



President's Message to Unitholders

Fiscal 2002 has been witness to a positive restructuring of Carfinco. Securityholders unanimously approved the reorganization of Carfinco Inc. ("Carfinco") on October 2, 2002, pursuant to a plan of arrangement (the "Reorganization"). On November 27, 2002, the reorganization to an income trust was completed. Under the terms of the arrangement, shareholders of Carfinco received one Trust Unit (a "Unit") of Carfinco Income Fund (the "Fund") for each Carfinco common share held. The common shares of Carfinco (listed on Tier 3 of the TSX Venture Exchange (the "TSXV")) discontinued trading on November 26, 2002 and the Units of the Fund commenced trading on Tier 1 of the TSXV on December 6, 2002, under the symbol 'CFN.UN'.

The total costs related to the Reorganization were \$615,813. Of this amount, \$268,188 was allocated against share capital as restructuring costs. The remaining \$347,625 was recorded as deferred financing fees, as they relate to the restructuring of the senior bank credit facility and the subordinated debentures. These deferred costs will be amortized over the remaining term of the senior bank credit facility. Subsequent to the Reorganization, the bank credit facility has been extended by one year; however, the above costs will continue to be amortized over the original term of the bank credit facility.

In the fourth quarter of fiscal 2002, we experienced higher than normal delinquencies due to economic uncertainty combined with seasonal factors. We also experienced lower than normal recoveries on repossessed vehicles sold at auction, due largely to the weak demand for used vehicles in the United States. Consequently, our net charge offs were higher than normal for the fourth quarter. We expect these factors to continue into the first quarter of 2003 and return to normal levels of delinquency towards the end of the first quarter of fiscal 2003.

In continuing with our philosophy of maintaining a strong foundation for Carfinco, we increased the allowance for future credit losses during the fourth quarter of fiscal 2002 by \$480,000, bringing the allowance for future credit losses to \$3,065,000. This represents an increase of \$1,100,000 (56%) from the \$1,965,000 recorded as at December 31, 2001.

Taking into account the costs associated with the Reorganization, higher than normal net charge offs and the significant increase in the allowance for future credit losses, the net loss before income tax for the fourth quarter of fiscal 2002 was \$183,544, bringing the earnings before income tax to \$997,426 for fiscal 2002.

The earnings before income tax of \$997,426 for fiscal 2002, represents an increase of \$175,902 (21.4%) over the \$821,524 stated for the twelve month period ended August 31, 2001.

Please review Management's Discussion and Analysis for a complete review and comparison of the fiscal year-end.

Thank you to our unitholders, our employees and customers.

Tracy A. Graf
President and Chief Executive Officer

Overview

Carfinco Income Fund (the "Fund") is an unincorporated open-end mutual fund trust established under the laws of the Province of Ontario by a Deed of Trust made as of August 26, 2002. The Fund owns 100% of Carfinco Holdings Trust, a wholly-owned unincorporated trust, established under the laws of Ontario and 100% of Carfinco Inc., a wholly-owned subsidiary, established under the laws of Ontario. Carfinco Holdings Trust holds an 86.04% interest, and is the limited partner of Carfinco Limited Partnership, and Carfinco Inc. ("Carfinco") holds the remaining 13.96% interest, and is the general partner of Carfinco Limited Partnership. Carfinco Limited Partnership is a continuation of the business formerly conducted by Carfinco Inc. and its wholly-owned subsidiary, Canadian Automotive Finance Corporation.

The Fund, through Carfinco Limited Partnership, 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 Fund (and formerly, Carfinco) has acquired more than \$16.8 million in repair finance contracts and \$55.0 million in vehicle purchase contracts. The Fund targets borrowers who are typically unable to obtain financing from traditional sources.

To fund the acquisition of receivables, the Fund utilizes its borrowings under its credit facility, as well as, borrowings through subordinated debenture issuances. The Fund 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

The Fund reported earnings before income taxes of \$997,426 for the twelve-month period ended December 31, 2002 (fiscal 2002), as compared to \$387,131 for the four months ended December 31, 2001 (stub-fiscal 2001) and the \$821,524 for the twelve months ended August 31, 2001 (fiscal 2001).

Revenues. The Fund's revenues for the twelve-month period ended December 31, 2002 were \$8,566,382, compared to the annualized amount of \$7,722,588 for stub-fiscal 2001 and \$5,808,794 for fiscal 2001. 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 twelve-month period ended December 31, 2002 was \$1,637,115. This compares to the annualized amount of \$1,545,828 for stub-fiscal 2001 and \$1,417,606 reported for fiscal 2001, even though the average outstanding debt level has increased. This comparability is the result of decreases in the prime interest rate during calendar 2001, which assisted in keeping the overall cost of borrowings down.

Provision for Credit Losses. The provision for credit losses for the twelve-month period ended December 31, 2002 totalled \$3,595,452, compared to \$1,012,338 for stub-fiscal 2001 (\$3,037,014 annualized) and \$1,891,515 for fiscal 2001. Of the \$3,595,452 in provision expenses, \$1,100,000 was used to increase the allowance for credit losses recorded on the balance sheet and \$2,495,452 was used to offset net portfolio losses.

Operating Expenses. The operating expenses for the twelve-month period ended December 31, 2002 totalled \$2,336,389, compared to \$ 659,451 for stub-fiscal 2001 (\$1,978,353 annualized) and \$1,678,149 for fiscal 2001.

Advertising and marketing for the twelve-month period ended December 31, 2002 totalled \$43,616.

Amortization expense for the twelve-month period ended December 31, 2002 totalled \$63,788. Purchases of capital assets were \$32,682 during the same period.

General and administrative expenses were \$1,270,758 for the twelve-month period ended December 31, 2002, compared to \$365,300 (\$1,095,900 annualized) incurred during stub-fiscal 2001 and 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 \$958,227 for the twelve-month period ended December 31, 2002, compared to \$273,196 (\$819,588 annualized) for stub-fiscal 2001 and \$696,009 for fiscal 2001. In order to support the growth in its operations and the finance receivables portfolio, the number of employees has increased from 22 at August 31, 2001 to 25 at December 31, 2002.

Asset Review

Total assets increased by \$2,615,091 to \$24,488,778 at December 31, 2002 from 21,873,687 at December 31, 2001, an increase of 12.0%. Non-producing assets have increased \$351,840 from \$330,182 at December 31, 2001 to \$682,022 at December 31, 2002. The increase in non-producing assets is due to the \$181,000 income taxes receivable and the increase in deferred costs associated with the restructuring of the debt facilities in fiscal 2002.

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 Fund's expansion in the non-prime sector of the auto finance industry and the overall buoyancy of the used car market. The Fund's strategy continues to be that of the alternative lender to major financial institutions in the higher risk used vehicle finance market.

The finance receivables (net) grew during the twelve-month period ended December 31, 2002 by \$2,263,251, or 10.5%, to \$23,806,756. The actual principal of finance receivables (before addition of accrued interest and deduction of allowance for credit losses) grew by \$3,285,803, or 14.2%, during this period. Funds advanced on finance receivables amounted to \$18,077,736 for fiscal 2002, compared to \$5,554,198 (\$16,662,594 annualized) for stub-fiscal 2001 and \$20,012,610 for fiscal 2001.

The Fund 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 Fund believes that the allowance for credit losses is currently adequate to absorb potential losses in the finance receivable portfolio.

The Fund's allowance for credit losses was \$3,065,000 at December 31, 2002, up \$1,100,000, or 56.0% from the \$1,965,000 at December 31, 2001. During this same period, the principal of finance receivables increased 14.2%. Allowance for credit losses as a percent of finance receivables was 11.4% at December 31, 2002, compared to 8.4% at December 31, 2001. The Fund will continue to monitor its credit loss experience and make additional provisions, as it deems appropriate.

Liquidity and Capital Resources

The Fund'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 Fund'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 Fund provide the needed capital to fund the anticipated expansion of the Fund, loan purchases, and investments in operating infrastructure for fiscal 2003.

Credit Facility. The Fund executed a credit facility on November 27, 2002 with a national association 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, 2002, a total of \$17,726,512 was outstanding under the credit facility. The termination date of the credit facility is August 31, 2004 (see Note 16 to the consolidated financial statements).

Subordinated Debt. As of December 31, 2002, the Fund had outstanding \$3,710,000 of 16% non-convertible subordinated debt, an increase of \$1,150,000 over the \$2,560,000 outstanding at December 31, 2001. Of the total subordinated debt outstanding, \$2,260,000 matures in February 2004 and \$1,450,000 matures in December 2007.

Risk Management

Liquidity Risk. As is customary in the Fund's industry, the credit facility and subordinated debt instruments need to be renewed on a periodic basis. The Fund has been successful in renewing and expanding these facilities on a periodic basis. If the Fund was unable to renew these facilities on acceptable terms, there could be a material adverse effect on the Fund'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 Fund. 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 Fund originates transactions in a relatively high-risk segment of the consumer finance industry, and, therefore, write offs are anticipated. The management of the Fund 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 Fund 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 Fund 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.

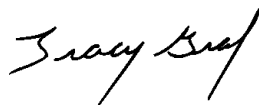
Interest Rate Risk. The Fund's earnings are affected by changes in interest rates as a result of its dependence upon a credit facility, which bears interest at a floating rate. The receivable portfolio bears interest at a fixed rate, therefore, the Fund carries the risk of smaller interest rate spreads in the event market interest rates increase.

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 Income Fund. 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 Trustees is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee, which is comprised of four non-management Trustees, 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

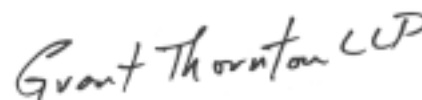
Independent Auditors' Report

To the Unitholders of
Carfinco Income Fund

We have audited the consolidated balance sheets of Carfinco Income Fund as at December 31, 2002 and 2001 and the consolidated statements of earnings and equity, cash flows, and distributable cash and cumulative cash distributions for each of the periods ended December 31, 2002 and 2001, and August 31, 2001. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2002 and 2001 and the results of its operations and cash flows for each of the periods ended December 31, 2002 and 2001, and August 31, 2001 in accordance with Canadian generally accepted accounting principles.



Edmonton, Canada
February 7, 2003

Chartered Accountants

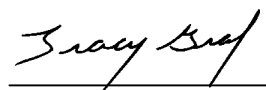
Carfinco Income Fund
Consolidated Balance Sheets



	<u>December 31</u> <u>2002</u>	December 31 <u>2001</u>
Assets		
Finance receivables - net (Note 4)	\$ 23,806,756	\$ 21,543,505
Other assets	19,544	54,928
Capital assets (Note 6)	157,091	188,197
Deferred costs	324,387	87,057
Income taxes receivable	<u>181,000</u>	<u>-</u>
	<u>\$ 24,488,778</u>	<u>\$ 21,873,687</u>
Liabilities		
Bank indebtedness (Note 7)	\$ 17,290,852	\$ 16,746,846
Payables and accruals	449,114	86,596
Income taxes payable	-	77,259
Future income taxes (Note 11)	-	22,041
Long term debt (Note 8)	<u>3,710,000</u>	<u>2,640,017</u>
	<u>21,449,966</u>	<u>19,572,759</u>
Unitholders' Equity (Note 9)		
Share capital	-	2,378,167
Deficit	-	(77,239)
Fund unit equity	<u>3,038,812</u>	<u>-</u>
	<u>3,038,812</u>	<u>2,300,928</u>
	<u>\$ 24,488,778</u>	<u>\$ 21,873,687</u>

Commitments (Note 12)

On behalf of the Board of Trustees

 Trustee

 Trustee

See accompanying notes to the consolidated financial statements.

Carfinco Income Fund
Consolidated Statements of Earnings and Equity



	December 31 2002 (12 months)	December 31 2001 (4 months)	August 31 2001 (12 months)
Revenues			
Interest income	\$ 7,159,720	\$ 2,150,319	\$ 4,537,758
Administration fees	<u>1,406,662</u>	<u>423,877</u>	<u>1,271,036</u>
	<u>8,566,382</u>	<u>2,574,196</u>	<u>5,808,794</u>
Expenses			
Interest	1,637,115	515,276	1,417,606
Provision for credit losses	3,595,452	1,012,338	1,891,515
Advertising and marketing	43,616	3,025	27,172
Amortization	63,788	17,930	54,773
General and administrative	1,270,758	365,300	900,195
Salaries and benefits	<u>958,227</u>	<u>273,196</u>	<u>696,009</u>
	<u>7,568,956</u>	<u>2,187,065</u>	<u>4,987,270</u>
Earnings before income taxes	<u>997,426</u>	<u>387,131</u>	<u>821,524</u>
Income taxes (Note 11)			
Current	276,754	105,084	-
Future	<u>(22,041)</u>	<u>72,005</u>	<u>350,353</u>
	<u>254,713</u>	<u>177,089</u>	<u>350,353</u>
Net earnings	<u>\$ 742,713</u>	<u>\$ 210,042</u>	<u>\$ 471,171</u>
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Equity, beginning of period	\$ 2,300,928	\$ 2,090,886	\$ 1,619,715
Net earnings	742,713	210,042	471,171
Change in fund units/ shares in period (Note 9)	<u>(4,829)</u>	<u>-</u>	<u>-</u>
Equity, end of period	<u>\$ 3,038,812</u>	<u>\$ 2,300,928</u>	<u>\$ 2,090,886</u>
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Earnings per fund unit/share			
Basic (Note 13)	<u>\$ 0.06</u>	<u>\$ 0.02</u>	<u>\$ 0.04</u>
Diluted (Note 13)	<u>\$ 0.05</u>	<u>\$ 0.02</u>	<u>\$ 0.04</u>

See accompanying notes to the consolidated financial statements.

Carfinco Income Fund
Consolidated Statements of Cash Flows



	<u>December 31</u> <u>2002</u> (12 months)	December 31 <u>2001</u> (4 months)	August 31 <u>2001</u> (12 months)
Increase (decrease) in cash and cash equivalents:			
Operating			
Net earnings	\$ 742,713	\$ 210,042	\$ 471,171
Adjustments to reconcile net earnings to net cash from operations:			
Provision for credit losses	3,595,452	1,012,338	1,891,515
Amortization	63,788	17,930	54,773
Accrued interest	(77,448)	(38,837)	(110,099)
Administration fees receivable	(905,205)	(333,843)	(813,124)
Deferred costs	(237,330)	10,502	52,162
Future income taxes	(22,041)	72,005	350,353
Income taxes receivable/payable	(258,259)	77,259	-
Payables and accruals	362,518	(35,182)	(222,797)
Other assets	35,384	(17,122)	(7,396)
	<u>3,299,572</u>	<u>975,092</u>	<u>1,666,558</u>
Investing			
Funds advanced on finance receivables	(18,077,736)	(5,554,198)	(20,012,610)
Principal collections on finance receivables	13,201,686	3,610,825	9,785,699
Purchase of capital assets	(32,682)	(24,110)	(21,887)
	<u>(4,908,732)</u>	<u>(1,967,483)</u>	<u>(10,248,798)</u>
Financing			
Issuance of long term debt	5,160,000	100,000	585,000
Repayment of long term debt	(4,090,017)	(8,398)	(25,192)
Issuance of share capital	381,925	-	-
Fund restructuring costs	(268,188)	-	-
Fund trust unit cash distribution	(118,566)	-	-
	<u>1,065,154</u>	<u>91,602</u>	<u>559,808</u>
Net decrease in cash and cash equivalents	(544,006)	(900,789)	(8,022,432)
Bank Indebtedness			
Beginning of period	<u>(16,746,846)</u>	<u>(15,846,057)</u>	<u>(7,823,625)</u>
End of period	<u>\$ (17,290,852)</u>	<u>\$ (16,746,846)</u>	<u>\$ (15,846,057)</u>
Supplemental cash flow information:			
Income taxes paid	<u>\$ 534,957</u>	<u>\$ 26,279</u>	<u>\$ -</u>
Interest paid	<u>\$ 1,501,336</u>	<u>\$ 482,978</u>	<u>\$ 1,408,133</u>
Non-cash investing and financing activities:			
Shares issued by purchase financing	<u>\$ 128,550</u>	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to the consolidated financial statements.

Carfinco Income Fund
Consolidated Statements of Distributable Cash and
Cumulative Cash Distributions



	December 31 <u>2002</u> (12 months)
Net earnings	\$ 742,713
Adjustments	
Provision for credit losses	3,595,452
Amortization	63,788
Accrued interest	(77,448)
Administration fees receivable	(905,205)
Deferred costs	(237,330)
Future income taxes	(22,041)
Income taxes receivable/payable	(258,259)
Payables and accruals	362,518
Other assets	<u>35,384</u>
	3,299,572
Amounts reinvested by Fund	
Sustaining finance receivable portfolio and capital expenditures	<u>3,181,006</u>
Total distributable cash earned and distributable during the period	<u>\$ 118,566</u>
Actual cash distributions per trust unit	<u>\$ 0.008</u>
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Cumulative cash distributions, beginning of period	\$ -
Actual cash distributions for the period	<u>118,566</u>
Cumulative cash distributions, end of period	<u>\$ 118,566</u>
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See accompanying notes to the consolidated financial statements.

Carfinco Income Fund

Notes to the Consolidated Financial Statements

December 31, 2002



1. Organization of the fund and description of the business

Carfinco Income Fund (the "Fund") is an unincorporated open-end mutual fund trust established under the laws of the Province of Ontario by a Deed of Trust made as of August 26, 2002. The Fund owns 100% of Carfinco Holdings Trust ("CHT"), a wholly-owned unincorporated trust, established under the laws of Ontario and 100% of Carfinco Inc. ("CAR"), a wholly-owned subsidiary, established under the laws of Ontario. CHT holds 86.04% and is the limited partner of Carfinco Limited Partnership ("Carfinco LP") and CAR holds the remaining 13.96% and is the general partner of Carfinco LP. Carfinco LP is a continuation of the business formerly conducted by Carfinco Inc. ("Carfinco") and its wholly-owned subsidiary Canadian Automotive Finance Corporation. Carfinco LP is in the business of providing consumer financing for vehicle purchases.

The units of the Fund are publicly traded on the TSX Venture Exchange, under the symbol "CFN.UN".

2. Summary of significant accounting policies

The consolidated financial statements of the Fund have been prepared by management in accordance with Canadian generally accepted accounting principles and are as follows:

Basis of consolidation

These financial statements include the accounts of the Fund, CHT, CAR and Carfinco LP. All inter-company accounts and transactions have been eliminated on consolidation. Any subsequent reference to the Fund within the Notes to the Consolidated Financial Statements refers to the consolidated Fund.

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, balances with banks, net of bank overdrafts and the bank credit facility. Debentures and other long term 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.

Allowance for credit losses

The management of the Fund 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 Fund 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 Fund'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 finance receivables in arrears, the perceived effect of current economic conditions or other circumstances on the remaining finance receivables, the historical industry ratios of write offs, and the Fund's current write off and recovery experience.

Carfinco Income Fund

Notes to the Consolidated Financial Statements

December 31, 2002



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

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 Fund is a "unit trust" for income tax purposes. As such, the Fund is taxed on any taxable income not allocated to unitholders. Under the terms of the Deed of Trust, all or virtually all of the taxable income will be allocated to unitholders resulting in no income tax expense for the Fund.

The Fund follows the liability method of accounting for income taxes for its incorporated subsidiary. Under this method, the Fund 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 debt financing are deferred and amortized to interest on a straight-line basis over the terms of the debt.

Stock based compensation

During the year, Carfinco had a stock option plan, which is described in Note 9. Carfinco followed the intrinsic value based method of accounting for such awards; consequently, no compensation expense was recognized for stock options as the exercise price was set at the market price on the issue date of the awards. Consideration received by Carfinco on the exercise of stock options was credited to share capital/Fund unit equity.

The Fund does not currently have a unit based compensation plan.

Distributions to unitholders

The Fund will distribute all or virtually all of its distributable cash each year, net of any reserve deemed prudent by the trustees of the Fund. Distributable cash is currently determined by the trustees as net earnings for the year of the Fund, adjusted for non-cash items, and further adjusted by amounts reinvested by the Fund to sustain investing activities and growth.

3. Reorganization of capital structure

Pursuant to a Deed of Trust dated August 26, 2002, the Fund was established. Pursuant to a plan of arrangement, 100% of the common shares of Carfinco were exchanged, on a one for one basis, into common trust units of Carfinco Income Fund. The effective date of the arrangement was November 27, 2002.

Carfinco Income Fund
Notes to the Consolidated Financial Statements

December 31, 2002



3. Reorganization of capital structure (cont'd)

This reorganization of the capital structure of Carfinco has been accounted for using the continuity of interests method of accounting, whereby the Fund is treated as a continuation of Carfinco. The comparative figures for December 31, 2001 and August 31, 2001 are the financial results of Carfinco.

4. Finance receivables	December 31 2002	December 31 2001
Principal of finance receivables	\$ 26,445,372	\$ 23,159,569
Accrued interest	<u>426,384</u>	<u>348,936</u>
Finance receivables	26,871,756	23,508,505
Less: allowance for credit losses (Note 5)	<u>(3,065,000)</u>	<u>(1,965,000)</u>
Finance receivables – net	<u>\$ 23,806,756</u>	<u>\$ 21,543,505</u>

5. Allowance for credit losses	December 31 2002 (12 months)	December 31 2001 (4 months)
Allowance, beginning of period	\$ 1,965,000	\$ 1,621,038
Provision for credit losses	3,595,452	1,012,338
Write offs	(3,175,852)	(812,032)
Recoveries	<u>680,400</u>	<u>143,656</u>
Allowance, end of period	<u>\$ 3,065,000</u>	<u>\$ 1,965,000</u>

6. Capital assets			December 31 2002	December 31 2001
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Computer and office equipment	\$ 123,302	\$ 79,933	\$ 43,369	\$ 56,303
Computer software	152,362	78,424	73,938	87,373
Furniture and fixtures	64,735	31,122	33,613	42,767
Leasehold improvements	<u>12,345</u>	<u>6,174</u>	<u>6,171</u>	<u>1,754</u>
	<u>\$ 352,744</u>	<u>\$ 195,653</u>	<u>\$ 157,091</u>	<u>\$ 188,197</u>

7. Bank indebtedness	December 31 2002	December 31 2001
Bank credit facility	\$ (17,726,512)	\$ (16,747,679)
Bank balance	<u>435,660</u>	<u>833</u>
	<u>\$ (17,290,852)</u>	<u>\$ (16,746,846)</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 stated termination date of the credit facility is August 31, 2003 (Note 16).

Carfinco Income Fund
Notes to the Consolidated Financial Statements

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7. Bank indebtedness (cont'd)

The collateral security lodged by the Fund to support the credit facility is a general security agreement covering all property held by the Fund and personal guarantees in the amount of \$1,000,000 provided by two trustees of the Fund.

The terms of the credit facility provide for certain covenants, all of which the Fund was in compliance with at December 31, 2002, except for a covenant concerning quarterly income. The bank has provided a waiver of this covenant for the fourth quarter of 2002.

8. Long term debt

	<u>December 31</u> <u>2002</u>	<u>December 31</u> <u>2001</u>
16% debentures, maturing on June 19, 2002	\$ -	\$ 960,000
16% debentures, maturing on February 18, 2004	2,260,000	-
16% debenture, maturing on August 28, 2005	-	1,500,000
16% debenture, maturing on December 27, 2007	1,350,000	-
16% debenture, maturing on November 30, 2006	-	100,000
16% debenture, maturing on December 27, 2007	100,000	-
Prime plus 2.5% bank term loans repayable in monthly instalments of \$2,100 plus interest. The collateral security lodged by Carfinco to support the loans were the related capital assets.	-	80,017
	<u>\$ 3,710,000</u>	<u>\$ 2,640,017</u>

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

2003	\$ -
2004	2,260,000
2005	-
2006	-
2007	<u>1,450,000</u>
	<u>\$ 3,710,000</u>

Debentures

During the year, the Fund issued additional non-convertible debentures for proceeds of \$1,300,000. As part of the reorganization dated November 27, 2002, the debentures held by Carfinco were redeemed and subsequently reissued by the Fund with a maturity date of February 18, 2004.

The debentures are unsecured, mature on February 18, 2004 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 Fund during the term of the debentures, at the option of the Fund.

Debenture

During the year, the Fund redeemed \$150,000 of the \$1,500,000 non-convertible debenture. As part of the reorganization dated November 27, 2002, the debenture(s) held by Carfinco were redeemed and subsequently reissued by the Fund with a maturity date of December 27, 2007.

The debentures are unsecured, mature on December 27, 2007, 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 Fund during the term of the debentures, at the option of the Fund.

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Notes to the Consolidated Financial Statements

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9. Fund unit equity

Authorized:

The Fund's Deed of Trust provides that an unlimited number of trust units may be authorized and issued. Each trust unit is transferable, carries the right to one vote and represents an equal undivided beneficial interest in any distribution from the Fund and in the net assets of the Fund in the event of termination or winding-up of the Fund. All trust units are of the same class with equal rights and privileges.

Issued:	<u>number</u>	<u>2002</u>	<u>number</u>	<u>2001</u>
Deficit, beginning of period	-	\$ (77,239)	-	\$ (287,281)
Share capital, beginning of period	<u>12,288,750</u>	<u>2,378,167</u>	<u>12,288,750</u>	<u>2,378,167</u>
Shareholders' equity, beginning of period	<u>12,288,750</u>	<u>2,300,928</u>	<u>12,288,750</u>	<u>2,090,886</u>
Shares issued upon exercise of share options	882,000	217,975	-	-
Shares issued upon exercise of share warrants	1,650,000	292,500	-	-
Share purchase financing	-	(128,550)	-	-
Fund restructuring costs	-	(268,188)	-	-
Fund unit cash distribution	-	(118,566)	-	-
Change in units/shares in period	<u>2,532,000</u>	<u>(4,829)</u>	-	-
Net income for the period	-	<u>742,713</u>	-	<u>210,042</u>
Fund unit equity	<u>14,820,750</u>	<u>\$ 3,038,812</u>	<u>12,288,750</u>	<u>\$ 2,300,928</u>

Warrants

On January 14, 1999, in connection with the execution of a non-bank credit facility, Carfinco issued 1,500,000 warrants to signatories (two of the directors of Carfinco) 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 May 14, 2002, 1,162,500 of these warrants were exercised for proceeds of \$209,250 and on August 20, 2002 the remaining 337,500 warrants were exercised for proceeds of \$60,750.

On August 31, 2000, in connection with the bank credit facility, as disclosed in Note 7, Carfinco issued 150,000 warrants to a signatory (a director of Carfinco) 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. On August 20, 2002, these warrants were exercised for proceeds of \$22,500.

The Fund does not currently have any outstanding warrants.

Stock options

Effective January 1, 2002, the Fund prospectively adopted the recommendations of the Canadian Institute of Chartered Accountants (CICA) with respect to the accounting for stock-based compensation and other stock-based payments.

Carfinco provided compensation to certain employees and directors in the form of stock options. Carfinco followed the intrinsic value based method of accounting for such awards; consequently, no compensation expense was recognized for stock options as the exercise price was set at the market price on the issue date of the awards. When the options were exercised, the proceeds received were recorded as share capital. If Carfinco had adopted the fair value based method of accounting for its stock option plan, the effect on compensation expense would have been immaterial with no effect on earnings per fund unit/share.

9. Fund unit equity (cont'd)

The details on the stock options outstanding during the period are as follows:

	December 31, 2002		December 31, 2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	997,000	\$ 0.25	997,000	\$ 0.25
Granted	145,000	0.42	4,500	0.45
Cancelled	(10,000)	0.42	(4,500)	0.45
Expired	(250,000)	0.35	-	-
Exercised	(882,000)	0.25	-	-
Outstanding, end of period	<u>-</u>	<u>\$ -</u>	<u>997,000</u>	<u>\$ 0.25</u>
Options exercisable, end of period	<u>-</u>	<u>\$ -</u>	<u>709,500</u>	<u>\$ 0.29</u>

The Fund does not currently have a unit based compensation plan.

Distribution of income to unitholders

Pursuant to the Deed of Trust of the Fund, the trustees must distribute all or virtually all of the income of the Fund for the fiscal year, determined in accordance with the Income Tax Act, to the unitholders of the Fund. If the Fund does not pay cash distributions for the total distributable amount of income, the remaining income of the Fund is distributed through additional common trust units having a value equal to the cash shortfall. As at December 31, 2002, the Fund had \$296,415 in distributable income of which \$118,566 was distributed in cash and the remaining \$177,849 was distributed through additional common trust units to the unitholders.

Immediately after any distribution of common trust units, the number of outstanding common trust units will be consolidated such that each common trust unitholder will hold the same number of common trust units as before the distribution. On December 31, 2002, a total of 355,698 common trust units were issued to distribute the remaining taxable income of \$177,849, and were immediately consolidated.

Share purchase financing

The Fund entered into share loan agreements on August 20, 2002 with two individuals who are employees and/or trustees of the Fund. The loans have an aggregate principal amount of \$128,550, bear interest at the prescribed interest rate and are repayable in full on August 20, 2007. The loans are secured by 762,500 trust units acquired pursuant to the exercise of options and warrants related to the financing. As at December 31, 2002, the market value of the security was \$366,000.

10. Related party transactions

The Fund has an agreement with Patuca Corporation ("Patuca") for services provided on an on-going basis. Carfinco LP entered into a Consulting Services Agreement with Patuca on August 28, 2002 and pursuant to this agreement on November 27, 2002, Carfinco LP commenced incurring a fixed monthly fee of \$13,375 and a variable monthly fee of one-twelfth of 0.2% of the outstanding principal amount of the finance receivables. The fee represents fair value for services provided.

During fiscal 2002, payments of \$166,820 (four months ended December 31, 2001 - \$21,400, twelve months ended August 31, 2001 - \$64,200) were made to Patuca and at December 31, 2002, there was \$18,020 (December 31, 2001 - \$nil) payable to Patuca. Patuca is controlled by individuals who are trustees and/or unitholders of the Fund.

Carfinco Income Fund
Notes to the Consolidated Financial Statements

December 31, 2002



10. Related party transactions (cont'd)

The Fund issued debentures in the aggregate principal amount of \$200,000 to family members of David Rosenkrantz, a trustee of the Fund. During fiscal 2002, interest payments of \$32,000 (four months ended December 31, 2001 - \$10,696 twelve months ended August 31, 2001 - \$24,620) were made to these debenture holders.

The related party transactions occurred at the exchange amount, which is the consideration established and agreed to by the related parties.

11. Income taxes

Under the terms of the Deed of Trust, all or virtually all of the taxable income will be allocated to unitholders. No future taxes were recorded by the Fund in 2002, as there is no Canadian tax obligation. All income tax for 2002 was incurred by Carfinco and by Canadian Automotive Finance Corporation prior to the reorganization.

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:

	<u>December 31</u> <u>2002</u> <u>(12 months)</u>	December 31 <u>2001</u> (4 months)	August 31 <u>2001</u> (12 months)
Earnings before income taxes	\$ 997,426	\$ 387,131	\$ 821,524
Income subject to tax for unitholders	<u>(296,415)</u>	<u>-</u>	<u>-</u>
Total earnings subject to Canadian tax	<u>\$ 701,011</u>	<u>\$ 387,131</u>	<u>\$ 821,524</u>
Statutory Canadian corporate tax rates	39.00%	41.62%	43.15%
Income taxes at statutory combined federal and provincial rates	\$ 273,394	\$ 161,124	\$ 354,488
Increase (decrease) from statutory rate resulting from:			
Income tax rate adjustments	-	(1,809)	(13,106)
Other	<u>(18,681)</u>	<u>17,774</u>	<u>8,971</u>
Provision for income taxes	<u>\$ 254,713</u>	<u>\$ 177,089</u>	<u>\$ 350,353</u>

At December 31, 2002, the Fund had tax pools that exceeded its carrying values of assets and liabilities that is comprised of the following:

Allowance for credit losses	\$ 312,888
Capital assets	(45,157)
Share/unit issue costs	236,173
Tax loss carry forwards	13,822
Unearned administration fees	<u>(300,000)</u>
Total tax values in excess of carrying values	<u>\$ 217,726</u>

12. Commitments

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

2003	\$ 84,000
2004	84,000
2005	7,000

Carfinco Income Fund
Notes to the Consolidated Financial Statements

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13. Earnings per fund unit/share

The computation of basic earnings per fund unit/share has been calculated using the weighted average number of common trust units/shares outstanding during the period.

A reconciliation of the denominators for the per fund unit/share calculations is outlined below:

	December 31 2002 (12 months)	December 31 2001 (4 months)	August 31 2001 (12 months)
Basic weighted average fund units/shares	13,344,948	12,288,750	12,288,750
Effect of dilutive options and warrants	-	1,415,467	640,056
Effect of dilutive share purchase financing	491,869	-	-
Dilutive weighted average fund units/shares	<u>13,836,817</u>	<u>13,704,217</u>	<u>12,928,806</u>

There is no change to the numerator in the calculation of diluted earnings per fund unit/share for any period.

14. Fair value of financial instruments

The Fund's financial instruments include finance receivables, bank indebtedness, payables and accruals and long term debt. The nature of these instruments and the Fund's operations expose the Fund to interest rate risk and industry credit risk. The Fund 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 Fund'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 Fund secures individual finance receivables by registering a security interest/lien against tangible assets. The Fund performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary. The Fund maintains provisions for potential credit losses, and any such losses to date have been within management's expectations.

Carfinco Income Fund
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December 31, 2002



15. Comparative figures

Certain of the previous period's figures have been reclassified to conform to the current period's format of presentation.

16. Subsequent events

On March 17, 2003, the Fund executed the first amendment to the credit facility agreement dated November 27, 2002. Certain terms within the credit facility were amended and the termination date of the facility was changed to August 31, 2004.

Trustees

Tracy A. Graf
President
Carfinco Inc.
Edmonton, Alberta

David Prussky
Director
Patica Corporation
Toronto, Ontario

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

David Rosenkrantz
Director
Patica Corporation
Toronto, Ontario

Simon Serruya
New Strategic Business Development
Yogen Früz
Toronto, Ontario

Maurice Kagan
Chief Financial Officer and Secretary
Residential Equities Real Estate Trust
Toronto, Ontario

Brent Channell
Principal
Thales Corp.
Toronto, Ontario

Officers (Carfinco Inc.)

Tracy A. Graf
President
Carfinco Inc. (General Partner for Carfinco LP)

Troy S.F. Graf
Vice President
Carfinco Inc.

David Prussky
Treasurer
Carfinco Inc.

Bankers

Bank of Montreal
Argyll Branch
6240 – 97 Street
Edmonton, Alberta T6E 3J6

Auditors

Grant Thornton LLP
Scotia Place 2, Suite 1401
10060 Jasper Avenue
Edmonton, Alberta T5J 3R8

Solicitors

Bennett Jones LLP
4500 Bankers Hall East
855 – 2nd Street S.W.
Calgary, Alberta T2P 4K7

Transfer Agent

Equity Transfer Services Inc.
Richmond Adelaide Centre, Suite 420
120 Adelaide Street West
Toronto, Ontario M5H 4C3

Stock Exchange Listing

The TSX Venture Exchange
Trading Symbol: CFN.UN

Head Office

Suite 100, 4207 – 98 Street
Edmonton, Alberta T6E 5R7
Telephone: (780) 413-7549
1-888-486-4356
Facsimile: (780) 450-1134
1-888-486-7456
Website: www.carfinco.com
Email: carfinco@carfinco.com

Annual Meeting

April 22, 2003 at 10:00 a.m. (EST)
Patica Corporation
Suite 904, 105 Adelaide Street West
Toronto, Ontario