debentures at fair value, the expenses related to the issuance of the convertible debenture were expensed when incurred.

### ***Share-based Payments***

The Black-Scholes model is used to fair value options issued by the Company. The model requires the use of subjective assumptions including the expected share price volatility. In addition, the options issued have characteristics different from those of traded options so the Black-Scholes option-pricing model may not provide a reliable single measure of the fair value of options issued. Changes in the subjective assumptions can have a material effect on the fair value estimate.

### ***Interest Rate Swaps***

Hedge accounting requires recognition of the fair value of all derivative instruments on the statement of financial position as either assets or liabilities. Changes in a derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met. Gains and losses on derivative hedging instruments must be recorded in either other comprehensive income or current earnings, depending on the nature and designation of the instrument.

Pawnee's interest rate swaps are not considered trading instruments as Pawnee intends to hold them until maturity. Nonetheless, the interest rate swaps do not qualify as a hedge for accounting purposes, and are therefore recorded as separate derivative financial instruments. Accordingly, the estimated fair value of the interest rate swaps is recorded as an asset or a liability on the accompanying consolidated statement of financial position. Payments made and received pursuant to the terms of the interest rate swaps are recorded as an adjustment to interest expense, and adjustments to the fair value of the interest rate swaps are recorded as gain or loss on interest rate swaps. The fair value of interest rate swaps is based upon the estimated net present value of cash flows.

### ***Taxes***

Pawnee and Lease-Win use the asset and liability method to account for taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for future tax benefits for which realization is not considered more likely than not. Pawnee and Lease-Win account for their lease arrangements as operating leases for federal tax reporting purposes. This results in temporary differences between financial and tax reporting for which deferred taxes have been provided.

Significant management judgment is required in determining the provision for taxes, deferred tax assets and liabilities and any necessary valuation allowance recorded against net deferred tax assets. The process involves summarizing temporary differences resulting from the different treatment of items, for example, leases for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated statement of financial position. Management must then assess the likelihood that deferred tax assets will be recovered from future taxable income or tax carry-back availability and, to the extent management believes recovery is not probable, a valuation allowance must be established. To the extent that we establish a valuation allowance in a period, an expense must be recorded within the tax provision in the statement of income. The Company's estimate of its future taxes will vary based on actual results of the factors described above, and such variations may be material.

**FUTURE ACCOUNTING CHANGES***Financial Liabilities: Measurement*

In October 2010, the IASB issued *IFRS 9 Financial Instruments*, which represents the completion of the first part of a three-part project to replace IAS 39, *Financial Instruments: Recognition and Measurement* with a new standard. As per the new standard, an entity choosing to measure a liability at fair value will present the portion of the change in its fair value due to changes in the entity's own credit risk in the other comprehensive income or loss section of the entity's statement of comprehensive loss, rather than within profit or loss. Additionally, IFRS 9 includes revised guidance related to the de-recognition of financial instruments. The Company plans to adopt these new standards when they become effective and is currently assessing the impact of this standard.

*Financial Instruments (Classification and Measurement)*

IFRS 9, *Financial Instruments* will replace IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9.

The mandatory effective date of IFRS 9 has been deferred until completion of the entire financial instruments project.

*Operating segments*

The amendments to IFRS 8, *Operating Segments* issued in December 2013, require an entity to disclose the judgments made by management in applying the aggregation criteria for reportable segments. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014.

Certain new accounting standards and interpretations have been published by the IASB or the IFRIC that are not mandatory for the December 31, 2013 reporting period. The following standards are not expected to have any material impact on the Company's consolidated financial statements:

IAS 28 (as revised in 2003) and IAS 31  
IAS 19 *Employee Benefits* (amended in 2011)  
IAS 28 *Investments in Associates and Joint Ventures* (amended in 2011)  
IFRIC 21 *Leases*

**RISK FACTORS**

An investment in Common Shares entails certain risk factors that should be considered carefully.

Chesswood operates in a dynamic environment that involves various risks and uncertainties, many of which are beyond our control and which could have an effect on our business, revenues, operating results, cash flow and financial condition. Readers should carefully review the risk factors in the Company's annual information form filed with various Canadian securities regulatory authorities through SEDAR (the System for Electronic Document Analysis and Retrieval) at [www.sedar.com](http://www.sedar.com), a summary of which are set out below.

***Dependence on Key Personnel***

Our operating companies depend to a large extent upon the abilities and continued efforts of their key operating personnel and senior management teams.

***Relationships with Brokers and Other Origination Sources***

Pawnee has formed relationships with hundreds of origination sources, comprised primarily of equipment finance brokerage firms. Pawnee relies on these relationships to generate applications and originations. The failure to maintain effective relationships with its brokers and other origination sources or decisions by them to refer transactions to, or to sign contracts with, other financing sources could impede Pawnee's ability to generate transactions.

Similarly, the business models of Windset, Case Funding and Northstar depend to a large extent on referral relationships.

***Risk of Future Legal Proceedings***

Our operating companies are threatened from time to time with, or are named as defendants in, or may become subject to, various legal proceedings, fines or penalties in the ordinary course of conducting their respective businesses. A significant judgment or the imposition of a significant fine or penalty on an operating company (or on a company engaged in a similar business, to the extent the operating company operates in a similar manner) could have a material adverse impact on our business, financial condition and results of operations, and on the amount of cash available for dividends to our shareholders.

***Interest Rate Fluctuations***

Our operating companies (and, in particular, Pawnee Windset and Northstar) are exposed to fluctuations in interest rates under their borrowings. Increases in interest rates (to the extent not mitigated by interest hedging arrangements) may have a material adverse impact on our businesses, financial condition and results of operations, and on the amount of cash available for dividends to our shareholders.

The leases and loans are written at fixed interest rates and terms. The operating companies generally, finances their activities using both fixed rate and floating rate funds. To the extent the operating companies finance fixed rate leases and loans with floating rate funds, they are exposed to fluctuations in interest rates such that an increase in interest rates could narrow or eliminate the margin between the yield on a lease and loan and the effective interest rate paid by the borrower. While Pawnee enters into interest rate swaps to mitigate rate fluctuation risk, there can be no assurances that these arrangements will be sufficient to fully protect Pawnee against interest rate risks, or that Pawnee will be able to maintain such arrangements on a continuing basis.

***Portfolio Delinquencies; Inability to Underwrite Lease and Loan Applications***

Pawnee's receivables consist primarily of lease and loan receivables originated under programs designed to serve smaller, often owner-operated businesses that have limited access to traditional financing. There is a high degree of risk associated with equipment financing for such parties. The typical borrower in Pawnee's portfolio is a start-up business that has not established business credit or a more established business that has experienced some business or personal credit difficulty at some time in its history. As a result, such leases entail a relatively higher risk and may be expected to experience higher levels of delinquencies and loss levels. Pawnee cannot guarantee that the delinquency and loss levels of its receivables will correspond to the historical levels Pawnee has experienced on its portfolio and there is a risk that delinquencies and losses could increase significantly.

In addition, since defaulted leases and loans and certain delinquent leases and loans cannot be used as collateral under its variable rate financing facilities, higher than anticipated lease defaults and delinquencies could adversely affect Pawnee's liquidity by reducing the amount of funding available to it under these financing arrangements. Furthermore, increased rates of delinquencies or loss levels could result in adverse changes to the terms of future financing arrangements, including increased interest rates payable to lenders and the imposition of more burdensome covenants and increased credit enhancement requirements.

Analogous risks are faced by Windset, Northstar and Case Funding in their business.

***Deterioration in Economic or Business Conditions; Impact of Significant Events and Circumstances***

Our operating companies' results may be negatively impacted by various economic factors and business conditions, including the level of economic activity in the markets in which they operate. To the extent that economic activity or business conditions deteriorate, delinquencies and credit losses may increase. Delinquencies and credit losses generally increase during economic slowdowns or recessions such as that recently experienced in the United States. As our operating companies extend credit primarily to small businesses, many of their customers may be particularly susceptible to economic slowdowns or recessions, and may be unable to make scheduled lease or loan payments during these periods. Unfavourable economic conditions may also make it more difficult for our operating companies to maintain new origination volumes and the credit quality of new leases and loans at levels previously attained. Unfavourable economic conditions could also increase funding costs or operating cost structures, limit access to credit facilities, securitizations and other capital markets or result in a decision by lenders not to extend further credit. Sherway, as the operator of a premium brand, new car dealership, could also be negatively affected by deteriorating economic conditions which result in reduced new car sales.

In addition, the leasing and working capital loan industries generally may be affected by changes in accounting treatment for leases and loans, and negative publicity with respect to, among other things, fraud or deceptive practices by certain participants in the industry. Greater governmental scrutiny is also a risk, especially as to the tax treatment of certain transaction structures or other aspects of these transactions that, if changed, could result in additional tax, fee or other revenue to that governmental authority. Any of these factors may make leasing less attractive or diminish the profitability of the existing financing alternatives offered by our operating companies.

In addition to being impacted by factors or conditions in the United States, political economic or other significant events or circumstances outside of North America (whether political unrest which impacts upon the prices of oil and other commodities or otherwise) can ultimately significantly impact upon North American economic conditions which, in turn, could result in the adverse implications described in the first paragraph under this heading. Similarly, natural disasters in any relevant place in the world may directly (through impact on supplies of goods or equipment to our businesses) or indirectly impact upon our operations or results.

#### ***Losses from Leases and Loans***

Losses from leases and loans in excess of our operating companies' expectations would have a material adverse impact on our businesses, financial condition and results of operations, and on the amount of cash available for dividends to our shareholders.

Changes in economic conditions, the risk characteristics and composition of the portfolio, bankruptcy laws, and other factors could impact our operating companies' actual and projected net credit losses and the related allowance for credit losses. Should there be a significant change in the above noted factors, then our operating companies may have to set aside additional reserves which could have a material adverse impact on their respective business, financial condition and results of operations and on the amount of cash available for dividends to our shareholders.

Determining the appropriate level of the allowance is an inherently uncertain process and therefore the determination of this allowance may prove to be inadequate to cover losses in connection with a portfolio of leases and loans. Factors that could lead to the inadequacy of an allowance for credit losses may include the inability to appropriately underwrite credit risk of new originations, effectively manage collections, or anticipate adverse changes in the economy or discrete events adversely affecting specific customers, industries or geographic areas.

#### ***Adverse Events or Legal Determinations in Areas With High Geographic Concentrations of Leases or Loans***

If judicial or other governmental rulings or actions or interpretations of laws adverse to the equipment finance business and/or the working capital loan business in general or to business practices engaged in by our operating companies, or adverse economic conditions or the occurrence of other significant events such as natural disasters and terrorist attacks, were to occur in a geographic region with a high concentration of leases/loans or equipment financed from our operating companies, there could be a material adverse impact on our business, financial condition and results of operation, and the amount of cash available for dividends to our shareholders.

#### ***External Financing***

Our operating subsidiaries depend and will continue to depend on the availability of credit from external financing sources to continue to finance new leases/loans, refinance existing leases/loans and satisfy their other working capital needs. The operating subsidiaries may be unable to obtain additional financing on acceptable terms or at all. If any or all of their funding sources become unavailable on acceptable terms or at all, or if any of their credit facilities are not renewed or re-negotiated upon expiration of their terms, the operating subsidiaries may not have access to the financing necessary to conduct their respective businesses, which would limit their ability to finance their operations.

Although Chesswood is providing Case Funding with funds for its initial financing, and the initial financing for Windset is being accessed through Pawnee's credit facilities, the long-term success of Case Funding and Windset will require that each obtains external financing on acceptable terms. There can be no assurance that external financing will be available.

#### ***"Characterization" Risks***

If an applicable court or regulatory authority were to make an adverse finding, or take an adverse action on the basis that one of Pawnee's form of lease is not a true lease for commercial law, tax law, or other legal purposes, adverse consequences could result

with respect to leases entered into in such form including the loss of preferred creditor status (which would impact upon Pawnee's rights to recover on its claim), limitations on finance charges and other fees that can be enforced, and additional federal, state and other (income or sales) taxes payable by Pawnee.

Case Funding's non-recourse advances may be re-characterized in certain jurisdictions, as loans or determined to be improper fee-splitting, which would adversely affect the collectability of the advances, and the ability to generate future advance originations.

#### ***Defenses to Enforcement of a Significant Number of Leases and Loans***

Certain defenses and recovery impediments are more common in micro and small-ticket equipment finance transactions than with respect to equipment finance providers in other segments of the equipment finance industry. Management believes that certain of these risks are sufficiently addressed in Pawnee's existing documentation and related business practices. However, there are other risks that Pawnee has not addressed for various reasons, including that certain of these risks are not susceptible to being addressed either at all, or without incurring cost inefficiencies or taking other measures deemed unacceptable by Pawnee's management based on a risk-reward assessment. Pawnee has never experienced any material occurrence of these risks nor have these risks historically had a material adverse impact on Pawnee. However, there is no assurance that these risks will not have a material adverse impact on Pawnee's business, financial condition and results of operations in the future.

#### ***Origination, Funding and Administration of Transactions***

Our operating companies' origination, funding and transaction administration practices could result in certain vulnerabilities in its enforcement rights. For example, certain leases and loans are assignments of transactions already documented by its brokers. Acquiring leases/loans by this "indirect" process subjects our operating companies to various risks, including risks that might arise by reason of the broker's insolvency, administrative inadequacies or fraudulent practices, as well as any third party claims against the broker or its rights with respect to the assigned lease or loan. Any of these broker related risks can impair our operating companies' rights with respect to recovering the rents and/or property under its leases and loans. Pawnee has not been involved in any claims or litigation in relation to such risks and Pawnee does not conduct lien searches in the name of, require lien releases from, or file financing statements against the lease broker.

If the lessee/borrower or broker is the party to whom the vendor of the equipment has agreed to sell the property at the time of its delivery, then, under applicable commercial law, the lessee/borrower or broker, as applicable, may be deemed to have acquired title to the property prior to Pawnee's having funded the transaction. It has not been Pawnee's practice to ensure that the title to the leased property has not already passed or to obtain assurances that it is acquiring good title to that property free of liens and other third party claims. The manner in which Pawnee purchases the equipment is typical in this market segment, especially with respect to similarly situated equipment financing providers. Pawnee has not yet faced any meaningful challenge or adverse consequence from this practice, but there can be no assurance that such a challenge or consequence will not occur in the future.

In most circumstances where the equipment is less than U.S.\$15,000 (or U.S.\$10,000 if for a home business) for Pawnee's core product and U.S.\$35,000 for the "B+" product, Pawnee's practice of requiring only a verbal confirmation that the property has been delivered and irrevocably accepted under the subject lease or loan, and/or inspecting the property to confirm the same, could make Pawnee vulnerable to certain defenses. By way of example, Pawnee's deemed failure to deliver conforming property under the lease or loan documents could be a defense to a lessee/borrower's "unconditional" obligation to pay the rents and certain other amounts. Pawnee has not suffered any material losses relating to these practices, however, there can be no assurance that it would not in the future.

#### ***Changes in Governmental Regulations, Licensing and Other Laws and Industry Codes of Practice***

Finance companies are subject to laws and regulations relating to extending financing generally and are also members of industry associations which have adopted, among other things, codes of business practice. Laws, regulations and codes of business practice may be adopted with respect to existing leases and loans or the leasing, marketing, selling, pricing, financing and collections processes which might increase the costs of compliance, or require it to alter its respective business, strategy or operations, in a fashion that could hamper the ability to conduct business in the future.

A change in laws applicable to tort claims may reduce the availability of appropriate cases for Case Funding to underwrite.



***Licensing Requirements***

If an applicable court or regulatory authority were to make an adverse finding or otherwise take adverse action with respect to our operating companies based on their failure to have a finance lender's or other license or registration required in the applicable state, our operating companies would have to change business practices and could be subject to financial or other penalties.

***Fees, Rates and Charges***

Some of our operating companies' documents often require payment of late payment fees, late charge interest, and other charges either relating to the non-payment, or enforcement of its leases and loans. It could be determined that these fees and/or the interest rates charged exceed applicable statutory or other legal limits. If the charges are deemed to be punitive and not compensatory, or to have other attributes that are inconsistent with, or in violation of, applicable laws, they could be difficult to enforce. A number of charges payable with respect to equipment finance transactions in the micro and small-ticket equipment finance market have been the subject of litigation by customers against financing parties over the past few years. Although our subsidiaries are not currently the subject of any such litigation, there can be no assurance that a lessee/borrower or a group of lessees/borrowers will not attempt to bring a lawsuit against our subsidiaries in relation to fees and charges, which our subsidiaries may or may not be successful in defending.

Our operating companies believe that fee programs are designed and administered so as to comply with legal requirements and are within the range of industry practices in their market segments. Nevertheless, certain attributes of these fees or charges, and their practices, including that its leases and loans typically provide for several different fees and charges resulting in a substantial amount of fee income and the possibility that the fees and charges may exceed actual costs involved or may otherwise be deemed excessive, could attract litigation, including class actions, that would be costly even if our subsidiaries were to prevail and as to which no assurance can be given of their successful defense. In addition to the risk of litigation, fee income is important to our subsidiaries and the failure of our subsidiaries to continue to collect most or all of these fees could have a material adverse impact on our business, financial condition and results of operations, and on the amount of cash available for dividends to our shareholders.

***Possible Acquisitions***

The growth strategy for the Company includes seeking out acquisitions in the financial services industries. Acquisitions, if they occur, may increase the size of the operations as well as increase the amount of indebtedness that may have to be serviced by Chesswood and its subsidiaries. There is no assurance that such acquisitions can be made on satisfactory terms, or at all. The successful integration and management of acquired businesses involve numerous risks that could adversely affect the growth and profitability of Chesswood and its subsidiaries. There is no assurance that such acquisitions will be successfully integrated.

***Insurance***

To ensure that the lessor or funder of the leased or financed property suffering a loss receives the related insurance proceeds, the lease or loan also requires that the lessor or funder be named as a loss payee under the requisite casualty coverage. However, each lessee/borrower is ultimately relied upon to obtain and maintain the required coverage for financed equipment but there is no certainty that they will obtain the requisite coverage either conforming to the requirements of the lease or loan, or at all. Additionally, there are often policy provisions including exclusions, deductibles and other conditions that by their terms, or by reason of a breach, could limit, delay or deny coverage. There can be no assurance that any insurance will protect our operating company's interest in the equipment, and the failure by the lessee/borrower to obtain insurance or the failure by the operating companies to receive the proceeds from such insurance policies could have a material adverse impact on our business, financial condition and results of operations, and on the amount of cash available for dividends to our shareholders.

***Lessor Liability***

There is a risk that a lessor, such as Pawnee or Northstar, could be deemed liable for harm to persons or property in connection with, among other things, the ownership or leasing of the leased property, or the conduct or responsibilities of the parties to the lease relating to that property. The liability may be contractual (such as warranties regarding the equipment), statutory such as federal, state or provincial environmental liability or pursuant to various legal theories (such as negligence). There have been cases in which a lessor has been held responsible for damage caused by leased property without a showing of negligence or wrong-doing on the lessor's part. Even if a lessor ultimately succeeds in defending itself or settling any related litigation, the related costs and any settlement amount could be significant.

***Liability for Misuse of Leased Equipment***

There is no practical manner to ensure that leased equipment or a leased vehicle will be used, maintained or caused to comply with applicable law. Pawnee and Northstar requires its lessees to deliver evidence of compliance with same as a condition to funding but has no assurance that a lessee will take the appropriate actions during the lease term to address any use, maintenance or compliance issues which may arise. A lessee's conduct (or lack thereof) could subject Pawnee or Northstar, as applicable, to liability to third parties.

***Estimates Relating to Value of Leases***

Based on the particular terms of a lease, equipment finance companies estimate the residual value of the financed equipment, which is recorded as an asset on its statement of financial position. At the end of the lease term, equipment finance companies seek to realize the recorded residual for the equipment by selling the equipment to the lessee or in the secondary market or through renewal of the lease by the lessee. The ultimate realization of the recorded residual values depends on numerous factors, including: accurate initial estimate of the residual value; the general market conditions and interest rate environment at the time of expiration of the lease; the cost of comparable new equipment; the obsolescence of the leased equipment; any unusual or excessive wear and tear on or damage to the equipment; and the effect of any additional or amended government regulations.

If Pawnee or Northstar (in connection with those leases where the lessee is not obligated to either purchase the equipment or guarantee the residual value of the equipment at the end of the term of the lease) is unable to accurately estimate or realize the residual values of the leased equipment subject to their leases, the amount of recorded assets on its statement of financial position will have been overstated.

***Competition From Alternative Sources of Financing***

The business of micro and small-ticket equipment finance in the United States is highly fragmented and competitive. Pawnee focuses its business on the segment of the micro and small-ticket equipment finance market involving start-up businesses that have not established business credit or established businesses that have experienced some credit difficulty in their history that do not meet the credit standards of more traditional financing sources. Pawnee's main competition comes from leasing companies, home equity loans, and credit cards.

If Pawnee expands its suite of products to target potential lessees with higher credit scores or if the creditworthiness of its potential customers increases for various external reasons, it can expect to face competition from more traditional financing sources as well, including: national, regional and local finance companies; captive finance and equipment finance companies affiliated with major equipment manufacturers; and financial services companies, such as commercial banks, thrifts and credit unions.

Many of the firms and institutions providing financing alternatives are substantially larger than Pawnee and have considerably greater financial, technical and marketing resources. Some of them may have a lower cost of funds and access to funding sources that are unavailable to Pawnee. A lower cost of funds could enable a competitor to offer leases with pricing lower than that of Pawnee, potentially forcing Pawnee to decrease its prices or lose origination volume. In addition, some financing sources may have higher risk tolerances or different risk assessments, which could allow them to establish more origination sources and customer relationships to increase their market share. Please also see "Outlook" above.

Further, because there are fewer barriers to entry with respect to the micro and small-ticket equipment finance market, new competitors could enter this market at any time, especially if an improvement in the economy leads to a greater ability of small businesses to establish improved levels of creditworthiness.

Similarly, competition from a variety of other funding sources may result in a decrease in demand for Case Funding's, Windset's and Northstar's financing products.

***Fraud by Lessees, Borrowers, Vendors or Brokers***

While our operating companies makes every effort to verify the accuracy of information provided to it when making a decision whether to underwrite a lease or loan and has implemented systems and controls to protect itself against fraud, in a small number of cases in the past our operating companies have been a victim of fraud by lessees/borrowers, vendors and brokers. In cases of fraud, it is difficult and often unlikely that our operating companies will be able to collect amounts owing under a lease or loan or

repossess the related equipment. Increased rates of fraud could have a material adverse impact on our business, financial condition and results of operations, and on the amount of cash available for dividends to our shareholders.

Case Funding may face similar risks with respect to information provided to it by attorneys and plaintiffs.

#### ***Protection of Intellectual Property***

Chesswood's operating subsidiaries continually develop and improve their brand recognition, which are an important factor in maintaining a competitive position. No assurance can be given that others will not independently develop substantially similar branding. Despite the efforts of our operating subsidiaries to protect their proprietary rights, unauthorized parties may attempt to obtain and use information that they regard as proprietary. Stopping unauthorized use of such proprietary rights may be difficult, time-consuming and costly. There can be no assurance that our operating subsidiaries will be successful in protecting their proprietary rights.

#### ***Uncertainty of Outcome of Cases***

The returns on loans and/or advances made by Case Funding, and thus the returns for Chesswood, depend on litigation outcomes in the form of judgments or settlements. Litigation of individual cases entails a large degree of uncertainty, including (1) the legal liability of the defendant, (2) the level of actual or perceived damages assessed by a judge or a jury, (3) the ability of the defendant, or the defendant's insurance company, to pay a settlement or judgment, (4) the abilities of plaintiff's counsel, (5) the assessment of fault and causation, (6) the legal nature of the claim, and (7) the amount of monetary damages ultimately awarded. It is also possible that a claimant may die or abandon his or her case, that the lawyer may abandon the plaintiff's case, or that the defendant, the law firm, or the defendant's insurance carrier may declare bankruptcy. Case Funding is also reliant on the capabilities of the attorneys handling the cases in which it provides funding to effectively litigate claims with due skill and care. If an attorney fails to perform his or her duties effectively, the outcome of the case could be negatively impacted, which could have a material adverse effect on Case Funding's level of returns. Any negative event, including but not limited to those described above, may prevent Case Funding from realizing expected returns. While Case Funding undertakes to review the capabilities, experience and track records of the attorneys litigating cases it is considering for its loans, there is no guarantee that the actual outcome of a case will be in line with the expected outcome of that case, and Case Funding will not have any right to control, influence or manage the litigation or settlement of a case. Although Case Funding will seek to weigh such uncertainties in the due diligence conducted before making a funding decision, and intends to reduce risk by funding in a broad array of cases, there can be no assurance that the outcome of any given litigated claim or basket of claims can be predicted, whether or not the probabilities were correctly assessed by Case Funding.

#### ***Uncertainty in the Timing of Litigation Settlements and Awards***

The nature of litigation recoveries, including the timing and amounts recovered, are outside the control of Case Funding. Individual claims may be resolved over drastically varying times: for example, as short as one month, or longer than three years. Case Funding will be required to wait for an indeterminate period of time after an advance/loan is made to fully collect money from judgment recoveries. Once an advance/loan is made, the collection cycle is out of Case Funding's control. Therefore, there is no assurance as to collection times, and collections will likely be irregular. Also, there is no guarantee that Case Funding will be able to achieve results that will permit it to generate any particular rates of return in any given period. Case Funding may experience significant fluctuations in its operating results and cash flows from period to period due to a number of factors, including the changes in value of the advances/loans that it makes, and the collection and recognition of recoveries of its loans and returns. This may affect the amount of funds available each quarter for dividend payments.

#### ***Case Funding May Have Difficulty Collecting on its Investments***

If plaintiffs or law firms to which Case Funding has advanced or loaned funds, do not pay Case Funding pursuant to the terms of the advances/loans made, Case Funding may be required to pursue costly legal actions to collect. It is also possible that a plaintiff's attorney or a law firm may attempt to renegotiate the ultimate amount owed to Case Funding or that there is not enough proceeds from the case to repay Case Funding in full. In these situations, Case Funding may accept a smaller return than anticipated in order to accommodate and maintain business relationships or avoid litigation. In either event, the failure of Case Funding to collect or the necessity of legal action to collect could ultimately harm or reduce the potential cash flow.

***Limited Underwriting Experience or Underwriting Errors***

Case Funding and Windset have a limited history of precedents upon which to base its case and loan evaluation. While the Company believes that its management and underwriters have the experience to evaluate borrowers, plaintiffs, cases, and attorney loans, Case Funding and Windset are newer entities and thus has limited history in underwriting upon which shareholders may rely. There is no guarantee that Case Funding and Windset will be able to successfully assess the merits of all loans and cases for which it provides funding, which, in turn, could adversely affect the financial results and cash flows of the business and/or Chesswood.

Case Funding and Windset may fail to correctly apply their own underwriting standards for a loan and/or advance, or may fail to account for or identify a material risk factor which could impact the success or value of a loan and/or advance thereby impacting the value of the Company's interests in such a loan and/or an advance.

***Case Funding may be Unable to Obtain Key Information about Cases***

Case Funding's need for information about a case during its due diligence review may potentially result in an adverse outcome on the examined case. In general, communications between a client and the client's attorney are privileged. However, Case Funding requires certain information to assess the case. Case Funding keeps such information and communications confidential, but a court may determine that the disclosure of such communications to Case Funding amounts to a waiver by the client of the privilege attached to such information or documents. If this were to occur, the defendant may have the right to discover such communications and use them against the plaintiff in the course of the lawsuit. Alternatively, the prospect of a waiver of privilege may cause the plaintiff or the plaintiff's attorney to withhold key information about the case from Case Funding in order to preserve the privilege. Therefore, the inability of Case Funding to obtain the information it needs to assess the case, or the possibility that privileged information could be discoverable by the defendants and used against the plaintiff, may increase the likelihood of negative outcomes on a loan and/or advance in that case.

***Ethics and Legal Restrictions Vary by State***

There have traditionally been legal and professional ethics restrictions on legal financing in the United States. These include the general prohibition from purchasing claims from plaintiffs (known as maintenance, as well as a form of maintenance called champerty), restrictions on assignment of certain kinds of claims, and ethical restrictions on participating in a lawyer's contingent fee interests (including ethical rules against sharing fees with non-lawyers). Maintenance prohibits the maintaining, supporting, promoting or assisting of another person's lawsuit, with money or otherwise. Champerty makes it illegal for a stranger to acquire a party's right to sue. States impose different rules regarding champerty and maintenances. If Case Funding were to be found in violation of a state's maintenance or champerty laws it could have a material adverse effect on the results of its loans and/or advances. Courts in any or all of the jurisdictions in which the loans and/or advances are made may conclude that Case Funding's loans and/or advances constitute "champerty" or "maintenance." Such a conclusion could make agreements with plaintiffs voidable, subject to fines or other sanctions, or otherwise negatively impact results. Due to these and similar rules, a number of states will not permit loans and/or advances like those Case Funding would typically make, and therefore Case Funding is limited in which states it may make loans and/or advances, which reduces the available funding opportunities. In other states, the funding of legal claims has not been considered by the courts or ethics authorities, nor specifically addressed by statute. In these situations, Case Funding may rely only on its own analysis as to the legality of loans and/or advances in these jurisdictions. Regardless of its analysis as to such legality, in jurisdictions where no legal or ethical guidance is available, Case Funding's loans and/or advances may be open to challenge, a reduction in value, or even cancellation, which would adversely impact financial results and the cash flow.

United States federal or state governmental bodies may enact laws limiting the rights of injured victims to sue or be compensated under some or all circumstances. Any such action could substantially limit or prevent entirely future funding opportunities for Case Funding. Changes in law or ethical rules in jurisdictions where restrictions on the types of loans and/or advances made by Case Funding currently do not apply could further reduce or limit opportunities for Case Funding to make loans and/or advances, or could result in the diminution or elimination of the value of the loans and/or advances already made by Case Funding in those jurisdictions.

***Evaluation and Disclosure of Cases and Case Performance***

Details of actual cases that Case Funding has funded in or intends to fund in will not be disclosed on a named basis to Shareholders, and in any event not all information relevant to the evaluation of any case will be permitted by law or professional ethics codes of conduct to be made available to Case Funding or the Shareholders. In particular, any sharing with Case Funding or the Shareholders of confidential information protected by attorney-client privilege or by attorney work-product doctrine could waive all protection of that information. Such waiver could severely damage the value of the underlying claim by giving the opponent access to sensitive information. Any agreement to share with Shareholders any information and evidence related to the case could preclude the plaintiff from entering into confidentiality agreements with co-plaintiffs in the same matter. Such sharing could also make discovery from the adverse party problematical as most discovery is covered by court-issued protective orders that ensure the confidentiality of all parties. A breach of a protective order could subject a party to serious sanctions that would impact the value of the underlying claim. In some instances, case settlements and case prospects will be confidential and/or subject to lawyer-client privilege. Accordingly, Shareholders will not have an opportunity to evaluate for themselves cases in which Case Funding intends to or does fund, and therefore Shareholders will be dependent upon the judgment and ability of Case Funding. The valuation of each potential loan or advance will be subject to policies adopted by Case Funding and may not reflect the actual financial prospects of such loan or advance at any given time.

***Concentration Risk***

Certain loans may represent a significant proportion of Case Funding's total assets. As a result, the impact on Case Funding's performance and the potential returns will be more adversely affected if any one of those loans were to perform badly, than would be the case if Case Funding's portfolio of loans were more diversified.

***Failure of Computer and Data Processing Systems***

Our operating companies are dependent upon the successful and uninterrupted functioning of their computer and data processing systems. The failure of these systems could interrupt operations or materially impact upon the ability of our operating subsidiaries to originate and service their lease and loan portfolio and broker networks. If sustained or repeated, a system failure could negatively affect these operations. Our operating companies maintain confidential information regarding lessees and borrowers in their computer systems. This infrastructure may be subject to physical break-ins, computer viruses, programming errors, attacks by third parties or similar disruptive problems. A security breach of computer systems could disrupt operations, damage reputation and result in liability.

***Competition in the Automobile Retailing Industry***

The automobile retailing industry is competitive. In large metropolitan areas, consumers have a number of choices in deciding where to purchase a new or used vehicle and where to have such vehicle serviced.

***Manufacturers' Control Over Dealerships and the Acura Framework Agreement***

Automobile dealerships operate pursuant to dealer agreements with automobile manufacturers. Through the terms and conditions of these dealer agreements, automobile manufacturers exert considerable influence over the operations of dealerships.

The success of an automobile dealership is highly dependent upon the overall success of the line of vehicles that each dealership sells. Sherway's business is affected to varying degrees by the demand for its manufacturer's vehicles, and by the financial condition, management, marketing, production and distribution capabilities of such manufacturers. In addition, the timing, structure and amount of manufacturer incentives may impact the timing and profitability of sales transactions. Events such as labour disputes and other production disruptions that may adversely affect a manufacturer may also adversely affect Sherway. Similarly, the delivery of vehicles from manufacturers later than scheduled or diminished availability to Sherway of popular makes, models and/or accessories, which may occur particularly during periods of new product introductions, can lead to reduced sales during such periods. Moreover, any event that causes adverse publicity involving such manufacturers may have an adverse effect on Sherway.

***Security Risks***

Despite implementation of network security measures similar to most other on-line e-commerce sites, the infrastructure of the website and the Company's management network is potentially vulnerable to computer break-ins and similar disruptive problems.



***Cyclical and Seasonality***

Sales of motor vehicles, particularly new vehicles, historically have been subject to cyclical and seasonal variations. Management believes that the industry is affected by many factors, including general economic conditions, consumer confidence, and the level of personal discretionary spending, interest rates and credit availability. There can be no assurance that the industry will not experience sustained periods of decline in vehicle sales, particularly new vehicle sales, in the future.

***Imported Products***

A significant portion of the new vehicle business of Sherway involves the sale of vehicles, parts or vehicles composed of parts that are manufactured outside North America. As a result, the operations of Sherway are subject to customary risks of selling imported merchandise, including fluctuations in the value of currencies, changes in import duties, exchange controls, trade restrictions, work stoppages and general political and economic conditions in foreign countries.

***Environmental Matters***

Sherway is subject to a wide range of federal, provincial and local environmental laws and regulations, including those governing discharges to the air and water, the storage of petroleum substances and chemicals, the handling and disposal of wastes and the remediation of contamination arising from spills and releases. As with automobile dealerships generally, and parts, service and collision service centre operations in particular, Sherway's business involves the generation, use, handling and disposal of hazardous or toxic substances or wastes.

Environmental laws and regulations have become very complex and it has become very difficult for businesses that routinely handle hazardous and non-hazardous wastes to achieve and maintain full compliance with all applicable environmental laws. From time to time, Sherway can be expected to experience incidents and encounter conditions that will not be in compliance with environmental laws and regulations.

However, Sherway has not been subject to any material environmental liabilities in the past and it is not anticipated that any material environmental liabilities will be incurred by it in the future. In addition, to minimize the risk of environmental liability related to acquired dealerships, Sherway intends to obtain environmental studies on such dealerships as a condition to their acquisition.

Environmental laws and regulations and their interpretation and enforcement are changed frequently and the trend of more expansive and stricter environmental legislation and regulations is likely to continue. Hence, there can be no assurance that compliance with environmental laws or regulations or the future discovery of unknown environmental conditions will not require additional expenditures or that such expenditures would not be material.

***Risks Related to our Structure and Exchange Rate Fluctuations***

The dividends expected to be paid to our shareholders will be denominated in Canadian dollars, however, a significant percentage of our revenues are expected to be derived from the U.S. dollar revenues of our U.S. operating subsidiaries, which are in U.S. dollars. Changes in the value of the U.S. dollar could have a negative impact on the amount in Canadian dollars available for dividends to our shareholders.

***Unpredictability and Volatility of Share Price***

A publicly-traded company will not necessarily trade at values determined by reference to the underlying value of its business. The prices at which the Common Shares will trade cannot be predicted. The market price of the Common Shares could be subject to significant fluctuations in response to variations in quarterly operating results and other factors. The annual yield on the Common Shares as compared to the annual yield on other financial instruments may also influence the price of Common Shares in the public trading markets. In addition, the securities markets have experienced significant price and volume fluctuations from time to time in recent years that often have been unrelated or disproportionate to the operating performance of particular issuers. These broad fluctuations may adversely affect the market price of the Common Shares.

### ***Leverage, Restrictive Covenants***

Pawnee, Northstar and Sherway have third party debt service obligations under their respective credit facilities. The degree to which our subsidiaries are leveraged could have important consequences to our shareholders, including: (i) the ability of such subsidiaries to obtain additional financing for working capital in the future may be limited; (ii) a portion of the cash flow from the assets of such subsidiaries may be dedicated to the payment of the principal of and interest on their respective indebtedness, thereby reducing funds available for distribution to the Company; and (iii) certain of the respective borrowings of such subsidiaries will be at variable rates of interest, which will expose them to the risk of increased interest rates. The ability of such subsidiaries to make scheduled payments of the principal of or interest on, or to refinance, their indebtedness will depend on their future cash flow, which is subject to their respective assets, prevailing economic conditions, prevailing interest rate levels, and financial, competitive, business and other factors, many of which are beyond their control.

### ***Restrictions on Potential Growth***

The payout by our operating companies of a significant portion of their earnings available for distribution will make additional capital and operating expenditures dependent upon increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of our operating companies and their cash flow.

### ***Canadian Income Tax Matters***

The income of the Company and its related entities must be computed in accordance with Canadian and foreign tax laws, as applicable, and the Company is subject to Canadian tax laws, all of which may be changed in a manner that could adversely affect the amount of distributable cash.

### ***United States Income Tax Matters***

There can be no assurance that U.S. federal income tax laws and administrative policies will not develop or be changed in a manner that adversely affects our shareholders.

## **RELATED PARTY TRANSACTIONS**

1) Pawnee leases a 10,800 square foot office facility. The lessor is a related party because of common ownership between itself and the holders of the Class B and C common shares of U.S. Acquisitionco (the subsidiary through which the Company holds its interest in Pawnee). Minimum lease payments are U.S. \$212,890 per annum, triple net. The lease expires on April 30, 2016, and contains an option to renew for an additional five year term. The expense is included in general and administrative expense and is translated at the average exchange rate for the period. At December 31, 2013 and December 31, 2012 there was no amount payable in respect of the lease.

2) Case Funding provides Quick Cash Inc. ("Quick Cash"), an entity controlled by a director of Case Funding and the CEO of Case Funding, with personnel and facilities to manage the portfolio of existing loans managed by Quick Cash and required origination and placement services in respect of future loans (Quick Cash is prohibited from making loans, other than those which Case Funding does not wish to make and Quick Cash is responsible for all out-of-pocket third party fees and expenses relating to its business).

Payments received for services provided will be as follows:

Months	Amount per month (\$ thousands)
January 2012 – June 2012	\$16
July 2012 – June 2013	\$4
July 2013 – June 2014	\$1

This revenue is recorded in Ancillary finance and other fee income. The amounts were determined at the time of Case Funding's acquisition and reflect negotiated market terms and the expected level of administrative services that will be provided to Quick Cash over the term of the agreement.

## CONTROLS & PROCEDURES

Chesswood's Chief Executive Officer and Director of Finance evaluated, or caused an evaluation under their supervision, of the design and operating effectiveness of the Company's disclosure controls and procedures (as defined in National Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings) as at December 31, 2013 and have concluded that the disclosure controls and procedures were appropriately designed and have been effective, subject to the weaknesses described below.

Chesswood has also established internal controls over financial reporting (as defined in National Instrument 52-109) ("ICFR") to provide reasonable assurance regarding the reliability of the Company's financial reporting and preparation of its financial statements for external purposes in accordance with GAAP. The Company's Chief Executive Officer and Director of Finance assessed, or caused an assessment under their supervision, of the design and operating effectiveness of the Company's ICFR as at December 31, 2013 using the Committee of Sponsoring Organizations Internal Control - Integrated Framework. Based on that assessment, it was determined that the Company's ICFR was designed appropriately and was effective with the below noted exceptions.

The Company's audit committee is working with management on its independent review regime and monitoring the implementation of the other control enhancement steps envisioned below.

### Weakness of Controls

Based on management's evaluation of controls, it was concluded that the Company's disclosure controls and procedures and its ICFR had some weaknesses. A material weakness is defined as a deficiency, or a combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim consolidated financial statements will not be prevented or detected on a timely basis. The weaknesses in disclosure controls and procedures and ICFR, and the additional processes undertaken to address such weaknesses, can be summarized as follows:

#### 1) Segregation of Duties

Given the Company's size, it has limited resources within the finance department at head office to adequately segregate duties and to permit or necessitate the comprehensive documentation of all policies and procedures that form the basis of an effective design of ICFR. As a result, the Company is reliant on the knowledge of a limited number of employees and on the performance of mitigating procedures during its financial close process to ensure that the consolidated financial statements are presented fairly in all material respects. Although the finance department of Pawnee has staffing levels which the Company's management believes is appropriate in the context of the scope of Pawnee's operations, and although the individuals comprising the members of the Company's management and Pawnee's management responsible for financial reporting are considered to have appropriate proficiency and experience to effectively perform their respective duties, the nature and size of the Company's operations are such that the duties are performed by a small number of persons. While management of the Company believes that the flow of information and degree of consultation with the finance personnel of Pawnee is significant, in order to mitigate the risk of material misstatement in the consolidated financial statements, the Company implemented additional review and monitoring controls at head office on a monthly basis, and at Pawnee on a quarterly basis, beginning in the second quarter of 2009. In addition, further steps to cross train existing personnel have been undertaken where possible.

#### 2) Information Technology Controls

Due to the relatively small size of the Company, the Company has not been able to maintain effective controls over certain key end user computing applications, such as spreadsheets, used in the Company's financial reporting process as well as appropriate security controls to manage access to key information. Controls pertaining to access profiles and password protocols require revision to mitigate the risk of inappropriate access to systems and applications. In addition, improvements to exception reporting are required to ensure that any unauthorized modification of the data or formulas within spreadsheets is identified and reported. It should be noted that the foregoing weaknesses relate to the Company and its systems and that Pawnee's systems are believed to be more commensurate with the scope of its operations.

Given the above noted weaknesses, the Company has performed additional analyses and other post-closing procedures to ensure the consolidated financial statements are prepared accurately and completely and that the disclosed data is in accordance with GAAP.

### 3) Anti-fraud controls

As a result of the lack of segregation of duties at the Company level as described above, the anti-fraud controls are limited. While management found no evidence of fraudulent activity, the Director of Finance has access to both accounting records and corporate assets, principally the operating bank account, and prepares journal entries without any independent review. Management feels the existing signing authorities and current review of bank balances is sufficient to mitigate the risk.

No changes were made to the design of the Company's ICFR during the quarter ended December 31, 2013 that would have materially affected or would be reasonably likely to materially affect the Company's ICFR.

It should be noted that a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, including instances of fraud, if any, have been detected. These inherent limitations include, amongst other items: (i) that management's assumptions and judgments could ultimately prove to be incorrect under varying conditions and circumstances; (ii) the impact of undetected errors; and (iii) controls may be circumvented by the unauthorized acts of individuals, by collusion of two or more people, or by management override.

The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential (future) conditions.

## MARKET FOR SECURITIES

The Company's convertible debentures due December 31, 2018 are traded on the Toronto Stock Exchange under the symbol CHW.DB. Trading in the convertible debentures only commenced on December 16, 2013. During the 10 business day period ending December 31, 2013, the highest price was \$103.40 and the lowest price was \$97.75.

The Common Shares are traded on the Toronto Stock Exchange under the symbol CHW. The following table summarizes the high and low sales prices of the Common Shares and the average daily trading volume for each month in the year ended December 31, 2013, as reported by the Toronto Stock Exchange.

2013	High	Low	Average Daily Volume
January	\$9.30	\$8.86	6,024
February	\$9.67	\$8.90	34,417
March	\$9.98	\$9.37	10,372
April	\$11.00	\$9.70	14,445
May	\$12.30	\$10.11	21,734
June	\$11.20	\$10.10	8,578
July	\$12.49	\$10.72	8,658
August	\$12.95	\$11.06	11,583
September	\$12.90	\$11.99	8,922
October	\$13.96	\$12.56	12,738
November	\$16.72	\$13.80	25,183
December	\$18.75	\$14.07	18,313
	<u>\$18.75</u>	<u>\$8.86</u>	<u>14,818</u>

**ADDITIONAL INFORMATION**

Additional information about Chesswood is available:

- At the [www.chesswoodgroup.com](http://www.chesswoodgroup.com) website
- At the [www.sedar.com](http://www.sedar.com) website
- Via email to [investorrelations@chesswoodgroup.com](mailto:investorrelations@chesswoodgroup.com), or
- Via phone at 416-386-3099



## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of Chesswood Group Limited and all of the information in this Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by Management in accordance with International Financial Reporting Standards. These statements include some amounts that are based on best estimates and judgment. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Financial information used elsewhere in the Annual Report is consistent with that in the financial statements. The MD&A also includes information regarding the impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from our present assessment of this information because future events and circumstances may not occur as expected.

Chesswood Group Limited's policy is to maintain systems of internal accounting and administrative controls of high quality, consistent with reasonable cost. Such systems are designed to provide reasonable assurance that the financial information is relevant, accurate and reliable and that the Corporation's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and is ultimately responsible for approving the financial statements. The Board carries out this responsibility principally through its Audit Committee.

As more fully detailed in the accompanying MD&A, based on an assessment of the Corporation's ICFR using the Committee of Sponsoring Organizations Internal Control Integrated Framework, it was concluded that the Corporation's ICFR had certain weaknesses. Given the relatively small size of the Corporation's head office finance department personnel, the ICFR assessment concluded that (i) there were limited resources to adequately segregate duties and to permit or necessitate the comprehensive documentation of all policies and procedures that form the basis of an effective design of ICFR, (ii) the Corporation (at its head office) had not maintained effective controls over certain key end-user computer applications and appropriate security controls to manage access to key information, profiles and password protocols, and that improvement to exception reports were required and (iii) as a result of the lack of segregation of duties as referred to above, the anti-fraud controls are limited. It was also determined that the Corporation's whistle-blower policy had not been provided to part-time sales and mechanical staff at the Corporation's automotive dealership.

In order to mitigate the risk of material misstatement in the Corporation's consolidated financial statements, the Corporation (i) has additional review and monitoring controls at head office on a monthly basis and (ii) performs additional analysis and other post-closing procedures. No material exceptions were noted based on the year end procedures and no evidence of fraudulent activity was found.

The Audit Committee is appointed by the Board and is comprised of a majority of outside Directors. The committee meets periodically with Management and the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues to satisfy itself that each party is properly discharging its responsibilities. The Audit Committee reviews the Corporation's annual consolidated financial statements, the external auditors' report and other information in the Annual Report. The committee reports its findings to the Board for consideration by the Board when it approves the consolidated financial statements for issuance to the shareholders.

The consolidated financial statements have been audited by BDO Canada LLP, the independent external auditors, in accordance with generally accepted auditing standards on behalf of the Shareholders. The Auditors' Report outlines the nature of their examination and their opinion on the consolidated financial statements. BDO Canada LLP has full and unrestricted access to the Audit Committee to discuss their audit and related findings as to the integrity of the financial reporting.



Barry Shafran  
President & CEO  
March 7, 2014

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## Independent Auditor's Report

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### To the Shareholders of Chesswood Group Limited

We have audited the accompanying consolidated financial statements of Chesswood Group Limited, which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years ended December 31, 2013 and December 31, 2012, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Chesswood Group Limited as at December 31, 2013 and December 31, 2012 and its financial performance and its cash flows for the years ended December 31, 2013 and December 31, 2012 in accordance with International Financial Reporting Standards.

*BOO Canada LLP*

Chartered Accountants, Licensed Public Accountants

March 7, 2014  
Toronto, Ontario

**CHESSWOOD GROUP LIMITED**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
(in thousands of dollars)

	Note	December 31, 2013	December 31, 2012
<b>ASSETS</b>			
Cash	5	\$ 22,659	\$ 5,591
Accounts receivable	6	1,199	771
Inventories	7	7,836	7,881
Prepaid expenses and other assets	8	1,800	985
Finance receivables	9	159,301	124,250
Deferred tax assets	24(c)	832	359
Property and equipment	14	1,215	893
Intangible assets	15	7,026	6,795
Goodwill	16	14,653	13,870
<b>TOTAL ASSETS</b>		<b>\$ 216,521</b>	<b>\$ 161,395</b>
<b>LIABILITIES</b>			
Accounts payable and other liabilities	17	\$ 7,096	\$ 8,260
Vehicle financing	18	6,368	6,199
Interest rate swaps	19	1,201	2,489
Borrowings	20	77,305	47,577
Customer security deposits	21	11,830	10,994
Convertible debentures	22	20,680	—
Deferred tax liabilities	24(d)	23,883	25,321
		<b>148,363</b>	<b>100,840</b>
<b>SHAREHOLDERS' EQUITY</b>			
Common shares	25	45,169	44,215
Non-controlling interest		10,114	9,357
Reserve - share-based compensation	26	3,909	3,160
Accumulated other comprehensive income (loss)		953	(1,883)
Retained earnings		8,013	5,706
		<b>68,158</b>	<b>60,555</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>\$ 216,521</b>	<b>\$ 161,395</b>

Approved by the Board of Directors



Fred Steiner, Chairman



Clare R Copeland

*Please see notes to the consolidated financial statements.*

**CHESSWOOD GROUP LIMITED**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**  
(in thousands of dollars, except per share amounts)

	<i>Note</i>	<b>2013</b>	<b>2012</b>
<b>Finance revenue</b>			
Interest revenue on finance leases and loans		\$ 37,128	\$ 31,062
Ancillary finance and other fee income		5,580	4,886
		<u>42,708</u>	<u>35,948</u>
<b>Finance expenses</b>			
Interest expense		4,016	3,414
Provision for credit losses		6,495	5,279
		<u>10,511</u>	<u>8,693</u>
<b>Finance margin</b>		<u>32,197</u>	<u>27,255</u>
<b>Revenue - automotive operations</b>		<u>52,031</u>	<u>50,648</u>
<b>Cost of sales - automotive operations</b>			
Change in inventories		46	(1,802)
Automobiles, parts, and other costs		44,940	46,230
Interest expense		162	239
		<u>45,148</u>	<u>44,667</u>
<b>Automotive gross margin</b>		<u>6,883</u>	<u>5,981</u>
<b>Gross margin before expenses</b>		<u>39,080</u>	<u>33,236</u>
<b>Expenses</b>			
Personnel expenses		11,035	10,026
Other expenses		7,802	6,693
Amortization - property and equipment	14	193	179
Amortization - intangible assets	15	169	500
		<u>19,199</u>	<u>17,398</u>
<b>Income before undernoted items</b>		<u>19,881</u>	<u>15,838</u>
Contingent consideration		—	725
Financing costs - convertible debentures	22	(2,035)	—
Unrealized gain on interest rate swaps	19	1,413	7
Unrealized gain on foreign exchange		478	57
<b>Income before taxes</b>		<u>19,737</u>	<u>16,627</u>
Provision for taxes	24	(8,832)	(7,638)
<b>Net income</b>		<u>\$ 10,905</u>	<u>\$ 8,989</u>
<b>Attributable to:</b>			
Common shareholders		\$ 9,497	\$ 7,815
Non-controlling interest		\$ 1,408	\$ 1,174
Basic earnings per share	28	\$ 0.96	\$ 0.80
Diluted earnings per share	28	\$ 0.89	\$ 0.77

*Please see notes to the consolidated financial statements.*

**CHESSWOOD GROUP LIMITED**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**  
**(in thousands of dollars)**

	<u>2013</u>	<u>2012</u>
Net income	\$ 10,905	\$ 8,989
Other comprehensive income (loss):		
Unrealized gain (loss) on translation of foreign operations	<u>3,257</u>	<u>(1,073)</u>
Comprehensive income for the year	<u>\$ 14,162</u>	<u>\$ 7,916</u>
<b>Attributable to:</b>		
Common shareholders	\$ 12,333	\$ 6,882
Non-controlling interest	\$ 1,829	\$ 1,034

*Please see notes to the consolidated financial statements.*



**CHESSWOOD GROUP LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**  
(in thousands of dollars)

	Note	Common shares	Common shares	Non- controlling interest	Share-based compensation reserve	Accumulated other comprehensive income (loss)	Retained earnings	2013 Total
		(# '000s)						
<b>Shareholders' equity - December 31, 2012</b>		<b>9,843</b>	<b>\$ 44,215</b>	<b>\$ 9,357</b>	<b>\$ 3,160</b>	<b>\$ (1,883)</b>	<b>\$ 5,706</b>	<b>\$ 60,555</b>
Net income		—	—	1,408	—	—	9,497	10,905
Dividends declared	27	—	—	(1,072)	—	—	(7,190)	(8,262)
Share-based compensation		—	—	—	1,345	—	—	1,345
Exercise of restricted share units	26	46	340	—	(340)	—	—	—
Exercise of options	26	81	614	—	(256)	—	—	358
Unrealized gain on translation of foreign operations		—	—	421	—	2,836	—	3,257
<b>Shareholders' equity - December 31, 2013</b>		<b>9,970</b>	<b>\$ 45,169</b>	<b>\$ 10,114</b>	<b>\$ 3,909</b>	<b>\$ 953</b>	<b>\$ 8,013</b>	<b>\$ 68,158</b>

	Note	Common shares	Common shares	Non- controlling interest	Share-based compensation reserve	Accumulated other comprehensive loss	Retained earnings	2012 Total
		(# '000s)						
<b>Shareholders' equity - December 31, 2011</b>		<b>9,811</b>	<b>\$ 43,845</b>	<b>\$ 9,269</b>	<b>\$ 2,269</b>	<b>\$ (950)</b>	<b>\$ 4,447</b>	<b>\$ 58,880</b>
Net income		—	—	1,174	—	—	7,815	8,989
Dividends declared	27	—	—	(946)	—	—	(6,293)	(7,239)
Share-based compensation		—	—	—	1,436	—	—	1,436
Exercise of restricted share units	26	40	306	—	(306)	—	—	—
Exercise of options	26	72	423	—	(239)	—	—	184
Repurchase of common shares under issuer bid	25	(80)	(359)	—	—	—	(263)	(622)
Unrealized loss on translation of foreign operations		—	—	(140)	—	(933)	—	(1,073)
<b>Shareholders' equity - December 31, 2012</b>		<b>9,843</b>	<b>\$ 44,215</b>	<b>\$ 9,357</b>	<b>\$ 3,160</b>	<b>\$ (1,883)</b>	<b>\$ 5,706</b>	<b>\$ 60,555</b>

*Please see notes to the consolidated financial statements.*

**CHESSWOOD GROUP LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**  
**(in thousand of dollars)**

	<i>Note</i>	<b>2013</b>	<b>2012</b>
<b>OPERATING ACTIVITIES</b>			
Net income		<b>\$ 10,905</b>	\$ 8,989
Costs associated with investing or financing activities included in net income		<b>1,443</b>	—
Non-cash items included in net income			
Amortization		<b>362</b>	679
Provision for credit losses		<b>9,241</b>	7,381
Share-based compensation expense		<b>1,345</b>	1,436
Provision for taxes		<b>8,832</b>	7,638
Other non-cash items	29	<b>(1,033)</b>	(698)
Cash from operating activities before change in net operating assets		<b>31,095</b>	25,425
Change in net operating assets			
Finance receivables	29	<b>(34,874)</b>	(23,453)
Borrowings - net	29	<b>25,638</b>	7,048
Other net operating assets	29	<b>134</b>	147
		<b>(9,102)</b>	(16,258)
Cash from operating activities before income tax refunds and payments		<b>21,993</b>	9,167
Income tax refund received		<b>462</b>	24
Income taxes paid		<b>(15,544)</b>	(2,615)
<b>Cash from operating activities</b>		<b>6,911</b>	6,576
<b>INVESTING ACTIVITIES</b>			
Acquisition costs	36(a)	<b>(88)</b>	—
Purchase of property and equipment		<b>(510)</b>	(261)
<b>Cash used in investing activities</b>		<b>(598)</b>	(261)
<b>FINANCING ACTIVITIES</b>			
Proceeds from convertible debentures - net of costs	22	<b>18,645</b>	—
Payment of financing costs		<b>(212)</b>	(403)
Proceeds from exercise of options	26	<b>358</b>	184
Repurchase of common shares	25	—	(622)
Cash dividends paid	27	<b>(8,140)</b>	(7,181)
<b>Cash from (used in) financing activities</b>		<b>10,651</b>	(8,022)
Unrealized foreign exchange gain (loss) on cash		<b>104</b>	(40)
Net increase (decrease) in cash		<b>17,068</b>	(1,747)
Cash, beginning of year		<b>5,591</b>	7,338
<b>Cash, end of year</b>		<b>\$ 22,659</b>	\$ 5,591

*Please see notes to the consolidated financial statements.*

## TABLE OF NOTES

1	<a href="#"><u>NATURE OF BUSINESS AND BASIS OF PREPARATION</u></a>	50
2	<a href="#"><u>CONSOLIDATION</u></a>	50
3	<a href="#"><u>SIGNIFICANT ACCOUNTING POLICIES</u></a>	51
4	<a href="#"><u>ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE</u></a>	58
5	<a href="#"><u>CASH</u></a>	59
6	<a href="#"><u>ACCOUNTS RECEIVABLE</u></a>	59
7	<a href="#"><u>INVENTORIES</u></a>	59
8	<a href="#"><u>PREPAID EXPENSES AND OTHER ASSETS</u></a>	60
9	<a href="#"><u>FINANCE RECEIVABLES</u></a>	60
10	<a href="#"><u>NET INVESTMENT IN LEASES</u></a>	60
11	<a href="#"><u>EQUIPMENT FINANCING AGREEMENTS AND WORKING CAPITAL LOANS</u></a>	61
12	<a href="#"><u>FINANCE RECEIVABLES PAST DUE</u></a>	62
13	<a href="#"><u>LEGAL FINANCE RECEIVABLES</u></a>	63
14	<a href="#"><u>PROPERTY AND EQUIPMENT</u></a>	63
15	<a href="#"><u>INTANGIBLE ASSETS</u></a>	64
16	<a href="#"><u>GOODWILL</u></a>	65
17	<a href="#"><u>ACCOUNTS PAYABLE AND OTHER LIABILITIES</u></a>	67
18	<a href="#"><u>VEHICLE FINANCING</u></a>	67
19	<a href="#"><u>INTEREST RATE SWAPS</u></a>	67
20	<a href="#"><u>BORROWINGS</u></a>	68
21	<a href="#"><u>CUSTOMER SECURITY DEPOSITS</u></a>	68
22	<a href="#"><u>CONVERTIBLE DEBENTURES</u></a>	69
23	<a href="#"><u>MINIMUM PAYMENTS</u></a>	70
24	<a href="#"><u>TAXES</u></a>	70
25	<a href="#"><u>COMMON SHARES</u></a>	72
26	<a href="#"><u>COMPENSATION PLANS</u></a>	73
27	<a href="#"><u>DIVIDENDS</u></a>	75
28	<a href="#"><u>EARNINGS PER SHARE</u></a>	77
29	<a href="#"><u>CASH FLOW SUPPLEMENTARY DISCLOSURE</u></a>	77
30	<a href="#"><u>CONTINGENT LIABILITIES AND OTHER FINANCIAL COMMITMENTS</u></a>	78
31	<a href="#"><u>FINANCIAL INSTRUMENTS</u></a>	78
32	<a href="#"><u>CAPITAL MANAGEMENT</u></a>	85
33	<a href="#"><u>RELATED PARTY TRANSACTIONS</u></a>	85
34	<a href="#"><u>SEASONAL OPERATIONS</u></a>	86
35	<a href="#"><u>SEGMENT INFORMATION</u></a>	86
36	<a href="#"><u>SUBSEQUENT EVENTS</u></a>	88

## 1. NATURE OF BUSINESS AND BASIS OF PREPARATION

Chesswood Group Limited (the “Company”) is incorporated under the laws of the Province of Ontario. The Company’s head office is located at 4077 Chesswood Drive, Toronto, Ontario, M3J 2R8.

The Company holds all of the limited partnership units of Chesswood Holding LP (“Holding LP”). Holding LP holds a 100% interest in Chesswood Holdings Ltd. and substantially all of the limited partnership units of Sherway LP (“Sherway”). Chesswood Holdings Ltd. owns 100% of the shares of the operating company, Lease-Win Limited (“Lease-Win”), Case Funding Inc. (“Case Funding”), as well as 100% of the shares of Chesswood U.S. Acquisition Co Ltd. (“U.S. Acquisitionco”), a corporation which owns 100% of the shares of the operating company Pawnee Leasing Corporation (“Pawnee”), incorporated in Colorado, United States and Windset Capital Corporation (“Windset”), incorporated in Delaware, United States.

As partial consideration for the acquisition of Pawnee in May 2006, 1,274,601 Class B shares and 203,936 Class C shares of a subsidiary (U.S. Acquisitionco) were issued (“Exchangeable Securities”). The Exchangeable Securities are non-voting shares of U.S. Acquisitionco and are fully exchangeable for Common Shares of the Company, on a one-for-one basis, for no additional consideration, through a series of steps and entitle the holders to receive the same dividends as the Common Shares. Attached to the Exchangeable Securities are Special Voting Units of the Company which provide the holders of the Exchangeable Securities voting equivalency to Company Shareholders. The Exchangeable Securities are reflected as non-controlling interest. Under IAS 27, the Exchangeable Securities must be shown as non-controlling interest because they are equity in a subsidiary not attributable, directly or indirectly, to the parent even though they have no voting powers in the subsidiary. There are no restrictions to the Company’s ability to access or use assets and settle liabilities of U.S. Acquisitionco as a result of the non-controlling interest. The non-controlling interest share of the Company’s consolidated net assets and net income is appropriately shown on the consolidated financial statements.

Through its interest in Pawnee, the Company is involved in the business of micro and small-ticket equipment financing to small businesses in the start-up and “B” credit market in the lower 48 states of the United States. Through its interest in Windset, the Company is involved in the business of providing working capital loans to small businesses in many of the lower 48 states of the United States. Through its interest in Case Funding, the Company is involved in the legal finance business in the United States. Through its interest in Sherway LP, the Company is involved in selling, servicing and leasing Acura automobiles in the Province of Ontario. Through its interest in Lease-Win Limited (“Lease-Win”), Chesswood owns cars4U.com.

The consolidated financial statements have been prepared on the going concern and historical cost bases, except for derivative financial instruments, liabilities held for trading and hybrid financial liabilities designated as at fair value through net income or loss, which have been measured at fair value. In order to improve clarity, certain items have been combined on the statements of financial position with detail provided separately in the notes.

The reporting currency is the Canadian dollar. The financial statements are presented in thousands of Canadian dollars except per share amounts and as otherwise noted. The functional currency of the Company, Holding LP, Chesswood Holdings Ltd., Sherway LP, and Lease-Win is the Canadian dollar. The functional currency of U.S. Acquisitionco, Pawnee, Windset and Case Funding is the United States dollar. The statements of income and cash flows of the subsidiaries located in the United States have been translated using the average rate for the years ended December 31, 2013 and 2012. The statements of financial position have been translated using the rate on the date of the statements of financial position and the exchange difference is included in other comprehensive income.

The Company’s consolidated financial statements were authorized for issue on March 7, 2014 by the Board of Directors.

## 2. CONSOLIDATION

The consolidated financial statements include the financial statements of the Company and its subsidiaries as noted above. Subsidiaries are consolidated using the purchase method from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated as long as control is held. The financial statements of all subsidiaries are prepared for the same reporting period as the Company, using uniform accounting policies in accordance with IFRS 10, *Consolidated Financial Statements*. All intra-group balances and items of income and expense resulting from intra-group transactions are eliminated in full.

Transaction costs incurred in connection with business combinations are expensed as incurred.

The consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”). The term IFRS also includes all International Accounting Standards (“IAS”); all interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”) mandatory for the fiscal years 2013 and 2012 are also applied.

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### **Exercise of judgment and use of accounting estimates and assumptions**

The preparation of the Company's consolidated financial statements in accordance with IFRS requires management to apply a significant degree of judgment in applying the Company's financial accounting policies and to make certain assumptions and estimates that have a material effect on the reported amounts of assets, liabilities, revenue and expenses.

The assumptions and estimates are based on premises that reflect the facts that are known at any given time. Future economic factors are inherently difficult to predict and are beyond management's control. If the actual development differs from the assumptions and estimate, the premises used and, if necessary, the carrying amounts for the assets and liabilities in question are adjusted accordingly. The exercise of judgment is based on management's experience and also on past history. As a result, actual amounts could differ from these estimates.

There were no significant changes in estimates made in the interim periods that have been adjusted in the final quarter.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are:

##### *Net investment in leases*

The leases entered into by the Company are considered to be finance leases in nature, based on an evaluation of all the terms and conditions and the determination that the Company has transferred substantially all the risks and rewards of legal ownership of the asset to the lessee.

##### *Legal finance receivables*

Our legal financing business has three principal products - attorney loans, plaintiff advances and medical liens. Attorney loans are collateralized loans to contingency fee-based law firms based on a combination of an assessment of the likelihood of a successful outcome for a pool of cases put forward by the law firm, and the creditworthiness of the borrowers. Plaintiff advances are structured as a purchase of an interest in the proceeds of a legal claim and are made (or declined) based on the probability of success and potential claim size, not the plaintiff's credit. Advances are on a non-recourse basis where Case Funding forfeits its entire advance and any related fees if the plaintiff is not successful in the claim. Such advances are not characterized as loans because there is no promise to repay in the event the plaintiff does not succeed in his/her claim. Medical lien financing refers, generally, to the purchase of existing medical debt obligations of patients involved in existing litigation that is the result of an injury or multiple injuries. Case Funding will purchase, at a discount to the face value, the accounts receivable of medical facilities that relates to patients that undergo procedures necessary to remedy injuries from an incident that is the subject of litigation.

Attorney loans and medical lien financing are deemed to be a financial asset as they are a contractual right to receive cash from another entity and are considered to be loans and receivables for accounting purposes, based on an evaluation of all the terms and conditions of the contracts. The contracts are deemed to have fixed or determinable payments, in that the payments are due when the underlying cases are settled, the date of which cannot be known and is therefore estimated. Loans and receivables are accounted for at amortized cost using the effective interest method; however the effective interest rate is calculated using estimated cash flows based on an estimated settlement date.

Plaintiff advances are deemed to be a financial asset as they are a contractual right to receive cash from another entity and are considered to be available-for-sale financial assets for accounting purposes, based on an evaluation of all the terms and conditions of the contracts. The terms of the plaintiff advances are on a non-recourse basis, and payment depends on the success and potential size of claims. Thus, the terms may limit the expected cash flows and, other than for credit deterioration, they were deemed not to be loans and receivables. Available-for-sale financial assets are valued at fair value, the accretion in value is recognized based on the effective interest method and recognized in finance income, and any changes in fair value are recorded in other comprehensive income until realized.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are:

##### *Impairment of non-financial assets*

The Company's impairment test of non-financial assets is based on the value-in-use which is estimated using a discounted cash flow model. The cash flows are derived from budgets for the next five years, excluding restructuring activities and future investments. Other than the cash flow estimates, the value-in-use is most sensitive to the discount rate used and the growth rate applied beyond the five year estimate.



### *Impairment of financial asset receivables*

Quantifying the impairment of financial asset receivables is based on: for receivables that are in default, estimates of the carrying value that will ultimately not be collected and, for finance receivables that are in default, the application of current delinquency rates at each reporting date.

### *Fair values*

The fair value of interest rate derivatives, certain assets acquired and consideration paid in business acquisitions and available for sale financial assets are estimated using valuation techniques based on assumptions of, for example, estimated future cash flows, future interest rate movements, the probability of success of legal claims and the timing of collections. The estimated fair values are sensitive to changes in these assumptions.

### *Contingent consideration and bonus*

Contingent consideration and bonus relates to the Incentive Payment Amount on the acquisition of Case Funding and represents the fair value of the contingent consideration payable. The consideration is payable in the event that Case Funding's normalized net income ("NNI") for the 25th through 36th months following the Acquisition Date (June 10, 2011) achieves the targeted amount of approximately U.S.\$4.7 million (the "Targeted Amount"), whereby an amount of U.S.\$1.4 million (the "Incentive Payment Amount") (or an identical percentage adjusted portion of the Incentive Payment Amount if NNI is less than, but at least 90% of, the Targeted Amount) will be paid no later than the 38th month. It was determined at December 31, 2013 that the probability that the Targeted Amount would be reached was minimal.

The estimate of the fair value of contingent consideration and bonus payable requires very subjective assumptions to be made of various potential operating result scenarios and discount rates. Although the Company believes that there will be no Incentive Payment Amount due in June 2014, it will continue to periodically review NNI results and an updated assessment of various probability weighted projected NNI scenarios. If circumstances change and the Company determines that an earn-out payment may be due, such future revisions may materially change the estimate of the fair value of contingent consideration and therefore materially affect the Company's future financial results.

### *Taxes*

Determining the value of deferred tax assets recognized requires an estimate of the value of tax benefits that will eventually be realized by the Company.

U.S. federal tax legislation enacted in 2004 addresses perceived U.S. tax concerns over "corporate inversion" transactions. A "corporate inversion" generally occurs when a non-U.S. entity acquires "substantially all" of the equity interests in, or the assets of, a U.S. corporation or partnership, if, after the acquisition, former equity holders of the U.S. corporation or partnership own a specified level (referred to as the "percentage identity") of equity in the non-U.S. entity, excluding equity interests acquired in the acquiring entity in public offerings associated with the acquisition. Adverse U.S. tax consequences are only triggered if:

- (a) Pawnee sells or licenses any of its assets as part of its acquisition by the Company, or licenses any assets to a related non-U.S. entity during the subsequent 10 years; or
- (b) If it does sell or license any such assets, it does not offset its U.S. tax arising from such sales or licenses with loss carry-forwards, foreign tax credits or certain tax amounts with similar attributes.

Management has concluded that either or both of these conditions will not be triggered.

### *Share-based payments*

The Black-Scholes option-pricing model is used to fair value options issued by the Company. The model requires the use of subjective assumptions including the expected share price volatility. In addition, the options issued have characteristics different from those of traded options so the Black-Scholes option-pricing model may not provide a reliable single measure of the fair value of options issued. Changes in the subjective assumptions can have a material effect on the fair value estimate.

### **Cash**

Cash is comprised of cash and highly liquid investments with original maturities of three months or less.

## Inventories

Inventories are valued at the lower of cost and net realizable value. The cost of new and used vehicles is determined using the specific item method and includes all direct expenditures required to bring each vehicle to its present location and condition, which includes preparing the vehicles for sale. The cost of automobile parts is the purchase cost on a first-in, first-out basis.

Net realizable value is the estimated selling price in the ordinary course of business less the costs necessary to make a sale.

## Net investment in leases

The net investment in leases arises from the Company's automotive and equipment leasing operations and is described below under Revenue recognition.

## Allowance for doubtful accounts

The Company assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and the event has a negative impact on the estimated cash flows of the financial asset and the loss can be reliably estimated. Potential losses expected as a result of future events, no matter how likely based on past historical evidence, are not allowed to be recognized.

The carrying amount of the financial asset is reduced through the use of an allowance for doubtful accounts and the amount of loss is recognized as a provision for credit losses. Individually significant loans and receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Loans and receivables that are not considered to be individually impaired are reviewed for impairment on a group basis, determined by reference to the shared delinquency characteristics.

Lease and loan receivables are composed of a large number of homogenous leases and loans, with relatively small balances. Thus, the evaluation of the allowance for credit losses is performed collectively for the lease and loan receivable portfolio. Allowance for doubtful accounts on finance receivables is comprised of the net investment in leases and loan value that is over 30 days delinquent, plus any leases/loans identified as impaired less than 30 days delinquent.

## Property and equipment

Property and equipment are measured at acquisition or purchase cost less scheduled depreciation based on the useful economic lives of the assets. No components (those parts of individual property and equipment assets having different economic lives than the remainder of the asset) have been identified. Scheduled depreciation is based on the following annual rates, which are reassessed annually:

Leasehold improvements	straight-line over the remaining lease term
Service equipment and vehicles	20% or 30% declining balance
Furniture and equipment	20% to 30% declining balance
Computer hardware	20% to 30% declining balance

## Goodwill and intangible assets

Goodwill is initially measured at cost which represents the excess of the fair value of consideration paid for a business acquisition over the Company's share of the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Purchased intangible assets are recognized as assets in accordance with IAS 38, *Intangible Assets*, where it is probable that the use of the asset will generate future economic benefits and where the cost of the asset can be determined reliably. Intangible assets acquired are initially recognized at cost of purchase and are subsequently carried at cost less accumulated amortization, if applicable, and accumulated impairment losses.

The useful lives of intangible assets are assessed as either finite or indefinite. Management has determined that trade names and the framework agreement have indefinite lives. The broker relationships are considered to have a finite life and are amortized on a scheduled straight-line basis over their estimated useful life of seven years.

The amortization period and method of amortization for intangible assets with finite lives are reassessed annually. Changes in the useful life or in the pattern of economic benefits derived are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. Intangible assets with indefinite useful lives are not amortized but

are tested for impairment annually at the cash generating unit level and are reviewed annually to determine whether the indefinite life continues to be applicable. Any change from indefinite life to finite life would be accounted for prospectively.

### **Impairment of non-financial assets**

Impairment testing is applied on an individual asset basis unless an asset does not generate cash inflows that are largely independent of the cash inflows generated by other assets or groups of assets. None of the Company's non-financial assets generate independent cash inflows and therefore all non-financial assets are allocated to cash generating units ("CGU") for purposes of assessing impairment. CGUs are defined as the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Impairment losses are recognized when the carrying amount of a CGU exceeds the recoverable amount, which is the greater of the CGU's fair value less cost to sell and its value in use. Value in use is the present value of the estimated future cash flows from the CGU discounted using a pre-tax rate that reflects current market rates and the risks inherent in the business of each CGU. If the recoverable amount of the CGU is less than its carrying amount, the CGU is considered impaired and is written down to its recoverable amount. The impairment loss is allocated to reduce the carrying amount of the assets of the CGU, first to reduce the carrying amount of the CGU's goodwill and then to the other assets of the CGU allocated pro-rata on the basis of the carrying amount of each asset.

Impairment losses of continuing operations are recognized in the statement of income.

A previously recognized impairment loss for non-financial assets, excluding goodwill, is reversed if there has been a change in the assumptions used to determine recoverable amount since the previous impairment loss was recognized. The carrying amount after the reversal cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Impairment losses relating to goodwill cannot be reversed.

CGUs to which goodwill and intangible assets with indefinite lives have been allocated are tested for impairment annually as at December 31, and all CGUs are tested for impairment more frequently when there is an indication that the CGU may be impaired.

### **Revenue recognition**

The Company's leasing operations use standard lease contracts which are non-cancelable finance leases and provide for monthly lease payments for periods of one to five years. Leases are accounted for as finance leases because substantially all of the risks and rewards incidental to legal ownership of the property are transferred to the lessee. The total present value of minimum lease payments to be received over the lease term is recognized at the commencement of the lease. The difference between this total value, net of incremental execution costs, such as broker commission, and the cost of the leased asset is deferred income and is recognized as a reduction of the lease receivable, with the net result shown as net investment in leases. The deferred income is then recognized over the life of the lease using the effective interest method, which provides a constant rate of return on the net investment throughout the lease term.

The Company's revenue from the sale of automobiles is recognized when the following conditions are met: the risks and rewards of ownership of the vehicle are transferred to the customer, the sales price is agreed or determinable and the receipt of payment is probable. Revenues are stated net of discounts, if any. All other parts and service revenue is recorded when goods are delivered or services are completed and the receipt of payment can be assumed.

The Company's revenue generated through the cars4U.com web-site is recorded on a net basis and represents the commissions earned on the transactions. Commissions are recognized when the transaction has been completed between the vender and purchaser and when the amount of commission revenue can be measured reliably and receipt of payment is probable.

Income on attorney loans and medical liens is recognized using the effective interest method, as described below under financial instruments - loans and receivables.

Plaintiff advances are carried at fair value, with the accretion in value is recognized based on the effective interest method and recognized in finance income, and any changes in fair value are recorded in other comprehensive income until realized.

### **Share-based payment transactions**

From time to time, the Company compensates certain members of management in the form of share-based compensation. The cost of equity-settled transactions with employees is recognized, together with a corresponding increase in equity, over the period during which the performance and or service conditions are fulfilled and ending on the vesting date at which point the employees become fully entitled to the award. The cumulative expense also takes into account the number of equity instruments that the Company expects will ultimately vest.

The fair-value of option grants are calculated using the Black-Scholes option pricing model and recognized as compensation expense over the vesting period of those grants and a corresponding adjustment is made to Reserves in Shareholders' Equity. Any consideration received on exercise of options together with amounts previously credited to Reserves for these options is credited to Common Shares.

The fair-value of Restricted Share Units ("RSUs") granted is calculated based on the market price of the Common Shares on the day of the grant. RSUs granted are considered to be in respect of future services and are recognized as compensation expense over the vesting period with a corresponding adjustment credited to Reserves in Shareholders' Equity. On exercise of the restricted units the amounts previously credited to Reserves is credited to Common Shares. Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense determined as if the terms had not been modified. Additional expense is recognized for any modification which increases the total fair value of the share-based compensation arrangement, or is otherwise beneficial to the employee at the date of the modification.

When an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation and any expense not yet recognized is recognized immediately.

The dilutive effect of outstanding options is reflected as additional equity in the computation of diluted earnings per share.

### **Taxes**

Taxes are accounted for using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the deferred tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary for deferred tax benefits for which realization is not considered probable.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising from investments in subsidiaries that are not expected to reverse in the foreseeable future.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

### **Earnings or loss per share**

Earnings or loss per share is computed in accordance with IAS 33, *Earnings per Share*, as a measure of the income or loss for ordinary equity holders. Basic earnings per share is calculated by dividing net income or loss by the average number of outstanding shares. Diluted earnings per share is calculated to reflect the dilutive effect, if any, of any other commitment or instruments.

### **Foreign currency transactions**

The financial statements of consolidated entities which are prepared in a foreign currency are translated using the functional currency concept of IAS 21, *The Effects of Changes in Foreign Exchange Rates*. The functional currency of a subsidiary is determined on the basis of the primary economic environment in which it operates and typically corresponds to the local currency. Income and expenses of subsidiaries with a different functional currency than the Company's presentation currency are translated in the Company's consolidated financial statements at the average exchange rate for the reporting period, and assets and liabilities are translated at the closing rate. Exchange differences arising from the translation are recognized in other comprehensive income.

Foreign currency payables and receivables in the statement of financial position are recorded at the transaction date at cost. Exchange gains and losses arising from conversion of monetary assets and liabilities at exchange rates at the end of the reporting period are recognized as income or expense.

The U.S. dollar exchange rates used in the Company's consolidated financial statements, are as follows:

Closing rate as at		Average rate for the years ended	
<b>December 31, 2013</b>	December 31, 2012	<b>December 31, 2013</b>	December 31, 2012
<b>1.0636</b>	0.9949	<b>1.0299</b>	0.9996

## Financial instruments

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are recognized initially at fair value plus transaction costs, except for financial assets and financial liabilities carried at fair value through net income or loss, which are measured initially at fair value.

Financial assets are derecognized when the contractual rights to the cash flows from the asset expire or when the asset and substantially all related risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

### Financial assets

The subsequent measurement of financial assets depends on their classification as follows:

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such financial assets are carried at amortized cost using the effective interest rate method. Gains and losses are recognized in the statement of income when the loans or receivables are derecognized or impaired. See Allowance for doubtful accounts.

Broker commissions related to the origination of financing leases are deferred and recorded as an adjustment to the yield of the net investment in financing leases.

The Company's cash, accounts receivable, net investment in leases, equipment financing agreements, working capital loan receivables, attorney loans and medical liens are classified as loans and receivables.

#### *Financial assets at fair value through net income or loss*

Financial assets at fair value through net income or loss include financial assets that are either classified as held for trading or that meet certain conditions and are designated at fair value through net income or loss upon initial recognition. All derivative financial instruments are included in this category, except for those that are designated and effective hedge instruments. Upon initial recognition, attributable transaction costs are recognized in net income or loss as incurred.

Assets in this category are subsequently measured at fair value with gains or losses recognized in net income or loss. The fair values of derivative financial instruments are based on changes in observable prices in active markets or by a valuation technique where no market exists.

The Company had no financial instruments in this category at December 31, 2013 and 2012.

#### *Held to maturity investments*

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity other than loans and receivables. Financial instruments are classified as held to maturity investments if the Company has the intention and ability to hold them to maturity.

Subsequent to initial recognition held to maturity investments are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, determined, for example, by reference to external credit ratings, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying value of the investment, including impairment losses, are recognized in net income or loss.

The Company had no financial instruments in this category at December 31, 2013 and 2012.

#### *Available for sale financial assets*

Available for sale financial assets are non-derivative financial assets that are either designated as available for sale or do not qualify for inclusion in any other category.



Available for sale financial assets for which fair value cannot be estimated reliably are measured at cost and any impairment losses are recognized in net income or loss. All other available for sale financial assets are measured at fair value. Gains and losses are recognized in other comprehensive income and presented in the available for sale reserve within equity, except for the accretion in value based on the effective interest method, impairment losses and foreign exchange differences on monetary assets, which are recognized in net income or loss. Upon initial recognition, attributable transaction costs are recognized in net income or loss as incurred. When the asset is disposed of or is determined to be impaired the cumulative gain or loss recognized in other comprehensive income is reclassified from equity to net income or loss and presented as a reclassification adjustment within other comprehensive income.

The Company's plaintiff advances are designated as available for sale financial assets for accounting purposes.

### ***Financial liabilities***

The categories of financial liabilities and their subsequent measurement are as follows:

#### ***Financial liabilities at fair value through net income or loss***

Financial liabilities at fair value through net income or loss include financial liabilities that are either classified as held for trading or in defined circumstances, are designated at fair value through net income or loss upon initial recognition. When certain conditions are satisfied, *IAS 39, Financial Instruments: Measurement and Recognition*, requires embedded derivatives to be separately recognized and measured at fair value; changes in fair value in periods subsequent to initial recognition are recognized in net income or loss. In order to avoid the measurement inconsistencies that would result from separate accounting for multiple embedded derivatives, IAS 39 allows an entity to designate the entire hybrid contract as at fair value through net income or loss. All contingent consideration payable is also included in this category. Derivative financial instruments that are designated as effective hedge instruments are excluded from this category.

The Company's interest rate swap contracts are classified as held for trading for accounting purposes. The convertible debentures issued during the year are designated as at fair value through net income or loss. The Company has not designated any financial instruments as hedges for accounting purposes.

Liabilities in this category are measured at fair value with gains or losses recognized in net income or loss. The fair values of derivative financial instruments are based on changes in observable prices in active markets or by a valuation technique where no market exists. Transaction costs attributable to the issuance of financial liabilities at fair value through net income or loss are recognized in net income or loss as incurred.

#### ***Loans and borrowings***

Interest bearing loans and borrowings not otherwise categorized as financial liabilities at fair value through net income or loss are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in net income or loss when the liabilities are derecognized. Transaction costs incurred in connection with the issuance of loans and borrowings are capitalized and recorded as a reduction of the carrying amount of the related financial liabilities and amortized using the effective interest method.

The Company's financial liabilities include vehicle financing, borrowings, and accounts payable and other liabilities.

### **Statement of cash flows**

The statement of cash flows, which is compiled using the indirect method, shows cash flows from operating, investing, and financing activities, and the Company's cash at the beginning and end of the year. Cash flows in foreign currencies have been translated at the average rate for the period. Exchange rate differences affecting cash items are presented separately in the statement of cash flows.

Cash flow from operating activities comprises net income (loss) adjusted for non-cash items, changes in working capital and operational net assets. Receipts and payments with respect to tax are included in cash from operating activities. The Company considers finance receivables, vehicle financing, borrowings, and customer security deposits as operational assets and liabilities as they directly relate to the core business. The changes in these operational assets and liabilities are shown in cash flows from operating activities and the associated interest revenue and interest expenses are included in operating activities and not investing or financing activities.

Cash flow from investing activities comprises payments relating to business acquisitions and property and equipment.

Cash flow from financing activities comprises payment of dividends, proceeds from convertible debentures and stock issues, and the purchase and sale of treasury stock.

## Accounting standards adopted in the current year

The Company adopted IFRS 13, *Fair Value Measurement*, which resulted in additional disclosures in the annual consolidated financial statements.

The following amendments to standards were adopted in the current year with no significant effect on the Company's consolidated financial statements:

- (i) IAS 1, *Presentation of Financial Statements* ("IAS 1")
- (ii) IAS 12, *Income Taxes* ("IAS 12") Deferred Tax: Recovery of Underlying Assets - Amendments to IAS 12
- (iii) Amendments to IFRS 7, *Financial Instruments: Disclosures* - *Offsetting Financial Assets and Financial Liabilities*
- (iv) IFRS 10, *Consolidated Financial Statements*
- (v) IFRS 12, *Disclosure of Interests in Other Entities*
- (vi) Amendments to IAS 32, *Financial Instruments: Presentation*
- (vii) IFRS 7, *Financial Instruments: Disclosures*, amendments regarding Disclosures - Transfers of Financial Assets
- (viii) IFRS 11, *Joint Arrangements* (new; to replace IAS 31 and SIC-13)

## 4. ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

### *Financial Liabilities: Measurement*

In October 2010, the IASB issued *IFRS 9 Financial Instruments*, which represents the completion of the first part of a three-part project to replace IAS 39, *Financial Instruments: Recognition and Measurement* with a new standard. As per the new standard, an entity choosing to measure a liability at fair value will present the portion of the change in its fair value due to changes in the entity's own credit risk in the other comprehensive income or loss section of the entity's statement of comprehensive loss, rather than within profit or loss. Additionally, IFRS 9 includes revised guidance related to the de-recognition of financial instruments. The Company plans to adopt these new standards when they become effective and is currently assessing the impact of this standard.

### *Financial Instruments (Classification and Measurement)*

IFRS 9, *Financial Instruments* will replace IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9.

The mandatory effective date of IFRS 9 has been deferred until completion of the entire financial instruments project.

### *Operating segments*

The amendments to IFRS 8, *Operating Segments* issued in December 2013, require an entity to disclose the judgments made by management in applying the aggregation criteria for reportable segments. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014.

Certain new accounting standards and interpretations have been published by the IASB or the IFRIC that are not mandatory for the December 31, 2013 reporting period. The following standards are not expected to have any material impact on the Company's consolidated financial statements:

- IAS 28 (as revised in 2003) and IAS 31
- IAS 19 *Employee Benefits* (amended in 2011)
- IAS 28 *Investments in Associates and Joint Ventures* (amended in 2011)
- IFRIC 21 *Levies*

## 5. CASH

### *Operating line of credit*

At December 31, 2013 and 2012, Sherway had an authorized line of credit of \$1.5 million which was not utilized at either date. The line of credit is secured by assignments of the accounts receivable and a general security agreement over the assets of the dealership.

At December 31, 2013, Sherway had an authorized non-revolving demand loan facility available in the amount of \$2.5 million which was not utilized. The demand loan is to finance leasehold improvements at the dealership. The demand loan is secured by assignments of the accounts receivable and a general security agreement over the assets of the Partnership. The loan bears interest of prime plus 1.5% and is to be repaid in part by contribution from Honda's Acura Advanced Facility Program Enhancement program with the balance repaid from the dealership's funds over the next 5 years.

See Note 18 - *Vehicle financing*, and Note 20 - *Borrowings*, for additional credit facilities available to Sherway and Pawnee.

## 6. ACCOUNTS RECEIVABLE

The accounts receivable balance principally relates to the Sherway dealership and includes amounts due from the manufacturer for financing contracts in transit, which are typically collected within seven to ten days.

The aging of the accounts receivable is as follows:

	December 31, 2013	December 31, 2012
	(\$ thousands)	
Current	\$ 1,146	\$ 688
31-60 days	18	51
61-90 days	9	14
More than 90 days	26	18
	<u>1,199</u>	<u>771</u>
Allowance for doubtful accounts	—	—
	<u>\$ 1,199</u>	<u>\$ 771</u>

Accounts receivable that are impaired at December 31, 2013 and 2012 are nominal.

## 7. INVENTORIES

	December 31, 2013	December 31, 2012
	(\$ thousands)	
New and demonstrator vehicles	\$ 5,986	\$ 6,204
Used vehicles	1,726	1,521
Parts and other	124	156
	<u>\$ 7,836</u>	<u>\$ 7,881</u>

The majority of the new and demonstrator vehicles are pledged as security for the vehicle financing floor plan facility (Note 18 - *Vehicle financing*). If the new and demonstrator vehicles are not specifically pledged under the vehicle financing floor plan facility they are pledged under a general security agreement over the dealership's other assets for the lines of credit. The lines of credit were not utilized at December 31, 2013 and 2012.

During the year-ended December 31, 2013, cost of sales relating to vehicles and part sales totaled \$44.8 million (2012 - \$44.1 million). During the year-ended December 31, 2013, demonstrator vehicles were written down by \$84,100 (2012 - \$82,500) based

on the utilization of the vehicles. This cost is included in other expenses. Used vehicles were not written down during the current or prior years. There was no reversal of any write-downs of inventory during the current or prior year. The provisions for valuation and usage included in inventory total \$144,200 (2012 - \$81,300).

## 8. PREPAID EXPENSES AND OTHER ASSETS

Prepaid expenses and other assets comprise:

	December 31, 2013	December 31, 2012
	(\$ thousands)	
Property tax receivable	\$ 325	\$ 335
Tax receivable	1,070	367
Other prepaid expenses and current assets	277	241
Sales tax receivable	86	—
Deposits – premises	42	42
	<u>\$ 1,800</u>	<u>\$ 985</u>

Prepaid expenses and other assets typically have maturities of less than one year, except for the deposits on the premises.

## 9. FINANCE RECEIVABLES

Finance receivables comprise:

	Note	December 31, 2013	December 31, 2012
		(\$ thousands)	
Net investment in leases	10	\$ 127,145	\$ 111,905
Equipment financing agreements and working capital loans	11	21,195	6,700
Legal finance receivables	13	10,961	5,645
		<u>\$ 159,301</u>	<u>\$ 124,250</u>

## 10. NET INVESTMENT IN LEASES

(a) Net investment in leases, which represents Pawnee's U.S. equipment leases, includes the following:

	December 31, 2013	December 31, 2012
	(\$ thousands)	
Total minimum lease payments for leases	\$ 160,363	\$ 140,297
Residual values of leased equipment	19,159	17,923
	<u>179,522</u>	<u>158,220</u>
Initial direct costs of lease acquisition	9,165	8,447
Unearned income	(57,969)	(51,871)
<b>Net investment in leases before allowance for doubtful accounts</b>	<u>130,718</u>	<u>114,796</u>
Allowance for doubtful accounts (b)	(3,573)	(2,891)
<b>Net investment in leases</b>	<u>\$ 127,145</u>	<u>111,905</u>
Current portion	47,143	46,432
<b>Net investment in leases – long-term portion</b>	<u>\$ 80,002</u>	<u>\$ 65,473</u>

(b) The activity in the allowance for doubtful accounts is as follows:

	For the years ended	
	December 31, 2013	December 31, 2012
	(\$ thousands)	
Balance, beginning of year	\$ 2,891	\$ 2,424
Provision for credit losses	6,196	5,200
Impact of change in foreign exchange rates	216	(52)
Charge-offs	(8,462)	(6,783)
Recoveries	2,732	2,102
Balance, end of year	\$ 3,573	\$ 2,891

Scheduled collections of minimum lease payments receivable at December 31, 2013 are presented in the following table. The Company's experience has shown that the actual contractual payment streams will vary depending on a number of variables including: prepayment rates, charge-offs and modifications. Accordingly, the following scheduled collections of minimum lease payments as at December 31, 2013 are not to be regarded as a forecast of future cash collections.

	Minimum lease payments
	(\$ thousands)
2014	\$ 70,782
2015	49,223
2016	26,761
2017	11,323
2018 and thereafter	2,274
Total minimum lease payments	\$ 160,363

New leases entered into by Pawnee during the year-ended December 31, 2013 resulted in an increase in the minimum lease payments recognized of \$102.8 million (2012 - \$90.8 million); the associated residual receivable for these new leases totaled \$6.2 million (2012 - \$6.8 million); and the unearned income totaled \$45.4 million (2012 - \$40.2 million).

## 11. EQUIPMENT FINANCING AGREEMENTS AND WORKING CAPITAL LOANS

Equipment Financing Agreements ("EFAs") and Working Capital Loans ("WCLs") are deemed to be financial instrument assets as they represent contractual rights to receive cash from another entity and are classified as loans and receivables for accounting purposes, based on an evaluation of all the terms and conditions of the contracts. Loans and receivables are accounted for at amortized cost using the effective interest rate method.

	December 31, 2013	December 31, 2012
	(\$ thousands)	
Equipment financing agreements	\$ 18,947	\$ 6,742
Working capital loans	2,422	—
Allowance for doubtful accounts (a)	(174)	(42)
<b>Equipment Financing Agreements and Working Capital Loans</b>	<b>\$ 21,195</b>	<b>\$ 6,700</b>
Current portion	7,755	1,617
EFAs and WCLs – long-term portion	\$ 13,440	\$ 5,083



- (a) Pawnee's underwriting requirements and standards for EFAs are the same as those required for leases. At December 31, 2013 there were no delinquent WCLs. The activity in the allowance for doubtful accounts is as follows:

	For the years ended	
	<b>December 31, 2013</b>	December 31, 2012
	(\$ thousands)	
Balance, beginning of year	\$ 42	\$ —
Provision for credit losses	293	46
Charge-offs	(176)	(4)
Recoveries	15	—
Balance, end of year	<b>\$ 174</b>	<b>\$ 42</b>

## 12. FINANCE RECEIVABLES PAST DUE

Lease receivables, EFAs and WCLs are each composed of a large number of homogenous receivables respectively, with relatively small balances. Thus, the evaluation of the allowance for credit losses is performed collectively for the portfolios.

The following aging represents the full carrying value of the leases, EFAs and WCLs and not just the payments that are past due. The balances presented exclude the \$11.8 million (December 31, 2012 - \$11.0 million) in security deposits received from borrowers and the collateral held (including potential proceeds from repossessed vehicles and equipment, and potential recoveries from personal guarantees) that would offset any charge-offs. An estimate of the fair value for the collateral and personal guarantees cannot reasonably be determined.

	As of December 31, 2013				
(\$ thousands)	Current	1-30 days	31 - 60 days	61 - 90 days	Over 90 days
Equipment lease receivables	\$ 123,676	\$ 4,086	\$ 1,369	\$ 505	\$ 1,082
EFA's & WCLs	20,927	329	23	4	86
	<b>144,603</b>	<b>4,415</b>	<b>1,392</b>	<b>509</b>	<b>1,168</b>
Impaired	183	208	263	146	1,168
Past due but not impaired	\$ —	\$ 4,207	\$ 1,129	\$ 363	\$ —

	As of December 31, 2012				
(\$ thousands)	Current	1-30 days	31 - 60 days	61 - 90 days	Over 90 days
Equipment lease receivables	\$ 109,454	\$ 2,752	\$ 1,335	\$ 372	\$ 883
EFA's	6,700	-	42	-	-
	<b>116,154</b>	<b>2,752</b>	<b>1,377</b>	<b>372</b>	<b>883</b>
Impaired	44	90	436	87	883
Past due but not impaired	\$ —	\$ 2,662	\$ 941	\$ 285	\$ —

The net investment in leases at Pawnee that have been modified (in 2012 or prior) and are current at December 31, 2013 is \$2.5 million (December 31, 2012 - \$2.4 million). On average the lease terms have been modified to extend the leases by approximately 2.7 months. Leases modified at Pawnee during the year-ended December 31, 2013 had a total net investment in lease balance at the time of modification of \$4.3 million (2012 - \$4.7 million). These amounts reflect the net investment in lease balances prior to payments collected since modification, or leases that terminated early after modifications or leases charged-off after modification. There were no EFA's that were modified in 2013 or 2012.

### Collateral

Pawnee is entitled to repossess financed equipment and vehicles if the borrower defaults on their lease or loan contract. At Pawnee, when a lease or loan is charged-off, the related equipment no longer has a carrying value on the financial statements. Any amounts recovered from the sale of equipment after a charge-off, are credited to the allowance for doubtful accounts when

received; in the year-ended December 31, 2013, the proceeds from the disposal of repossessed equipment that was charged-off totaled \$842,000 (2012 - \$533,000). Repossessed equipment is held at various warehouses throughout the U.S. owned by a company contracted to repossess and remarket the equipment.

### 13. LEGAL FINANCE RECEIVABLES

Legal finance receivables consist of:

	December 31, 2013	December 31, 2012
	(\$ thousands)	
Attorney loans and medical liens	\$ 4,642	\$ 2,296
Plaintiff advances	6,319	3,349
<b>Legal finance receivables</b>	<b>10,961</b>	<b>5,645</b>
Current portion (i)	5,322	2,728
Legal finance receivables – long-term portion	\$ 5,639	\$ 2,917

It was determined that there is no objective evidence that any of the attorney loans or medical liens are individually impaired at December 31, 2013 and 2012, thus an allowance for doubtful accounts was not recognized.

- (i) The contracts are deemed to have fixed or determinable payments, in that the payments are due when the underlying cases are settled, the date of which cannot be known and is therefore estimated. Plaintiff advances are made on a non-recourse basis, and repayment depends on the success and potential size of respective claims. Thus, the current portion of legal finance receivables is subject to a degree of estimation.

### 14. PROPERTY AND EQUIPMENT

	Leasehold improvements	Service equipment and vehicles	Furniture and equipment	Computer hardware	Total
	(\$ thousands)				
<b>Cost:</b>					
December 31, 2011	\$ 726	\$ 210	\$ 524	\$ 482	\$ 1,942
Additions (a)	73	—	27	161	261
Disposals	—	—	—	—	—
Translation	—	—	—	—	—
December 31, 2012	\$ 799	\$ 210	\$ 551	\$ 643	\$ 2,203
Additions	151	—	17	342	510
Disposals	—	—	(18)	(107)	(125)
Translation	—	—	(4)	1	(3)
<b>December 31, 2013</b>	<b>\$ 950</b>	<b>\$ 210</b>	<b>\$ 546</b>	<b>\$ 879</b>	<b>\$ 2,585</b>

	Leasehold improvements	Service equipment and vehicles	Furniture and equipment	Computer hardware	Total
<b>Accumulated amortization:</b>					
			(\$ thousands)		
December 31, 2011	\$ 526	\$ 125	\$ 220	\$ 262	\$ 1,133
Amortization – current year	66	17	52	44	179
Disposals	—	—	—	—	—
Translation	—	—	(1)	(1)	(2)
December 31, 2012	\$ 592	\$ 142	\$ 271	\$ 305	\$ 1,310
Amortization – current year	36	13	54	90	193
Disposals	—	—	(17)	(114)	(131)
Translation	—	—	(1)	(1)	(2)
<b>December 31, 2013</b>	<b>\$ 628</b>	<b>\$ 155</b>	<b>\$ 307</b>	<b>\$ 280</b>	<b>\$ 1,370</b>

	Leasehold improvements	Service equipment and vehicles	Furniture and equipment	Computer hardware	Total
<b>Carrying amount:</b>					
			(\$ thousands)		
December 31, 2011	\$ 200	\$ 85	\$ 304	\$ 220	\$ 809
December 31, 2012	\$ 207	\$ 68	\$ 280	\$ 338	\$ 893
<b>December 31, 2013</b>	<b>\$ 322</b>	<b>\$ 55</b>	<b>\$ 239</b>	<b>\$ 599</b>	<b>\$ 1,215</b>

- (a) Leasehold improvements include \$204,700 in costs related to Sherway's re-imaging upgrade of the dealership that have not been amortized. While not final, the estimated costs for the project are between \$2.5 million and \$3.0 million. Initial funding for the re-imaging upgrade will be provided by Sherway's bank (See Note 5 - Cash). Once complete, a large portion of the costs will be reimbursed by Acura Canada. The construction began in March 2014.

## 15. INTANGIBLE ASSETS

	Indefinite useful life		Finite useful life	
	Trade names	Framework agreement	Broker relationships	Total
<b>Cost:</b>				
			(\$ thousands)	
December 31, 2011	\$ 5,868	\$ 889	\$ 3,560	\$ 10,317
Acquisitions	—	—	—	—
Translation	(128)	—	(77)	(205)
December 31, 2012	\$ 5,740	\$ 889	\$ 3,483	\$ 10,112
Acquisitions	—	—	—	—
Translation	397	—	239	636
<b>December 31, 2013</b>	<b>\$ 6,137</b>	<b>\$ 889</b>	<b>\$ 3,722</b>	<b>\$ 10,748</b>

	Trade names	Framework agreement	Broker relationships	Total
<b>Accumulated amortization:</b>				
		(\$ thousands)		
December 31, 2011	\$ —	\$ —	\$ 2,882	\$ 2,882
Amortization – current year	—	—	500	500
Translation	—	—	(65)	(65)
December 31, 2012	\$ —	\$ —	\$ 3,317	\$ 3,317
Amortization – current year	—	—	169	169
Translation	—	—	236	236
<b>December 31, 2013</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 3,722</b>	<b>\$ 3,722</b>

	Trade names	Framework agreement	Broker relationships	Total
<b>Carrying amount:</b>				
		(\$ thousands)		
December 31, 2011	\$ 5,868	\$ 889	\$ 678	\$ 7,435
December 31, 2012	\$ 5,740	\$ 889	\$ 166	\$ 6,795
<b>December 31, 2013</b>	<b>\$ 6,137</b>	<b>\$ 889</b>	<b>\$ —</b>	<b>\$ 7,026</b>

Trade names were acquired in the acquisitions of Pawnee and Case Funding and can be renewed annually, at nominal cost and for an indefinite period. There is no legal limit to the life of these trade names. The framework agreement, which was acquired in the acquisition of Sherway, can be renewed every five years at no cost and with no limit on the number of renewal periods. The businesses to which these intangible assets relate have established names in the market and, given the stability in the demand for their products and services, management expects to be able to derive economic benefit from these intangible assets for an indefinite period of time and has therefore determined them to be of indefinite life.

The following table shows the carrying amount of indefinite-lived identifiable intangible assets by CGU as at:

	December 31, 2013	December 31, 2012
	(\$ thousands)	
Pawnee	\$ 5,743	\$ 5,372
Case Funding	394	368
Sherway	889	889
Total indefinite-lived intangible assets	\$ 7,026	\$ 6,629

## 16. GOODWILL

The goodwill allocated to each CGU and movements in goodwill consist of the following:

	Pawnee	Case Funding	Sherway	Total
<b>Cost:</b>				
		(\$ thousands)		
December 31, 2011	\$ 36,887	\$ 664	\$ 3,923	\$ 41,474
Translation	(802)	(14)	—	(816)
December 31, 2012	\$ 36,085	\$ 650	\$ 3,923	\$ 40,658
Translation	2,492	44	—	2,536
<b>December 31, 2013</b>	<b>\$ 38,577</b>	<b>\$ 694</b>	<b>\$ 3,923</b>	<b>\$ 43,194</b>

	Pawnee	Case Funding	Sherway	Total
		(\$ thousands)		
<b>Accumulated impairment:</b>				
December 31, 2011	\$ 25,949	\$ —	\$ 1,403	\$ 27,352
Impairment – current year	—	—	—	—
Translation	\$ (564)	\$ —	\$ —	\$ (564)
December 31, 2012	\$ 25,385	\$ —	\$ 1,403	\$ 26,788
Impairment – current year	—	—	—	—
Translation	1,753	—	—	1,753
<b>December 31, 2013</b>	<b>\$ 27,138</b>	<b>\$ —</b>	<b>\$ 1,403</b>	<b>\$ 28,541</b>

	Pawnee	Case Funding	Sherway	Total
		(\$ thousands)		
<b>Carrying amount:</b>				
December 31, 2011	\$ 10,938	\$ 664	\$ 2,520	\$ 14,122
December 31, 2012	\$ 10,700	\$ 650	\$ 2,520	\$ 13,870
<b>December 31, 2013</b>	<b>\$ 11,439</b>	<b>\$ 694</b>	<b>\$ 2,520</b>	<b>\$ 14,653</b>

The Company completed its annual goodwill impairment test as at December 31, 2013 and 2012 and determined that no impairment had occurred. Goodwill is considered impaired to the extent that its carrying amount exceeds its recoverable amount. The recoverable amounts of the Company's CGUs were determined based on their value-in-use ("VIU"). The calculation of VIU incorporated five years of cash flow estimates and was based on the following key variables:

- The five years of cash flows were based on achieving key operating metrics and drivers based on management estimates, past history and the current economic outlook, and were approved by Chesswood management. The VIU for Pawnee is most sensitive to assumptions of lease origination volumes and net charge-offs. The VIU for Sherway is most sensitive to assumptions of vehicle sales and gross margins.
- Terminal value incorporated into the VIU calculations was estimated by applying the growth rates in the following chart to cash flow estimates for the fifth year. The growth rates reflect the historical average core inflation rate which does not exceed the long term average growth rate for the industry.

	Pawnee	Case Funding	Sherway
Terminal value growth rates:			
December 31, 2012	3.0%	3.0%	2.0%
December 31, 2013	3.0%	3.0%	2.0%

- The following pre-tax discount rates were applied in determining the recoverable amount of the CGUs. The discount rates were based on the weighted average cost of capital, adjusted for a liquidity and a risk premium.

	Pawnee	Case Funding	Sherway
Pre-tax discount rates:			
December 31, 2012	30.05%	23.62%	24.47%
December 31, 2013	30.82%	23.83%	26.32%

The Company believes that any reasonably possible change in the key assumptions on which its CGU's recoverable amounts are based would not cause the CGU's carrying amounts to exceed their recoverable amounts. If the future were to adversely differ from management's best estimate of key assumptions and associated cash flows were to be materially adversely affected, the Company could potentially experience future material impairment charges in respect of its goodwill and intangible assets with indefinite lives.



## 17. ACCOUNTS PAYABLE AND OTHER LIABILITIES

Accounts payable and other liabilities comprise:

	<b>December 31, 2013</b>	December 31, 2012
	<i>(\$ thousands)</i>	
Dividends payable	\$ 744	\$ 623
Accounts payable	388	451
Sales tax payable	850	867
Customer deposits and prepayments	161	224
Unfunded leases and EFAs	1,359	1,590
Taxes payable	39	1,975
Payroll related payables and accruals	1,012	1,053
Accrued liabilities	1,677	631
Property taxes payable on equipment leases	298	296
Withholding taxes payable	466	425
Deferred lease incentive	102	125
	<b>\$ 7,096</b>	<b>\$ 8,260</b>

All amounts are due within one year, except for deferred lease incentive which is being amortized over the remaining term of the leases which expire in 2017.

## 18. VEHICLE FINANCING

Sherway has an \$8.5 million floor plan facility available, bearing interest at the bank's prime rate plus 0.625% (2012 - 0.625%) or the Canadian Dollar Offering Rate ("CDOR") plus 1.25% (2012 - 2.125%), secured by the related vehicles and a general security agreement over the dealership's other assets. Advances under the floor plan are due on the earlier of the date of sale of the related vehicle and 12 months after the receipt of the loan. The repayment terms of 12 months may be extended for an additional 90 days, subject to an immediate repayment of 10% of the principal amount. Under the facility, repayment may be extended for a second 90-day term subject to a further 20% repayment. Based on monthly average debt levels, the effective interest rate paid during the year was 2.77% (2012 - 3.25%).

## 19. INTEREST RATE SWAPS

Pawnee enters into interest rate swap agreements under its banking facility, that provide for payment of an annual fixed rate, in exchange for a LIBOR based floating rate amount. The interest rate swaps are intended to offset a portion of the variable interest rate risk on the credit facility.

Pawnee's interest rate swaps are not considered trading instruments as Pawnee intends to hold them until maturity. The interest rate swaps do not qualify as a hedge for accounting purposes, and are therefore recorded as separate derivative financial instruments. Accordingly, the estimated fair value of the interest rate swaps are recorded as a liability on the accompanying consolidated statement of financial position. Payments made and received pursuant to the terms of the interest rate swaps are recorded as an adjustment to interest expense. Adjustments to the fair value of the interest rate swaps are recorded as fair value adjustments on the statement of income. The fair value of interest rate swaps is based upon the estimated net present value of cash flows.

The following swap agreements were outstanding at December 31, 2013:

<b>Effective Date</b>	<b>Notional Amount U.S.\$</b>	<b>Annual Fixed Rate</b>	<b>Maturity Date</b>
March 2011	\$15 million	3.12%	March 2014
March 2012	\$15 million	4.00%	March 2015
April 2013	\$15 million	0.96%	April 2016
March 2014	\$15 million	1.33%	March 2017
March 2015	\$15 million	1.56%	March 2017
April 2015	\$15 million	2.12%	March 2019
April 2016	\$15 million	2.11%	March 2018

See Note 36(d) - *Subsequent events*, for interest rates swaps entered into after December 31, 2013.

## 20. BORROWINGS

Borrowings are comprised of:

	<b>December 31, 2013</b>	December 31, 2012
	(\$ thousands)	
Pawnee credit facility	\$ 77,887	\$ 48,089
Deferred financing costs – Pawnee	(582)	(512)
Borrowings – Pawnee	<u>\$ 77,305</u>	<u>\$ 47,577</u>

Pawnee's credit facility allows borrowings of up to U.S.\$85.0 million (December 31, 2012 - U.S.\$85.0 million) subject to, among other things, certain percentages of eligible gross lease receivables, of which U.S.\$73.2 million was utilized at December 31, 2013 (2012 - U.S.\$48.3 million). The facility can be extended, subject to certain conditions, to U.S.\$115.0 million (2012 - U.S.\$115.0 million). This credit facility is secured by substantially all of Pawnee's assets, contains negative covenants including maintaining leverage and interest coverage ratios, requires Pawnee to mitigate its interest rate risk by entering interest rate swaps for a notional amount not less than 50% of the outstanding amount, and matures on July 24, 2016. At December 31, 2013 and 2012, Pawnee was in compliance with all covenants. Based on monthly average debt levels, the effective interest rate paid during the year was 4.91% (2012 - 5.78%).

In November 2013, Pawnee's syndicate of lenders approved amendments to the current banking agreement that provide Windset with access to a maximum of US\$5.0 million of capital from Pawnee's credit facility.

Subsequent to year end, Pawnee's syndicate of lenders approved amendments to the current banking agreement that provide Windset with access to a maximum of US\$10.0 million of capital from Pawnee's credit facility. See Note 36(b) - *Subsequent events*.

## 21. CUSTOMER SECURITY DEPOSITS

Customer security deposits are held for the full term of the lease and then returned or applied to the purchase option of the equipment at the lessee's request, unless the lessee has previously defaulted in which case the deposit is applied against the lease receivable at that time. Past experience suggests that a very high percentage of the customer deposits are applied to the purchase option of the leased equipment at the end of the lease term, or as an offset against outstanding lease receivables.

	<b>December 31, 2013</b>	December 31, 2012
	(\$ thousands)	
Security deposits that will be utilized within one year	<b>\$ 3,483</b>	\$ 3,151
Security deposits that will be utilized in future years	<b>8,347</b>	7,843
	<b>\$ 11,830</b>	\$ 10,994

## 22. CONVERTIBLE DEBENTURES

On December 16, 2013, the Company issued a total of \$20.0 million of convertible debentures. The debentures mature on December 31, 2018, and bear interest at a rate of 6.5% per annum, payable semi-annually. The outstanding principal under the debentures may, at the option of the holders, be converted into common shares of the Company at a conversion price of \$21.25 per share at any time. After the Company exercises its redemption right and prior to the date specified for redemption, each holder has the ability to convert their convertible debentures to common shares. Upon a holder's election to convert debentures, the Company may elect to pay the holder cash in lieu of delivering shares. The Company also has the right to satisfy its payment obligations under the debentures (subsequent to obtaining any required regulatory approvals) by issuing common shares (based on a deemed issue price of 95% of the current market value).

The Company has the following options to redeem the convertible debentures prior to maturity:

- After December 31, 2016 and prior to December 31, 2017, the Company has the option to redeem the debentures provided the current market price for the purposes of the debentures, is at least 125% of the conversion price of \$21.25.
- Subsequent to December 31, 2017 and prior to December 31, 2018, the Company has the option to redeem the debentures provided the redemption price at a price equal to the principal amount including accrued and unpaid interest.

The convertible debentures balance at the end of the year is comprised of:

	<b>December 31, 2013</b>	December 31, 2012
	(\$ thousands)	
Principal amount recognized on issuance	<b>\$ 20,000</b>	\$ —
Fair value adjustment	<b>680</b>	—
Balance at December 31	<b>\$ 20,680</b>	\$ —

	<b>December 31, 2013</b>	December 31, 2012
	(\$ thousands)	
Fair value adjustment for the year	<b>\$ 680</b>	\$ —
Issuance costs	<b>1,355</b>	—
Financing costs - convertible debentures	<b>\$ 2,035</b>	\$ —

## 23. MINIMUM PAYMENTS

The following are the contractual principal payments and maturities of financial liabilities and other commitments:

(\$ thousands)	2014	2015	2016	2017	2018 +	Total
Accounts payable and other liabilities	\$ 7,021	\$ 29	\$ 31	\$ 15	\$ —	\$ 7,096
Vehicle financing	6,368	—	—	—	—	6,368
Interest rate swaps	115	752	186	274	(126)	1,201
Borrowings (i)	—	—	77,305	—	—	77,305
Customer security deposits (ii)	3,483	3,188	2,825	1,601	733	11,830
Convertible debentures	—	—	—	—	20,000	20,000
	<u>\$ 16,987</u>	<u>\$ 3,969</u>	<u>\$ 80,347</u>	<u>\$ 1,890</u>	<u>\$ 20,607</u>	<u>\$123,800</u>
Other financial commitments (iii)	901	783	596	278	119	2,677
Total commitments	<u>\$ 17,888</u>	<u>\$ 4,752</u>	<u>\$ 80,943</u>	<u>\$ 2,168</u>	<u>\$ 20,726</u>	<u>\$126,477</u>

- Pawnee's financing credit facility is a line-of-credit and, as such, the balance can fluctuate. The credit facility matures in 2016.*
- The Company's experience has shown that the actual contractual payment streams will vary depending on a number of variables including: prepayment rates, charge-offs and modifications. Accordingly, the scheduled contractual payments of customer security deposits shown in the table above are not to be regarded as a forecast of future cash payments.*
- The Company and its subsidiaries are committed to future minimum rental payments under existing leases for premises, excluding occupancy costs and property tax, expiring in 2015 and 2018.*

For other commitments, refer to Note 30 - *Contingent liabilities and other financial commitments*.

## 24. TAXES

- (a) Tax expense consists of the following:

	For the years ended	
	December 31, 2013	December 31, 2012
	(\$ thousands)	
Current tax expense	\$ 12,391	\$ 4,649
Deferred tax expense (recovery)	(3,559)	2,989
Total tax expense	<u>\$ 8,832</u>	<u>\$ 7,638</u>

- (b) The table below shows the reconciliation between tax expense reported in the Statement of Income and the tax expense that would have resulted from applying the combined Canadian Federal and Ontario tax rate of 26.5% (2012 - 26.5%) to income before income taxes.

	For the years ended	
	December 31, 2013	December 31, 2012
	(\$ thousands)	
Income before taxes	\$ 19,737	\$ 16,627
Canadian tax rate	26.5%	26.5%
Theoretical tax expense	5,230	4,406
Tax cost of non-deductible items	231	176
Deferred tax assets not recognized	343	535
Withholding tax on intercompany dividend	543	488
Higher effective tax rates in foreign jurisdictions	2,544	2,082
Other	(59)	(49)
Total tax expense	\$ 8,832	\$ 7,638

(c) The tax effects of the temporary differences giving rise to the Company's deferred tax asset are as follows:

	December 31, 2013	December 31, 2012
	(\$ thousands)	
Deferred tax assets:		
Intangible assets	\$ 653	\$ 704
Financing costs	501	—
Tax losses carried forward	939	653
	2,093	1,357
Deferred tax liabilities:		
Unrealized fair value accretion on plaintiff advances	683	227
Deferred tax assets, net	\$ 1,410	\$ 1,130
Deferred tax assets not recognized	(578)	(771)
	\$ 832	\$ 359

Deferred tax assets are recognized to the extent that realization of the related tax benefit through future taxable profits is probable.

At December 31, 2013, Sherway had \$1.4 million (2012 - \$1.5 million) in deductible temporary differences related to intangible assets for which deferred tax assets have not been recognized. At December 31, 2013, Case Funding had U.S.\$2.1 million (2012 - U.S.\$1.5 million) in tax losses carried forward and taxable timing differences of U.S.\$1.6 million (2012 - \$553,000). The tax benefit of U.S.\$500,200 (2012 - U.S.\$1.0 million) in excess of taxable timing differences has not been recognized.

The Company has determined that it is probable that all other deferred tax assets will be realized through a combination of future reversals of temporary differences and taxable income.

- (d) The tax effects of the significant components of temporary differences giving rise to the Company's net deferred tax liabilities are as follows:

	<b>December 31, 2013</b>	December 31, 2012
	(\$ thousands)	
Deferred tax assets:		
Leased assets	\$ 22,156	\$ 14,142
Allowance for doubtful accounts	1,474	1,136
Tax losses carried forward	12	103
Accrued liabilities	1,347	1,735
	<b>\$ 24,989</b>	<b>\$ 17,116</b>
Deferred tax liabilities:		
Finance receivables	\$ 48,872	\$ 42,437
Deferred taxes liabilities, net	\$ 23,883	\$ 25,321
Deferred taxes liabilities to be realized in the next 12 months	\$ 7,379	\$ 8,311

The Company has determined that it is probable that all recognized deferred tax assets will be realized through a combination of future reversals of temporary differences and taxable income.

The Company has not recognized deferred tax liabilities in respect of unremitted earnings in foreign subsidiaries, totaling \$13.9 million (2012 - \$20.2 million), as it is not considered probable that this temporary difference will reverse in the foreseeable future.

- (e) Deferred tax balances within the consolidated statements of financial position were comprised of the following:

	<b>December 31, 2013</b>	December 31, 2012
	(\$ thousands)	
Deferred tax assets (c)	\$ 832	\$ 359
Deferred taxes liabilities (d)	(23,883)	(25,321)
Net deferred taxes liabilities	<b>\$ (23,051)</b>	<b>\$ (24,962)</b>

Reconciliation of net deferred tax liabilities:

	<b>2013</b>	2012
	(\$ thousands)	
Balance, beginning of year	\$ (24,962)	\$ (22,464)
Deferred tax recovery (expense) in the statements of income (a)	3,559	(2,989)
Translation difference recognized in OCI	(1,648)	491
Net change in net deferred tax liabilities during the year	1,911	(2,498)
Balance, end of year	<b>\$ (23,051)</b>	<b>\$ (24,962)</b>

## 25. COMMON SHARES

### *Normal course issuer bids*

In August 2011, the Board of Directors approved the repurchase and cancellation of up to 655,072 of the Company's outstanding Common Shares for the period commencing August 25, 2011 and ending on August 24, 2012. From January 1, 2012 to August



24, 2012, 58,538 Common Shares were repurchased under the normal course issuer bid resulting in a decrease of \$262,250 in Common Share capital and \$182,400 in Retained Earnings.

In August 2012, the Board of Directors approved the repurchase and cancellation of up to 658,943 of the Company's outstanding Common Shares for the period commencing August 25, 2012 and ending on August 24, 2013. From August 25, 2012 to December 31, 2012, 21,436 Common Shares were repurchased under this normal course issuer bid resulting in a decrease of \$97,000 in Common Share capital and \$80,000 in Retained Earnings.

In August 2013, the Board of Directors approved the repurchase and cancellation of up to 688,614 of the Company's outstanding Common Shares for the period commencing August 25, 2013 and ending on August 24, 2014. No Common Shares have been repurchased under this normal course issuer bid. Decisions regarding the timing of purchases are based on market conditions and other factors.

## 26. COMPENSATION PLANS

### (a) Share options

A summary of the number of options outstanding is as follows:

	For the years ended	
	December 31, 2013	December 31, 2012
Balance, beginning of period	1,522,900	1,227,750
Granted	—	367,500
Exercised	(81,272)	(72,350)
Forfeited	(10,000)	—
Balance, end of period	1,431,628	1,522,900

During the year-ended December 31, 2013, no options were granted (2012 - 367,500). The options vest 30% at the end of the first year, another 35% at the end of the second year, and the remaining 35% at the end of the third year. The option exercise price is equal to the 10-day volume weighted average price of the Shares at the date prior to the day such Options were granted and are satisfied through the issue of common shares upon exercise. The options expire on the 10th anniversary of the grant date.

The value of the options granted during the year was determined using the Black-Scholes option pricing model with the following assumptions:

	2013	2012
Weighted average share price at date	-	\$7.93
Expected volatility (*)	-	63% - 71%
Expected life [years]	-	5 - 7
Expected dividend yield	-	7.25% - 8.12%
Risk-free interest rate	-	1.25% - 1.53%
Weighted average grant date fair value	-	\$2.54

(\*) based on the historical volatility of the Company's share price over expected life of options.

During the year ended December 31, 2013, personnel expense and reserve - share-based compensation included \$816,800 (2012 - \$1.1 million) relating to option expense. As of December 31, 2013, unrecognized non-cash compensation expense related to the outstanding options was \$357,800 (2012 - \$1.2 million), which is expected to be recognized over the remaining vesting period.

During the year ended December 31, 2013, 81,272 options were exercised (2012 - 72,400) for total cash consideration of \$357,800 (2012 - \$183,700). On exercise, the fair value of options that had been expensed to date during the vesting period of \$256,000 (2012 - \$238,800) was transferred from Reserve to Common Shares. For the options exercised in 2013, the weighted average share price at the date of exercise was \$11.40 (2012 - \$7.99).

An analysis of the options outstanding at December 31, 2013 is as follows:

Grant date	Number of options outstanding	Vested	Expiry date	Exercise price
May 10, 2006	100,000	100,000	May 9, 2016	\$ 10.00
June 23, 2009	168,900	168,900	June 22, 2019	\$ 2.06
April 13, 2010	197,728	197,728	April 13, 2020	\$ 4.49
April 25, 2011	276,000	177,125	April 24, 2021	\$ 7.79
June 10, 2011	129,500	77,000	June 9, 2021	\$ 7.73
December 6, 2011	200,000	130,000	December 6, 2021	\$ 6.14
June 25, 2012	229,500	66,750	June 24, 2022	\$ 7.45
July 9, 2012	5,000	1,500	July 8, 2022	\$ 7.42
December 6, 2012	125,000	37,500	December 6, 2022	\$ 8.86
	<u>1,431,628</u>	<u>956,503</u>		

At December 31, 2013, the weighted average exercise price is \$6.61 (2012 - \$6.50) and the weighted average remaining contractual life for all options outstanding is 7.04 years (2012 - 8.01 years). The options exercisable at December 31, 2013 have a weighted average exercise price of \$6.12 (2012 - 630,400 options at \$5.39).

See Note 36 (e), *Subsequent events*, for stock options exercised after December 31, 2013.

(b) Restricted share units

A summary of the restricted share units outstanding is as follows:

	For the years ended	
	December 31, 2013	December 31, 2012
Balance, beginning of period	<u>69,000</u>	57,000
Granted	<b>51,500</b>	51,500
Exercised	<b>(45,500)</b>	(39,500)
Balance, end of period	<u><b>75,000</b></u>	<u>69,000</u>

During the year ended December 31, 2013, an aggregate of 44,000 (2012 - 44,000) restricted share units ("RSUs") were granted to directors and expire in ten years. The grantees of such RSUs are not entitled to the dividends paid before the RSUs are exercised. Such RSUs vest one year from the date of issue and are to be settled by the issue of Common Shares. RSUs granted are in respect of future services and are expensed over the vesting period. Compensation cost is measured based on the market price of the Common Shares on the date of the grant of the RSUs, which was \$11.65.

During the year ended December 31, 2013, 7,500 (2012 - 7,500) RSUs were granted in accordance with the Case Funding purchase agreement to a senior executive of Case Funding, the RSUs vested immediately and were exercised by the executive. Compensation cost was measured based on the market price of the Common Shares on the acquisition date of Case Funding, which was \$7.73.

During the year ended December 31, 2013, personnel expense and reserve - share-based compensation included \$528,200 (2012 - \$317,600) relating to RSUs.

On exercise of the 45,500 RSUs during the year ended December 31, 2013 (2012 - 39,500), the value of the RSUs of \$340,100 (2012 - \$306,300) that had been expensed during the vesting period was transferred from reserve - share-based compensation to Common Share capital. For the 45,500 RSUs exercised in 2013, the weighted average share price at the date of exercise was \$10.93 (2012 - 39,500 shares at \$7.35).

As of December 31, 2013, unrecognized non-cash compensation expense related to non-vested RSUs was \$199,400 (2012 - \$158,100).

The following RSUs are outstanding at December 31, 2013:

Grant date	Number of RSUs outstanding	Vested	Expiry date	Exercise price
April 13, 2010	20,000	20,000	April 12, 2020	\$ 4.49
April 25, 2011	5,000	5,000	April 24, 2021	\$ 7.79
June 25, 2012	6,000	6,000	June 24, 2022	\$ 7.45
May 22, 2013	44,000	—	May 21, 2023	\$ 11.65
	<u>75,000</u>	<u>31,000</u>		

## 27. DIVIDENDS

The following dividends were paid to Common Shareholders and Exchangeable Securities holders during the year-ended December 31, 2013:

Record date	Payment date	Cash dividend per share (\$)	Total dividend amount (\$ thousands)
December 31, 2012	January 16, 2013	\$ 0.055	\$ 623
January 31, 2013	February 15, 2013	\$ 0.055	623
February 28, 2013	March 15, 2013	\$ 0.060	679
March 31, 2013	April 16, 2013	\$ 0.060	681
April 30, 2013	May 15, 2013	\$ 0.060	681
May 31, 2013	June 15, 2013	\$ 0.060	682
June 30, 2013	July 16, 2013	\$ 0.060	684
July 31, 2013	August 15, 2013	\$ 0.060	685
August 31, 2013	September 17, 2013	\$ 0.060	686
September 30, 2013	October 15, 2013	\$ 0.060	686
October 31, 2013	November 15, 2013	\$ 0.060	686
November 30, 2013	December 17, 2013	\$ 0.065	744
<b>Paid during the year-ended December 31, 2013</b>			<b>\$ 8,140</b>

The following dividends were declared but not paid to Common Shareholders and Exchangeable Securities holders during the year-ended December 31, 2013 and are included in accounts payable and other liabilities:

Record date	Payment date	Cash dividend per share (\$)	Total dividend amount (\$ thousands)
December 31, 2013	January 15, 2014	\$ 0.065	\$ 744

The following dividends were declared before the financial statements were authorized for issue but not recognized during the year-ended December 31, 2013:

Record date	Payment date	Cash dividend per share (\$)	Total dividend amount
			(\$ thousands)
January 31, 2014	February 18, 2014	\$ 0.065	\$ 744
February 28, 2014	March 17, 2014	\$ 0.065	745
			<b>\$ 1,489</b>

The following dividends were paid to Common Shareholders and Exchangeable Securities holders during the year-ended December 31, 2012:

Record date	Payment date	Cash dividend per share (\$)	Total dividend amount
			(\$ thousands)
December 31, 2011	January 16, 2012	\$ 0.050	\$ 564
January 31, 2012	February 15, 2012	\$ 0.050	565
February 28, 2012	March 15, 2012	\$ 0.050	565
March 31, 2012	April 16, 2012	\$ 0.050	565
April 30, 2012	May 15, 2012	\$ 0.050	566
May 31, 2012	June 15, 2012	\$ 0.055	622
June 30, 2012	July 16, 2012	\$ 0.055	621
July 31, 2012	August 15, 2012	\$ 0.055	621
August 31, 2012	September 17, 2012	\$ 0.055	623
September 30, 2012	October 15, 2012	\$ 0.055	623
October 31, 2012	November 15, 2012	\$ 0.055	623
November 30, 2012	December 17, 2012	\$ 0.055	623
Paid during the year-ended December 31, 2012			\$ 7,181

The following dividends were declared but not paid to Common Shareholders and Exchangeable Securities holders during the year-ended December 31, 2012 and are included in accounts payable and other liabilities:

Record date	Payment date	Cash dividend per share (\$)	Total dividend amount
			(\$ thousands)
December 31, 2012	January 15, 2013	\$ 0.055	\$ 623

## 28. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net earnings for the year by the weighted average number of common shares outstanding during the year.

	For the years ended	
	December 31, 2013	December 31, 2012
Weighted average number of common shares outstanding	9,909,930	9,825,875
Dilutive effect of options	665,486	331,982
Dilutive effect of RSUs	77,066	58,918
Weighted average common shares outstanding for diluted earnings per share	10,652,482	10,216,775

Convertible debentures, issued during the year, convertible into 941,176 common shares, and options to purchase nil common shares (2012 - 512,500) were outstanding during the year but were not included in the calculation of diluted earnings per share due to their anti-dilutive effect for the year.

## 29. CASH FLOW SUPPLEMENTARY DISCLOSURE

	For the years ended	
	December 31, 2013	December 31, 2012
	(\$ thousands)	
<b>Non-cash items included in net income - other</b>		
Gain on sale of leased vehicles	\$ —	\$ (77)
Amortization of deferred financing costs	178	168
Unrealized loss on convertible debentures	680	—
Contingent consideration and bonus payable	—	(725)
Unrealized gain on interest rate swaps	(1,413)	(7)
Unrealized gain on foreign exchange	(478)	(57)
	<u>\$ (1,033)</u>	<u>\$ (698)</u>
<b>Finance receivables – change in</b>		
Net investments in leases – pledged	\$ —	\$ 814
Net investments in leases	(16,547)	(13,420)
Equipment finance agreements	(11,200)	(6,730)
Working capital loans	(2,346)	—
Legal finance receivables	(4,781)	(4,117)
	<u>\$ (34,874)</u>	<u>\$ (23,453)</u>

	For the years ended	
	December 31, 2013	December 31, 2012
	(\$ thousands)	
<b>Borrowings – change in</b>		
Line-of-credit – Pawnee – net	\$ 25,638	\$ 7,755
Securitization debt payments	—	(707)
	<u>\$ 25,638</u>	<u>\$ 7,048</u>
<b>Other net operating assets - change in</b>		
Accounts receivable	\$ (428)	\$ 436
Inventories	46	(1,802)
Prepaid and other assets	(1,105)	1
Accounts payable and other liabilities	1,378	494
Vehicle financing	169	1,274
Customer security deposits	74	(256)
	<u>\$ 134</u>	<u>\$ 147</u>
<b>Non-cash transactions</b>		
Common shares issued on exercise of restricted share units	<u>\$ 340</u>	<u>\$ 306</u>

### 30. CONTINGENT LIABILITIES AND OTHER FINANCIAL COMMITMENTS

#### (a) Contingent liabilities

The Company is subject to various claims and legal actions in the normal course of its business, from various customers, suppliers and others. Since the individual value of each claim and the total value of all claims as at December 31, 2013 and December 31, 2012 were not material, additional disclosure is not required.

#### (b) Other financial commitments

- The Company has entered into retention agreements with certain employees whereby such employees shall be entitled to certain retention severance amounts upon the occurrence of events identified in each respective agreement. Included in the retention agreement of Chesswood's Chief Executive Officer is an award of 125,000 options.
- Incentive Payment Amount on the acquisition of Case Funding - The consideration is payable in the event that Case Funding's normalized net income ("NNI") for the 25th through 36th months following the Acquisition Date (June 10, 2011) achieves the targeted amount of approximately U.S.\$4.7 million (the "Targeted Amount"), whereby an amount of U.S.\$1.4 million (the "Incentive Payment Amount") (or an identical percentage adjusted portion of the Incentive Payment Amount if NNI is less than, but at least 90% of, the Targeted Amount) will be paid no later than the 38th month.

### 31. FINANCIAL INSTRUMENTS

#### (a) Categories and measurement hierarchy

All financial instruments measured at fair value and for which fair value is disclosed are categorized into one of three hierarchy levels, described below, for disclosure purposes. Each level is based on the transparency of the inputs used to measure the fair values of assets and liabilities:

- Level 1 Inputs - quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date;



- (ii) Level 2 Inputs - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
- (iii) Level 3 Inputs - techniques which use inputs which have a significant effect on the recorded fair value for the asset or liability that are not based on observable market data (unobservable inputs).

The categories to which the financial instruments are allocated under IAS 39 are:

	<u>Category</u>
AFS	Available for sale
L&R	Loans and receivables
L&B	Loans and borrowings
HFT	Held for trading
FVTP	Fair value through profit or loss

The fair values of financial instruments are classified using the IFRS 7, *Financial Instruments: Disclosures*, measurement hierarchy as follows:

**December 31, 2013**

	<u>Category</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Carrying Value</u> (\$ thousands)
<b>ASSETS</b>					
Cash (iii)	L&R	\$ 22,659	\$ —	\$ —	22,659
Accounts receivable (iii)	L&R	—	1,199	—	1,199
EFAs & WCLs (i)	L&R	—	21,195	—	21,195
Attorney loans and medical liens (i)	L&R	—	4,642	—	4,642
Plaintiff advances	AFS	—	—	6,319	6,319
<b>LIABILITIES</b>					
Accounts payable (iii)	L&B		(7,096)	—	(7,096)
Vehicle financing (ii)	L&B		(6,368)	—	(6,368)
Interest rate swaps (iv)	HFT	—	(1,201)	—	(1,201)
Borrowings (ii)	L&B		(77,305)	—	(77,305)
Customer security deposits	L&B		(11,830)		(11,830)
Convertible debentures (v)	FVTP	(20,680)	—	—	(20,680)
Total net assets (liabilities) classified as financial instruments		\$ 1,979	\$ (76,764)	\$ 6,319	\$ (68,466)

					December 31, 2012	
	Category	Level 1	Level 2	Level 3	Carrying Value	(\$ thousands)
<b>ASSETS</b>						
Cash (iii)	L&R	\$ 5,591	\$ —	\$ —	\$	5,591
Accounts receivable (iii)	L&R	—	771	—		771
EFAs & WCLs (i)	L&R	—	6,700	—		6,700
Attorney loans and medical liens (i)	L&R	—	2,295	—		2,295
Plaintiff advances	AFS	—	—	3,349		3,349
<b>LIABILITIES</b>						
Accounts payable (iii)	L&B	—	(8,260)	—		(8,260)
Vehicle financing (ii)	L&B	—	(6,199)	—		(6,199)
Interest rate swaps (iv)	HFT	—	(2,489)	—		(2,489)
Borrowings (ii)	L&B	—	(47,577)	—		(47,577)
Customer security deposits	L&B	—	(10,994)	—		(10,994)
Total net assets (liabilities) classified as financial instruments		\$ 5,591	\$ (65,753)	\$ 3,349	\$	(56,813)

- (i) There is no organized market for the legal finance receivables. Therefore the carrying value is the amortized cost using the effective interest rate method. The contract interest rates approximate current market rates.
- (ii) The stated value of the vehicle financing and borrowings approximates fair values, as the interest rates attached to these instruments are representative of current market rates, for loans with similar terms, conditions and maturities. See Note 18 - *Vehicle financing* and Note 20 - *Borrowings* for effective interest rates.
- (iii) Carrying amounts are expected to be reasonable approximations of fair value for cash and for financial instruments with short maturities, including accounts receivable and accounts payable.
- (iv) The Company determines the fair value of its interest rate swap under the income valuation technique using a discounted cash flow model. Significant inputs to the valuation model include the contracted notional amount, LIBOR rate yield curves and the applicable credit-adjusted risk-free rate yield curve. The Company's interest rate derivative is included in the Level 2 fair value hierarchy because all the significant inputs are directly or indirectly observable. For the rates on the interest rate swaps, see Note 19 - *Interest rate swaps*.
- (v) The convertible debentures have several embedded derivative features which were determined to not meet the criteria for treatment as equity components and would otherwise be required to be recognized as separate financial instruments, measured at fair value through profit or loss. The Company has elected under IAS 39.11A to designate the entire convertible debentures (and all the embedded derivatives) as a combined financial liability at fair value through profit or loss. The fair value of the convertible debentures is based on their trading price on the Toronto Stock Exchange every reporting period; as a result, there may be increased volatility in the reported net income. The \$1.4 million of costs related to the issuance of the convertible debenture were expensed when incurred; thus no transaction costs are capitalized in the fair value of the convertible debentures.

Transfers between levels are considered to occur on the date that the fair valuation methodology changes. There were no transfers between levels during the current or prior year.

(b) *Reconciliation of Level 3 Financial Instruments*

The following table sets forth a summary of changes in the carrying value of plaintiff advances:

	For the years ended	
	December 31, 2013	December 31, 2012
	(\$ thousands)	
Balance, beginning of year	\$ 3,349	\$ 915
Originations	3,125	2,560
Fair value accretion (i)	1,731	763
Losses	(11)	(33)
Collections	(2,193)	(834)
Foreign exchange impact (ii)	318	(22)
Balance, end of year	\$ 6,319	\$ 3,349

- (i) Management considered that the change in fair value for plaintiff advances, which are carried at fair value, related to the amortization of interest or successful settlement of advances during the period. The fair value accretion on plaintiff advances is included in interest revenue on finance leases and loans on the statement of income.
- (ii) Difference between year-end foreign exchange rate and average exchange rate; the amount is included in other comprehensive income.

Fair value measurements are based on level 3 inputs of the three-level hierarchy system which indicates inputs for the assets that are not based on observable market data (unobservable inputs). Plaintiff advances are initially recorded at their fair value, equivalent to the funds advanced. Subsequent measurement of plaintiff advances is at fair value utilizing a fair value model developed by the Company.

The principal assumptions used in the fair value model are as follows:

- Estimated duration of each plaintiff advance;
- Best estimate of anticipated outcome;
- Monthly fee per advance contract on nominal value of each plaintiff advance; and
- Market interest rate at which estimated cash flows are discounted.

The fair value of plaintiff advances is reviewed quarterly on an individual case basis. Events that may trigger changes to the fair value of each plaintiff advance include the following:

- Successful and unsuccessful judgments of claims in which the Company has a plaintiff advance;
- Outstanding appeals against both successful and unsuccessful judgments;
- Receipt of funds to settle plaintiff advances;
- A case is dismissed with prejudice (meaning, it can never be re-filed anywhere);
- Change in monthly fee assessed on plaintiff advances;
- Market interest rate at which estimated cash flows are discounted.

Inherent to the underwriting process is the approval for funding of cases that have a high probability of success, to be achieved either in pre-trial settlement or as a result of a judgment by a court. At December 31, 2013, the average size of a plaintiff advance is U.S.\$10,861 (2012 - U.S.\$9,990). The fair value estimate is inherently subjective being based largely on an estimate of the duration of plaintiff advance and its potential settlement. In the Company's opinion there is no useful alternative valuation that would better quantify the market risk inherent in the portfolio and there are no inputs or variables to which the value of the plaintiff advances are correlated.

A 10% change in the estimated duration of plaintiff advances, while all other variables remain constant, would have no significant impact on the Company's net income and net assets.

(c) *Gains and losses on financial instruments*

The following table shows the net gains and losses arising for each IAS 39 category of financial instrument.

	For the years ended	
	December 31, 2013	December 31, 2012
	(\$ thousands)	
Loans and receivables:		
Provision for credit losses	\$ (6,495)	\$ (5,279)
Designated as at fair value through net income or loss:		
Convertible debentures	(680)	—
Held for trading:		
Interest rate swaps	1,413	7
Net loss	<u>\$ (5,762)</u>	<u>\$ (5,272)</u>

(d) *Financial Risk Management*

In the normal course of business, the Company manages risks that arise as a result of its use of financial instruments. These risks include credit, liquidity and market risk. Market risks can include interest rate risk, foreign currency risk and other price risk.

There have been no changes in the Company's objectives, policies or processes for managing or for measuring any of the risks to which it is exposed since the previous year end.

i) *Credit risk*

Credit risk stems primarily from the potential inability of a customer or counterparty to a financial instrument to meet its contractual obligations, notwithstanding the existence of any collateral received. The Company's maximum exposure to credit risk is represented by the carrying amounts of cash, accounts receivable and finance receivables.

The Company's excess cash is held in accounts with a major Canadian chartered bank or at J.P. Morgan Chase in the United States. Management has estimated credit risk with respect to such balances to be nominal and monitors changes in the status of these financial institutions to mitigate potential credit risk.

Accounts receivable principally relate to the Sherway dealership. Of the total, 81.1% (2012 - 69.7%) represent amounts due from the manufacturer and financing contracts in transit, which are typically collected within seven to ten days. Credit risk for accounts receivable arises primarily due to the concentration of the receivable with the automotive manufacturer.

Pawnee's and Windset's investment in finance receivables are originated with smaller, often owner-operated, businesses that have limited access to traditional financing. The typical borrower is a start-up business that has not established business credit or a business that has experienced some business credit difficulty at some time in its history. As a result, such leases and loans entail higher credit risk (reflected in higher than expected levels of delinquencies and loss) relative to the business equipment financing market as a whole.

Credit risk is mitigated by: funding only "business essential" commercial equipment, where the value of the equipment is less than U.S.\$75,000, obtaining at least one personal guarantee for each lease or loan, and by diversification on a number of levels, including: geographical across the United States, type of equipment funded, the industries in which Pawnee's lessees/borrowers operate and statistically through the number of customers, none of which is individually significant. Furthermore, Pawnee's credit risk is mitigated by the fact that the standard lease/loan contract most often requires that the lessee/borrower provide two payments as a security deposit, which, in the case of default, is applied against the lease/loan receivable; otherwise the deposit is held for the full term of the lease/loan and is then returned or applied to the purchase option of the equipment at the lessee's option.

Pawnee is entitled to repossess leased equipment if the lessees default on their lease contracts in order to minimize any credit losses. When an asset previously accepted as collateral is acquired, it undergoes a process of repossession and disposal in accordance with the legal provisions of the relevant market. Please see Note 12 - *Finance receivables past due*, for a further discussion on the repossession of collateral.

Pawnee's lease and loan receivables consist of a large number of homogenous leases and loans, with relatively small balances, and as such, the evaluation of the allowance for credit losses is performed collectively for the lease and loan receivable portfolio. More detailed information regarding this methodology is provided in the section on accounting policies.

Additional information on finance lease receivables that have been renegotiated or are considered to be impaired is provided in Note 10 - *Net Investment in leases*.

For Case Funding's attorney loans, in order to mitigate the potential for loss, the loans will always be in an amount significantly less than the contingency fees that Case Funding expects, after its own independent evaluation, the attorney is likely to earn from the basket of existing cases against which the loan is made. Case Funding's advance rate is a maximum of 15% of the expected total fees. Only cases already in progress are eligible for inclusion in a basket.

Repayment of Case Funding's attorney loans is required by contract to be made on a priority basis, meaning that attorney fees resulting from settlements of cases from the basket are generally required to be used first to repay the loan, further reducing the potential for loan losses.

In the case of attorney loans, terms generally include; guarantees of the law firm, guarantees of the partners (often joint and several), registered liens against all of the firm's cases, a direction that requires the trust accounts to repay Case Funding first upon receipt of proceeds and that all proceeds are to be held in escrow when received; generous effective annual rates of interest of which a portion is paid monthly, and the balance is paid upon payout or partial payout; requirement to report on an ongoing basis the status of cases in the basket; provision of the firm's monthly bank statements; notice provisions for all settled cases including copies of all remittance cheques; and quarterly financial statements of the firm.

Plaintiff advances are made on the probability of success and potential claim size, not the plaintiff's credit score. The standard for this industry is that advances are made on a non-recourse, at-risk basis where the funder forfeits its entire advance and any related fees if the plaintiff is not successful in the lawsuit. Inherent to the underwriting process is the approval for funding of cases that have a high probability of success, to be achieved either in pre-trial settlement or as a result of a judgment by a court. At December 31, 2013, the average size of a plaintiff advance is U.S.\$10,861 (2012 - U.S.\$9,990).

## **ii) Liquidity risk**

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Company's objective is to maintain low cash balances, investing any free cash in finance receivables as needed and using any excess to pay down debt on the primary financing facilities. The subsidiaries fund working capital needs, finance receivable originations and growth using advances under credit facilities available when operating cash flow is not sufficient. At December 31, 2013, the Company has \$13.5 million (2012 - \$18.1 million) in additional borrowings available under various credit facilities to fund business operations.

The Company's operations and growth are financed through a combination of the cash flows from operations and from borrowings under existing credit facilities. Prudent liquidity risk management requires managing and monitoring liquidity on the basis of a rolling cash flow forecast and ensuring adequate committed credit facilities are in place, to the extent possible, to meet funding needs.

Pawnee has a credit facility that allows borrowings of up to U.S. \$85.0 million, and an accordion feature of up to U.S. \$115 million, subject to certain percentages of eligible gross lease receivables, of which U.S. \$73.2 million was utilized at December 31, 2013 (2012 U.S. \$48.3 million). See Note 20 - *Borrowings*. At this time, management believes that the syndicate of financial institutions that provides Pawnee's credit facility is financially viable and will continue to provide this facility, however there are no guarantees in the current economic environment.

Most of the Company's operating subsidiaries are subject to bank and/or manufacturer covenants relative to leverage and/or working capital. Pawnee is restricted in its ability to further merge, make acquisitions or be acquired, and is precluded from incurring additional debt without lender approval. Furthermore, dividends from Pawnee may not exceed 95% of Pawnee's consolidated net income, as determined in accordance with U.S. GAAP but excluding mark-to-market adjustments for interest rate swaps. The maturity structure for undiscounted contractual cash flows is presented in Note 23 - *Minimum payments*.

**iii) Market risk**

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market price risks faced by the Company relate to the trading price of convertible debentures, interest rates and foreign currency.

**iv) Trading price of convertible debentures**

The convertible debentures issued during the current year are measured at fair value at each reporting date with changes in fair value recognized in net income or loss. Fair value is based on the trading price of the debentures on the Toronto Stock Exchange. Therefore changes in trading price have a direct impact on net assets and net income or loss. The Company does not hedge this fair value price exposure.

**v) Interest rate risk**

Pawnee's leases are written at fixed effective interest rates. To the extent that Pawnee finances fixed rate leases with floating rate funds, the Company is exposed to fluctuations in interest rates such that an increase in interest rates could narrow the margin between the yield on a lease and the interest rate paid by the Company to finance the working capital.

Pawnee manages and mitigates this interest rate risk, as a condition of its borrowing facility, by entering into interest rate swap agreements for a notional amount not less than 50% of the aggregate commitment. The interest rate swap agreements provide for payment of a fixed rate and, in return, Pawnee receives payment of the LIBOR-based floating rate. Pawnee's bank has the option to terminate the swaps, typically one year prior to the maturity date. See Note 19 - *Interest rate swaps*, for more information relating to interest rate swaps.

The following table presents a sensitivity analysis for a reasonable fluctuation in interest rates in the U.S. market and the effect on the Company for the year-ended December 31, 2013 and 2012:

	For the years ended			
	December 31, 2013		December 31, 2012	
	+100 bps	-100 bps	+100 bps	-100 bps
	(\$ thousands)			
Increase (decrease) in interest expense	\$ 260	\$ (260)	\$ 215	\$ (215)
Increase (decrease) in net income and equity	\$ (182)	\$ 182	\$ (161)	\$ 161

**vi) Foreign currency risk**

The Company is exposed to fluctuations in the U.S. dollar exchange rate because significant operating cash inflows are generated in the U.S. while dividends are paid to shareholders in Canadian dollars. For the year-ended December 31, 2013 dividends paid totaled \$8.1 million (2012 - \$7.2 million).

Assets and liabilities of foreign operations denominated in foreign currencies are translated into Canadian dollars at the exchange rates in effect at each period-end date. Revenue and expenses denominated in foreign currencies are translated into Canadian dollars at the average exchange rate for the period. The resulting unrealized exchange gains or losses on translation are reported in other comprehensive income. Therefore, currency risk is an important factor for assessing the Company's net income and financial position.

The following table presents a sensitivity analysis for a hypothetical fluctuation in U.S. dollar exchange rates and the effect on the Company for the years ended December 31, 2013 and 2012:

	December 31, 2013	December 31, 2012
U.S. Denominated Balances		
	(\$ thousands)	
Year-end exchange rate	1.0636	0.9949
U.S. denominated net assets in U.S.\$ held in Canada	\$ 254	\$ 37
Effect of a 10% increase or decrease in the Cdn/U.S. dollar on U.S. denominated net assets	\$ 25	\$ 4



### 32. CAPITAL MANAGEMENT

The Company's capital is comprised of shareholders' equity which at December 31, 2013 comprised \$68.2 million (2012 - \$60.6 million) and convertible debentures. The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in the long-term and to provide adequate returns for shareholders.

The Company manages the capital structure and makes adjustments in light of changes in economic conditions and the risk profile of the underlying assets. The Company uses various measures including the amount of dividends paid to shareholders.

There have been no changes in the Company's objectives, policies or processes for managing capital during the year.

The Company is not subject to externally imposed regulatory capital requirements. However, each of the Company's operating subsidiaries is subject to bank and/or manufacturer covenants relative to leverage and/or working capital. These bank covenants safeguard the capital in each of its operating subsidiaries. Pawnee is restricted in its ability to further merge, acquire companies or be acquired, or incur additional debt without lender approval. Furthermore, dividends from Pawnee are limited to compliance with all bank covenants and may not exceed 95% of Pawnee's consolidated net income, as determined in accordance with U.S. GAAP, excluding mark-to-market adjustments for interest rate swaps.

In July 2012, Pawnee renewed and expanded its credit facility, for a term of four years, expiring July 24, 2016. The credit facility was increased to U.S.\$85 million from U.S.\$55 million while the accordion feature of the loan agreement was increased to U.S.\$115 million from U.S.\$85 million. See Note 20, *Borrowings*. In 2012, Chesswood contributed U.S.\$2.0 million of additional capital to Pawnee, in conjunction with the new credit facility, to further support Pawnee's growth. Chesswood contributed another U.S.\$1.0 million of additional capital to Pawnee and Windset in 2013. Subsequent to year end Chesswood contributed another U.S.\$1.75 million of additional capital into Windset to support its growth.

The Company's subsidiaries' objective is to maintain low cash balances, investing any free cash in finance receivables as needed and using any excess to pay down debt on the primary financing facilities. The subsidiaries fund working capital needs, lease originations and growth using advances under credit facilities available when operating cash flow is not sufficient. At December 31, 2013, the Company's operating subsidiaries had \$13.5 million (2012 - 18.1 million) in additional borrowings available under various credit facilities, before any accordion provision, to fund business operations.

The Company itself does not have a credit facility available. Credit facilities of its operating subsidiaries are used to provide funding for the respective subsidiary's operations (namely to provide financing for the purchase of assets which are to be the subject of lease originations or to acquire vehicle inventory and support working capital). The credit facilities are not intended to directly fund dividends by the Company (and these facilities generally limit the amount which can be distributed to the Company up to the net income of the subject subsidiary).

Under Pawnee's debt to equity covenant calculation, customer security deposits are treated as an offset to net investment in leases and are not considered debt. There are no bank covenants relating to the consolidated debt to equity calculation.

### 33. RELATED PARTY TRANSACTIONS

The Company has no parent or other ultimate controlling party.

The Company had the following transactions and balances with related parties:

- (a) Pawnee, a U.S. subsidiary of the Company, leases a 10,800 square foot office facility from an entity that is controlled by the holders of the Class B and Class C shares of U.S. Acquisition Co Ltd, a non-operating subsidiary of the Company. Minimum lease payments are U.S.\$212,890 per annum, triple net. The lease expires on April 30, 2016, and contains an option to renew for an additional five year term. The expense is included in other expense and is translated at the average exchange rate for the period. At December 31, 2013 and December 31, 2012 there was no amount payable in respect of the lease.
- (b) Case Funding provides Quick Cash Inc. ("Quick Cash"), an entity controlled by a director of Case Funding and the CEO of Case Funding, with personnel and facilities to manage the portfolio of existing loans managed by Quick Cash and required origination and placement services in respect of future loans (Quick Cash is prohibited from making loans, other than those which Case Funding does not wish to make and Quick Cash is responsible for all out-of-pocket third party fees and expenses relating to its business). Payments received and committed for services provided are as follows:

Months	Amount per month
	<i>(\$ thousands)</i>
January 2012 – June 2012	\$16
July 2012 – June 2013	\$4
July 2013 – June 2014	\$1

This revenue is recorded in Ancillary finance and other fee income. The amounts were determined at the time of Case Funding's acquisition and reflect negotiated market terms and the expected level of administrative services that will be provided to Quick Cash over the term of the agreement.

(c) Compensation of key management

The Company's key management consists of the President & Chief Executive Officer, Chief Financial Officer and the Board of Directors. Key management compensation is as follows:

	For the years ended	
	<b>December 31, 2013</b>	December 31, 2012
	<i>(\$ thousands)</i>	
Salaries, fees and other short-term employee benefits	<b>\$ 1,163</b>	\$ 1,100
Share-based compensation	<b>890</b>	742
Compensation expense of key management	<b>\$ 2,053</b>	\$ 1,842

### 34. SEASONAL OPERATIONS

The Company's automotive business follows a seasonal pattern, with revenue and net income based on past experience being significantly lower in the first quarter than in other quarterly periods.

Tax expense reflects the mix of taxing jurisdictions in which pre-tax income and losses were recognized. However, because the geographical mix of pre-tax income and losses in interim periods may not be reflective of full year results, this may distort the Company's interim period effective tax rate.

### 35. SEGMENT INFORMATION

Segments are identified on the same basis that is used internally to manage and to report on performance, taking into account the products and services of each segment and the organizational structure of the Company. The Company's operations consist of three reportable segments: Equipment Financing, Legal Financing, and Automotive Operations.

Chesswood's Equipment Financing segment is located in the United States and is involved in small-ticket equipment leasing and lending to small businesses in the start-up and "B" credit markets in the lower 48 states. Our Automotive Operations segment sells and services predominantly Acura automobiles and leases Acura and other brand automobiles in the province of Ontario, Canada. Our Legal Financing segment is located in the United States and is a provider of legal financing to plaintiffs and attorneys throughout the United States. At December 31, 2013, Windset information is aggregated with Equipment Financing segment.

Segment information is prepared in conformity with the accounting policies adopted for the Company's financial statements.

The role of the "chief operating decision maker" with respect to resource allocation and performance assessment is embodied in the position of Chief Executive Officer. The performance of the Equipment Financing, Legal Financing, and Automotive Operations segments is measured on the basis of net income or loss before tax. Net assets, which are defined as total segment assets less total segment liabilities, are used as the basis of assessing the allocation of resources.

When compared with the last annual financial statements, there are no differences in the basis of segmentation or in the basis of measuring segment results.

Selected information by segment and geographically is as follows:

For the year ended December 31, 2013					
	(\$ thousands)				
	Equipment Financing – U.S.	Legal Financing – U.S.	Automotive operations - Canada	Corporate overhead - Canada	Total
Interest revenue on finance leases and loans	\$ 34,292	\$ 2,836	—	\$ —	\$ 37,128
Ancillary finance and other fee income	5,381	199	—	—	5,580
Interest expense (a)	(4,016)	—	—	—	(4,016)
Provision for credit losses	(6,484)	(11)	—	—	(6,495)
<b>Finance margin</b>	<b>29,173</b>	<b>3,024</b>	<b>—</b>	<b>—</b>	<b>32,197</b>
Revenue - automotive operations	—	—	52,031	—	52,031
Cost of sales – automotive operations	—	—	(45,148)	—	(45,148)
<b>Gross margin before expenses</b>	<b>29,173</b>	<b>3,024</b>	<b>6,883</b>	<b>—</b>	<b>39,080</b>
Personnel expenses	4,306	1,263	3,059	1,062	9,690
Share-based compensation expense	224	164	67	890	1,345
Other expenses	3,650	906	2,092	1,154	7,802
Amortization	272	8	79	3	362
<b>Income before undernoted items</b>	<b>20,721</b>	<b>683</b>	<b>1,586</b>	<b>(3,109)</b>	<b>19,881</b>
Financing costs – convertible debentures	0	—	—	(2,035)	(2,035)
Unrealized gain on interest rate swaps	1,413	—	—	—	1,413
Unrealized gain on foreign exchange	—	—	—	478	478
<b>Income before taxes</b>	<b>22,134</b>	<b>683</b>	<b>1,586</b>	<b>(4,666)</b>	<b>19,737</b>
Provision for (recovery of) taxes	8,770	—	(102)	164	8,832
<b>Net income</b>	<b>\$13,364</b>	<b>\$683</b>	<b>\$1,688</b>	<b>\$(4,830)</b>	<b>\$10,905</b>
Net cash from (used in) operating activities	\$ 10,628	\$ (3,529)	\$ 1,618	\$ (1,806)	\$ 6,911
Net cash used in investing activities	\$ (251)	\$ (43)	\$ (216)	\$ (88)	\$ (598)
Net cash used in financing activities	\$ (212)	\$ —	\$ —	\$ 10,863	\$ 10,651
Total Assets	\$ 168,673	\$ 12,376	\$ 13,018	\$ 22,454	\$ 216,521
Total Liabilities	\$ 117,991	\$ 573	\$ 7,038	\$ 22,761	\$ 148,363
Finance receivables	\$ 148,340	\$ 10,961	\$ —	\$ —	\$ 159,301
Goodwill	\$ 11,439	\$ 694	\$ 2,520	\$ —	\$ 14,653
Intangible assets	\$ 5,743	\$ 394	\$ 889	\$ —	\$ 7,026
Property and equipment expenditures	\$ 251	\$ 43	\$ 216	\$ —	\$ 510

(a) includes \$637,700 in non-cash interest expense, based on the imputed interest savings on the customer security deposits, interest revenue on leases on loans is higher by the same amount.

For the year ended December 31, 2012						
(\$ thousands)						
	Equipment Financing – U.S.	Legal Financing – U.S.	Automotive operations – Canada	Corporate overhead – Canada	Total	
Interest revenue on finance leases and loans	\$ 29,595	\$ 1,351	\$ 116	\$ —	\$ 31,062	
Ancillary finance and other fee income	4,636	250	—	—	4,886	
Interest expense (a)	(3,399)	—	(15)	—	(3,414)	
Provision for credit losses	(5,272)	(33)	26	—	(5,279)	
Finance margin	25,560	1,568	127	—	27,255	
Revenue - automotive operations	—	—	50,648	—	50,648	
Cost of sales – automotive operations	—	—	(44,667)	—	(44,667)	
Gross margin before expenses	25,560	1,568	6,108	—	33,236	
Personnel expenses	3,745	1,022	2,782	1,041	8,590	
Share-based compensation expense	338	253	103	742	1,436	
Other expenses	3,214	494	2,262	723	6,693	
Amortization	582	2	90	5	679	
Income before undernoted items	17,681	(203)	871	(2,511)	15,838	
Contingent consideration and bonus	—	725	—	—	725	
Unrealized loss on interest rate swaps	7	—	—	—	7	
Unrealized loss on foreign exchange	—	—	—	57	57	
Income before taxes	17,688	522	871	(2,454)	16,627	
Provision for (recovery of) taxes	6,836	399	(105)	508	7,638	
Net income	\$ 10,852	\$ 123	\$ 976	\$ (2,962)	\$ 8,989	
Net cash from (used in) operating activities	\$ 10,276	\$ (4,045)	\$ 2,361	\$ (2,016)	\$ 6,576	
Net cash used in investing activities	\$ (123)	\$ (39)	\$ (92)	\$ (7)	\$ (261)	
Net cash used in financing activities	\$ (403)	\$ —	\$ —	\$ (7,619)	\$ (8,022)	
Total Assets	\$ 137,045	\$ 7,116	\$ 13,590	\$ 3,644	\$ 161,395	
Total Liabilities	\$ 92,142	\$ 155	\$ 7,147	\$ 1,396	\$ 100,840	
Finance receivables	\$ 118,605	\$ 5,645	\$ —	\$ —	\$ 124,250	
Goodwill	\$ 10,700	\$ 650	\$ 2,520	\$ —	\$ 13,870	
Intangible assets	\$ 5,538	\$ 368	\$ 889	\$ —	\$ 6,795	
Property and equipment expenditures	\$ 123	\$ 39	\$ 92	\$ 7	\$ 261	

(a) includes \$680,500 in non-cash interest expense, based on the imputed interest savings on the customer security deposits, interest revenue on leases on loans is higher by the same amount.

### 36. SUBSEQUENT EVENTS

#### (a) Business acquisition

On January 31, 2014, the Company completed the acquisition of all of the outstanding shares of Northstar Leasing Corporation (“Northstar”) for \$10.4 million in cash. Northstar is a long-standing non-prime commercial equipment finance company, located in Barrie, Ontario. The acquisition enables the Company to expand the geographical coverage of its North American small ticket platform, leveraging the experience and expertise of Pawnee’s presence in the U.S. to complement that of Northstar. These

synergistic benefits to the Group are not recognizable intangible assets and are included in the goodwill amount for financial reporting purposes.

Chesswood has engaged an independent valuation firm to assist us in determining the fair value of the assets acquired, liabilities and provisions assumed, and related deferred income tax impacts. The valuation is in progress and will be completed within six months from the date of acquisition.

The preliminary purchase price allocation to the fair value of assets and liabilities acquired, as presented below, includes estimates and is subject to change, based on external valuation.

	January 31, 2014
	(\$ thousands)
Net investment in leases-pledged	\$ 5,831
Net investment in leases	7,385
Prepaid expenses and other assets	74
Property and equipment	24
Goodwill and intangible assets	4,362
Total assets	<u>\$ 17,676</u>
Accounts payable and other current liabilities	\$ 188
Securitization debt	6,142
Lease financing	405
Customer security deposits	541
Total liabilities	<u>\$ 7,276</u>
Net assets acquired	<u>\$ 10,400</u>
Consideration - cash	<u>\$ 10,400</u>

None of the goodwill is expected to be deductible for tax purposes. Due to the proximity of the acquisition to the approval date of the financial statements, the disclosure of revenue and profit of Northstar since acquisition have not been provided.

Northstar has the following other commitments:

(\$ thousands)	2014	2015	2016	Total
Other financial commitments	\$ 43	\$ 44	\$ 30	\$ 117

Transaction costs relating to this acquisition of \$88,000 were expensed during the year ended December 31, 2013 and are included in other expenses. Further transaction costs are estimated to be \$150,000 and will be expensed as incurred subsequent to the year end.

*(b) Increased investment in Windset and expansion of credit facility available to Windset*

Early in 2014, Pawnee's syndicate of lenders approved further amendments to Pawnee's credit facility so as to provide Windset with access to another U.S.\$5.0 million in capital, to a maximum of U.S.\$10.0 million of capital from Pawnee's credit facility. In conjunction with this amendment, Chesswood contributed U.S.\$1.75 million of additional capital to Windset to support its growth.

*(c) Foreign exchange forward contract*

On January 6, 2014, Pawnee entered into a forward exchange contract to deliver U.S.\$7.0 million at an exchange rate of U.S. \$0.9386, per Canadian dollar, on March 31, 2014.

*(d) Interest rate swap contracts*

The following interest rate swap agreements were entered into after December 31, 2013:

Effective Date	Notional Amount U.S.\$	Annual Fixed Rate	Maturity date
March 2017	\$15 million	2.88%	March 2018
March 2017	\$15 million	3.23%	March 2019

*(e) Stock options*

Subsequent to year-end, 5,750 stock options were exercised.



**Chesswood Group Limited**

**Directors and Officers**

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**Directors and Officers**

**Frederick W. Steiner**

Director  
Chairman of Chesswood Group Limited  
Chairman, Audit and Governance Committee  
*C.E.O., Imperial Coffee and Services Inc.*

**Clare Copeland**

Director  
Chairman, Compensation Committee  
*Vice-Chair, Falls Management Company*  
*Chairman, Toronto Hydro Corporation*

**Jeffrey Wortsman**

Director  
*President & C.E.O., Danier Leather Inc.*

**Barry Shafran**

Director  
*President & C.E.O., Chesswood Group Limited*  
*Chairman and C.E.O., Pawnee Leasing Corporation*

**David Obront**

Director  
*President, Carpool Two Ltd.*

**Robert Day**

Director  
*Former Chairman, Pawnee Leasing Corporation*

**Samuel Leeper**

Director  
*Former C.E.O., Pawnee Leasing Corporation*

**Executive Team**

Barry Shafran  
*President & C.E.O.*  
*Chesswood Group Limited*  
*Chairman and C.E.O.*  
*Pawnee Leasing Corporation*

**Lisa Stevenson**

*Director of Finance*  
*Chief Financial Officer*

**Other Information**

**Auditors**

*BDO Canada LLP*

**Transfer Agent**

*Equity Financial Trust Company*

**Corporate Counsel**

*McCarthy Tétrault LLP*

**Website**

*[www.chesswoodgroup.com](http://www.chesswoodgroup.com)*

**Toronto Stock Exchange Symbol**

*CHW*  
*CHW.DB*



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