

ANNUAL REPORT
1998

CARFINCO INC.



MANAGEMENT'S DISCUSSION AND ANALYSIS

General

During the year, the Company focused on the setting up of new Repairers in Alberta, British Columbia and Ontario as well as servicing the existing network of repair facilities. Management is satisfied with the acceptance of the "Fix'Em Up Payment Plan" in the automotive repair industry as evidenced by the 1,182 Repairers who have become part of the network during fiscal '98; an increase of 376% from 314 in fiscal '97 to a total of 1,496 facilities.

In 1998 CARFINCO witnessed an internal evolution as the company grew to a level which required the formation of divisions within the company. These divisions include a marketing division, which deals with the set up and service of Repair Facilities, a credit division dealing with new applications, a portfolio management division dealing with past due accounts and an accounting division.

Fiscal '98 also witnessed the introduction of the Commercial Vehicle Repair Financing Program, which has had a positive contribution to the growth of the portfolio.

Fiscal '98 represents the first full twelve month reporting period for CARFINCO with fiscal '97 representing only eight months of cumulative activity from the date of Incorporation and only five months of actual operations.

The following discussion should be read in conjunction with the Company's consolidated financial statements.

Results of Operation

The Company recorded a growth of 698% in the Finance Receivables Portfolio during fiscal '98. The portfolio grew from \$382,990 at August 31, 1997 to \$3,055,233 at August 31, 1998, an increase of \$2,672,243.

During the fiscal period of September 1, 1997 to August 31, 1998, CARFINCO Inc. reported total Revenues of \$602,704, an increase of \$560,381 (1,324%) from fiscal '97 revenues of \$42,323.

The total expenses increased by \$671,576 (242%) from \$277,784 in fiscal '97 to \$949,360 in fiscal '98. Interest expense grew from \$5,069 in fiscal '97 to \$81,820 in fiscal '98, directly corresponding with the growth in the finance receivables portfolio. Likewise, the provision for credit losses increased proportionately from \$11,600 in fiscal '97 to \$118,575 in fiscal '98. Advertising and marketing rose from \$21,243 in fiscal '97 to \$65,294 in fiscal

'98 reflecting the growth in the base of Authorized Repairers. General and administrative expenses increased by \$188,598 to \$351,543. The largest portion of the increase was the loan administration expense, which increased by \$91,662, directly reflecting increased business activity. Salaries and regional manager fees increased from \$74,220 in fiscal 97 to \$322,996 in fiscal 98. The increase in this expense reflects the expansion from Alberta alone, into the British Columbia and Ontario markets.

Liquidity and Capital Resources

The Company has negotiated a \$7,500,000 loan facility with a non-bank lender. This facility will provide greater flexibility in meeting cash requirements needed to continue funding automotive and commercial vehicle repairs. The Company's ability to grow depends upon its continued ability to obtain substantial long-term debt and equity capital through access to the financial markets or otherwise. Factors which could affect the Company's access to the financial markets, or the costs of such financing, included changes in interest rates, general economic conditions, the perception of the Company's business in the financial markets, results of operations, leverage and business prospects.

It is expected that direct competition will eventually emerge, however, CARFINCO's program strictly focuses on the Automotive Repair Industry and can therefore provide a greater degree of knowledgeable service to the individual consumer. The Company's ability to evaluate the needs of each Customer's automotive repair situation will remain a competitive advantage over other forms of consumer financing.

Delinquency rates have been in line with Management's projections, with a total of \$39,250 being written off as at August 31, 1998 and \$575 being recovered. The Companies portfolio management division will exhaust all avenues in the continued efforts to recover written off accounts. Management feels that the current provision for credit losses of 3% of the portfolio is more than sufficient with the aggressive approach the Company has toward delinquent accounts. Management acknowledges the importance of monitoring and controlling the delinquent accounts as the finance receivables portfolio increases.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements, the notes thereto and other financial information enclosed have been prepared by, and are the responsibility of, the Management of CARFINCO Inc. These financial statements have been prepared in accordance with generally accepted accounting principles, using Management's best estimates and judgements when appropriate.

The Board of Directors is responsible for ensuring that Management fulfills its responsibility for financial reporting and internal control. The Audit Committee, which is comprised of three Directors, meets with Management as well as the external auditors to satisfy itself that Management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the report of the auditors. The auditors have full and unrestricted access to the Audit Committee.

The financial statements have been audited by Grant Thornton, the independent auditors, in accordance with generally accepted auditing standards.

(signed)
"Tracy A. Graf"

Tracy A. Graf
President and Chief Executive Officer

(signed)
"Troy S.F. Graf"

Troy S.F. Graf
Chief Financial Officer

CORPORATE INFORMATION

Directors

Tracy A. Graf
President and Chief Executive Officer
CARFINCO Inc.
Edmonton, Alberta

Edward C. McClelland
President
Gambit Consultants Inc.
Burlington, Ontario

Gordon J. Reykdal
President and Chief Executive Officer
RTO Enterprises Inc.
Edmonton, Alberta

David Prussky
President
Patca Corporation
Toronto, Ontario

Officers

Tracy A. Graf
President and
Chief Executive Officer

Troy S.F. Graf
Vice President and
Chief Financial Officer

Paul M. Stein
Corporate Secretary

David Prussky
Treasurer

Bankers

Canadian Imperial Bank of Commerce
Commerce Place, Suite 1900
10155 - 102nd Street
Edmonton, Alberta T5J 4G8

Auditors

Grant Thornton, Chartered Accountants
Scotia Place 1, Suite 2400
10060 Jasper Avenue
Edmonton, Alberta T5J 3R8

Solicitors

Cassels Brock & Blackwell
Scotia Plaza, Suite 2100
40 King Street West
Toronto, Ontario M5H 3C2

Stock Exchange Listing

The Canadian Dealing Network
Trading Symbol: **CAAR**

Transfer Agent

Equity Transfer Services Inc.
Suite 420, 120 Adelaide Street West
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100 Greystone IV
4207 - 98 Street
Edmonton, Alberta T6E 5R7
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Chartered Accountants
Canadian Member Firm of
Grant Thornton International

Grant Thornton 

Carfinco Inc.
Consolidated
Financial Statements
August 31, 1998

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Auditors' Report

To the Shareholders of
Carfinco Inc.

We have audited the consolidated balance sheet of Carfinco Inc. as at August 31, 1998 and the consolidated statements of loss and deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at August 31, 1998 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

Edmonton, Canada
October 16, 1998

(signed)
"Grant Thornton"

Chartered Accountants

Carfinco Inc.

Consolidated Statement of Loss and Deficit

Year Ended August 31

1998

1997

Revenues		
Interest income	\$ 402,550	\$ 19,814
Administration fees	177,904	15,477
Investment income	<u>22,250</u>	<u>7,032</u>
	<u>602,704</u>	<u>42,323</u>
Expenses		
Interest	81,820	5,069
Provision for credit losses	118,575	11,600
Advertising and marketing	65,294	21,243
Depreciation	9,132	2,707
General and administrative (Note 11)	351,543	162,945
Salaries and regional manager fees	<u>322,996</u>	<u>74,220</u>
	<u>949,360</u>	<u>277,784</u>
Net loss	(346,656)	(235,461)
Deficit, beginning of year	<u>(235,461)</u>	<u>-</u>
Deficit, end of year	<u><u>\$ (582,117)</u></u>	<u><u>\$ (235,461)</u></u>
Loss per share – basic	<u><u>\$ (0.05)</u></u>	<u><u>\$ (0.06)</u></u>

See accompanying notes to the consolidated financial statements.

Carfinco Inc.

Consolidated Balance Sheet

August 31 1998 1997

Assets

Current

Finance receivables	\$ 3,055,233	\$ 382,990
Less allowance for credit losses	<u>91,500</u>	<u>11,600</u>
Finance receivables – net (Note 3)	2,963,733	371,390
Restricted cash	-	800,000
Other assets	<u>38,395</u>	<u>2,606</u>
	3,002,128	1,173,996

Capital assets (Note 5) 39,933 16,594

\$ 3,042,061 \$ 1,190,590

Liabilities

Current

Bank indebtedness (Note 6)	\$ 1,411,754	\$ 631,971
Payables and accruals	<u>79,168</u>	<u>54,791</u>
	<u>1,490,922</u>	<u>686,762</u>

Shareholders' Equity

Share capital (Note 7)	2,133,256	739,289
Deficit	<u>(582,117)</u>	<u>(235,461)</u>
	<u>1,551,139</u>	<u>503,828</u>

\$ 3,042,061 \$ 1,190,590

Subsequent events (Note 13)

On behalf of the Board

(signed)

"Tracy A Graf"

_____ Director

(signed)

"Gordon J. Reykdal"

_____ Director

See accompanying notes to the consolidated financial statements.

Carfinco Inc.**Consolidated Statement of Changes in Financial Position**

Year ended August 31

1998

1997

Cash derived from (applied to)

Operating

Net loss	\$ (346,656)	\$ (235,461)
Accrued interest	(56,489)	(7,361)
Administration fees not collected	(107,605)	(13,829)
Depreciation	9,132	2,707
Provision for credit losses	<u>118,575</u>	<u>11,600</u>
	(383,043)	(242,344)
Change in non-cash operating working capital (Note 10)	<u>(11,412)</u>	<u>52,185</u>
	<u>(394,455)</u>	<u>(190,159)</u>

Investing

Funds advanced on finance receivables	(3,900,590)	(396,692)
Principal collections on finance receivables	1,353,630	34,892
Purchase of capital assets	(32,763)	(19,301)
Disposal of capital assets	<u>428</u>	<u>-</u>
	<u>(2,579,295)</u>	<u>(381,101)</u>

Financing

Issuance of share capital	1,432,075	876,000
Share issue costs	<u>(38,108)</u>	<u>(136,711)</u>
	<u>1,393,967</u>	<u>739,289</u>

Net (decrease) increase in cash (1,579,783) 168,029

Cash (bank indebtedness)

Beginning of year	<u>168,029</u>	<u>-</u>
End of year	<u>\$ (1,411,754)</u>	<u>\$ 168,029</u>

Cash represented by

Restricted cash	\$ -	\$ 800,000
Bank indebtedness	<u>(1,411,754)</u>	<u>(631,971)</u>
	<u>\$ (1,411,754)</u>	<u>\$ 168,029</u>

See accompanying notes to the consolidated financial statements.

Carfinco Inc.

Notes to the Consolidated Financial Statements

August 31, 1998

1. Operations

Carfinco Inc. (the "Company") was incorporated under the Business Corporations Act (Ontario) on December 30, 1996. The Company owns 100% of Canadian Automotive Repair Finance Corporation, which is a company incorporated under the Business Corporations Act (Alberta). On May 7, 1997, the Company completed an Initial Public Offering and its shares were listed on the Canadian Dealing Network (symbol "CAAR").

The Company is in the business of providing consumer financing for automotive repairs.

2. Summary of significant accounting policies

The financial statements have been prepared in accordance with generally accepted accounting principles and reflect the following policies:

Basis of consolidation

These financial statements include the accounts of the Company and its wholly owned subsidiary, Canadian Automotive Repair Finance Corporation.

Finance receivables

Finance receivables are recorded at their principal amounts, including accrued interest, less allowance for credit losses.

Interest income is recorded on the accrual basis. Recognition of interest income is suspended when, in management's view, a loss is likely to occur. Fees related to the origination of loans are recognized when the finance receivable is recorded. Charges related to the subsequent administration of the finance receivables are recognized upon collection of funds.

Allowance for credit losses

The management of the Company establishes and maintains an allowance for credit losses which it considers the best possible estimate of probable credit losses existing in the finance receivable portfolio. The allowance for credit losses consists of specific and general components, which are deducted from the finance receivable portfolio. The specific component includes those accounts, which, in management's view, are not considered recoverable. The general component includes a provision for credit losses, which is conservative in nature and includes an estimation of losses by reference to historical industry ratios of write-offs and to current recovery experience.

Carfinco Inc.

Notes to the Consolidated Financial Statements

August 31, 1998

2. Summary of significant accounting policies (cont'd)

Capital assets

Capital assets are recorded at cost net of accumulated depreciation. Depreciation is provided on the declining balance method at rates calculated to depreciate the cost of the assets over their estimated useful lives as follows:

Computer and office equipment	30%, declining balance
Furniture and fixtures	20%, declining balance

Financial instruments

The company's financial instruments consist of cash, finance receivables, bank indebtedness and payables and accruals. Unless otherwise indicated, it is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

3. Finance receivables	<u>1998</u>	<u>1997</u>
Principal of finance receivables	\$ 2,998,744	\$ 375,629
Accrued interest	<u>56,489</u>	<u>7,361</u>
Finance receivables	3,055,233	382,990
Less: allowance for credit losses (Note 4)	<u>(91,500)</u>	<u>(11,600)</u>
Net finance receivables	<u>\$ 2,963,733</u>	<u>\$ 371,390</u>

4. Allowance for credit losses	<u>1998</u>	<u>1997</u>
Allowance, beginning of year	\$ 11,600	\$ -
Provision for credit losses	118,575	11,600
Write-offs	(39,250)	-
Recoveries	<u>575</u>	<u>-</u>
Allowance, end of year	<u>\$ 91,500</u>	<u>\$ 11,600</u>

Carfinco Inc.

Notes to the Consolidated Financial Statements

August 31, 1998

5. Capital assets			1998	1997
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Computer and office equipment	\$ 35,119	\$ 8,415	\$ 26,704	\$ 10,204
Furniture and fixtures	<u>16,516</u>	<u>3,287</u>	<u>13,229</u>	<u>6,390</u>
	<u>\$ 51,635</u>	<u>\$ 11,702</u>	<u>\$ 39,933</u>	<u>\$ 16,594</u>

Depreciation provided for in the current period totalled \$9,132.

6. Bank indebtedness

The bank indebtedness is a demand credit facility which is the lesser at any time of a) \$2,500,000 and b) the total of 65% of acceptable outstanding finance contracts.

The bank holds a general security agreement covering all property held by the Company.

7. Share capital

Authorized:

Unlimited number of Class A common shares

Issued:	# of shares	1998	# of shares	1997
Balance, beginning of year	5,100,000	\$ 739,289	-	\$ -
Issued for cash to founding shareholders	-	-	1,500,000	70,500
Issued in exchange for all issued and outstanding shares of subsidiary	-	-	1,500,000	70,500
Issued for cash in Initial Public Offering	-	-	2,100,000	735,000
Issued on conversion of warrants	1,931,000	676,075	-	-
Issued for cash in private placement	948,000	255,960	-	-
Issued for shares in private placement	<u>1,852,000</u>	<u>500,040</u>	<u>-</u>	<u>-</u>
	9,831,000	2,171,364	5,100,000	876,000
Share issue costs	<u>-</u>	<u>(38,108)</u>	<u>-</u>	<u>(136,711)</u>
Balance, end of year	<u>9,831,000</u>	<u>\$ 2,133,256</u>	<u>5,100,000</u>	<u>\$ 739,289</u>

Carfinco Inc.

Notes to the Consolidated Financial Statements

August 31, 1998

7. Share capital (cont'd)

Stock options

The Company has entered into incentive stock options with directors, officers and employees. As at August 31, 1998, the Company has granted the following options to purchase common shares:

<u>Number of shares</u>	<u>Exercise Price \$</u>	<u>Expiry Date</u>
400,000	0.35	April 7, 2002
210,000 (1)	0.35	May 7, 1999
200,000 (2)	0.40	November 20, 2000
125,000 (3)	0.35	April 7, 2002
60,000	0.36	June 23, 1999
<u>50,000 (4)</u>	0.36	June 23, 2003

\$ 1,045,000

- (1) Pursuant to an Agency Agreement dated April 16, 1997
- (2) Vested over three year period commencing November 20, 1997
- (3) Pursuant to a Promotor's Option Agreement dated April 7, 1997
- (4) Vested over a three year period commencing June 23, 1998

Escrowed shares

Pursuant to a voluntary Escrow Agreement dated April 16, 1997, an aggregate of 709,886 common shares of the Company have been escrowed for three years. Under the terms of the April 16, 1997 Escrow Agreement, 10% of the escrowed shares shall be released on January 17, 1998 and 30% of the escrowed shares shall be released on each of the first, second and third anniversaries of the initial release. As at August 31, 1998, 638,897 common shares remain in escrow under the voluntary Escrow Agreement of April 16, 1997.

8. Related party transactions

The Company renewed the Alliance and Service Agreement dated April 7, 1997 with RTO Enterprises Inc., whereby RTO will supply support services for a period of six months at \$2,675 per month, which represents fair value for services provided, renewable semi-annually. The renewal period is from November 1, 1997 to April 30, 1998. The agreement was not renewed subsequent to April 30, 1998. During the year, \$5,350 was paid to RTO. At August 31, 1998, there was no amount payable to RTO. A director of RTO Enterprises Inc. is a shareholder and a director of Carfinco Inc.

Carfinco Inc.

Notes to the Consolidated Financial Statements

August 31, 1998

8. Related party transactions (cont'd)

The Company entered into a Consulting Agreement dated April 7, 1997 with Patuca Corporation, whereby Patuca will provide on-going financial consulting advice for a three year period, commencing May 1, 1997, for an initial fee of \$1,000 per month increasing to \$5,000 per month when the company completes additional equity financing of at least \$1,000,000. The fee represents fair value for services provided. The fees have been waived by Patuca Corporation for both the years ending August 31, 1998 and 1997. During the year, no payments were made to Patuca and at August 31, 1998, there was no amount payable to Patuca. Patuca Corporation is controlled by individuals who are directors and/or shareholders of Carfinco Inc.

A group of shareholders purchased 1,852,000 shares of Carfinco Inc. by exchanging shares of another public company with a fair market value of \$500,400. Carfinco Inc. subsequently sold the shares of the public company with no gain or loss resulting on the transaction for accounting purposes.

9. Income taxes

To August 31, 1998, the company incurred tax losses of \$396,650 which may be applied against future taxable income within the allowable provisions prescribed by the Income Tax Act. During the year the company realized a taxable gain on the disposition of shares of another public company which was offset by tax losses within the company.

If not utilized these losses will expire as follows:

2002	\$	8,381
2003		6,535
2004		273,648
2005		<u>108,086</u>
	\$	<u>396,650</u>

The potential tax benefit of these losses has not been reflected in the financial statements.

10. Change in non-cash operating working capital	1998	1997
Other assets	\$ (35,789)	\$ (2,606)
Payables and accruals	<u>24,377</u>	<u>54,791</u>
	<u>\$ (11,412)</u>	<u>\$ 52,185</u>

Carfinco Inc.

Notes to the Consolidated Financial Statements

August 31, 1998

11. General and administrative expenses	1998	1997
Audit and legal	\$ 17,804	\$ 10,861
Bank charges	14,107	2,217
Communications	44,721	10,850
Loan administration	99,238	7,576
Office	75,635	79,609
Printing and design	12,793	24,743
Public reporting	15,936	2,194
Rent	12,239	1,450
Travel	59,070	23,445
	<u>\$ 351,543</u>	<u>\$ 162,945</u>

12. Commitments

The Company is committed to a long term operating lease for building space. The minimum annual lease payments required are as follows:

Year ending August 31,	
1999	\$ 27,300
2000	27,300
2001	27,300
2002	27,300
2003	13,775

13. Subsequent events

Subsequent to the year end, the company has secured the following refinancing arrangements and financing commitments:

- Credit facility from a non-bank lender with a limit of \$7,500,000, bearing interest at Canadian prime plus 3.5% with borrowings between 1.0 million and 3.0 million and Canadian prime plus 3.0% with borrowings between 3.0 million and 7.5 million, due January 14, 2002.
- First priority and exclusive perfected security interest in all loan and sales finance receivables of Canadian Automotive Repair Finance Corporation whether now owned or thereafter acquired will be pledged as security for the credit facility.

Carfinco Inc.

Notes to the Consolidated Financial Statements

August 31, 1998

14. Uncertainty due to the Year 2000 Issues

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

15. Financial instruments

As disclosed in the summary of significant accounting policies, the company holds various forms of financial instruments. The nature of these instruments and Carfinco Inc.'s operations expose the company to interest rate risk and industry credit risk. Carfinco Inc. manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

a) Interest rate risk

Bank indebtedness and subsequent refinancing, as disclosed in Note 13, bear interest at a floating rate. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates.

Finance receivables bear interest at a fixed rate. The fixed rate finance receivable is subject to interest rate price risk, as the value will fluctuate as a result of changes in market rates.

b) Fair market value

The carrying values of cash, finance receivables, bank indebtedness and payables and accruals meeting the definition of a financial instrument approximate their fair value.

c) Credit risk

The company's finance receivables are from transactions within the consumer finance industry, and as such, the company is exposed to all the risks of that industry. The company manages its risks by taking security in the form of a security interest/lien against a motor vehicle or other tangible asset.