

Carfinco Inc.



President's Message to Shareholders

The December 31, 2001 figures represent a four-month transitional period. The directors of the Company voted to move the fiscal year end from August 31 to December 31, as to coincide the fiscal year end with the calendar year end. This change will result in simplified reporting and in reduced administrative costs.

These audited financial statements compare the four months from September 1, 2001 to December 31, 2001 to the twelve months from September 1, 2000 to August 31, 2001 (fiscal 2001). Due to the future growth of the finance receivable portfolio and seasonal costs, annualizing the four-month transitional period ended December 31, 2001, does not necessarily produce an accurate comparison to the twelve months ended August 31, 2001.

For discussion purposes, the figures below are based on the four-month period of September 1, 2001 to December 31, 2001 (2001 period) compared to the four-month period of September 1, 2000 to December 31, 2000 (2000 period).

The net finance receivables increased \$8,638,633 (67%) from the \$12,904,872 at the end of the 2000 period (December 31, 2000) to \$21,543,505 stated at the end of the 2001 period (December 31, 2001).

Revenues increased \$1,185,640 (85%), from \$1,388,556 for the 2000 period to \$2,574,196 stated for the 2001 period. Earnings before income taxes increased \$309,772 (400%), from \$77,359 for the 2000 period to \$387,131 stated for the 2001 period.

Expenses increased \$875,867 (67%), from \$1,311,198 for the 2000 period to \$2,187,065 stated for the 2001 period. This increase is mainly due to the provision for credit losses, which increases with the growth of the finance receivable portfolio. The provision for credit losses increased \$578,073 (133%), from \$434,265 for the 2000 period to \$1,012,338 stated for the 2001 period. The \$578,073 increase in the provision for credit losses, represents 66% of the total increase in expenses.

The allowance for credit losses increased \$895,900 (84%), from \$1,069,100 for the 2000 period to \$1,965,000 stated for the 2001 period.

Management continues to evaluate policies, procedures and controls to effectively maximize operational efficiencies, thus decreasing the percentage of operating expenses to average finance receivables.

On behalf of the Board of Directors, I would like thank all involved in the continued success of the Company.

A handwritten signature in black ink that reads "Tracy Graf". The signature is written in a cursive, flowing style.

Tracy A. Graf
President and Chief Executive Officer

Overview

Carfinco Inc. is a holding company and operates through its wholly-owned subsidiary, Canadian Automotive Finance Corporation. Established in March 1997, the Company purchases loans originated by select independent and franchise vehicle dealers to consumers buying late model used automobiles. Since commencing the purchase of contracts in March 1997, the Company has acquired more than \$16.7 million in repair finance contracts and \$35.6 million in vehicle purchase contracts. The Company targets borrowers who are typically unable to obtain financing from traditional sources. On January 30, 2001, the Company discontinued its automotive repair finance program.

To fund the acquisition of receivables, the Company utilizes its borrowings under its credit facility, as well as, borrowings through subordinated debenture issuances. The Company generates interest and fee income on its finance receivables and pays interest expense on borrowings under its credit facility and on outstanding subordinated debentures.

Results of Operations

Carfinco Inc. reported earnings before income taxes of \$387,131, for the four-month period ended December 31, 2001, as compared to \$821,524 for the twelve months ended August 31, 2001.

Revenues. The Company's revenues for the four-month period ended December 31, 2001 were \$2,574,196. Revenues continue to increase in conjunction with the growth in the finance receivables portfolio. The larger portfolio generates additional interest income and origination and collection activity generates additional administration fee income.

Interest. The interest expense for the four-month period ended December 31, 2001 was \$515,276, and \$1,545,828 annualised. The annualised amount of \$1,545,828 compares to the \$1,417,606 reported for the twelve-month period ended August 31, 2001, even though the average outstanding debt level has increased by 34%. This is the result of decreases in the prime interest rate during fiscal 2001, continuing into the transitional period, which assisted in keeping the overall cost of borrowings down.

Provision for Credit Losses. The provision for credit losses for the four-month period ended December 31, 2001 totalled \$1,012,338, compared to \$1,891,515 for the twelve-month period ended August 31, 2001. Of the \$1,012,338 in provision expenses, \$343,962 was used to increase the allowance for credit losses recorded on the balance sheet and \$668,376 was used to offset net portfolio losses.

Operating Expenses. The operating expenses for the four-month period ended December 31, 2001 totalled \$659,451, compared to \$1,678,149 for the twelve-month period ended August 31, 2001.

Advertising and marketing for the four-month period ended December 31, 2001 totalled \$3,025.

Amortization expense for the four-month period ended December 31, 2001 totalled \$17,930. Purchases of capital assets were \$24,110 during the same period.

General and administrative expenses were \$365,300 for the four-month period ended December 31, 2001, compared to the \$900,195 incurred during fiscal 2001. Growth in general and administrative expenses is a reflection of the growth in the finance receivables portfolio.

Salaries and benefits expenses totalled \$273,196 for the four-month period ended December 31, 2001. In order to support the growth in its operations and the finance receivables portfolio, the number of employees has increased from 15 at August 31, 2000, to 22 at August 31, 2001 and to 23 at December 31, 2001.

Asset Review

The Company's growth momentum continued during the four-month period ended December 31, 2001. Total assets increased by \$1,266,551 to \$21,873,687 at December 31, 2001, an increase of 6.1% over August 31, 2001. Non-producing assets have decreased \$37,164 from \$367,346 at August 31, 2001 to \$330,182 at December 31, 2001. As a percentage of total assets, the non-producing assets have decreased 0.3% from 1.8% to 1.5%.

Finance Receivables. All finance receivables are secured, under the applicable provincial personal property registry, by motor vehicle collateral. The increase in the size of the finance receivable portfolio is due to the Company's expansion into the non-prime sector of the auto finance industry and the overall buoyancy of the used car market. The Company's strategy continues to be that of the alternative lender to major financial institutions in the higher risk used vehicle finance market.

Carfinco's finance receivables (net) grew during the four-month period year by \$1,303,715, or 6.4%, to \$21,543,505. Funds advanced on finance receivables amounted to \$5,554,198 for the four-month period or \$16,662,594 annualised, compared to \$20,012,610 last year. Funding levels for fiscal 2002 are expected to be comparable to the twelve month period ended August 31, 2001.

Higher funding volumes and slower portfolio repayment have resulted from the strategic focus on vehicle purchase loans, which have higher principal balances at origination and longer repayment terms. As at August 31, 2000, the finance receivable portfolio consisted of 72.2% vehicle purchase loans, whereas, at August 31, 2001, this had increased to 94.4% of the portfolio and at December 31, 2001 to 97.7%. The repair portfolio is expected to wind down completely during fiscal 2002.

The Company continues to adhere to consistent underwriting standards to achieve portfolio growth. This consistency helps build relationships with our dealer network, as well as, establish a consistent historical loss trend.

Allowance for Credit Losses. The provision for credit losses on loans is made in an amount sufficient to maintain the allowance for credit losses at a level considered adequate to cover probable losses of principal and interest in the existing portfolio. Probable losses are estimated based on contractual delinquency status and historical loss experience. The Company believes that the allowance for credit losses is currently adequate to absorb potential losses in the finance receivable portfolio.

The Company's allowance for credit losses was \$1,965,000 at December 31, 2001, up \$343,962, or 21.2% from the \$1,621,038 at August 31, 2001. During this same period, the finance receivable portfolio increased 6.4%. Allowance for credit losses as a percent of finance receivables was 8.4% at December 31, 2001, compared to 7.4% at August 31, 2001 and 7.6% at August 31, 2000. The Company will continue to monitor its credit loss experience and make additional provisions, as it deems appropriate.

Liquidity and Capital Resources

The Company's primary sources of cash have been; cash flows from operating activities, borrowings under its credit facility, and the issuance of debt and equity. The Company's primary uses of cash have been; the funding of advances on finance receivables and the purchase of certain capital assets. Management believes that the resources available to the Company provide the needed capital to fund the anticipated expansion of the Company, loan purchases, and investments in operating infrastructure for fiscal 2002.

Credit Facility. In fiscal 2000, the Company entered into a credit facility with an authorized branch of a foreign bank. The amount of borrowings available under this facility is \$25,000,000, subject to a defined borrowing base. The bank credit facility is the primary source of cash for funding growth in the finance receivable portfolio. As at December 31, 2001, a total of \$16,747,679 was outstanding under the credit facility. The termination date of the credit facility is August 31, 2003.

Subordinated Debt. As of December 31, 2001, the Company had outstanding \$2,560,000 of 16% non-convertible subordinated debt, an increase of \$100,000 over the \$2,460,000 outstanding at August 31, 2001. Of the total subordinated debt outstanding, \$960,000 matures in June 2002, \$1,500,000 matures in August 2005 and \$100,000 matures in November 2006.

Risk Management

Liquidity Risk. As is customary in the Company's industry, the above credit facility and subordinated debt instruments need to be renewed on a periodic basis. The Company has been successful in renewing and expanding these facilities on a periodic basis. If the Company was unable to renew these facilities on acceptable terms, there could be a material adverse effect on the Company's financial position, results of operations and liquidity.

Credit Risk. Credit risk management is the management of the credit risk associated with the total finance receivable portfolio. This is the risk of the loss of principal and/or interest from the failure of debtors, for any reason, to honour the financial or contractual obligations to the Company. In the event of payment default, the collateral value of the financed vehicle may not cover the outstanding contract balance and costs of recovery.

The Company originates transactions in a relatively high-risk segment of the consumer finance industry, and, therefore, write offs are anticipated. 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 Company reviews static pool origination, historical industry ratios of write offs, current write offs and recovery experience, estimates of the underlying collateral value, and economic conditions and trends to make the necessary judgments as to the appropriateness of the allowance for loan losses. Although the Company uses many resources to assess the adequacy of loss reserves, there is no precise method for estimating the future losses in the finance receivable portfolio.

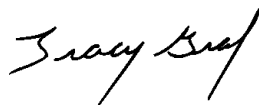
Interest Rate Risk. The Company's earnings are affected by changes in interest rates as a result of its dependence upon a credit facility, which bears interest at a floating rate. The receivable portfolio bears interest at a fixed rate, therefore, the Company carries the risk of smaller interest rate spreads in the event market interest rates increase. At this time, the Company is monitoring short and long term interest rates and is investigating the possibility of locking the interest rate on a portion of our floating rate credit facility.

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 Canadian generally accepted accounting principles, using Management's best estimates and judgments 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 LLP, the independent auditors, in accordance with Canadian generally accepted auditing standards.



Tracy A. Graf
Chief Executive Officer



Troy S.F. Graf
Chief Financial Officer

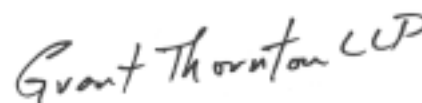
Independent Auditors' Report

To the Shareholders of
Carfinco Inc.

We have audited the consolidated balance sheets of Carfinco Inc. as at December 31, 2001 and August 31, 2001 and the consolidated statements of earnings and deficit and cash flows for the periods 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 Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material 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 December 31, 2001 and August 31, 2001 and the results of its operations and cash flows for the periods then ended in accordance with Canadian generally accepted accounting principles.



Edmonton, Canada
January 9, 2002

Chartered Accountants

Carfinco Inc.
Consolidated Balance Sheets



	<u>December 31</u> <u>2001</u>	<u>August 31</u> <u>2001</u>
Assets		
Finance receivables - net (Note 3)	\$ 21,543,505	\$ 20,239,790
Other assets	54,928	37,806
Capital assets (Note 5)	188,197	182,017
Deferred costs	87,057	97,559
Future income taxes	<u>-</u>	<u>49,964</u>
	<u>\$ 21,873,687</u>	<u>\$ 20,607,136</u>

Liabilities

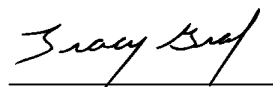
Bank indebtedness (Note 6)	\$ 16,746,846	\$ 15,846,057
Payables and accruals	86,596	121,778
Income taxes payable	77,259	-
Future income taxes (Note 10)	22,041	-
Long term debt (Note 7)	<u>2,640,017</u>	<u>2,548,415</u>
	<u>19,572,759</u>	<u>18,516,250</u>

Shareholders' Equity

Share capital (Note 8)	2,378,167	2,378,167
Deficit	<u>(77,239)</u>	<u>(287,281)</u>
	<u>2,300,928</u>	<u>2,090,886</u>
	<u>\$ 21,873,687</u>	<u>\$ 20,607,136</u>

Commitments (Note 11)

On behalf of the Board


 _____ Director


 _____ Director

See accompanying notes to the consolidated financial statements.

Carfinco Inc.
Consolidated Statements of Earnings and Deficit



	December 31	August 31
	2001	2001
	<u>(4 months)</u>	<u>(12 months)</u>
Revenues		
Interest income	\$ 2,150,319	\$ 4,537,758
Administration fees	<u>423,877</u>	<u>1,271,036</u>
	<u>2,574,196</u>	<u>5,808,794</u>
Expenses		
Interest	515,276	1,417,606
Provision for credit losses	1,012,338	1,891,515
Advertising and marketing	3,025	27,172
Amortization	17,930	54,773
General and administrative	365,300	900,195
Salaries and benefits	<u>273,196</u>	<u>696,009</u>
	<u>2,187,065</u>	<u>4,987,270</u>
Earnings before income taxes	<u>387,131</u>	<u>821,524</u>
Income taxes		
Current	105,084	-
Future	<u>72,005</u>	<u>350,353</u>
	<u>177,089</u>	<u>350,353</u>
Net earnings	<u>\$ 210,042</u>	<u>\$ 471,171</u>
<hr/>		
Deficit, beginning of period	\$ (287,281)	\$ (758,452)
Net earnings	<u>210,042</u>	<u>471,171</u>
Deficit, end of period	<u>\$ (77,239)</u>	<u>\$ (287,281)</u>
Earnings per share – basic (Note 12)	<u>\$ 0.017</u>	<u>\$ 0.038</u>
Earnings per share – diluted (Note 12)	<u>\$ 0.015</u>	<u>\$ 0.036</u>

See accompanying notes to the consolidated financial statements.

Carfinco Inc.
Consolidated Statements of Cash Flows



	December 31	August 31
	2001	2001
	(4 months)	(12 months)
Increase (decrease) in cash and cash equivalents		
Operating		
Net earnings	\$ 210,042	\$ 471,171
Adjustments to reconcile net earnings to net cash from operations:		
Provision for credit losses	1,012,338	1,891,515
Amortization	17,930	54,773
Accrued interest	(38,837)	(110,099)
Administration fees receivable	(333,843)	(813,124)
Deferred costs	10,502	52,162
Future income taxes	72,005	350,353
Income taxes payable	77,259	-
Payables and accruals	(35,182)	(222,797)
Other assets	(17,122)	(7,396)
	<u>975,092</u>	<u>1,666,558</u>
Investing		
Funds advanced on finance receivables	(5,554,198)	(20,012,610)
Principal collections on finance receivables	3,610,825	9,785,699
Purchase of capital assets	(24,110)	(21,887)
	<u>(1,967,483)</u>	<u>(10,248,798)</u>
Financing		
Issuance of long term debt	100,000	585,000
Repayment of long term debt	(8,398)	(25,192)
	<u>91,602</u>	<u>559,808</u>
Net decrease in cash and cash equivalents	(900,789)	(8,022,432)
Cash and cash equivalents		
Beginning of period	<u>(15,846,057)</u>	<u>(7,823,625)</u>
End of period	<u>\$ (16,746,846)</u>	<u>\$ (15,846,057)</u>
Supplemental cash flow information:		
Income taxes paid	\$ 26,279	\$ -
Interest paid	\$ 482,978	\$ 1,408,133

See accompanying notes to the consolidated financial statements.

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 Finance Corporation, which is a company incorporated under the Business Corporations Act (Alberta).

The Company's common shares are publicly traded on the Canadian Venture Exchange, under the symbol "YCR".

The Company is in the business of providing consumer financing for vehicle purchases. On January 30, 2001, the Company discontinued its automotive repair finance program.

During the current period, the Company changed its fiscal year-end from August 31 to December 31.

2. Summary of significant accounting policies

The financial statements have been prepared in accordance with Canadian 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 Finance Corporation.

Use of estimates

In preparing financial statements in conformity with Canadian generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and balances with banks, net of bank overdrafts. Bank borrowings are considered to be financing activities.

Finance receivables

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

Revenue recognition

Interest income is recorded on an accrual basis. Fee income related to the origination of loans is recognized when the finance receivable is recorded. Charges related to the subsequent administration of the finance receivables are recognized upon collection of funds.

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

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 accumulated specific and general components, which are deducted from the finance receivable portfolio.

The Company considers a finance receivable to be impaired when it is no longer reasonably assured of the timely collection of the full amount of principal and interest. The Company's finance receivable portfolio is comprised of a large number of homogenous consumer loans, with relatively small balances, originated in the same industry and geographic region, and as such, the recognition of impairment is estimated collectively for the group. The estimated impairment is determined by assessing the individual loans in arrears, the perceived effect of current economic conditions or other circumstances on the remaining loans, the historical industry ratios of write offs, and the Company's current write off and recovery experience.

Interest income is accrued and earned in accordance with the terms of the original loan agreement on all finance receivables, which have not been individually identified as impaired.

Capital assets

Capital assets are recorded at cost. Capital assets are amortized over their estimated useful lives, using the following rates and methods:

Computer and office equipment	30%, declining balance
Computer software	Straight-line over a five year period
Furniture and fixtures	20%, declining balance
Leasehold improvements	Straight-line over the term of the related lease

Amortization is recorded at one-half of the above rates in the year of acquisition on all capital assets except computer software and leasehold improvements.

Income taxes

The Company recognizes both the current and future income tax consequences of all transactions that have been recognized in the financial statements. Future income tax assets and liabilities are determined based on the tax rates that are expected to apply when the assets or liabilities are reported for tax purposes.

Deferred costs

The costs of obtaining long term financing are deferred and amortized to interest on long term debt on a straight-line basis over the terms of the debt.

Stock option plan

The Company has a stock option plan, which is described in Note 8. No compensation expense is recognized when stock options are issued. Consideration received by the Company on the exercise of stock options is credited to share capital.

3. Finance receivables	<u>December 31</u> <u>2001</u>	<u>August 31</u> <u>2001</u>
Principal of finance receivables	\$ 23,159,569	\$ 21,550,729
Accrued interest	<u>348,936</u>	<u>310,099</u>
Finance receivables	<u>23,508,505</u>	21,860,828
Less: allowance for credit losses (Note 4)	<u>(1,965,000)</u>	<u>(1,621,038)</u>
Finance receivables – net	<u>\$ 21,543,505</u>	<u>\$ 20,239,790</u>

4. Allowance for credit losses	<u>December 31</u> <u>2001</u> <u>(4 months)</u>	<u>August 31</u> <u>2001</u> <u>(12 months)</u>
Allowance, beginning of period	\$ 1,621,038	\$ 900,000
Provision for credit losses	<u>1,012,338</u>	1,891,515
Write offs	<u>(812,032)</u>	<u>(1,587,700)</u>
Recoveries	<u>143,656</u>	<u>417,223</u>
Allowance, end of period	<u>\$ 1,965,000</u>	<u>\$ 1,621,038</u>

5. Capital assets			<u>December 31</u> <u>2001</u>	<u>August 31</u> <u>2001</u>
	<u>Cost</u>	<u>Accumulated</u> <u>Amortization</u>	<u>Net</u> <u>Book Value</u>	<u>Net</u> <u>Book Value</u>
Computer and office equipment	\$ 116,898	\$ 60,595	\$ 56,303	\$ 52,720
Computer software	134,161	46,788	<u>87,373</u>	96,571
Furniture and fixtures	63,741	20,974	<u>42,767</u>	30,504
Leasehold improvements	<u>5,262</u>	<u>3,508</u>	<u>1,754</u>	<u>2,222</u>
	<u>\$ 320,062</u>	<u>\$ 131,865</u>	<u>\$ 188,197</u>	<u>\$ 182,017</u>

6. Bank indebtedness	<u>December 31</u> <u>2001</u>	<u>August 31,</u> <u>2001</u>
Bank credit facility	\$ (16,747,679)	\$ (15,872,133)
Bank balance	<u>833</u>	<u>26,076</u>
	<u>\$ (16,746,846)</u>	<u>\$ (15,846,057)</u>

Bank credit facility

The bank credit facility is a demand loan which is the lesser at any time of: a) \$25,000,000 and b) the total of an advance rate applied to the value of acceptable outstanding finance receivables. The credit facility bears interest at prime plus 1.5%.

The bank holds a general security agreement covering all property held by the Company and personal guarantees in the amount of \$1,000,000.

The terms of the credit facility provide for certain covenants, all of which the Company was in compliance with at December 31, 2001.



7. Long term debt	December 31 2001	August 31 2001
16% debentures, maturing on June 19, 2002	\$ 960,000	\$ 960,000
16% debenture, maturing on August 28, 2005	1,500,000	1,500,000
16% debenture, maturing on November 30, 2006	100,000	-
Bank term loan repayable in monthly payments of \$1,856, bearing interest at prime plus 2.5%, amortized over 5 years. The collateral security lodged by the Company to support the loan is the related computer equipment and software	70,528	77,952
Bank term loan repayable in monthly payments of \$244, bearing interest at prime plus 2.5%, amortized over 5 years. The collateral security lodged by the Company to support the loan is the related furniture and office equipment	9,489	10,463
	\$ 2,640,017	\$ 2,548,415

Principal repayments in each of the next five years are due as follows:

2002	\$ 985,200
2003	25,200
2004	25,200
2005	1,504,417
2006	100,000
	\$ 2,640,017

Debentures

On June 19, 2000, the Company issued non-convertible debentures pursuant to a trust indenture for proceeds of \$1,375,000. On August 28, 2000, the Company redeemed a non-convertible debenture in the amount of \$1,000,000.

On June 19, 2001, the Company issued non-convertible debentures pursuant to a trust indenture for proceeds of \$225,000. During the fiscal period ended August 31, 2001, the Company issued non-convertible debentures not pursuant to a trust indenture for proceeds of \$360,000.

The debentures are unsecured, mature on June 19, 2002 and bear interest at 16% per annum. The interest payments are payable monthly in arrears. The debentures may be redeemed, in whole or part, by the Company during the term of the debentures, at the option of the Company.

Debenture

On August 28, 2000, the Company issued a non-convertible debenture for proceeds of \$1,500,000.

On November 30, 2001, the Company issued a non-convertible debenture for proceeds of \$100,000.

The debentures are unsecured, and mature on August 28, 2005 and November 30, 2006, respectively, and bear interest at 16% per annum. The interest payments are payable monthly in arrears. The debentures may be redeemed, in whole or part, by the Company after a term of 2 years, at the option of the Company.



8. Share capital

December 31
2001

August 31
2001

Authorized:

Unlimited number of Class A common shares

Issued:

12,288,750 common shares

\$ 2,378,167

\$ 2,378,167

Warrants

On January 14, 1999, in connection with the execution of a non-bank credit facility, the Company issued 1,500,000 warrants to signatories (two of the directors of Carfinco Inc.) of limited recourse personal guarantees of \$1,000,000. The warrants are exercisable into 1 common share per warrant at a price of \$0.18, with an expiry date of January 14, 2004.

On August 31, 2000, in connection with the bank credit facility, as disclosed in Note 6, the Company issued 150,000 warrants to a signatory (a director of Carfinco Inc.) of a limited recourse personal guarantee of \$500,000. The warrants are exercisable into 1 common share per warrant at a price of \$0.15 with an expiry date of August 31, 2005.

Stock options

The Company has entered into incentive stock options with directors, officers and employees, the details of which are as follows:

	December 31 <u>2001</u> (4 months)	August 31 <u>2001</u> (12 months)
Balance, beginning of period	997,000	960,000
Granted	4,500	59,500
Cancelled	<u>(4,500)</u>	<u>(22,500)</u>
Balance, end of period	<u>997,000</u>	<u>997,000</u>

These options were granted at prices between \$0.15 and \$0.35, and expire between April 7, 2002 and July 27, 2005.

9. Related party transactions

The Company has an agreement with Patuca Corporation for services provided on an on-going basis for a fee of \$5,350 per month. The fee represents fair value for services provided. During the four month period ended December 31, 2001, payments of \$21,400 (fiscal 2001 - \$64,200) were made to Patuca and at December 31, 2001, there was \$nil (August 31, 2001 - \$nil) payable to Patuca. Patuca Corporation is controlled by individuals who are directors and/or shareholders of Carfinco Inc.

In connection with the issuance of debentures pursuant to a trust indenture, debentures in the aggregate principal amount of \$200,000 were issued to associates of a director of Carfinco Inc. During the period, interest payments of \$10,696 (fiscal 2001 - \$24,620) were made to these debenture holders.

10. Income taxes

Income tax expense differs from the amount computed by applying the statutory provincial and federal income tax rates to the respective periods' earnings before income taxes. These differences result from the following items:

	December 31 2001 (4 months)	August 31 2001 (12 months)
Earnings before income taxes	\$ 387,131	\$ 821,524
Statutory Canadian corporate tax rates	41.62%	43.15%
Income taxes at statutory combined federal and provincial rates	\$ 161,124	\$ 354,488
Increase (decrease) from statutory rate resulting from:		
Income tax rate adjustments	(1,809)	(13,106)
Other	17,774	8,971
	\$ 177,089	\$ 350,353

The components of the future income tax liability at December 31, 2001 are as follows:

Future income tax liabilities (assets)

Allowance for credit losses	\$ (83,075)
Capital assets	25,591
Deferred costs	(15,475)
Unearned administration fees	<u>95,000</u>
Net future income tax liability	<u>\$ 22,041</u>

11. Commitments

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

2002	\$ 83,400
2003	83,400
2004	83,400
2005	6,950

12. Earnings per share

The computation of basic earnings per share have been calculated using the weighted average number of common shares outstanding for the four month period ended December 31, 2001 which amounted to 12,288,750 (fiscal 2001 – 12,288,750). In computing diluted earnings per share 1,415,467 (fiscal 2001 – 640,056) shares were added to the weighted average number of common shares outstanding for the four month period ended December 31, 2001 for the dilutive effect of stock options and warrants.

13. Fair value of financial instruments

The Company's financial instruments include finance receivables, bank indebtedness, payables and accruals and long term debt. The nature of these instruments and the Company's operations expose the Company to interest rate risk and industry credit risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

a) Interest rate risk

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.

Bank indebtedness bears 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.

Long term debt bears interest at a fixed rate. The fixed rate long term debt 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 the aforementioned financial instruments approximate their fair value.

c) Credit risk

The Company's finance receivables are a result of transactions within the consumer finance industry, and as such, contain an element of credit risk in the event that the counter parties are unable to meet the terms of the agreements. The Company minimizes its risks by taking security in the form of a security interest/lien against tangible assets. The Company performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary. The Company maintains provisions for potential credit losses, and any such losses to date have been within management's expectations.

Directors

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

David Prussky
Director
Patica Corporation
Toronto, Ontario

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

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

David Rosenkrantz
Director
Patica Corporation
Toronto, Ontario

Simon Serruya
Executive Vice President
CoolBrands International Inc.
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

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Annual Meeting

The annual meeting of the common shareholders of Carfinco Inc. will be held on April 5, 2002 at the corporate Head Office, Suite 100, 4207 – 98 Street, Edmonton, Alberta, at 9:30 a.m. (MST).